

OLD POINT FINANCIAL CORP
Form 10-K
March 18, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

or

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

For the transition period from _____ to _____

Commission file number 000-12896

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

Virginia 54-1265373
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

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

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

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

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

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

None

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

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

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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 every Interactive Data File required to be submitted 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 such files). Yes No

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

The aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of June 29, 2018 was \$109,738,216 based on the closing sales price on the NASDAQ Capital Market of \$28.86.

There were 5,185,151 shares of common stock outstanding as of March 12, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Company's Annual Meeting of Stockholders to be held on May 28, 2019, are incorporated by reference in Part III of this report.

OLD POINT FINANCIAL CORPORATION

FORM 10-K

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Part I

Item 1. Business

GENERAL

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

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

The Bank is a national banking association that was founded in 1922. As of the end of 2018, the Bank had 19 branch offices serving the Hampton Roads localities of Hampton, Newport News, Norfolk, Virginia Beach, Chesapeake, Williamsburg/James City County, York County and Isle of Wight County. The Bank offers a complete line of consumer, mortgage and business banking services, including loan, deposit, and cash management services to individual and commercial customers.

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

As of December 31, 2018, the Company had assets of \$1,038.2 million, gross loans of \$774.0 million, deposits of \$843.1 million, and stockholders' equity of \$102.0 million. At year-end, the Company and its subsidiaries had a total of 301 employees, 16 of whom were part-time.

STRATEGIC ACQUISITION

On April 1, 2018, the Company acquired Citizens National Bank (Citizens). Under the terms of the merger agreement, Citizens stockholders received 0.1041 shares of Company common stock and \$2.19 in cash for each share of Citizens stock. Systems integration was completed in May 2018.

MARKET AREA AND COMPETITION

The Company's market area is located in Hampton Roads, situated in the southeastern corner of Virginia and boasting the world's largest natural deepwater harbor. The Hampton Roads Metropolitan Statistical Area (MSA) is the 37th most populous MSA in the United States according to the U.S. Census Bureau's 2010 census and the 3rd largest deposit market in Virginia, after Richmond and the Washington Metropolitan area, according to the Federal Deposit Insurance Corporation (FDIC). Hampton Roads includes the cities of Chesapeake, Hampton, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk, Virginia Beach and Williamsburg, and the counties of Isle of Wight, Gloucester, James City, Mathews, York and Surry. The market area is serviced by 56 banks, savings institutions and credit unions and, in addition, branches of virtually every major brokerage house serve the Company's market area.

The banking business in Virginia, and in the Company's primary service areas in the Hampton Roads MSA, is highly competitive and dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have over the Company is their ability to finance wide-ranging advertising campaigns, and by virtue of their greater total capitalization, to have substantially higher lending limits than the Company. Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution affect competition for deposits and loans. The Company competes by emphasizing customer service and technology, establishing long-term customer relationships and building customer loyalty, and providing products and services to address the specific needs of the Company's customers. The Company targets individual and small-to-medium size business customers. The Company also faces competitive pressure from large credit unions in the area. The three largest credit unions headquartered in the Hampton Roads MSA are Langley Federal Credit Union, Chartway Federal Credit Union, and Newport News Shipbuilding Employees' Credit Union.

The Company continues to build a strong presence in the business banking market, as well as expanding into other fee-based lines of business. In 2017, the Company purchased full ownership of Old Point Mortgage, LLC and launched Old Point Insurance, LLC. Through these comprehensive business services and new lines of business, the Company is able to service a highly lucrative market that offers increased opportunities for new fee-based revenue streams and to cross sell additional products.

AVAILABLE INFORMATION

The Company maintains a website on the Internet at www.oldpoint.com. The Company makes available free of charge, on or through its website, its proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). This reference to the Company's Internet address shall not, under any circumstances, be deemed to incorporate the information available at such Internet address into this Form 10-K or other SEC filings. The information available at the Company's Internet address is not part of this Form 10-K or any other report filed by the Company with the SEC. The Company's SEC filings can also be obtained on the SEC's website on the Internet at www.sec.gov.

REGULATION AND SUPERVISION

General. Bank holding companies, banks and their affiliates are extensively regulated under both federal and state law. The following summary briefly describes significant provisions of currently applicable federal and state laws and certain regulations and the potential impact of such provisions. This summary is not complete and is qualified in its entirety by reference to the particular statutory or regulatory provisions or proposals. Because regulation of financial institutions changes regularly and is the subject of constant legislative and regulatory debate, no assurance can be given as to forecast how federal and state regulation and supervision of financial institutions may change in the future and affect the Company's and the Bank's operations.

