

OLD POINT FINANCIAL CORP  
Form 10-Q  
May 12, 2015  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

or

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

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

Commission File Number: 000-12896

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

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

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

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

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

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

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

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

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

4,959,009 shares of common stock (\$5.00 par value) outstanding as of April 30, 2015

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OLD POINT FINANCIAL CORPORATION

FORM 10-Q

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Balance Sheets

|  | March<br>31, 2015  | December<br>31, 2014 |
|--|--|----------------------|
|  | (dollars in thousands<br>except per share data)<br>(unaudited) |                      |
| Assets   |  |                      |
| Cash and due from banks  | \$27,044   | \$31,081             |
| Interest-bearing due from banks  | 697  | 833                  |
| Federal funds sold   | 2,130  | 1,391                |
| Cash and cash equivalents  | 29,871   | 33,305               |
| Securities available-for-sale, at fair value   | 136,387  | 139,346              |
| Securities held-to-maturity (fair value of \$92,422 and \$94,406)  | 88,289   | 90,089               |
| Restricted securities  | 2,304  | 2,293                |
| Loans, net of allowance for loan losses of \$7,411 and \$7,075   | 547,824  | 528,919              |
| Premises and equipment, net  | 42,419   | 42,075               |
| Bank-owned life insurance  | 23,746   | 23,525               |
| Other real estate owned, net of valuation allowance of \$2,113 and \$2,908                               | 5,085  | 5,106                |
| Other assets   | 11,753   | 11,622               |
| Total assets   | \$887,678  | \$876,280            |
| Liabilities & Stockholders' Equity   |  |                      |
| Deposits:  |  |                      |
| Noninterest-bearing deposits   | \$192,596  | \$186,280            |
| Savings deposits   | 309,788  | 307,078              |
| Time deposits  | 225,942  | 223,296              |
| Total deposits   | 728,326  | 716,654              |
| Overnight repurchase agreements  | 35,547   | 37,404               |
| Term repurchase agreements   | 412  | 412                  |
| Federal Home Loan Bank advances  | 30,000   | 30,000               |
| Accrued expenses and other liabilities   | 3,855  | 3,313                |
| Total liabilities  | 798,140  | 787,783              |
| Commitments and contingencies  | --   | --                   |
| Stockholders' equity:  |  |                      |
| Common stock, \$5/share par value, 10,000,000 shares authorized; 4,959,009 shares issued and outstanding | 24,795   | 24,795               |
| Additional paid-in capital   | 16,392   | 16,392               |
| Retained earnings  | 54,012   | 53,203               |
| Accumulated other comprehensive loss, net  | (5,661 )   | (5,893 )             |

|  |           |           |
|--|-----------|-----------|
| Total stockholders' equity                 | 89,538    | 88,497    |
| Total liabilities and stockholders' equity | \$887,678 | \$876,280 |

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Income

|  | Three Months Ended<br>March 31,                                 |         |
|--|---|---------|
|  | 2015  | 2014    |
|  | (unaudited, in thousands<br>except share and per<br>share data) |         |
| <b>Interest and Dividend Income:</b>   |   |         |
| Interest and fees on loans   | \$6,355   | \$5,993 |
| Interest on due from banks   | 7   | 3       |
| Interest on federal funds sold   | 0   | 5       |
| <b>Interest on securities:</b>   |   |         |
| Taxable  | 686   | 1,005   |
| Tax-exempt   | 423   | 429     |
| Dividends and interest on all other securities   | 33  | 31      |
| Total interest and dividend income   | 7,504   | 7,466   |
| <b>Interest Expense:</b>   |   |         |
| Interest on savings deposits   | 52  | 71      |
| Interest on time deposits  | 528   | 649     |
| Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings | 8   | 9       |
| Interest on Federal Home Loan Bank advances  | 305   | 302     |
| Total interest expense   | 893   | 1,031   |
| Net interest income  | 6,611   | 6,435   |
| Provision for loan losses  | 275   | 250     |
| Net interest income, after provision for loan losses   | 6,336   | 6,185   |
| <b>Noninterest Income:</b>   |   |         |
| Income from fiduciary activities   | 980   | 955     |
| Service charges on deposit accounts  | 982   | 974     |
| Other service charges, commissions and fees  | 1,005   | 952     |
| Income from bank-owned life insurance  | 221   | 216     |
| Other  | 89  | 65      |
| Total noninterest income   | 3,277   | 3,162   |
| <b>Noninterest Expense:</b>  |   |         |
| Salaries and employee benefits   | 5,049   | 4,853   |
| Occupancy and equipment  | 1,327   | 1,114   |
| Data processing  | 358   | 423     |
| FDIC insurance   | 147   | 184     |
| Customer development   | 154   | 192     |
| Legal and audit expenses   | 114   | 124     |
| Other outside service fees   | 114   | 119     |
| Employee professional development  | 131   | 168     |
| Marketing and advertising  | 86  | 124     |
| Postage and courier  | 86  | 121     |
| Stationery and supplies  | 88  | 119     |
| Capital stock tax  | 114   | 134     |

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|  |           |           |
|--|-----------|-----------|
| ATM and check losses                               | 137       | 115       |
| Loss on write-down/sale of other real estate owned | 69        | 83        |
| Other  | 313       | 390       |
| Total noninterest expense                          | 8,287     | 8,263     |
| Income before income taxes                         | 1,326     | 1,084     |
| Income tax expense                                 | 121       | 107       |
| Net income   | \$1,205   | \$977     |
|  |           |           |
| Basic earnings per share                           |           |           |
| Weighted average shares outstanding                | 4,959,009 | 4,959,009 |
| Net income per share of common stock               | \$0.24    | \$0.20    |
|  |           |           |
| Diluted earnings per share                         |           |           |
| Weighted average shares outstanding                | 4,959,009 | 4,959,009 |
| Net income per share of common stock               | \$0.24    | \$0.20    |

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries  
 Consolidated Statements of Comprehensive Income

|   | Three Months<br>Ended<br>March 31,<br>2015 2014<br>(unaudited, in<br>thousands) |         |
|---|---|---------|
| Net income  | \$1,205   | \$977   |
| Other comprehensive income, net of tax  |   |         |
| Net unrealized gains on available-for-sale securities                           | 91  | 1,552   |
| Amortization of unrealized losses on securities transferred to held-to-maturity | 141   | 126     |
| Other comprehensive income  | 232   | 1,678   |
| Comprehensive income  | \$1,437   | \$2,655 |

See Notes to Consolidated Financial Statements.

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

| (unaudited, dollars in thousands except per share data) | Shares of<br>Common<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total       |
|---|------------------------------|-----------------|----------------------------------|----------------------|---|-------------|
| <b>THREE MONTHS ENDED MARCH 31, 2015</b>                |                              |                 |                                  |                      |   |             |
| Balance at beginning of period                          | 4,959,009                    | \$ 24,795       | \$ 16,392                        | \$ 53,203            | \$ (5,893)  | ) \$ 88,497 |
| Net income  | 0                            | 0               | 0                                | 1,205                | 0   | 1,205       |
| Other comprehensive income, net of tax                  | 0                            | 0               | 0                                | 0                    | 232   | 232         |
| Cash dividends (\$0.08 per share)                       | 0                            | 0               | 0                                | (396 )               | 0   | (396 )      |
| Balance at end of period                                | 4,959,009                    | \$ 24,795       | \$ 16,392                        | \$ 54,012            | \$ (5,661)  | ) \$ 89,538 |
| <b>THREE MONTHS ENDED MARCH 31, 2014</b>                |                              |                 |                                  |                      |   |             |
| Balance at beginning of period                          | 4,959,009                    | \$ 24,795       | \$ 16,392                        | \$ 50,376            | \$ (10,802)   | ) \$ 80,761 |
| Net income  | 0                            | 0               | 0                                | 977                  | 0   | 977         |
| Other comprehensive income, net of tax                  | 0                            | 0               | 0                                | 0                    | 1,678   | 1,678       |
| Cash dividends (\$0.06 per share)                       | 0                            | 0               | 0                                | (297 )               | 0   | (297 )      |
| Balance at end of period                                | 4,959,009                    | \$ 24,795       | \$ 16,392                        | \$ 51,056            | \$ (9,124)  | ) \$ 83,119 |

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Cash Flows

| Three Months Ended March 31,  | 2015                      | 2014     |
|---|---------------------------|----------|
|   | (unaudited, in thousands) |          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                           |          |
| Net income  | \$1,205                   | \$977    |
| Adjustments to reconcile net income to net cash provided by operating activities:               |                           |          |
| Depreciation and amortization   | 628                       | 486      |
| Provision for loan losses   | 275                       | 250      |
| Net amortization of securities  | 536                       | 560      |
| Net loss on disposal of premises and equipment  | 1                         | 0        |
| Net loss on write-down/sale of other real estate owned  | 69                        | 83       |
| Income from bank owned life insurance   | (221 )                    | (216 )   |
| Deferred tax expense  | 6                         | 0        |
| (Increase) decrease in other assets   | (257 )                    | 5        |
| Increase in other liabilities   | 542                       | 726      |
| Net cash provided by operating activities   | 2,784                     | 2,871    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                           |          |
| Purchases of available-for-sale securities  | (21,362)                  | (1,031 ) |
| Proceeds from redemption (cash used in purchases) of restricted securities                      | (11 )                     | 310      |
| Proceeds from maturities and calls of available-for-sale securities                             | 20,690                    | 170      |
| Proceeds from sales of available-for-sale securities  | 1,155                     | 1,000    |
| Paydowns on available-for-sale securities   | 2,367                     | 2,445    |
| Paydowns on held-to-maturity securities   | 1,725                     | 1,261    |
| Net increase in loans   | (19,634)                  | (9,586 ) |
| Proceeds from sales of other real estate owned  | 406                       | 573      |
| Purchases of premises and equipment   | (973 )                    | (2,212 ) |
| Net cash used in investing activities   | (15,637)                  | (7,070 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                           |          |
| Increase in noninterest-bearing deposits  | 6,316                     | 1,915    |
| Increase in savings deposits  | 2,710                     | 9,249    |
| Increase (decrease) in time deposits  | 2,646                     | (13,081) |
| Increase (decrease) in federal funds purchased, repurchase agreements and other borrowings, net | (1,857 )                  | 4,635    |
| Cash dividends paid on common stock   | (396 )                    | (297 )   |
| Net cash provided by financing activities   | 9,419                     | 2,421    |
| Net decrease in cash and cash equivalents   | (3,434 )                  | (1,778 ) |
| Cash and cash equivalents at beginning of period  | 33,305                    | 31,325   |
| Cash and cash equivalents at end of period  | \$29,871                  | \$29,547 |

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

|                    |       |         |
|--------------------|-------|---------|
| Cash payments for: |       |         |
| Interest           | \$887 | \$1,062 |

**SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS**

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|   |       |         |
|---|-------|---------|
| Unrealized gain on securities available-for-sale                                    | \$138 | \$2,351 |
| Loans transferred to other real estate owned  | \$454 | \$480   |
| Loans made to finance the sale of other real estate owned                           | \$0   | \$481   |
| Book value of equity securities transferred from other assets to available-for-sale | \$0   | \$100   |
| Amortization of unrealized loss on securities transferred to held-to-maturity       | \$214 | \$191   |

See Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (the Company) and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at March, 31, 2015 and December, 31, 2014 and the statements of income, comprehensive income, changes in stockholders' equity and cash flows for the three months ended March 31, 2015 and 2014. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2014 annual report on Form 10-K. Certain previously reported amounts have been reclassified to conform to current period presentation, none of which were material in nature.

PRINCIPLES OF CONSOLIDATION

The Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services N.A. (Trust). All significant intercompany balances and transactions have been eliminated in consolidation. The Company consolidates subsidiaries in which it holds, directly or indirectly, more than 50 percent of the voting rights or where it exercises control. Entities where the Company holds 20 to 50 percent of the voting rights, or has the ability to exercise significant influence, or both, are accounted for under the equity method. As discussed below, the Company consolidates entities deemed to be variable interest entities (VIEs) when it is determined to be the primary beneficiary.

NATURE OF OPERATIONS

Old Point Financial Corporation is a holding company that conducts substantially all of its operations through two subsidiaries, The Old Point National Bank of Phoebus and Old Point Trust & Financial Services, N.A. The Bank serves individual and commercial customers, the majority of which are in Hampton Roads, Virginia. As of March 31, 2015, the Bank had 18 branch offices. The Bank offers a full range of deposit and loan products to its retail and commercial customers. Trust offers a full range of services for individuals and businesses. Products and services include retirement planning, estate planning, financial planning, estate and trust administration, retirement plan administration, tax services and investment management services.