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

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

As a non-depository national banking association, Trust is subject to regulation, supervision and regular examination by the Comptroller. Trust's exercise of fiduciary powers must comply with regulations promulgated by the Comptroller at 12 C.F.R. Part 9 and with Virginia law.

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

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

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

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

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

Regulatory Reform. The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other events led to the adoption of numerous laws and regulations that apply to, and focus on, financial institutions. The most significant of these laws is the Dodd-Frank Act, which was enacted on July 21, 2010 and, in part, was intended to implement significant structural reforms to the financial services industry.

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In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the EGRRCPA) was enacted to reduce the regulatory burden on certain banking organizations, including community banks, by modifying or eliminating certain federal regulatory requirements. While the EGRRCPA maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than \$10 billion as well as for larger banks with assets above \$50 billion. In addition, the EGRRCPA included regulatory relief for community banks regarding regulatory examination cycles, call reports, application of the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, qualified mortgages, and risk weights for certain high-risk commercial real estate loans. However, federal banking regulators retain broad discretion to impose additional regulatory requirements on banking organizations based on safety and soundness and U.S. financial system stability considerations.

The Company continues to experience ongoing regulatory reform. These regulatory changes could have a significant effect on how the Company conducts its business. The specific implications of the Dodd-Frank Act, the EGRRCPA, and other potential regulatory reforms cannot yet be fully predicted and will depend to a large extent on the specific regulations that are to be adopted in the future. Certain aspects of the Dodd-Frank Act and the EGRRCPA are discussed in more detail below.

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

- changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the \$250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from \$100,000 to \$250,000;

- repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;

- created and centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (CFPB), which is discussed in more detail below;

- imposed limits for debit card interchange fees for issuers that have assets greater than \$10 billion, which also could affect the amount of interchange fees collected by financial institutions with less than \$10 billion in assets;

- restricted the preemption of state law by federal law and disallowed subsidiaries and affiliates of national banks from availing themselves of such preemption;

- imposed comprehensive regulation of the over-the-counter derivatives market subject to significant rulemaking processes, to include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;

- required loan originators to retain 5 percent of any loan sold or securitized, unless it is a "qualified residential mortgage", subject to certain restrictions;

- prohibited banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and

- implemented corporate governance revisions that apply to all public companies, not just financial institutions.

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

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

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

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

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

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

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

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

Community Bank Leverage Ratio. As a result of the EGRRCPA, the federal banking agencies were required to develop a Community Bank Leverage Ratio (the ratio of a bank's tangible equity capital to average total consolidated assets) for banking organizations with assets of less than \$10 billion, such as the Bank. On November 21, 2018, the federal banking agencies invited public comment on their proposal to establish the Community Bank Leverage Ratio framework. Under the proposal, a community banking organization would be eligible to elect the Community Bank Leverage Ratio framework if it has less than \$10 billion in total consolidated assets, limited amounts of certain assets

and off-balance sheet exposures, and a Community Bank Leverage Ratio greater than 9 percent. A qualifying community banking organization that has chosen the proposed framework would be automatically considered in compliance with the Basel III capital requirements and would be exempt from the complex Basel III risk-based capital calculations. Such a community banking organization would be considered to have met the capital ratio requirements to be “well capitalized” for the federal banking agencies’ Prompt Corrective Action rules provided it has a Community Bank Leverage Ratio greater than 9 percent. Because the proposal has not been finalized and a final rule has not been issued, it is difficult at this time to predict when or how this new capital ratio will ultimately be applied to community banking organizations or to predict the specific effects of the final rule.

Small Bank Holding Company. The EGRRCPA also expanded the category of bank holding companies that may rely on the Federal Reserve Board’s Small Bank Holding Company Policy Statement by raising the maximum amount of assets a qualifying bank holding company may have from \$1 billion to \$3 billion. In addition to meeting the asset threshold, a bank holding company must not engage in significant nonbanking activities, not conduct significant off-balance sheet activities, and not have a material amount of debt or equity securities outstanding and registered with the SEC (subject to certain exceptions). The Federal Reserve Board may, in its discretion, exclude any bank holding company from the application of the Small Bank Holding Company Policy Statement if such action is warranted for supervisory purposes.

In August 2018, the Federal Reserve Board issued an interim final rule to apply the Small Bank Holding Company Policy Statement to bank holding companies with consolidated total assets of less than \$3 billion. The policy statement, which, among other things, exempts certain bank holding companies from minimum consolidated regulatory capital ratios that apply to other bank holding companies. As a result of the interim final rule, which was effective August 30, 2018, the Company expects that it will be treated as a small bank holding company and will no longer be subject to regulatory capital requirements. The comment period on the interim final rule closed on October 29, 2018. The Bank remains subject to the regulatory capital requirements described above.