VARIABLE INTEREST ENTITIES

A legal entity is referred to as a VIE if any of the following conditions exist, which are outlined in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) variable interest accounting guidance (FASB ASC 810-10-15-14): (1) the total equity investment at risk is insufficient to permit the legal entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors that cannot make significant decisions about the entity's operations or that do not absorb their proportionate share of the expected losses or receive the expected returns of the entity.

Note 2. Securities

Amortized costs and fair values of securities held-to-maturity as of the dates indicated are as follows:

| Amortized<br>Cost | Gross<br>Unrealized | Gross<br>Unrealized | Fair<br>Value |
|-------------------|---------------------|---------------------|---------------|
|-------------------|---------------------|---------------------|---------------|

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|   | Gains          |          | Losses |            |
|---|----------------|----------|--------|------------|
|   | (in thousands) |          |        |            |
| March 31, 2015                                  |                |          |        |            |
| Obligations of U.S. Government agencies         | \$100          | \$ 0     | \$ (1  | ) \$99     |
| Obligations of state and political subdivisions | 29,380         | 644      | (6     | ) 30,018   |
| Mortgage-backed securities                      | 58,809         | 3,496    | 0      | 62,305     |
| Total   | \$88,289       | \$ 4,140 | \$ (7  | ) \$92,422 |
| December 31, 2014                               |                |          |        |            |
| Obligations of U.S. Government agencies         | \$100          | \$ 0     | \$ (3  | ) \$97     |
| Obligations of state and political subdivisions | 29,529         | 449      | (18    | ) 29,960   |
| Mortgage-backed securities                      | 60,460         | 3,889    | 0      | 64,349     |
| Total   | \$90,089       | \$ 4,338 | \$ (21 | ) \$94,406 |

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

|   | Amortized<br>Cost<br>(in thousands) | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------------------------|------------------------------|-------------------------------|---------------|
| March 31, 2015                                  |                                     |                              |                               |               |
| U.S. Treasury securities                        | \$6,500                             | \$ 0                         | \$ 0                          | \$6,500       |
| Obligations of U.S. Government agencies         | 17,987                              | 3                            | (149 )                        | 17,841        |
| Obligations of state and political subdivisions | 48,968                              | 823                          | (242 )                        | 49,549        |
| Mortgage-backed securities                      | 59,086                              | 90                           | (494 )                        | 58,682        |
| Money market investments                        | 629                                 | 0                            | 0                             | 629           |
| Corporate bonds                                 | 3,097                               | 12                           | (4 )                          | 3,105         |
| Other marketable equity securities              | 100                                 | 0                            | (19 )                         | 81            |
| Total   | \$136,367                           | \$ 928                       | \$ (908 )                     | \$136,387     |
| December 31, 2014                               |                                     |                              |                               |               |
| U.S. Treasury securities                        | \$20,000                            | \$ 0                         | \$ 0                          | \$20,000      |
| Obligations of U.S. Government agencies         | 4,768                               | 2                            | (152 )                        | 4,618         |
| Obligations of state and political subdivisions | 49,783                              | 698                          | (235 )                        | 50,246        |
| Mortgage-backed securities                      | 61,296                              | 34                           | (442 )                        | 60,888        |
| Money market investments                        | 719                                 | 0                            | 0                             | 719           |
| Corporate bonds                                 | 2,798                               | 3                            | (11 )                         | 2,790         |
| Other marketable equity securities              | 100                                 | 0                            | (15 )                         | 85            |
| Total   | \$139,464                           | \$ 737                       | \$ (855 )                     | \$139,346     |

There were no gains or losses recorded on the sale of available-for-sale securities in the three months ended March 31, 2015 or 2014.

#### OTHER-THAN-TEMPORARILY IMPAIRED SECURITIES

Management assesses whether the Company intends to sell or it is more-likely-than-not that the Company will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Company separates the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of expected future cash flows is due to factors that are not credit related, which are recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best-estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best-estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds, and structural support, including subordination and guarantees.

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

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The Company has not recorded impairment charges through income on securities for the three months ended March 31, 2015 or the year ended December 31, 2014.

TEMPORARILY IMPAIRED SECURITIES

The following table shows the number of securities with unrealized losses, and the gross unrealized losses and fair value of the Company's investments with unrealized losses that are deemed to be temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of the dates indicated.

|   | March 31, 2015          |            |                         |            |                         |            | Number of Securities |
|---|-------------------------|------------|-------------------------|------------|-------------------------|------------|----------------------|
|   | Less Than Twelve Months |            | More Than Twelve Months |            | Total                   |            |                      |
|   | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |                      |
| (dollars in thousands)                          |                         |            |                         |            |                         |            |                      |
| Securities Available-for-Sale                   |                         |            |                         |            |                         |            |                      |
| Debt securities:                                |                         |            |                         |            |                         |            |                      |
| U.S. Treasury securities                        | \$0                     | \$6,500    | \$0                     | \$0        | \$0                     | \$6,500    | 1                    |
| Obligations of U.S. Government agencies         | 0                       | 13,500     | 149                     | 4,038      | 149                     | 17,538     | 2                    |
| Obligations of state and political subdivisions | 102                     | 7,322      | 140                     | 4,002      | 242                     | 11,324     | 22                   |
| Mortgage-backed securities                      | 494                     | 47,000     | 0                       | 0          | 494                     | 47,000     | 6                    |
| Corporate bonds                                 | 1                       | 297        | 3                       | 497        | 4                       | 794        | 7                    |
| Other marketable equity securities              | 0                       | 0          | 19                      | 81         | 19                      | 81         | 1                    |
| Total securities available-for-sale             | \$597                   | \$74,619   | \$311                   | \$8,618    | \$908                   | \$83,237   | 39                   |
| Securities Held-to-Maturity                     |                         |            |                         |            |                         |            |                      |
| Obligations of U.S. Government agencies         | \$0                     | \$0        | \$1                     | \$99       | \$1                     | \$99       | 1                    |
| Obligations of state and political subdivisions | 2                       | 904        | 4                       | 539        | 6                       | 1,443      | 3                    |
| Total securities held-to-maturity               | \$2                     | \$904      | \$5                     | \$638      | \$7                     | \$1,542    | 4                    |
| Total securities                                | \$599                   | \$75,523   | \$316                   | \$9,256    | \$915                   | \$84,779   | 43                   |

|   | December 31, 2014       |            |                         |            |                         |            | Number of Securities |
|---|-------------------------|------------|-------------------------|------------|-------------------------|------------|----------------------|
|   | Less Than Twelve Months |            | More Than Twelve Months |            | Total                   |            |                      |
|   | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |                      |
| (dollars in thousands)                          |                         |            |                         |            |                         |            |                      |
| Securities Available-for-Sale                   |                         |            |                         |            |                         |            |                      |
| Debt securities:                                |                         |            |                         |            |                         |            |                      |
| U.S. Treasury securities                        | \$0                     | \$20,000   | \$0                     | \$0        | \$0                     | \$20,000   | 1                    |
| Obligations of U.S. Government agencies         | 0                       | 0          | 152                     | 4,316      | 152                     | 4,316      | 1                    |
| Obligations of state and political subdivisions | 2                       | 604        | 233                     | 11,951     | 235                     | 12,555     | 24                   |
| Mortgage-backed securities                      | 62                      | 16,589     | 380                     | 32,104     | 442                     | 48,693     | 6                    |
| Corporate bonds                                 | 3                       | 1,096      | 8                       | 792        | 11                      | 1,888      | 14                   |
| Other marketable equity securities              | 15                      | 85         | 0                       | 0          | 15                      | 85         | 1                    |

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|   |      |          |       |          |       |          |    |
|---|------|----------|-------|----------|-------|----------|----|
| Total securities available-for-sale             | \$82 | \$38,374 | \$773 | \$49,163 | \$855 | \$87,537 | 47 |
| Securities Held-to-Maturity                     |      |          |       |          |       |          |    |
| Obligations of U.S. Government agencies         | \$0  | \$0      | \$3   | \$97     | \$3   | \$97     | 1  |
| Obligations of state and political subdivisions | 2    | 1,261    | 16    | 1,203    | 18    | 2,464    | 6  |
| Total securities held-to-maturity               | \$2  | \$1,261  | \$19  | \$1,300  | \$21  | \$2,561  | 7  |
| Total securities                                | \$84 | \$39,635 | \$792 | \$50,463 | \$876 | \$90,098 | 54 |

Certain investments within the Company's portfolio had unrealized losses at March 31, 2015 and December 31, 2014, as shown in the tables above. The unrealized losses were caused by increases in market interest rates. Because the Company does not intend to sell the investments and management believes it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at March 31, 2015 or December 31, 2014.

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Restricted Securities

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

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

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

|   | March<br>31, 2015 | December<br>31, 2014 |
|---|-------------------|----------------------|
|   | (in thousands)    |                      |
| Mortgage loans on real estate:                |                   |                      |
| Residential 1-4 family                        | \$94,275          | \$91,318             |
| Commercial                                    | 280,445           | 287,531              |
| Construction                                  | 14,023            | 9,082                |
| Second mortgages                              | 14,591            | 13,403               |
| Equity lines of credit                        | 45,426            | 43,662               |
| Total mortgage loans on real estate           | 448,760           | 444,996              |
| Commercial loans                              | 41,600            | 37,698               |
| Consumer loans                                | 35,522            | 30,493               |
| Other   | 29,353            | 22,807               |
| Total loans                                   | 555,235           | 535,994              |
| Less: Allowance for loan losses               | (7,411 )          | (7,075 )             |
| Loans, net of allowance and deferred fees (1) | \$547,824         | \$528,919            |

(1) Deferred loan fees totaled \$476 thousand and \$473 thousand at March 31, 2015 and December 31, 2014, respectively.

Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts totaled \$511 thousand and \$541 thousand at March 31, 2015 and December 31, 2014, respectively.

**CREDIT QUALITY INFORMATION**

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

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

·Pass: Loans are of acceptable risk.

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

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

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

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

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

Credit Quality Information

As of March 31, 2015

(in thousands)

|                                     | Pass      | OAEM     | Substandard | Total     |
|-------------------------------------|-----------|----------|-------------|-----------|
| Mortgage loans on real estate:      |           |          |             |           |
| Residential 1-4 family              | \$92,599  | \$0      | \$ 1,676    | \$94,275  |
| Commercial                          | 265,125   | 10,505   | 4,815       | 280,445   |
| Construction                        | 12,976    | 0        | 1,047       | 14,023    |
| Second mortgages                    | 14,234    | 0        | 357         | 14,591    |
| Equity lines of credit              | 44,615    | 0        | 811         | 45,426    |
| Total mortgage loans on real estate | 429,549   | 10,505   | 8,706       | 448,760   |
| Commercial loans                    | 38,340    | 1,669    | 1,591       | 41,600    |
| Consumer loans                      | 35,494    | 0        | 28          | 35,522    |
| Other                               | 29,353    | 0        | 0           | 29,353    |
| Total                               | \$532,736 | \$12,174 | \$ 10,325   | \$555,235 |

Credit Quality Information

As of December 31, 2014

(in thousands)

|                                     | Pass      | OAEM     | Substandard | Total     |
|-------------------------------------|-----------|----------|-------------|-----------|
| Mortgage loans on real estate:      |           |          |             |           |
| Residential 1-4 family              | \$89,480  | \$0      | \$ 1,838    | \$91,318  |
| Commercial                          | 272,654   | 10,602   | 4,275       | 287,531   |
| Construction                        | 8,026     | 0        | 1,056       | 9,082     |
| Second mortgages                    | 13,306    | 0        | 97          | 13,403    |
| Equity lines of credit              | 42,976    | 0        | 686         | 43,662    |
| Total mortgage loans on real estate | 426,442   | 10,602   | 7,952       | 444,996   |
| Commercial loans                    | 36,007    | 1,669    | 22          | 37,698    |
| Consumer loans                      | 30,463    | 0        | 30          | 30,493    |
| Other                               | 22,807    | 0        | 0           | 22,807    |
| Total                               | \$515,719 | \$12,271 | \$ 8,004    | \$535,994 |

As of March 31, 2015 and December 31, 2014 the Company did not have any loans internally classified as Loss or Doubtful.