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank's deposits are insured by the DIF of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. The basic limit on FDIC deposit insurance coverage is \$250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations as an insured institution, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

Deposit Insurance Assessments. The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target "designated reserve ratio" (described in more detail below) of 2 percent for the DIF and, in lieu of dividends, provides for a lower assessment rate schedule when the reserve ratio reaches 2 percent and 2.5 percent. An institution's assessment rate is based on a statistical analysis of financial ratios that estimates the likelihood of failure over a three-year period, which considers the institution's weighted average CAMELS component rating, and is subject to further adjustments including those related to levels of unsecured debt and brokered deposits (not applicable to banks with less than \$10 billion in assets). At December 31, 2018, total base assessment rates for institutions that have been insured for at least five years range from 1.5 to 30 basis points applying to banks with less than \$10 billion in assets.

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

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

Federal Home Loan Bank of Atlanta. The Bank is a member of the Federal Home Loan Bank (FHLB) of Atlanta, which is one of 12 regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each FHLB makes loans to members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, the Bank must purchase and maintain stock in the FHLB. Additional information related to the Bank's FHLB stock can be found in Note 16: Fair Value Measurements of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data," of this report on Form 10-K.

Community Reinvestment Act. The Company is subject to the requirements of the CRA, which imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution's efforts in meeting community credit needs are currently assessed based on specified factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility. At its last evaluation in 2016, the Bank received an "Outstanding" CRA rating.

Confidentiality and Required Disclosures of Consumer Information. The Company is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure.

In August 2018, the CFPB published its final rule to update Regulation P pursuant to the amended Gramm-Leach-Bliley Act. Under this rule, certain qualifying financial institutions are not required to provide annual privacy notices to customers. To qualify, a financial institution must not share nonpublic personal information about customers except as described in certain statutory exceptions which do not trigger a customer's statutory opt-out right. In addition, the financial institution must not have changed its disclosure policies and practices from those disclosed in its most recent privacy notice. The rule sets forth timing requirements for delivery of annual privacy notices in the event that a financial institution that qualified for the annual notice exemption later changes its policies or practices in such a way that it no longer qualifies for the exemption.

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

Although these laws and programs impose compliance costs and create privacy obligations and, in some cases, reporting obligations, and compliance with all of the laws, programs, and privacy and reporting obligations may require significant resources of the Company and the Bank, these laws and programs do not materially affect the Bank's products, services or other business activities.

Cybersecurity. The federal banking agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution's board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking agencies expect financial institutions to establish lines of defense and ensure that their risk management processes also address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack. If the Company, the Bank or Trust fails to meet the expectations set forth in this regulatory guidance, the Company, the Bank or Trust could be subject to various regulatory actions and any remediation efforts may require significant resources.

In October 2016, the federal banking agencies issued proposed rules on enhanced cybersecurity risk-management and resilience standards that would apply to very large financial institutions and to services provided by third parties to these institutions. The comment period for these proposed rules has closed and a final rule has not been published. Although the proposed rules would apply only to bank holding companies and banks with \$50 billion or more in total consolidated assets, these rules could influence the federal banking agencies' expectations and supervisory requirements for information security standards and cybersecurity programs of smaller financial institutions, such as the Company, the Bank and Trust.

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

laws and regulations as part of its ongoing customer relations.

The CFPB is the federal regulatory agency responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than \$10 billion of assets and, to a lesser extent, smaller institutions. The CFPB supervises and regulates providers of consumer financial products and services and has rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth in Lending Act and the Real Estate Settlement Procedures Act). As a smaller institution (i.e., with assets of \$10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the FRB and to the Bank and Trust by the Comptroller. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's prudential regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and banks, could influence how the FRB and Comptroller apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise effect of the CFPB's consumer protection activities on the Company cannot be forecast. As of January 1, 2019, the Company and the Bank are not subject to the direct supervision of the CFPB.

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

The Bank's mortgage origination activities are also subject to Regulation Z, which implements the Truth in Lending Act. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined as mortgage loans without negative amortization, interest-only payments, balloon payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3% of the total loan amount. Under the EGRRCPA, most residential mortgages loans originated and held in portfolio by a bank with less than \$10 billion in assets will be designated as "qualified mortgages." Higher-priced qualified mortgages (e.g., subprime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Bank does not originate first mortgage loans at this time, and the first mortgages it purchases comply with Regulation Z's "qualified mortgage" rules. The Bank does originate second mortgages, or equity loans, and these loans do not conform to the qualified mortgage criteria but comply with applicable ability-to-repay rules.