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## AGE ANALYSIS OF PAST DUE LOANS BY CLASS

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

## Age Analysis of Past Due Loans as of March 31, 2015

|                                     | 30 - 59<br>Days<br>Past<br>Due<br>(in thousands) | 60 - 89<br>Days<br>Past<br>Due | 90 or<br>More<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Total<br>Current<br>Loans (1) | Total<br>Loans | Recorded<br>Investment<br>>90 Days<br>Past Due<br>and<br>Accruing |
|-------------------------------------|--|--------------------------------|--------------------------------------|----------------------|-------------------------------|----------------|---|
| Mortgage loans on real estate:      |  |                                |                                      |                      |                               |                |   |
| Residential 1-4 family              | \$595  | \$100                          | \$219                                | \$914                | \$93,361                      | \$94,275       | \$ 0  |
| Commercial                          | 266  | 0                              | 0                                    | 266                  | 280,179                       | 280,445        | 0   |
| Construction                        | 181  | 0                              | 494                                  | 675                  | 13,348                        | 14,023         | 0   |
| Second mortgages                    | 0  | 0                              | 247                                  | 247                  | 14,344                        | 14,591         | 0   |
| Equity lines of credit              | 93   | 0                              | 0                                    | 93                   | 45,333                        | 45,426         | 0   |
| Total mortgage loans on real estate | 1,135  | 100                            | 960                                  | 2,195                | 446,565                       | 448,760        | 0   |
| Commercial loans                    | 330  | 0                              | 0                                    | 330                  | 41,270                        | 41,600         | 0   |
| Consumer loans                      | 385  | 451                            | 1,386                                | 2,222                | 33,300                        | 35,522         | 1,386   |
| Other                               | 48   | 10                             | 6                                    | 64                   | 29,289                        | 29,353         | 6   |
| Total                               | \$1,898  | \$561                          | \$2,352                              | \$4,811              | \$550,424                     | \$555,235      | \$ 1,392  |

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

In the table above, the consumer category includes student loans with principal amounts that are 97 - 98% guaranteed by the federal government. The past due portion of these guaranteed loans totaled \$2.2 million at March 31, 2015.

## Age Analysis of Past Due Loans as of December 31, 2014

|                                     | 30 - 59<br>Days<br>Past<br>Due<br>(in thousands) | 60 - 89<br>Days<br>Past<br>Due | 90 or<br>More<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Total<br>Current<br>Loans (1) | Total<br>Loans | Recorded<br>Investment<br>>90 Days<br>Past Due<br>and<br>Accruing |
|-------------------------------------|--|--------------------------------|--------------------------------------|----------------------|-------------------------------|----------------|---|
| Mortgage loans on real estate:      |  |                                |                                      |                      |                               |                |   |
| Residential 1-4 family              | \$1,043  | \$55                           | \$792                                | \$1,890              | \$89,428                      | \$91,318       | \$ 0  |
| Commercial                          | 31   | 0                              | 432                                  | 463                  | 287,068                       | 287,531        | 0   |
| Construction                        | 0  | 0                              | 499                                  | 499                  | 8,583                         | 9,082          | 0   |
| Second mortgages                    | 81   | 32                             | 168                                  | 281                  | 13,122                        | 13,403         | 107   |
| Equity lines of credit              | 49   | 0                              | 0                                    | 49                   | 43,613                        | 43,662         | 0   |
| Total mortgage loans on real estate | 1,204  | 87                             | 1,891                                | 3,182                | 441,814                       | 444,996        | 107   |

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|                  |         |       |         |         |           |           |          |
|------------------|---------|-------|---------|---------|-----------|-----------|----------|
| Commercial loans | 195     | 0     | 10      | 205     | 37,493    | 37,698    | 10       |
| Consumer loans   | 1,099   | 323   | 1,019   | 2,441   | 28,052    | 30,493    | 1,019    |
| Other            | 51      | 3     | 5       | 59      | 22,748    | 22,807    | 5        |
| Total            | \$2,549 | \$413 | \$2,925 | \$5,887 | \$530,107 | \$535,994 | \$ 1,141 |

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

In the table above, the consumer category includes student loans with principal amounts that are 97 - 98% guaranteed by the federal government. The past due portion of these guaranteed loans totaled \$2.4 million at December 31, 2014.

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**NONACCRUAL LOANS**

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

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

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

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

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

| Nonaccrual Loans by Class           | March          | December |
|-------------------------------------|----------------|----------|
|                                     | 31,<br>2015    | 31, 2014 |
|                                     | (in thousands) |          |
| Mortgage loans on real estate       |                |          |
| Residential 1-4 family              | \$397          | \$ 924   |
| Commercial                          | 3,640          | 4,086    |
| Construction                        | 494            | 499      |
| Second mortgages                    | 247            | 61       |
| Total mortgage loans on real estate | 4,778          | 5,570    |
| Commercial loans                    | 0              | 0        |
| Total                               | \$4,778        | \$ 5,570 |

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

Three  
Months



|   | Ended      |       |
|---|------------|-------|
|   | March 31,  |       |
|   | 2015       | 2014  |
|   | (in        |       |
|   | thousands) |       |
| Interest income that would have been recorded under original loan terms | \$73       | \$213 |
| Actual interest income recorded for the period                          | 63         | 112   |
| Reduction in interest income on nonaccrual loans                        | \$10       | \$101 |

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**TROUBLED DEBT RESTRUCTURINGS**

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

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

The following table presents TDRs during the period indicated, by class of loan. There were no troubled debts restructured in the three months ended March 31, 2015.

Troubled Debt Restructurings by Class  
For the Three Months Ended March 31, 2014  
(dollars in thousands)

|                                | Number of<br>Modifications | Recorded<br>Investment<br>Prior to<br>Modification | Recorded<br>Investment<br>After<br>Modification | Current<br>Investment<br>on<br>March 31,<br>2014 |
|--------------------------------|----------------------------|--|---|--|
| Mortgage loans on real estate: |                            |  |   |  |
| Residential 1-4 family         | 1                          | \$ 276   | \$ 276  | \$ 275   |
| Construction                   | 1                          | 103  | 103   | 103  |
| Second mortgages               | 1                          | 89   | 89  | 89   |
| Total                          | 3                          | \$ 468   | \$ 468  | \$ 467   |

All loans restructured in the first three months of 2014 were given below-market rates for debt with similar risk characteristics. At March 31, 2015 and December 31, 2014, the Company had no outstanding commitments to disburse additional funds on any TDR. Also at March 31, 2015 and December 31, 2014, the Company had \$99 thousand and \$446 thousand in loans secured by 1 - 4 family residential real estate that were in the process of foreclosure.

The following table presents TDRs for the periods indicated for which there was a payment default where the default occurred within twelve months of restructuring. The Company considers a TDR in default when any of the following occurs: the loan, as restructured, becomes 90 days or more past due; the loan is moved to nonaccrual status following the restructure; the loan is restructured again under terms that would qualify it as a TDR if it were not already so classified; or any portion of the loan is charged off. In the first quarter of 2015, there were no defaulting TDRs where the default occurred within twelve months of restructuring.

Restructurings that Subsequently Defaulted  
For the Three Months Ended March 31, 2014  
(in thousands)

|                                | Recorded Investment in Defaulting Loans |
|--------------------------------|---|
| Mortgage loans on real estate: |   |
| Residential 1-4 family         | \$94                                    |

The TDR in the table above is factored into the determination of the allowance for loan losses as of the period indicated. This loan is included in the impaired loan analysis, as discussed below.

#### IMPAIRED LOANS

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

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

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

Impaired Loans by Class  
(in thousands)

|                                     | As of March 31, 2015     |                   |                |                      | For the three months ended March 31, 2015 |                     |
|-------------------------------------|--------------------------|-------------------|----------------|----------------------|---|---------------------|
|                                     | Recorded Investment      |                   |                | Associated Allowance | Average Recorded Investment               | Interest Recognized |
|                                     | Unpaid Principal Balance | Without Allowance | With Allowance |                      |   |                     |
| Mortgage loans on real estate:      |                          |                   |                |                      |   |                     |
| Residential 1-4 family              | \$2,224                  | \$1,831           | \$ 360         | \$ 89                | \$2,203                                   | \$ 26               |
| Commercial                          | 11,269                   | 4,291             | 5,291          | 137                  | 9,653                                     | 121                 |
| Construction                        | 596                      | 66                | 528            | 265                  | 598                                       | 1                   |
| Second mortgages                    | 603                      | 379               | 195            | 7                    | 605                                       | 3                   |
| Total mortgage loans on real estate | \$14,692                 | \$6,567           | \$ 6,374       | \$ 498               | \$13,059                                  | \$ 151              |
| Commercial loans                    | 1,500                    | 1,369             | 132            | 3                    | 1,637                                     | 23                  |
| Consumer loans                      | 13                       | 13                | 0              | 0                    | 13  | 0                   |
| Total                               | \$16,205                 | \$7,949           | \$ 6,506       | \$ 501               | \$14,709                                  | \$ 174              |

Impaired Loans by Class  
(in thousands)

|                                     | As of December 31, 2014  |                   |                |                      | For the year ended December 31, 2014 |                     |
|-------------------------------------|--------------------------|-------------------|----------------|----------------------|--------------------------------------|---------------------|
|                                     | Recorded Investment      |                   |                | Associated Allowance | Average Recorded Investment          | Interest Recognized |
|                                     | Unpaid Principal Balance | Without Allowance | With Allowance |                      |                                      |                     |
| Mortgage loans on real estate:      |                          |                   |                |                      |                                      |                     |
| Residential 1-4 family              | \$2,898                  | \$2,083           | \$ 646         | \$ 91                | \$4,099                              | \$ 126              |
| Commercial                          | 11,766                   | 4,729             | 5,322          | 163                  | 10,669                               | 449                 |
| Construction                        | 1,157                    | 623               | 534            | 270                  | 2,431                                | 55                  |
| Second mortgages                    | 506                      | 195               | 282            | 178                  | 470                                  | 25                  |
| Total mortgage loans on real estate | \$16,327                 | \$7,630           | \$ 6,784       | \$ 702               | \$17,669                             | \$ 655              |

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|                  |          |         |          |        |          |        |
|------------------|----------|---------|----------|--------|----------|--------|
| Commercial loans | 0        | 0       | 0        | 0      | 37       | 0      |
| Consumer loans   | 14       | 14      | 0        | 0      | 26       | 1      |
| Total            | \$16,341 | \$7,644 | \$ 6,784 | \$ 702 | \$17,732 | \$ 656 |

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

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

#### ALLOWANCE FOR LOAN LOSSES

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

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

Each portfolio segment has risk characteristics as follows:

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

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

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

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

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

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

historical loss percentage is then calculated by migration analysis and applied to each pool. The migration analysis applied to all pools is able to track the risk grading and historical performance of individual loans throughout a number of periods set by management, which provides management with information regarding trends (or migrations) in a particular loan segment. At December 31, 2014 and March 31, 2015, management used twelve-quarter migration periods.

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

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

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## ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$7.4 million adequate to cover loan losses inherent in the loan portfolio at March 31, 2015.