Volcker Rule. The Dodd-Frank Act prohibits bank holding companies and their subsidiary banks from engaging in proprietary trading except in limited circumstances, and places limits on ownership of equity investments in private equity and hedge funds (the Volcker Rule). The EGRRCPA exempted all banks with less than \$10 billion in assets (including their holding companies and affiliates) from the Volcker Rule, provided that the institution has total trading assets and liabilities of five percent or less of total assets, subject to certain limited exceptions. In December 2018, the federal banking agencies invited public comment on a proposal to exclude community banks from the application of the Volcker Rule. The Company believes that its financial condition and its operations are not and will not be significantly affected by the Volcker Rule, amendments thereto, or its implementing regulations.

Call Reports and Examination Cycle. All institutions, regardless of size, submit a quarterly call report that includes data used by federal banking agencies to monitor the condition, performance, and risk profile of individual institutions and the industry as a whole. The EGRRCPA contained provisions expanding the number of regulated institutions eligible to use streamline call report forms. In November 2018, the federal banking agencies issued a proposal to permit insured depository institutions with total assets of less than \$5 billion that do not engage in certain complex or international activities to file the most streamlined version of the quarterly call report, and to reduce data reportable on certain streamlined call report submissions.

In December 2018, consistent with the provisions of the EGRRCPA, the federal banking agencies jointly adopted final rules that permit banks with up to \$3 billion in total assets, that received a composite CAMELS rating of "1" or "2," and that meet certain other criteria (including not having undergone any change in control during the previous 12-month period, and not being subject to a formal enforcement proceeding or order), to qualify for an 18-month on-site examination cycle.

Future Regulation. From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial

institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank (or Trust) could have a material effect on our business.

Item 1A. Risk Factors

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

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

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

The Company generally seeks to maintain a neutral position in terms of the volume of assets and liabilities that mature or re-price during any period so that it may reasonably maintain its net interest margin; however, interest rate fluctuations, loan prepayments, loan production, deposit flows, and competitive pressures are constantly changing and influence the ability to maintain a neutral position. Generally, the Company's earnings will be more sensitive to fluctuations in interest rates depending upon the variance in volume of assets and liabilities that mature and re-price in any period. The extent and duration of the sensitivity will depend on the cumulative variance over time, the velocity and direction of changes in interest rates, shape and slope of the yield curve, and whether the Company is more asset sensitive or liability sensitive. Accordingly, the Company may not be successful in maintaining a neutral position and, as a result, the Company's net interest margin may be affected. For additional details, See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Sensitivity" in Item 7 of this report on Form 10-K.

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

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

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

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

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

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

Weaknesses in the commercial real estate markets could negatively affect the Company's financial performance due to the Company's concentration in commercial real estate loans. At December 31, 2018, the Company had \$347.9 million, or 44.94%, of total loans concentrated in commercial real estate, which includes, for purposes of this concentration, all construction loans, loans secured by multifamily residential properties, loans secured by farmland and loans secured by nonfarm, nonresidential properties. Commercial real estate loans expose the Company to a greater risk of loss than residential real estate and consumer loans. Commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Consequently, an adverse development with respect to one commercial real estate loan or credit relationship exposes the Company to a significantly greater risk of loss compared to an adverse development with respect to one residential real estate loan. Commercial real estate loans carry risks associated with the successful operation of a business if the properties are owner occupied. If the properties are non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts. Repayment of commercial real estate loans may, to a greater extent than residential real estate loans, be subject to adverse conditions in the real estate market or economy. Weak economic or market conditions may impair a borrower's business operations, slow the execution of new leases and lead to turnover in existing leases. The combination of these factors could result in deterioration in value of some of the Company's loans. The deterioration of one or more of the Company's significant commercial real estate loans could cause a significant increase in nonaccrual loans. An increase in nonaccrual loans could result in a loss of interest income from those loans, an increase in the provision for loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial performance.

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

In addition, Hampton Roads is home to one of the largest military installations in the world and one of the largest concentrations of Department of Defense personnel in the United States. Some of the Company's customers may be particularly sensitive to the level of federal government spending on the military or on defense-related products. Federal spending is affected by numerous factors, including macroeconomic conditions, presidential administration priorities, and the ability of the federal government to enact relevant appropriations bills and other legislation. Any of

these factors could result in future cuts to military or defense spending or increased uncertainty about federal spending, which could have a severe negative impact on individuals and businesses in the Company's primary service area. Any related increase in unemployment rates or reduction in business development activities in the Company's primary service area could lead to reductions in loan demand, increases in loan delinquencies, problem assets and foreclosures and reductions in loan collateral value, which could have a material adverse effect on the Company's operating results and financial condition.

The Company is subject to losses resulting from fraudulent and negligent acts on the part of loan applicants, correspondents or other third parties. The Company relies heavily upon information supplied by third parties, including the information contained in credit applications, employment and income documentation, property appraisals, title information, and equipment pricing and valuation, in deciding which loans to originate, as well as in establishing the terms of those loans. If any of the information upon which the Company relies during the loan approval process is misrepresented, either fraudulently or inadvertently, and the misrepresentation is not detected prior to asset funding, the value of the asset may be significantly lower than expected, the Company may fund a loan that it would not have otherwise funded or the Company may fund a loan on terms that it would not have otherwise extended. Whether a misrepresentation is made by the applicant or by another third party, the Company generally bears the risk of loss associated with the misrepresentation. In addition, a loan subject to a material misrepresentation is typically unsellable or subject to repurchase if it is sold prior to detection of the misrepresentation. The sources of the misrepresentation are often difficult to locate, and it may be difficult to recover any monetary loss the Company may suffer.

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

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

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

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

The Company and its subsidiaries are subject to extensive regulation which could adversely affect them. The Company is subject to extensive regulation by federal, state and local governmental authorities and is subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of operations, including those referenced above. Regulations adopted by these agencies, which are generally intended to protect depositors and customers rather than to benefit stockholders, govern a comprehensive range of matters

including, without limitation, ownership and control of the Company's shares, acquisition of other companies and businesses, permissible activities that the Company and its subsidiaries may engage in, maintenance of adequate capital levels and other aspects of operations. These regulations could limit the Company's growth by restricting certain of its activities. The laws, rules and regulations applicable to the Company are subject to regular modification and change. Regulatory changes could subject the Company to more demanding regulatory compliance requirements which could affect the Company in unpredictable and adverse ways. Such changes could subject the Company to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or damage to the Company's reputation, which could have a material adverse effect on the Company's business, financial condition and results of operations. Legislation and regulatory initiatives containing wide-ranging proposals for altering the structure, regulation and competitive relationship of financial institutions are introduced regularly. The Company cannot predict in what form or whether a proposed statute or regulation will be adopted or the extent to which such adoption may affect its business.

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

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

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

The Basel III Final Rules require higher levels of capital and liquidity, which could adversely affect the Company's net income and return on equity. The capital adequacy and liquidity guidelines applicable to the Company and the Bank under the Basel III Final Rules began to be phased in beginning in 2015. The Basel III Final Rules, fully phased in as of January 1, 2019, require the Company and the Bank to maintain substantially more capital as a result of higher minimum capital levels and more demanding regulatory capital risk-weightings and calculations. The changes to the standardized calculations of risk-weighted assets are complex and may create additional compliance burdens for the Company and the Bank. The Basel III Final Rules require the Company and the Bank to substantially change the manner in which they collect and report information to calculate risk-weighted assets, and may increase dramatically risk-weighted assets as a result of applying higher risk weightings to many types of loans and securities. As a result, the Company and the Bank may be forced to limit originations of certain types of commercial and mortgage loans, thereby reducing the amount of credit available to borrowers and limiting opportunities to earn interest income from the loan portfolio, which may have a detrimental impact on the Company's net income.

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

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

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

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

Additionally, the measure of the Company's ALL is dependent on the adoption and interpretation of accounting standards. In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," Under this ASU, the current incurred loss credit impairment methodology will be replaced with the CECL model, a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Accordingly, the implementation of the CECL model will change the Company's current method of providing ALL and may result in material changes in the Company's accounting for credit losses on financial instruments. The CECL model may create more volatility in the Company's level of ALL. If the Company is required to materially increase its level of ALL for any reason, such increase could adversely affect its business, financial condition, and results of operations. The amendment is effective for fiscal years beginning after December 15, 2019. See Note 1 "Summary of Significant Accounting Policies" in the "Notes to the Consolidated Financial Statements" contained in Item 8 of this Form 10-K for information regarding the Company's implementation of CECL.

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

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

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

The Company's future success depends on its ability to compete effectively in the highly competitive financial services industry. The Company faces substantial competition in all phases of its operations from a variety of different competitors. Growth and success depends on the Company's ability to compete effectively in this highly competitive financial services environment. Many competitors offer products and services that are not offered by the Company, and many have substantially greater resources, name recognition and market presence that benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively and may have larger lending limits that would allow them to serve the credit needs of larger customers. In addition, financial technology start-ups are emerging in key areas of banking. Some of the financial services organizations with which the Company competes are not subject to the same degree of regulation as is imposed on bank holding companies and

federally insured national banks, and may have broader geographic services areas and lower cost structures. As a result, these non-bank competitors have certain advantages over the Company in accessing funding and in providing various services. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Failure to compete effectively to attract new and retain current customers in the Company's markets could cause it to lose market share, slow its growth rate and may have an adverse effect on its financial condition and results of operations.