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

## ALLOWANCE FOR LOAN LOSSES AND RECORDED INVESTMENT IN LOANS

(in thousands)

|  | Commercial | Real Estate -<br>Construction | Real Estate -<br>Mortgage | Consumer  | Other    | Total     |
|--|------------|-------------------------------|---------------------------|-----------|----------|-----------|
| For the three months ended                           |            |                               |                           |           |          |           |
| March 31, 2015                                       |            |                               |                           |           |          |           |
| Allowance for Loan Losses:                           |            |                               |                           |           |          |           |
| Balance at the beginning of period                   | \$ 595     | \$ 703                        | \$5,347                   | \$ 219    | \$211    | \$7,075   |
| Charge-offs  | 0          | 0                             | (14 )                     | (28 )     | (38 )    | (80 )     |
| Recoveries   | 9          | 0                             | 107                       | 10        | 15       | 141       |
| Provision for loan losses                            | 82         | 193                           | (158 )                    | 109       | 49       | 275       |
| Ending balance                                       | \$ 686     | \$ 896                        | \$5,282                   | \$ 310    | \$237    | \$7,411   |
| Ending balance individually evaluated for impairment | \$ 3       | \$ 265                        | \$233                     | \$ 0      | \$ 0     | \$501     |
| Ending balance collectively evaluated for impairment | 683        | 631                           | 5,049                     | 310       | 237      | 6,910     |
| Ending balance                                       | \$ 686     | \$ 896                        | \$5,282                   | \$ 310    | \$237    | \$7,411   |
| Loan Balances:                                       |            |                               |                           |           |          |           |
| Ending balance individually evaluated for impairment | \$ 1,501   | \$ 594                        | \$12,347                  | \$ 13     | \$ 0     | \$14,455  |
| Ending balance collectively evaluated for impairment | 40,099     | 13,429                        | 422,390                   | 35,509    | 29,353   | 540,780   |
| Ending balance                                       | \$ 41,600  | \$ 14,023                     | \$434,737                 | \$ 35,522 | \$29,353 | \$555,235 |
|  |            |                               |                           |           |          |           |
|  |            |                               |                           |           |          |           |
| For the year ended December 31, 2014                 |            |                               |                           |           |          |           |
| Allowance for Loan Losses:                           |            |                               |                           |           |          |           |
| Balance at the beginning of period                   | \$ 350     | \$ 662                        | \$5,357                   | \$ 294    | \$168    | \$6,831   |
| Charge-offs  | (286 )     | (51 )                         | (563 )                    | (163 )    | (175 )   | (1,238 )  |
| Recoveries   | 55         | 173                           | 524                       | 64        | 66       | 882       |
| Provision for loan losses                            | 476        | (81 )                         | 29                        | 24        | 152      | 600       |
| Ending balance                                       | \$ 595     | \$ 703                        | \$5,347                   | \$ 219    | \$211    | \$7,075   |
| Ending balance individually evaluated for impairment | \$ 0       | \$ 270                        | \$432                     | \$ 0      | \$ 0     | \$702     |
| Ending balance collectively evaluated for impairment | 595        | 433                           | 4,915                     | 219       | 211      | 6,373     |
| Ending balance                                       | \$ 595     | \$ 703                        | \$5,347                   | \$ 219    | \$211    | \$7,075   |
| Loan Balances:                                       |            |                               |                           |           |          |           |
| Ending balance individually evaluated for impairment | \$ 0       | \$ 1,157                      | \$13,257                  | \$ 14     | \$ 0     | \$14,428  |
|  | 37,698     | 7,925                         | 422,657                   | 30,479    | 22,807   | 521,566   |



Ending balance collectively evaluated for  
impairment

|                |           |          |           |           |          |           |
|----------------|-----------|----------|-----------|-----------|----------|-----------|
| Ending balance | \$ 37,698 | \$ 9,082 | \$435,914 | \$ 30,493 | \$22,807 | \$535,994 |
|----------------|-----------|----------|-----------|-----------|----------|-----------|

Note 4. Low-Income Housing Tax Credits

The Company was invested in 4 separate housing equity funds at March 31, 2015 and 3 separate funds at December 31, 2014. The general purpose of these funds is to encourage and assist participants in investing in low-income residential rental properties located in the Commonwealth of Virginia; develop and implement strategies to maintain projects as low-income housing; deliver Federal Low Income Housing Credits to investors; allocate tax losses and other possible tax benefits to investors; and to preserve and protect project assets.

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The investments in these funds were recorded as other assets on the consolidated balance sheets and were \$663 thousand and \$722 thousand at March 31, 2015 and December 31, 2014, respectively. The expected terms of these investments and the related tax benefits run through 2030. During the quarters ended March 31, 2015 and 2014, the Company recognized tax credits and other tax benefits related to these investments of \$118 thousand and \$65 thousand, respectively. Total projected tax credits to be received for 2015 are \$328 thousand, which is based on the most recent quarterly estimates received from the funds. Additional capital calls expected for the funds totaled \$3.7 million and \$2.7 million at March 31, 2015 and December 31, 2014, respectively.

#### Note 5. Share-Based Compensation

Share-based compensation arrangements include stock options, restricted stock awards, performance-based awards, stock appreciation rights and employee stock purchase plans. Accounting standards require all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period.

Historically, the Company has only granted share-based compensation in the form of stock options. There were no options granted in the first three months months of 2015.

On March 9, 2008, the Company's 1998 Stock Option Plan expired. Options to purchase 78,085 shares of common stock were outstanding under the Company's 1998 Stock Option Plan at March 31, 2015. The exercise price of each option equals the market price of the Company's common stock on the date of the grant and each option's maximum term is ten years.

Stock option activity for the three months ended March 31, 2015 is summarized below:

|                                      | Shares   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Remaining<br>Contractual<br>Life<br>(in years) | Aggregate<br>Intrinsic<br>Value<br>(in<br>thousands) |
|--------------------------------------|----------|--|--|--|
| Options outstanding, January 1, 2015 | 81,210   | \$ 20.05                                 |  |  |
| Granted                              | 0        | 0  |  |  |
| Exercised                            | 0        | 0  |  |  |
| Canceled or expired                  | (3,125 ) | 20.05                                    |  |  |
| Options outstanding, March 31, 2015  | 78,085   | \$ 20.05                                 | 2.55   | \$ 0   |
| Options exercisable, March 31, 2015  | 78,085   | \$ 20.05                                 | 2.55   | \$ 0   |

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on March 31, 2015. This amount changes based on changes in the market value of the Company's common stock. As of March 31, 2015, the outstanding options had no intrinsic value because the exercise prices of all outstanding options were above the market value of a share of the Company's common stock.

No options were exercised during the three months ended March 31, 2015.

As of March 31, 2015, all outstanding stock options were fully vested and there was no unrecognized stock-based compensation expense.

## Note 6. Pension Plan

The Company provides pension benefits for eligible participants through a non-contributory defined benefit pension plan. The plan was frozen effective September 30, 2006; therefore, no additional participants will be added to the plan. The components of net periodic pension plan cost are as follows for the periods indicated:

| Three months ended March 31,   | 2015              | 2014 |
|--------------------------------|-------------------|------|
|                                | (in<br>thousands) |      |
| Interest cost                  | \$66              | \$68 |
| Expected return on plan assets | (89)              | (91) |
| Amortization of net loss       | 99                | 55   |
| Net periodic pension plan cost | \$76              | \$32 |

At March 31, 2015, management had not yet determined the amount, if any, that the Company will contribute to the plan in the year ending December 31, 2015.

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## Note 7. Stockholders' Equity and Earnings per Share

## STOCKHOLDERS' EQUITY – ACCUMULATED OTHER COMPREHENSIVE LOSS

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

|  | Three Months<br>Ended March<br>31, |         | Affected Line Item on            |
|--|------------------------------------|---------|----------------------------------|
|  | 2015                               | 2014    | Consolidated Statement of Income |
| Securities transferred to held-to-maturity |                                    |         |                                  |
| Amortization of unrealized loss            | \$(214)                            | \$(191) | Interest on securities (taxable) |
| Tax benefit                                | (73 )                              | (65 )   | Income tax expense               |
|  | \$(141)                            | \$(126) | Net of tax                       |

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

|                                   | Unrealized<br>Gains<br>(Losses)<br>on<br>Securities<br>Held-to-Maturity<br>(in thousands) | Unrealized<br>Losses on<br>Securities<br>Transferred to<br>Held-to-Maturity | Defined<br>Benefit<br>Pension<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Loss |
|-----------------------------------|---|---|--|---|
| Three Months Ended March 31, 2015 |   |   |  |   |
| Balance at beginning of period    | \$(78 )   | \$ (3,386 )   | ) \$(2,429 )                           | \$ (5,893 )                                   |
| Net change for the period         | 91  | 141   | 0                                      | 232   |
| Balance at end of period          | \$13  | \$ (3,245 )   | ) \$(2,429 )                           | \$ (5,661 )                                   |
| Three Months Ended March 31, 2014 |   |   |  |   |
| Balance at beginning of period    | \$(5,317)   | \$ (3,937 )   | ) \$(1,548 )                           | \$ (10,802 )                                  |
| Net change for the period         | 1,552   | 126   | 0                                      | 1,678   |
| Balance at end of period          | \$(3,765)   | \$ (3,811 )   | ) \$(1,548 )                           | \$ (9,124 )                                   |

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

|   | Three Months Ended<br>March 31, 2015 |                             |            |
|---|--------------------------------------|-----------------------------|------------|
|   | Pretax                               | Tax                         | Net-of-Tax |
|   | (in thousands)                       |                             |            |
| Unrealized gains on available-for-sale securities                             | \$ 138                               | \$ 47                       | \$ 91      |
| Amortization of unrealized loss on securities transferred to held-to-maturity | 214                                  | 73                          | 141        |
| Total change in accumulated other comprehensive loss                          | \$ 352                               | \$ 120                      | \$ 232     |
|   | Three Months Ended March<br>31, 2014 |                             |            |
|   | Pretax                               | Tax<br>Expense<br>(Benefit) | Net-of-Tax |
|   | (in thousands)                       |                             |            |
| Unrealized gains on available-for-sale securities                             | \$ 2,351                             | \$ 799                      | \$ 1,552   |
| Amortization of unrealized loss on securities transferred to held-to-maturity | 191                                  | 65                          | 126        |
| Total change in accumulated other comprehensive loss                          | \$ 2,542                             | \$ 864                      | \$ 1,678   |

#### EARNINGS PER COMMON SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares attributable to outstanding stock options. The Company did not include 78 thousand and 151 thousand potential common shares attributable to outstanding stock options in the diluted earnings per share calculation for the first three months of 2015 and 2014, respectively, because they were antidilutive.

#### Note 8. Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-01, "Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim

reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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In June 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606". This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition", most industry-specific guidance, and some cost guidance included in Subtopic 605-35, "Revenue Recognition—Construction-Type and Production-Type Contracts". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures". This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period". The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation – Stock Compensation (Topic 718)", should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company is currently assessing the impact that ASU 2014-12 will have on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-14, "Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure". The amendments in this ASU apply to creditors that hold government-guaranteed mortgage loans and is intended to eliminate the diversity in practice related to the classification of these guaranteed loans upon foreclosure. The new guidance stipulates that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if (1) the loan has a government guarantee that is not separable from the loan prior to foreclosure, (2) at

the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the other receivable should be measured on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. Entities may adopt the amendments on a prospective basis or modified retrospective basis as of the beginning of the annual period of adoption; however, the entity must apply the same method of transition as elected under ASU 2014-04. Early adoption is permitted provided the entity has already adopted ASU 2014-04. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern". This update is intended to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management is required under the new guidance to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued when preparing financial statements for each interim and annual reporting period. If conditions or events are identified, the ASU specifies the process that must be followed by management and also clarifies the timing and content of going concern footnote disclosures in order to reduce diversity in practice. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on its consolidated financial statements.

In November 2014, the FASB issued ASU No. 2014-16, "Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity". The amendments in this ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. The Company does not expect the adoption of ASU 2014-16 to have a material impact on its consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, "Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items". The amendments in this ASU eliminate from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of ASU 2015-01 to have a material impact on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling

financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Company does not expect the adoption of ASU 2015-02 to have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of ASU 2015-03 to have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." The amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer's accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. The amendments in this ASU are effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Company does not expect the adoption of ASU 2015-03 to have a material impact on its consolidated financial statements.

#### Note 9. Fair Value Measurements

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

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

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

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

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

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

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

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

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## ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

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

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

|   | Balance   | Fair Value Measurements at<br>March 31, 2015 Using<br>(in thousands)                      |   |  |
|---|-----------|---|---|--|
|   |           | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Available-for-sale securities                   |           |   |   |  |
| U.S. Treasury securities                        | \$6,500   | \$0   | \$6,500   | \$ 0   |
| Obligations of U.S. Government agencies         | 17,841    | 0   | 17,841  | 0  |
| Obligations of state and political subdivisions | 49,549    | 0   | 49,549  | 0  |
| Mortgage-backed securities                      | 58,682    | 0   | 58,682  | 0  |
| Money market investments                        | 629       | 0   | 629   | 0  |
| Corporate bonds                                 | 3,105     | 0   | 3,105   | 0  |
| Other marketable equity securities              | 81        | 0   | 81  | 0  |
| Total available-for-sale securities             | \$136,387 | \$0   | \$136,387   | \$ 0   |

|  | Balance | Fair Value Measurements at<br>December 31, 2014 Using<br>(in thousands)                   |   |  |
|--|---------|---|---|--|
|  |         | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |

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|   |           | (Level<br>1) |            |    |     |
|---|-----------|--------------|------------|----|-----|
| Available-for-sale securities                   |           |              |            |    |     |
| U.S. Treasury securities                        | \$20,000  | \$0          | \$ 20,000  | \$ | \$0 |
| Obligations of U.S. Government agencies         | 4,618     | 0            | 4,618      |    | 0   |
| Obligations of state and political subdivisions | 50,246    | 0            | 50,246     |    | 0   |
| Mortgage-backed securities                      | 60,888    | 0            | 60,888     |    | 0   |
| Money market investments                        | 719       | 0            | 719        |    | 0   |
| Corporate bonds                                 | 2,790     | 0            | 2,790      |    | 0   |
| Other marketable equity securities              | 85        | 0            | 85         |    | 0   |
| Total available-for-sale securities             | \$139,346 | \$0          | \$ 139,346 | \$ | \$0 |

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

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

##### Impaired loans

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 fair value and loss associated with impaired loans can be based on the observable market price of the loan, the fair value of the collateral securing the loan, or the present value of the loan's expected future cash flows. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable, with the vast majority of the collateral in real estate.

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

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

##### Other Real Estate Owned (OREO)

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







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|                  |         |     |      |          |
|------------------|---------|-----|------|----------|
| Commercial       | 1,973   | 0   | 0    | 1,973    |
| Construction     | 264     | 0   | 0    | 264      |
| Second mortgages | 104     | 0   | 0    | 104      |
| Total            | \$2,740 | \$0 | \$ 0 | \$ 2,740 |

Other real estate owned

|                        |         |     |      |          |
|------------------------|---------|-----|------|----------|
| Residential 1-4 family | \$884   | \$0 | \$ 0 | \$ 884   |
| Commercial             | 1,198   | 0   | 0    | 1,198    |
| Construction           | 2,139   | 0   | 0    | 2,139    |
| Total                  | \$4,221 | \$0 | \$ 0 | \$ 4,221 |

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The following table displays quantitative information about Level 3 Fair Value Measurements as of the dates indicated:

| Quantitative Information About Level 3 Fair Value Measurements |  |                      |                      |                             |    |
|--|--|----------------------|----------------------|-----------------------------|----|
|  | Fair Value<br>at<br>March 31,<br>2015<br>(dollars in<br>thousands) | Valuation Techniques | Unobservable Input   | Range (Weighted<br>Average) |    |
| Impaired loans   |  |                      |                      |                             |    |
| Residential 1-4 family real estate                             | \$ 115   | Market comparables   | Selling costs        | 7.25                        | %  |
|  |  |                      | Liquidation discount | 4.00                        | %  |
| Commercial real estate   | \$ 1,973   | Market comparables   | Selling costs        | 7.25                        | %  |
|  |  |                      | Liquidation discount | 4.00                        | %  |
| Construction   | \$ 263   | Market comparables   | Selling costs        | 0.00% - 7.25% (1.38         | %) |
|  |  |                      | Liquidation discount | 4.00% - 41.93% (34.69       | %) |
| Second mortgages   | \$ 40  | Market comparables   | Selling costs        | 7.25                        | %  |
|  |  |                      | Liquidation discount | 4.00                        | %  |
| Other real estate owned  |  |                      |                      |                             |    |
| Residential 1-4 family   | \$ 1,337   | Market comparables   | Selling costs        | 7.25                        | %  |
|  |  |                      | Liquidation discount | 4.00% - 10.00% (6.75        | %) |
| Commercial   | \$ 1,154   | Market comparables   | Selling costs        | 7.25                        | %  |
|  |  |                      | Liquidation discount | 4.00                        | %  |
| Construction   | \$ 1,708   | Market comparables   | Selling costs        | 7.25                        | %  |
|  |  |                      | Liquidation discount | 0.00% - 4.00% (2.96         | %) |

| Quantitative Information About Level 3 Fair Value Measurements |   |                      |                      |                             |    |
|--|---|----------------------|----------------------|-----------------------------|----|
|  | Fair Value<br>at<br>December<br>31, 2014<br>(dollars in<br>thousands) | Valuation Techniques | Unobservable Input   | Range (Weighted<br>Average) |    |
| Impaired loans   |   |                      |                      |                             |    |
| Residential 1-4 family real estate                             | \$ 399  | Market comparables   | Selling costs        | 7.25                        | %  |
|  |   |                      | Liquidation discount | 4.00                        | %  |
| Commercial real estate   | \$ 1,973  | Market comparables   | Selling costs        | 7.25                        | %  |
|  |   |                      | Liquidation discount | 4.00                        | %  |
| Construction   | \$ 264  | Market comparables   | Selling costs        | 0.00% - 7.25% (1.18         | %) |
|  |   |                      | Liquidation discount | 4.00% - 28.71% (24.70       | %) |
| Second mortgages   | \$ 104  | Market comparables   | Selling costs        | 7.25                        | %  |
|  |   |                      | Liquidation discount | 4.00                        | %  |
| Other real estate owned  |   |                      |                      |                             |    |
| Residential 1-4 family   | \$ 884  | Market comparables   | Selling costs        | 7.25                        | %  |
|  |   |                      | Liquidation discount | 4.00% - 10.00% (8.09        | %) |
| Commercial   | \$ 1,198  | Market comparables   | Selling costs        | 7.25                        | %  |

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|              |          |                    |                      |                |          |
|--------------|----------|--------------------|----------------------|----------------|----------|
| Construction | \$ 2,139 | Market comparables | Liquidation discount | 4.00% - 10.00% | (5.91 %) |
|              |          |                    | Selling costs        | 7.25% - 11.25% | (7.38 %) |
|              |          |                    | Liquidation discount | 0.00% - 10.00% | (2.68 %) |

ASC 825, "Financial Instruments," requires disclosure 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's assets.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

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#### CASH AND CASH EQUIVALENTS

The carrying amounts of cash and short-term instruments, including interest-bearing due from banks, approximate fair values.

#### RESTRICTED SECURITIES

The restricted security category is comprised of FHLB and FRB stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and they lack a market. When the FHLB or FRB repurchases stock, they repurchase at the stock's book value. Therefore, the carrying amounts of restricted securities approximate fair value.

#### LOANS RECEIVABLE

The fair value of a loan is based on its interest rate in relation to its risk profile, in comparison to what an investor could earn on a different investment with a similar risk profile. Variations in risk tolerance between lenders, and thus in risk pricing, can result in the same loan being priced differently at different institutions. A bank's experience with the type of lending (such as commercial real estate) can also impact its assessment of the riskiness of a loan. A comprehensive picture of competitors' rates in relation to borrower risk profiles is not available. Instead, the Company uses a model which estimates market value based on the loan's interest rate (regardless of its risk level) and rates for debt of similar maturities where market data is available. Since the rate and risk profile are the primary factors in determining the fair value of a loan, both of which are unobservable in the market, the Company classifies loans as Level 3 in the fair value hierarchy. Fair values for non-performing loans are estimated as described above.

#### BANK-OWNED LIFE INSURANCE

Bank-owned life insurance represents insurance policies on certain current and former officers of the Company. The cash value of the policies is estimated using information provided by the insurance carrier. The insurance carrier uses actuarial data to estimate the value of each policy, based on the age and health of the insured relative to other individuals about whom the carrier has information. Health information can be broken down into quantitative, observable inputs, such as smoking habits, blood pressure, and weight, which, along with the insured's age, can be compared to observable data the insurance carrier has available. The carrier can then estimate the cash value of each policy. Since the cash value represents the amount of cash the Company would receive when the policies are paid, the cash value closely approximates the fair value of the policies. Accordingly, bank-owned life insurance is classified as Level 2.

#### DEPOSIT LIABILITIES

The fair value of demand deposits, savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. Information about the rates paid by other institutions for deposits of similar terms is readily available, and rates are mainly influenced by the term of the deposit itself. As a result, fair value calculations are based on observable inputs, and are classified as Level 2.

#### SHORT-TERM BORROWINGS

The carrying amounts of federal funds purchased, overnight repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Since the contractual terms of these borrowings provide all information necessary to calculate the amounts that will be due at maturity, these liabilities are classified as Level 2.

#### LONG-TERM BORROWINGS

The fair values of the Company's long-term borrowings are estimated based on the current cost to repay the debt in full, discounted to current values and including any prepayment penalties that may apply. As the contractual terms of the borrowing provide all the necessary inputs for this calculation, long-term borrowings are classified as Level 2.

#### ACCRUED INTEREST

The calculation of accrued interest is based on readily observable information, such as the rate and term of the underlying asset or liability. Since these amounts are expected to be realized quickly (generally within 30 to 90 days), the carrying value approximates fair value and is classified as Level 2.

#### COMMITMENTS TO EXTEND CREDIT AND IRREVOCABLE LETTERS OF CREDIT

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At March 31, 2015 and December 31, 2014, the fair value of fees charged for loan commitments and irrevocable letters of credit was immaterial.

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

|  | Carrying Value | Fair Value Measurements at March 31, 2015 Using (in thousands) |   |   |
|--|----------------|--|---|---|
|  |                | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets</b>                            |                |  |   |   |
| Cash and cash equivalents                | \$29,871       | \$29,871   | \$ 0  | \$ 0                                      |
| Securities available-for-sale            | 136,387        | 0  | 136,387                                       | 0   |
| Securities held-to-maturity              | 88,289         | 0  | 92,422  | 0   |
| Restricted securities                    | 2,304          | 0  | 2,304   | 0   |
| Loans, net of allowances for loan losses | 547,824        | 0  | 0   | 552,243                                   |
| Bank owned life insurance                | 23,746         | 0  | 23,746  | 0   |
| Accrued interest receivable              | 2,600          | 0  | 2,600   | 0   |
| <b>Liabilities</b>                       |                |  |   |   |
| Deposits                                 | \$728,326      | \$0  | \$ 729,141                                    | \$ 0                                      |
| Overnight repurchase agreements          | 35,547         | 0  | 35,547  | 0   |
| Term repurchase agreements               | 412            | 0  | 411   | 0   |
| Federal Home Loan Bank advances          | 30,000         | 0  | 31,318  | 0   |
| Accrued interest payable                 | 261            | 0  | 261   | 0   |

|                               | Carrying Value | Fair Value Measurements at December 31, 2014 Using (in thousands) |   |   |
|-------------------------------|----------------|---|---|---|
|                               |                | Quoted Prices in Active Markets for Identical Assets (Level 1)    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets</b>                 |                |   |   |   |
| Cash and cash equivalents     | \$33,305       | \$33,305  | \$ 0  | \$ 0                                      |
| Securities available-for-sale | 139,346        | 0   | 139,346                                       | 0   |
| Securities held-to-maturity   | 90,089         | 0   | 94,406  | 0   |

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|  |           |     |            |         |
|--|-----------|-----|------------|---------|
| Restricted securities                    | 2,293     | 0   | 2,293      | 0       |
| Loans, net of allowances for loan losses | 528,919   | 0   | 0          | 527,138 |
| Bank owned life insurance                | 23,525    | 0   | 23,525     | 0       |
| Accrued interest receivable              | 2,695     | 0   | 2,695      | 0       |
| Liabilities                              |           |     |            |         |
| Deposits                                 | \$716,654 | \$0 | \$ 717,260 | \$ 0    |
| Overnight repurchase agreements          | 37,404    | 0   | 37,404     | 0       |
| Term repurchase agreements               | 412       | 0   | 410        | 0       |
| Federal Home Loan Bank advances          | 30,000    | 0   | 31,536     | 0       |
| Accrued interest payable                 | 255       | 0   | 255        | 0       |