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

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

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

The Company may need to raise additional capital in the future and such capital may not be available when needed or at all. The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs, particularly if its asset quality or earnings were to deteriorate significantly. Economic conditions and the loss of confidence in financial institutions may increase the Company's cost of funding and limit access to certain customary sources of capital, including inter-bank borrowings, repurchase agreements and borrowings from the Federal Reserve Bank's discount window. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of the Company's control, and the Company's financial performance.

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

The Company and its subsidiaries are subject to operational risk, which could adversely affect business, financial condition and results of operation. The Company and its subsidiaries, like all businesses, are subject to operational risk, including the risk of loss resulting from human error, fraud or unauthorized transactions due to inadequate or

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

The Company's directors and executive officers own a significant portion of the Company's common stock and can exert significant influence over its business and corporate affairs. The Company's directors and executive officers, as a group, beneficially owned 20.31% of the Company's common stock as of June 30, 2018. Consequently, if they vote their shares in concert, they can significantly influence the outcome of matters submitted to the Company's stockholders for approval, including the election of directors. The interests of the Company's directors and executive officers may conflict with the interests of other holders of the Company's common stock, and the Company's directors and executive officers may take actions affecting the Company with which other holders of the Company's common stock disagree.

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 31, 2018, the Company owned and leased buildings in the normal course of business. It owns its main office, which represents its corporate headquarters and includes a branch at 101 East Queen Street, Hampton, Virginia. As of March 12, 2019, the Bank operated nineteen branches in the Hampton Roads area of Virginia.

For more information concerning the amounts recorded for premises and equipment and commitments under current leasing agreements, see Note 7 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

None.
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EXECUTIVE OFFICERS OF THE REGISTRANT

| Name (Age) And Present Position | Served in Current Position Since | Principal Occupation During Past Five Years |
|--|----------------------------------|--|
| Robert F. Shuford, Sr. (81) Chairman, President & Chief Executive Officer Old Point Financial Corporation | 1965 | Chairman of the Board, President & Chief Executive Officer of the Company |
| Robert F. Shuford, Jr. (54) Executive Vice President/Bank Old Point Financial Corporation | 2015 | Executive Vice President/Bank of the Company since 2015; Chief Operating Officer & Senior Vice President/Operations of the Company from 2003 to 2015 President & Chief Executive Officer of the Bank since 2015; Senior Executive Vice President & Chief Operating Officer of the Bank from 2012 to 2015; Executive Vice President & Chief Operating Officer of the Bank from 2003 to 2012; Chairman of the Board of the Bank |
| Jeffrey W. Farrar (58) Chief Financial Officer & Senior Vice President/Finance Old Point Financial Corporation | 2017 | Chief Financial Officer & Senior Vice President/Finance of the Company; a Certified Public Accountant, Executive Vice President and Director of Wealth Management, Mortgage and Insurance for Union Bankshares Corporation from 2014 to 2017; and Chief Financial Officer for StellarOne Corporation and its predecessor companies from 1996 to 2013. Chief Financial Officer & Executive Vice President of the Bank |
| Eugene M. Jordan, II (64) Secretary to the Board & Executive Vice President/Trust Old Point Financial Corporation | 2003 | Secretary to the Board & Executive Vice President/Trust of the Company since 2015; Executive Vice President/ Trust of the Company from 2003 to 2015 President and Chief Executive Officer of Trust since 2003; Chairman of the Trust Board |
| Joseph R. Witt (58) Chief Business Development Officer & Senior Vice President Old Point Financial Corporation | 2008 | Chief Business Development Officer & Senior Vice President of the Company since 2015; Chief Administrative Officer & Senior Vice President/Administration of the Company from 2012 to 2015; Senior Vice President/ Corporate Banking/Human Resources of the Company from 2010 to 2012; Senior Vice President/Corporate Banking of the Company from 2008 to 2010 Senior Executive Vice President & Chief Business Development Officer of the Bank since 2015; Senior Executive Vice President & Chief Administrative |

Officer of the Bank from 2012 to 2015; Executive Vice President/ Corporate Banking & Human Resources Director of the Bank from 2010 to 2012

Part II

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

The common stock of the Company is quoted on the NASDAQ Capital Market under the symbol "OPOF". The approximate number of stockholders of record as of March 12, 2019 was 1,635. On that date, the closing price of the Company's common stock on the NASDAQ Capital Market was \$22.24. Additional information related to restrictions on funds available for dividend declaration can be found in Note 17 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

On January 12, 2010, the Company authorized a program to repurchase during any given calendar year up to an aggregate of 5 percent of the shares of the Company's common stock outstanding as of January 1 of that calendar year. The Company did not repurchase any shares of the Company's common stock under this plan during 2018. There is currently no stated expiration date for this program.

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Pursuant to the Company's stock option plans, participants may exercise stock options by surrendering shares of the Company's common stock that the participants already own. Shares surrendered by participants of these plans are repurchased at current market value pursuant to the terms of the applicable stock options. No such repurchases occurred during 2018.

Item 6. Selected Financial Data

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

SELECTED FINANCIAL HIGHLIGHTS

| At and for the Years ended December 31, (dollars in thousands except per share data) | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|-------------|-----------|-----------|-----------|-----------|
| RESULTS OF OPERATIONS | | | | | |
| Interest income | \$38,257 | \$32,934 | \$29,826 | \$30,295 | \$30,289 |
| Interest expense | 4,969 | 3,012 | 2,574 | 3,632 | 3,849 |
| Net interest income | 33,288 | 29,922 | 27,252 | 26,663 | 26,440 |
| Provision for loan losses | 2,861 | 4,160 | 1,930 | 1,025 | 600 |
| Net interest income after provision for loan losses | 30,427 | 25,762 | 25,322 | 25,638 | 25,840 |
| Noninterest income | 13,271 | 13,307 | 12,746 | 12,382 | 11,862 |
| Noninterest expenses | 38,500 | 39,195 | 34,111 | 34,332 | 33,390 |
| Income before income taxes | 5,198 | (126) | 3,957 | 3,688 | 4,312 |
| Income tax expense | 279 | (97) | 160 | 54 | 196 |
| Net income (loss) | \$4,919 | \$(29) | \$3,797 | \$3,634 | \$4,116 |
| FINANCIAL CONDITION | | | | | |
| Total assets | \$1,038,183 | \$981,826 | \$902,966 | \$896,787 | \$876,280 |
| Securities available for sale, at fair value | 148,247 | 157,121 | 199,365 | 214,192 | 139,346 |
| Loans held for investment, net of deferred fees and costs | 774,009 | 738,540 | 603,882 | 568,475 | 535,994 |
| Allowance for loan losses | 10,111 | 9,448 | 8,245 | 7,738 | 7,075 |
| Deposits | 843,144 | 783,594 | 784,502 | 746,471 | 716,654 |
| Total borrowings | 88,325 | 98,193 | 18,704 | 50,950 | 67,816 |
| Total liabilities | 936,177 | 885,438 | 808,976 | 803,611 | 787,783 |
| Stockholders' equity | 102,006 | 96,388 | 93,990 | 93,176 | 88,497 |
| PERTINENT RATIOS | | | | | |
| Return on average assets | 0.48 | % 0.00 | % 0.43 | % 0.41 | % 0.47 |
| Return on average equity | 4.93 | % (0.03 | % 3.99 | % 4.02 | % 4.81 |
| Net interest margin (FTE) (1) | 3.62 | % 3.64 | % 3.66 | % 3.56 | % 3.57 |
| Efficiency ratio | 82.69 | % 90.67 | % 85.28 | % 87.93 | % 87.18 |
| Tier 1 capital to risk weighted assets | 11.44 | % 11.18 | % 13.39 | % 13.78 | % 14.36 |
| Total capital to risk weighted assets | 12.59 | % 12.28 | % 14.51 | % 14.89 | % 15.44 |
| Leverage ratio | 9.77 | % 9.98 | % 10.68 | % 10.93 | % 10.75 |
| Tangible common equity / tangible assets | 9.65 | % 9.76 | % 10.41 | % 10.39 | % 10.10 |
| Cash dividends declared | \$0.44 | \$0.44 | \$0.40 | \$0.34 | \$0.26 |
| Book value | \$19.68 | \$19.20 | \$18.94 | \$18.79 | \$17.85 |
| ASSET QUALITY | | | | | |
| Nonaccrual loans | \$12,141 | \$12,882 | \$7,159 | \$4,582 | \$5,570 |