Note 10. Segment Reporting

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

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

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Information about reportable segments, and reconciliation of such information to the consolidated financial statements as of and for the three months ended March 31, 2015 and 2014 follows:

|                                  | Three Months Ended March 31, 2015<br>(in thousands) |         |                          |              |              |
|----------------------------------|---|---------|--------------------------|--------------|--------------|
|                                  | Bank  | Trust   | Unconsolidated<br>Parent | Eliminations | Consolidated |
| <b>Revenues</b>                  |   |         |                          |              |              |
| Interest and dividend income     | \$7,491   | \$13    | \$ 1,268                 | \$ (1,268 )  | \$ 7,504     |
| Income from fiduciary activities | 0   | 980     | 0                        | 0            | 980          |
| Other income                     | 2,051   | 261     | 50                       | (65 )        | 2,297        |
| Total operating income           | 9,542   | 1,254   | 1,318                    | (1,333 )     | 10,781       |
| <b>Expenses</b>                  |   |         |                          |              |              |
| Interest expense                 | 893   | 0       | 0                        | 0            | 893          |
| Provision for loan losses        | 275   | 0       | 0                        | 0            | 275          |
| Salaries and employee benefits   | 4,309   | 627     | 113                      | 0            | 5,049        |
| Other expenses                   | 3,035   | 236     | 32                       | (65 )        | 3,238        |
| Total operating expenses         | 8,512   | 863     | 145                      | (65 )        | 9,455        |
| Income before taxes              | 1,030   | 391     | 1,173                    | (1,268 )     | 1,326        |
| Income tax expense (benefit)     | 20  | 133     | (32 )                    | 0            | 121          |
| Net income                       | \$1,010   | \$258   | \$ 1,205                 | \$ (1,268 )  | \$ 1,205     |
| Capital expenditures             | \$318   | \$15    | \$ 0                     | \$ 0         | \$ 333       |
| Total assets                     | \$882,771   | \$5,848 | \$ 89,543                | \$ (90,484 ) | \$ 887,678   |

|                                  | Three Months Ended March 31, 2014<br>(in thousands) |       |                          |              |              |
|----------------------------------|---|-------|--------------------------|--------------|--------------|
|                                  | Bank  | Trust | Unconsolidated<br>Parent | Eliminations | Consolidated |
| <b>Revenues</b>                  |   |       |                          |              |              |
| Interest and dividend income     | \$7,454   | \$12  | \$ 1,052                 | \$ (1,052 )  | \$ 7,466     |
| Income from fiduciary activities | 0   | 955   | 0                        | 0            | 955          |
| Other income                     | 1,986   | 236   | 50                       | (65 )        | 2,207        |
| Total operating income           | 9,440   | 1,203 | 1,102                    | (1,117 )     | 10,628       |
| <b>Expenses</b>                  |   |       |                          |              |              |
| Interest expense                 | 1,031   | 0     | 0                        | 0            | 1,031        |
| Provision for loan losses        | 250   | 0     | 0                        | 0            | 250          |
| Salaries and employee benefits   | 4,098   | 645   | 110                      | 0            | 4,853        |
| Other expenses                   | 3,165   | 257   | 53                       | (65 )        | 3,410        |
| Total operating expenses         | 8,544   | 902   | 163                      | (65 )        | 9,544        |
| Income before taxes              | 896   | 301   | 939                      | (1,052 )     | 1,084        |
| Income tax expense (benefit)     | 43  | 102   | (38 )                    | 0            | 107          |

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|                      |           |         |           |              |            |
|----------------------|-----------|---------|-----------|--------------|------------|
| Net income           | \$853     | \$199   | \$ 977    | \$ (1,052 )  | \$ 977     |
| Capital expenditures | \$308     | \$7     | \$ 0      | \$ 0         | \$ 315     |
| Total assets         | \$865,222 | \$5,710 | \$ 83,120 | \$ (83,962 ) | \$ 870,090 |

The accounting policies of the segments are the same as those described in the summary of significant accounting policies reported in the Company's 2014 annual report on Form 10-K. The Company evaluates performance based on profit or loss from operations before income taxes, not including nonrecurring gains or losses.

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

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Note 11. Commitments and Contingencies

There have been no material changes in the Company's commitments and contingencies from those disclosed in the Company's 2014 annual report on Form 10-K.

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

Available Information

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

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company. The Company consists of the parent company and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services, N. A. (Trust), collectively referred to as the Company. This discussion should be read in conjunction with the consolidated financial statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements

In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include, but are not limited to, statements regarding profitability, including the focus on reducing time deposits; the net interest margin; strategies for managing the net interest margin and the expected impact of such efforts; liquidity; the loan portfolio and expected trends in the quality of the loan portfolio; the allowance and provision for loan losses; the effect of a sustained increase in nonperforming assets; the securities portfolio; the effect of increases in past due loans in the Company's purchased student loan portfolio; interest rate sensitivity; asset quality; levels of net loan charge-offs and nonperforming assets; levels of interest expense; levels and components of noninterest income and noninterest expense; lease expense; income taxes; expected impact of efforts to restructure the balance sheet; expected yields on the loan and securities portfolios; expected rates on interest-bearing liabilities; market risk; business and growth strategies; investment strategy; and financial and other goals. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" or other words of similar meaning. These statements can also be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to, changes in interest rates and yields; general economic conditions; uncertainty over future federal spending or the effects of federal budget cuts, particularly to the Department of Defense, on the Company's service area; the quality or composition of the loan or securities portfolios; changes in the volume and mix of interest-earning assets and interest-bearing liabilities; the effects of management's investment strategy and strategy to manage the net interest margin; the adequacy of the Company's credit quality review processes; the level of nonperforming assets and related charge-offs and recoveries; the federal government's guarantee of repayment of student loans purchased by the Company; the ability of the Company to diversify its sources of noninterest income;

the effect of the Company's sales training efforts for branch staff; the local real estate market; volatility and disruption in national and international financial markets; government intervention in the U.S. financial system; the application of the Basel III capital standards to the Company and its subsidiaries; FDIC premiums and/or assessments; penalties paid if the Company were to prepay its FHLB advance; demand for loan and other banking products and financial services in the Company's service area; levels of noninterest income and expense; deposit flows; competition; the use of inaccurate assumptions in management's modeling systems; technology; reliance on third parties for key services; adequacy of the allowance for loan losses; and changes in accounting principles, policies and guidelines. The Company could also be adversely affected by monetary and fiscal policies of the U.S. Government, as well as any regulations or programs implemented pursuant to the Dodd-Frank Act or other legislation and policies of the Office of the Comptroller of the Currency, U.S. Treasury and the Federal Reserve Board.

These risks and uncertainties, in addition to the risks and uncertainties identified in the Company's 2014 annual report on Form 10-K, should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

## General

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

## Critical Accounting Policies and Estimates

As of March 31, 2015, there have been no significant changes with regard to the critical accounting policies and estimates disclosed in the Company's 2014 annual report on Form 10-K. The accounting policy that required management's most difficult, subjective or complex judgments is the Company's allowance for loan losses. The Company's policies for calculating the allowance for loan losses are discussed in this Item 2 and in Note 3 of the Notes to the Consolidated Financial Statements included in this quarterly report on Form 10-Q, and are discussed in further detail in the Company's 2014 annual report on Form 10-K.

## Earnings Summary

Net income for the first three months of 2015 was \$1.2 million, or \$0.24 per diluted share, compared to net income of \$977 thousand, or \$0.20 per diluted share, for the first three months of 2014. This 23.34% increase is primarily attributable to higher net interest income and higher noninterest income, partially offset by higher noninterest expense and a higher provision for loan losses.

## Net Interest Income

The principal source of earnings for the Company is net interest income. Net interest income is the difference between interest and fees generated by earning assets and interest expense paid to fund them. Changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as their respective yields and rates, have a significant impact on the level of net interest income. The net interest margin is calculated by dividing tax-equivalent net interest income by average earning assets.

During the first quarter of 2015, the Company continued to grow loans, funding this growth through the securities portfolio, excess liquidity held in cash and due from banks, and increases in noninterest-bearing and savings deposits. This change helped the Company improve its net interest income and net interest margin, as loans typically bear higher yields than securities and significantly higher yields than cash and due from banks. On the other side of the balance sheet, the Company has worked to reduce the cost of its time deposits and focus on deposit growth in noninterest-bearing and savings accounts, which also contributed positively to the net interest margin. These shifts in both assets and liabilities increased the net interest margin for the first quarter of 2015 to 3.58%, from 3.43% for the first quarter of 2014.

Net interest income, on a fully tax-equivalent basis, was \$6.9 million in the first quarter of 2015, an increase of \$200 thousand from the first quarter of 2014, due to an increase in tax-equivalent interest income of \$62 thousand and a decrease in interest expense of \$138 thousand. Interest expense in the first three months of 2015 decreased 13.39% as compared to the first three months of 2014 primarily as a result of management's focus on allowing time deposits, which are currently the Company's most expensive deposit categories, to decrease through attrition.

During the three months ended March 31, 2015, the yield on average earning assets increased by 8 basis points over the comparable period in 2014. This increase was due to the reallocation of earning assets from securities to loans, as discussed above. At the same time, the average cost of funding liabilities decreased by 8 basis points, lowering interest expense. To manage the net interest margin in the current low-rate environment, the Company focused on building customer relationships to attract low-cost deposit accounts. Over the past year, higher-cost funds such as time deposits were allowed to mature without being renewed.

For the three months ended March 31, 2015, average earning assets decreased \$9.7 million when compared to the same periods of 2014. Although average loans grew significantly over these periods, the securities portfolio declined

at a faster rate as costlier liabilities were allowed to mature, which resulted in less excess liquidity for the Company to deploy through the securities portfolio.

The yield on average loans and cost of average interest-bearing liabilities both decreased due to persistent low rates set by the Federal Open Market Committee (FOMC) lowering the Federal Funds Target Rate during 2008 from 4.25% to a range of 0.00% to 0.25%. The FOMC has kept the Federal Funds Target Rate unchanged through March 31, 2015. As higher-yielding assets and higher-cost interest-bearing liabilities that were opened prior to 2008 mature, they are being replaced with lower-yielding loans and lower-cost interest-bearing liabilities. Assuming that the FOMC keeps interest rates at current levels, management believes that the decrease of the average rate on interest-bearing liabilities will continue to slow, as a high percentage of the Company's interest-bearing liabilities have already re-priced. Management also believes that the average yield on loans will continue to decline due to increased competition for loans in the Company's markets, and as loans are renewed or refinanced at lower current market rates. However, management believes the decrease should also continue to slow in future quarters.

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

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

|  | For the quarter ended March 31, |                                |                  |                    |                                |                  |
|--|---------------------------------|--------------------------------|------------------|--------------------|--------------------------------|------------------|
|  | 2015                            |                                |                  | 2014               |                                |                  |
|  | Average<br>Balance              | Interest<br>Income/<br>Expense | Yield/<br>Rate** | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Rate** |
|  | (dollars in thousands)          |                                |                  |                    |                                |                  |
| <b>ASSETS</b>  |                                 |                                |                  |                    |                                |                  |
| Loans*   | \$541,782                       | \$ 6,389                       | 4.72 %           | \$501,229          | \$ 6,000                       | 4.79 %           |
| Investment securities:   |                                 |                                |                  |                    |                                |                  |
| Taxable  | 137,200                         | 686                            | 2.00 %           | 184,062            | 1,005                          | 2.18 %           |
| Tax-exempt*  | 72,804                          | 641                            | 3.52 %           | 74,623             | 650                            | 3.48 %           |
| Total investment securities  | 210,004                         | 1,327                          | 2.53 %           | 258,685            | 1,655                          | 2.56 %           |
| Interest-bearing due from banks  | 10,637                          | 7                              | 0.26 %           | 4,619              | 3                              | 0.26 %           |
| Federal funds sold   | 2,194                           | 0                              | 0.00 %           | 9,314              | 5                              | 0.21 %           |
| Other investments  | 2,602                           | 33                             | 5.07 %           | 3,068              | 31                             | 4.04 %           |
| Total earning assets   | 767,219                         | \$ 7,756                       | 4.04 %           | 776,915            | \$ 7,694                       | 3.96 %           |
| Allowance for loan losses  | (7,200 )                        |                                |                  | (6,998 )           |                                |                  |
| Other nonearning assets  | 116,329                         |                                |                  | 99,925             |                                |                  |
| Total assets   | \$876,348                       |                                |                  | \$869,842          |                                |                  |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                            |                                 |                                |                  |                    |                                |                  |
| Time and savings deposits:   |                                 |                                |                  |                    |                                |                  |
| Interest-bearing transaction accounts                                  | \$11,280                        | \$ 1                           | 0.04 %           | \$11,835           | \$ 1                           | 0.03 %           |
| Money market deposit accounts  | 222,475                         | 42                             | 0.08 %           | 210,708            | 54                             | 0.10 %           |
| Savings accounts   | 72,611                          | 9                              | 0.05 %           | 67,708             | 16                             | 0.09 %           |
| Time deposits, \$100,000 or more                                       | 109,199                         | 270                            | 0.99 %           | 112,764            | 321                            | 1.14 %           |
| Other time deposits  | 115,625                         | 258                            | 0.89 %           | 138,110            | 328                            | 0.95 %           |
| Total time and savings deposits  | 531,190                         | 580                            | 0.44 %           | 541,125            | 720                            | 0.53 %           |
| Federal funds purchased, repurchase agreements and<br>other borrowings | 34,591                          | 8                              | 0.09 %           | 36,606             | 9                              | 0.10 %           |
| Federal Home Loan Bank advances  | 30,000                          | 305                            | 4.07 %           | 25,000             | 302                            | 4.83 %           |
| Total interest-bearing liabilities                                     | 595,781                         | 893                            | 0.60 %           | 602,731            | 1,031                          | 0.68 %           |
| Demand deposits  | 187,298                         |                                |                  | 182,867            |                                |                  |
| Other liabilities  | 3,815                           |                                |                  | 2,155              |                                |                  |
| Stockholders' equity   | 89,454                          |                                |                  | 82,089             |                                |                  |
| Total liabilities and stockholders' equity                             | \$876,348                       |                                |                  | \$869,842          |                                |                  |
| Net interest margin  |                                 | \$ 6,863                       | 3.58 %           |                    | \$ 6,663                       | 3.43 %           |

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

\*\*Annualized

#### Provision for Loan Losses

The provision for loan losses is a charge against earnings necessary to maintain the allowance for loan losses at a level consistent with management's evaluation of the portfolio. This expense is based on management's estimate of credit losses that may be sustained in the loan portfolio. Management's evaluation included credit quality trends, collateral values, the findings of internal credit quality assessments and results from external bank regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, were used in developing estimated loss factors for determining the loan loss provision.

The provision for loan losses was \$275 thousand in the first three months of 2015, compared to \$250 thousand in 2014. Management concluded that the provision was appropriate based on its analysis of the adequacy of the allowance for loan losses. Strong growth in the loan portfolio during the first quarter of 2015 required management to increase the provision.

Net loans charged off as a percent of total loans on an annualized basis were negative 0.04% for the first three months of 2015, or a net recovery of \$61 thousand as loan recoveries exceeded charge-offs during this quarter. This net recovery is compared to 0.19% in annualized net charge-offs, or \$247 thousand, in the first three months of 2014. Management does not believe that the net recovery seen in the first quarter of 2015 will continue in subsequent quarters, and expects that charge-offs during the remainder of the year will be closer to long-term historical averages unless national and local economic conditions do not continue to improve. At the same time, management does not expect that net charge-offs in future periods will be as high as those experienced during the recession of 2008 and 2009 and its aftermath. In addition to the possible effects of a wide-spread recession, possible future reductions in military and defense spending could cause higher local unemployment, which would likely cause an increase in nonperforming assets as individuals struggle to make loan payments. Increased nonperforming assets could cause increased charge-offs and lower earnings due to larger contributions to the loan loss provision and reductions in interest-accruing loans.

Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and accruing interest, restructured loans that are accruing interest and not performing according to their modified terms, and OREO. See Note 3 of the Notes to the Consolidated Financial Statements included in this quarterly report on Form 10-Q for an explanation of these categories. OREO includes foreclosed assets, which consist of real estate from foreclosures on loan collateral, and former branch sites that are no longer in use by the Bank. The majority of the loans past due 90 days or more and accruing interest are student loans with principal amounts that are 97 - 98% guaranteed by the federal government. When a loan changes from "past due 90 days or more and accruing interest" status to "nonaccrual" status, the loan is reviewed for impairment. In most cases, if the loan is considered impaired, then the difference between the value of the collateral and the principal amount outstanding on the loan is charged off. If the Company is waiting on an appraisal to determine the collateral's value or is in negotiations with the borrower or other parties that may affect the value of the collateral, management allocates funds to cover the deficiency to the allowance for loan losses based on information available to management at that time. In the case of TDRs, the restructuring may be to modify to an unsecured loan (e.g., a short sale) that the borrower can afford to repay. In these circumstances, the entire balance of the loan would be specifically allocated for, unless the present value of expected future cash flows was more than the current balance on the loan. It would not be charged off if the loan documentation supports the borrower's ability to repay the modified loan.

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

NONPERFORMING ASSETS

|  | March<br>31,<br>2015<br>(in thousands) | December<br>31,<br>2014 | Increase<br>(Decrease) |
|--|--|-------------------------|------------------------|
| Nonaccrual loans   |  |                         |                        |
| Real estate-construction                                   | \$494                                  | \$ 499                  | \$ (5 )                |
| Real estate-mortgage (1)                                   | 4,284                                  | 5,071                   | (787 )                 |
| Total nonaccrual loans                                     | \$4,778                                | \$ 5,570                | \$ (792 )              |
| Loans past due 90 days or more and accruing interest       |  |                         |                        |
| Commercial   | \$0                                    | \$ 10                   | \$ (10 )               |
| Real estate-mortgage (1)                                   | 0                                      | 107                     | (107 )                 |
| Consumer loans (2)   | 1,386                                  | 1,019                   | 367                    |
| Other  | 6                                      | 5                       | 1                      |
| Total loans past due 90 days or more and accruing interest | \$1,392                                | \$ 1,141                | \$ 251                 |
| Restructured loans   |  |                         |                        |
| Real estate-construction                                   | \$101                                  | \$ 102                  | \$ (1 )                |
| Real estate-mortgage (1)                                   | 11,445                                 | 12,203                  | (758 )                 |
| Consumer loans   | 13                                     | 13                      | 0                      |
| Total restructured loans                                   | \$11,559                               | \$ 12,318               | \$ (759 )              |
| Less nonaccrual restructured loans (included above)        | 3,615                                  | 4,240                   | (625 )                 |
| Less restructured loans currently in compliance (3)        | 7,944                                  | 8,078                   | (134 )                 |
| Net nonperforming, accruing restructured loans             | \$0                                    | \$ 0                    | \$ 0                   |
| Other real estate owned                                    |  |                         |                        |
| Construction, land development, and other land             | \$1,708                                | \$ 2,138                | \$ (430 )              |
| 1-4 family residential properties                          | 1,337                                  | 884                     | 453                    |
| Nonfarm nonresidential properties                          | 1,154                                  | 1,198                   | (44 )                  |
| Former branch sites  | 886                                    | 886                     | 0                      |
| Total other real estate owned                              | \$5,085                                | \$ 5,106                | \$ (21 )               |
| Total nonperforming assets                                 | \$11,255                               | \$ 11,817               | \$ (562 )              |

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

(2) Amounts listed include student loans with principal amounts that are 97 - 98% guaranteed by the federal government. The past due portion of these guaranteed loans totaled \$1.4 million at March 31, 2015 and \$1.0 million at December 31, 2014.

(3) As of March 31, 2015 and December 31, 2014, all of the Company's restructured accruing loans were performing in compliance with their modified terms.

Nonperforming assets as of March 31, 2015 were \$11.3 million, \$562 thousand lower than nonperforming assets as of December 31, 2014. Nonaccrual loans decreased \$792 thousand when comparing the balances as of March 31, 2015 to December 31, 2014, due primarily to the payoff of several loans. Loans past due 90 days or more and accruing interest increased \$251 thousand. As of March 31, 2015, nearly all of the \$1.4 million of loans past due 90 days or more and accruing interest were student loans on which the Company expects to experience minimal losses. Because the federal government has provided guarantees of repayment of these student loans in an amount ranging from 97% to 98% of

the total principal balance of the loans, management does not expect even significant increases in past due student loans to have a material effect on the Company.

The majority of the balance of nonaccrual loans at March 31, 2015 was related to a few large credit relationships. Of the \$4.8 million of nonaccrual loans at March 31, 2015, \$3.9 million or approximately 81.62% was comprised of two credit relationships of \$3.4 million and \$428 thousand. Total restructured loans decreased by \$759 thousand from December 31, 2014 to March 31, 2015 due to the payoff or foreclosure on three restructured loans. All accruing TDRs are performing in accordance with their modified terms. OREO decreased by \$21 thousand during the first three months of 2015, as additional foreclosures on 1 – 4 family residential property were more than offset by the sale of other properties, including three commercial properties. The former branch sites included in OREO are also listed for sale.

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The loans that make up the nonaccrual balance have been written down to their net realizable value. If the Company is waiting on an appraisal to determine the collateral's value, management allocates funds to cover the deficiency to the allowance for loan losses based on information available to management at the time. As shown in the table above, all nonaccrual loans at March 31, 2015 and December 31, 2014 were collateralized by real estate.

Management believes the Company has excellent credit quality review processes in place to identify problem loans quickly. The quality of the Company's loan portfolio has continued to improve over the past few years, with nonperforming assets generally stabilizing as troubled borrowers' finances have improved and troubled loans have been charged off or sold. Management remains cautious about the future and is well aware that if the economy does not continue to improve, or if reduced federal spending continues to negatively impact federal military and defense spending in the Company's service area, nonperforming assets could increase in future periods. As was seen in prior years, the effect of a sustained increase in nonperforming assets would be lower earnings caused by larger contributions to the loan loss provision, and lower levels of accruing loans, which in turn would be driven by larger impairments in the loan portfolio and higher levels of loan charge-offs.

As of March 31, 2015, the allowance for loan losses was 65.85% of nonperforming assets and 120.11% of nonperforming loans, compared to 59.87% and 105.42% as of December 31, 2014. As detailed in Note 3 of the Notes to the Consolidated Financial Statements included in this quarterly report on Form 10-Q, the Company saw a slight increase in substandard loans, from 1.49% to 1.86% of total loans, when comparing December 31, 2014 to March 31, 2015, based on internally assigned risk grades. The allowance for loan losses was 1.33% and 1.32% of total loans on March 31, 2015 and December 31, 2014, respectively.

#### Allowance for Loan Losses

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

The majority of the Company's TDRs and nonperforming loans are collateralized by real estate. When reviewing loans for impairment, the Company obtains current appraisals when applicable. If the Company has not yet received a current appraisal on loans being reviewed for impairment, any loan balance that is in excess of the estimated appraised value is allocated in the allowance. As of March 31, 2015 and December 31, 2014, the impaired loan component of the allowance for loan losses amounted to \$501 thousand and \$702 thousand, respectively. The decrease in this component was due to a change in the valuation method of one loan during the first quarter of 2015. This loan was previously valued by the collateral method, but continued performance by the borrower allowed the Company to begin using the cash flow method to value the loan.

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

Loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on whether the loan's payments are current (including loans 1 – 29 days past due), or are 30 – 59 days past due, 60 – 89 days past due, or 90 days or more past due. All other loans, including loans to consumers that are secured by real estate, are segmented by the Company's internally assigned risk grades: substandard, other assets

especially mentioned (rated just above substandard), and pass (all other loans). The Company may also assign loans to the risk grades of doubtful or loss, but as of March 31, 2015 and December 31, 2014, the Company had no loans in these categories.

With the December 31, 2014 and March 31, 2015 calculations, the historical loss was based on the past twelve quarters. Each quarter, management evaluates the historical period used to ensure that it provides the most appropriate reflection of risk related to the current loan portfolio.

The final component of the allowance consists of qualitative factors and includes items such as economic conditions, growth trends, loan concentrations, changes in certain loans, changes in underwriting, changes in management and legal and regulatory changes. On a combined basis, the historical loss and qualitative factor components amounted to \$6.9 million and \$6.4 million as of March 31, 2015 and December 31, 2014, respectively. Growth in the loan portfolio is the major reason for the increase in these combined components when comparing the allowance calculation as of March 31, 2015 to the allowance calculation as of December 31, 2014.

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As a result of management's analysis, the Company added, through the provision, \$275 thousand to the allowance for loan losses for the three months ended March 31, 2015. Management believes that the allowance has been appropriately funded for additional losses on existing loans, based on currently available information. The Company will continue to monitor the loan portfolio and levels of nonperforming assets closely and make changes to the allowance for loan losses when necessary.

#### Noninterest Income

Noninterest income was \$3.3 million in the three months ended March 31, 2015, up \$115 thousand or 3.64% when compared to the same period in 2014. All major categories of noninterest income increased in the three months ended March 31, 2015 as compared to the three months ended March 31, 2014, with the largest dollar increases in other service charges, commissions and fees and income from fiduciary activities. Other service charges, commissions and fees increased 5.57% to \$1.0 million in the three months ended March 31, 2015, as compared to the same period in 2014. This increase was mainly due to income from securities brokerage sales and income from merchant processing fees. Income from fiduciary activities increased 2.62% to \$980 thousand, primarily due to additional income collected for the administration of personal trust accounts.

Other noninterest income also increased, by 36.92% to \$89 thousand, primarily due to increased income from Old Point Mortgage and foreclosed properties. Income from Old Point Mortgage increased due to changes in staffing, which improved profitability in the first quarter of 2015 as compared to the first quarter of 2014. Foreclosed property income was increased by foreclosures in the fourth quarter of 2014 on properties occupied by rent-paying tenants.

#### Noninterest Expense

Noninterest expense increased only \$24 thousand, or 0.29%, when comparing the three months ended March 31, 2015 to the same period in 2014. While most categories of non-interest expense decreased, salaries and employee benefits and occupancy and equipment expenses, which are the two largest categories of noninterest expense, increased when comparing the three months ended March 31, 2015 to the same period in 2014. Salaries and employee benefits increased \$196 thousand, or 4.04%, due to three main factors: changes in staffing levels, with several vacant positions filled in the second and third quarters of 2014; changes in actuarial estimates, which increased the Company's pension expense; and accrued expense for year-end bonuses based on anticipated improved profitability in 2015 compared to 2014.

Occupancy and equipment expenses increased \$213 thousand, or 19.12%, for the three months ended March 31, 2015, when compared to the same period in 2014. In the second quarter of 2014, the Company finished its expansion of a branch office into its new corporate headquarters, and the building was recorded on the Company's balance sheet with a book value of \$14.1 million. The completion of this building increased depreciation, utilities and real estate taxes.

ATM and check losses increased \$22 thousand, or 19.13%, for the three months ended March 31, 2015, when compared to the same period in 2014, primarily as a result of fraud losses.

The remaining categories of noninterest expense decreased for the three months ended March 31, 2015 compared to the same period in 2014. The largest dollar decreases in noninterest expense between the first three months of 2015 and the first three months of 2014 were in data processing and other noninterest expenses. Data processing expense decreased \$65 thousand, or 15.37%, primarily as a result of the renegotiation of a contract affecting the Company's debit card expense. Loan expenses, which are included in other noninterest expenses, were reduced by the resolution of several problem loans in the third and fourth quarters of 2014; reduced loan expenses contributed to the decrease in other operating expenses of \$77 thousand, or 19.74%, for the three months ended March 31, 2015 compared to the same period in 2014.

#### Balance Sheet Review

Assets as of March 31, 2015 were \$887.7 million, an increase of \$11.4 million or 1.30% when compared to assets as of December 31, 2014. Loan demand continued to grow in the first quarter of 2015, with net loans increasing \$18.9

million or 3.57% between December 31, 2014 and March 31, 2015. With the exception of commercial real estate loans, all sub-segments of the Company's loan portfolio increased during the first three months of 2015, with the largest growth in the construction, consumer, and other sub-segments. The other sub-segment is somewhat volatile, as it includes warehouse lines of credit to mortgage companies, which fluctuate as demand for mortgage products changes. The construction loans sub-segment increased due to continued improvements in the economy, which led to increases in construction in the Company's market area. The increase in the consumer sub-segment was the result of continued purchases by the Company of certain consumer installment loans, with this product increasing \$5.1 million during the quarter. The Company maintains a dedicated reserve account for this portfolio of purchased loans. Any loan losses in this portfolio would be covered first by the reserve account, and then by the allowance for loan losses only if the funds available in the reserve account are not sufficient.

Loan growth was funded by both the asset and liability sides of the balance sheet. On the asset side, loan growth was funded by reductions in the securities portfolio and cash and cash equivalents between December 31, 2014 and March 31, 2015. As loans generally bear higher rates of interest than investment securities, and significantly higher rates than cash and due from banks, the shift in the mix of earning assets should provide additional increases to the net interest margin in subsequent quarters.

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Loan growth was funded on the liability side by increases in deposits, with total deposits increasing \$11.7 million between December 31, 2014 and March 31, 2015. In the first quarter of 2015, low-cost deposits grew \$9.0 million, while time deposits grew \$2.6 million. Rates on certain time products were set at or above current average rates in the Company's market in order to manage interest rate risk.

The Company's holdings of "Alt-A" type mortgage loans such as adjustable rate and nontraditional type loans were inconsequential, amounting to less than 1.00% of the Company's loan portfolio as of March 31, 2015.

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

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

| Loans Secured by 1 - 4 Family<br>First Mortgages,<br>1 - 4 Family Open-end and 1 - 4<br>Family Junior Liens<br>As of March 31, 2015<br>(dollars in thousands) |               |          |
|---|---------------|----------|
|   | Amount        | Percent  |
| Subprime  | \$20,938      | 14.62 %  |
| Non-subprime  | 122,303       | 85.38 %  |
|   | \$143,241     | 100.00 % |
| <br>Total loans   | <br>\$555,235 |          |
| <br>Percentage of Real<br>Estate-Secured Subprime<br>Loans to Total Loans   |               |          |
|   |               | 3.77 %   |

In addition to the subprime loans secured by real estate discussed above, as of March 31, 2015, the Company had an additional \$1.2 million in subprime consumer loans that were either not government guaranteed, were unsecured or were secured by collateral other than real estate. Together with the subprime loans secured by real estate, the Company's total subprime loans as of March 31, 2015 were \$22.1 million, amounting to 3.99% of the Company's total loans at March 31, 2015.

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

Average assets for the first three months of 2015 were \$876.3 million compared to \$869.8 million for the first three months of 2014, an increase of \$6.5 million or 0.75%. Comparing the first three months of 2014 to the first three months of 2015, lower yielding balances held in investment securities and cash and cash equivalents moved to higher yielding loans. Average loans increased \$40.6 million and average investment securities decreased by \$48.7 million

when comparing the first three months of 2014 to the same period in 2015.

#### Capital Resources

Total stockholders' equity as of March 31, 2015 was \$89.5 million, an increase of \$1.0 million or 1.18% from \$88.5 million at December 31, 2014. New capital requirements known as the Basel III Final Rules were effective January 1, 2015.

For purposes of the Basel III Final Rules (i) common equity Tier 1 capital (CET1) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stock and trust preferred securities; and (iii) Tier 2 capital consists principally of qualifying subordinated debt and preferred stock, and limited amounts of the allowance for loan losses. Total Capital is Tier 1 plus Tier 2 capital. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also implement a "countercyclical capital buffer," generally designed to absorb losses during periods of economic stress and to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. The Basel III Final Rules are discussed in detail in the Company's 2014 annual report on Form 10-K.

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The following is a summary of the Company's capital ratios at March 31, 2015. As shown below, these ratios were all well above the regulatory minimum levels, and demonstrate that the Company's capital position remains strong.

|                              | 2015                   |   | March<br>31, 2015 |
|------------------------------|------------------------|---|-------------------|
|                              | Regulatory<br>Minimums | % |                   |
| Common Equity Tier 1 Capital | 4.50                   | % | 13.67 %           |
| Tier 1 Capital               | 6.00                   | % | 13.67 %           |
| Tier 1 Leverage              | 4.00                   | % | 10.88 %           |
| Total Capital                | 8.00                   | % | 14.74 %           |

Book value per share was \$18.06 at March 31, 2015 as compared to \$16.76 at March 31, 2014. Cash dividends were \$396 thousand or \$0.08 per share in the first three months of 2015 and \$297 thousand or \$0.06 per share in the first three months of 2014.

### Liquidity

Liquidity is the ability of the Company to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments in securities and loans maturing within one year. The Company's internal sources of such liquidity are deposits, loan and investment repayments and securities available-for-sale. As of March 31, 2015, the Bank's unpledged, available-for-sale securities totaled \$90.4 million. The Company's primary external source of liquidity is advances from the FHLB.

A major source of the Company's liquidity is its large, stable deposit base. In addition, secondary liquidity sources are available through the use of borrowed funds if the need should arise, including secured advances from the FHLB. As of the end of the first quarter of 2015, the Company had \$234.8 million in FHLB borrowing availability. The Company has available short-term, unsecured borrowed funds in the form of federal funds lines of credit with correspondent banks. As of the end of the first quarter of 2015, the Company had \$50.0 million available in federal funds lines to handle any short-term borrowing needs.

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

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

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

### Contractual Obligations

In the normal course of business there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit that may or may not require cash outflows.

As of March 31, 2015, there have been no material changes outside the ordinary course of business in the Company's contractual obligations disclosed in the Company's 2014 annual report on Form 10-K.

Off-Balance Sheet Arrangements

As of March 31, 2015, there were no material changes in the Company's off-balance sheet arrangements disclosed in the Company's 2014 annual report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

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

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

Based on scheduled maturities only, the Company was liability sensitive as of March 31, 2015. It should be noted, however, that non-maturing deposit liabilities, which consist of money market, savings and interest-bearing and noninterest-bearing checking accounts, are less interest sensitive than other market driven deposits. At March 31, 2015, non-maturing deposit liabilities totaled \$502.4 million or 68.98% of total deposit liabilities.

In a rising rate environment, changes in these deposit rates have historically lagged behind the changes in earning asset rates, thus mitigating the impact from the liability sensitivity position. The asset/liability model allows the Company to reflect the fact that non-maturing deposits are less rate sensitive than other deposits by using a decay rate. The decay rate is a type of artificial maturity that simulates maturities for non-maturing deposits over the number of months that more closely reflects historical data. Using the decay rate, the model reveals that the Company is asset sensitive at the one-year time frame as of March 31, 2015.

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

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

Under the rate environment forecasted by management, rate changes in 50 to 100 basis point increments are applied to assess the impact on the Company's earnings at March 31, 2015. The rate change model assumes that these changes will occur gradually over the course of a year. The model reveals that a 50 basis point ramped decrease in rates would cause an approximate 0.42% annual decrease in net interest income. The model reveals that a 50 basis point ramped rise in rates would cause an approximate 0.69% annual increase in net interest income and that a 100 basis point ramped rise in rates would cause an approximate 1.04% increase in net interest income.

#### Item 4. Controls and Procedures.

Disclosure Controls and Procedures. Management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and 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, not absolute, assurance that

the objectives of the disclosure controls and procedures are met. 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.

**Internal Control over Financial Reporting.** Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). No changes in the Company's internal control over financial reporting occurred during the fiscal quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Because of its inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

There are no pending legal proceedings to which the Company, or any of its subsidiaries, is a party or to which the property of the Company or any of its subsidiaries is subject that, in the opinion of management, may materially impact the financial condition of the Company.

Item 1A. Risk Factors.

There have been no material changes in the risk factors faced by the Company from those disclosed in the Company's 2014 annual report on Form 10-K.

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

Pursuant to the Company's stock option plans, participants may exercise stock options by surrendering shares of the Company's common stock that the participants already own. Shares surrendered by participants of these plans are repurchased at current market value pursuant to the terms of the applicable stock options. During the quarter ended March 31, 2015, the Company did not repurchase any shares related to the exercise of stock options.

During the quarter ended March 31, 2015, the Company did not repurchase any shares pursuant to the Company's stock repurchase program.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

The Company has made no changes to the procedures by which security holders may recommend nominees to its board of directors.

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Item 6. Exhibits.

| Exhibit No. | Description  |
|-------------|--|
| 3.1         | Articles of Incorporation of Old Point Financial Corporation, as amended effective June 22, 2000 (incorporated by reference to Exhibit 3.1 to Form 10-K filed March 12, 2009)  |
| 3.2         | Bylaws of Old Point Financial Corporation, as amended and restated March 8, 2011 (incorporated by reference to Exhibit 3.2 to Form 8-K filed March 10, 2011)   |
| 10.7        | Summary of Old Point Financial Corporation Incentive Plan (incorporated by reference to Exhibit 10.7 to Form 8-K filed March 12, 2015)   |
| 31.1        | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 31.2        | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| 32.1        | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| 101         | The following materials from Old Point Financial Corporation's quarterly report on Form 10-Q for the quarter ended March 31, 2015, formatted in XBRL (Extensible Business Reporting Language), filed herewith: (i) Consolidated Balance Sheets (unaudited for March 31, 2015), (ii) Consolidated Statements of Income (unaudited), (iii) Consolidated Statements of Comprehensive Income (Loss) (unaudited), (iv) Consolidated Statements of Changes in Stockholders' Equity (unaudited), (v) Consolidated Statements of Cash Flows (unaudited), and (vi) Notes to Consolidated Financial Statements (unaudited) |

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.

OLD POINT FINANCIAL CORPORATION

May 12, 2015 /s/Robert F. Shuford, Sr.  
Robert F. Shuford, Sr.  
Chairman, President & Chief Executive Officer  
(Principal Executive Officer)

May 12, 2015 /s/Laurie D. Grabow  
Laurie D. Grabow  
Chief Financial Officer & Senior Vice President/Finance  
(Principal Financial & Accounting Officer)