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| | | | | | | | |
|--|-----------|----------------|-----------|-----------|-----------|---|---|
| OREO | \$83 | \$- | \$1,067 | \$2,741 | \$5,106 | | |
| ALLL / total outstanding loans | 1.31 | % 1.28 | % 1.37 | % 1.36 | % 1.32 | % | % |
| Nonaccrual loans / total loans | 1.57 | % 1.74 | % 1.19 | % 0.81 | % 1.04 | % | % |
| ALLL / nonaccrual loans | 83.28 | % 73.34 | % 115.17 | % 168.88 | % 127.02 | % | % |
| NPAs / total outstanding loans | 1.90 | % 2.18 | % 1.84 | % 1.88 | % 2.20 | % | % |
| Net charge-offs / total average loans | 0.29 | % 0.44 | % 0.24 | % 0.06 | % 0.07 | % | % |
| Provision / total average loans | 0.37 | % 0.62 | % 0.33 | % 0.18 | % 0.12 | % | % |
| PER SHARE DATA | | | | | | | |
| Basic earnings (loss) per share | \$0.96 | \$(0.01) | \$0.77 | \$0.73 | \$0.83 | | |
| Diluted earnings (loss) per share | \$0.96 | \$(0.01) | \$0.77 | \$0.73 | \$0.83 | | |
| Cash dividends declared | \$0.44 | \$0.44 | \$0.40 | \$0.34 | \$0.26 | | |
| Market value per share | \$21.83 | \$29.75 | \$25.00 | \$17.16 | \$15.00 | | |
| Book value per share | \$19.68 | \$19.20 | \$18.94 | \$18.79 | \$17.85 | | |
| Tangible book value per share | \$19.28 | \$19.08 | \$18.94 | \$18.79 | \$17.85 | | |
| Price to earnings ratio, diluted | 22.74 | (2,975.00) | 32.47 | 23.51 | 18.07 | | |
| Price to book value ratio | 1.11 | 1.55 | 1.32 | 0.91 | 0.84 | | |
| Dividend payout ratio | 45.83 | % (4,400.00 %) | 51.95 | % 46.58 | % 31.33 | % | % |
| Weighted average shares outstanding, basic | 5,141,364 | 4,991,060 | 4,959,173 | 4,959,009 | 4,959,009 | | |
| Weighted average shares outstanding, diluted | 5,141,429 | 4,991,060 | 4,960,934 | 4,959,009 | 4,959,009 | | |

(1) Computed on the fully tax-equivalent basis using a 21% rate for 2018 and a 34% rate for 2017, 2016, 2015, and 2014.

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

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

Caution About Forward-Looking Statements

In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include, but are not limited to, statements regarding profitability, including the focus on reducing time deposits; the net interest margin; strategies for managing the net interest margin and the expected impact of such efforts; levels and sources of liquidity; the loan portfolio and expected trends in the quality of the loan portfolio; the allowance and provision for loan losses; the effect of a sustained increase in nonperforming assets; the securities portfolio; monetary policy actions of the Federal Open Market Committee; changes in interest rates; interest rate sensitivity; asset quality; levels of net loan charge-offs and nonperforming assets; sales of OREO properties; levels of interest expense; levels and components of noninterest income and noninterest expense; lease expense; income taxes; expected impact of efforts to restructure the balance sheet; expected yields on the loan and securities portfolios; expected rates on interest-bearing liabilities; market risk; future impacts of the Tax Cuts and Jobs Act (the Tax Act) on the Company's operations; 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 are not limited to, effects of or changes in interest rates and yields; general economic and general business conditions, including unemployment levels; uncertainty over future federal spending or the budget priorities of the current presidential administration, particularly in connection with the Department of Defense, on the Company's service area; the Tax Act, including, but not limited to, the effect of the lower corporate income tax rate, including on the valuation of the Company's tax assets and liabilities; any future refinements to the Company's preliminary analysis of the impact of the Tax Act on the Company; changes in the effect of the Tax Act due to issuance of interpretive regulatory guidance or enactment of corrective or supplemental legislation; the transfer of the securities portfolio from held-to-maturity securities to available-for-sale securities; the quality or composition of the loan or securities portfolios; changes in the volume and mix of interest-earning assets and interest-bearing liabilities; the effects of management's investment strategy and strategy to manage the net interest margin; the adequacy of the Company's credit quality review processes; the level of nonperforming assets and related charge-offs and recoveries; turnover times experienced by the mortgage companies to which the Company has extended warehouse lines of credit; the performance of the Company's re-opened indirect automobile dealer lending program; the federal government's guarantee of repayment of student and small business loans purchased by the Company; the ability of the Company to diversify its sources of noninterest income; new incentive structure for securities brokerage activities; the local real estate market; volatility and disruption in national and international financial markets; government intervention in the U.S. financial system; application of the Basel III capital standards to the Company and its subsidiaries; FDIC premiums and/or assessments; demand for loan and other banking products and financial services in the Company's primary service area; levels of noninterest income and expense; deposit flows; competition; the use of inaccurate assumptions in management's modeling systems; technological risks and developments and cyber-attacks, threats, and events; any interruption or breach of security in the Company's information systems or those of the Company's third party vendors or other service providers; reliance on third parties for key services; adequacy of the allowance for loan losses; and changes in accounting principles, policies and guidelines. The Company could also be adversely affected

by monetary and fiscal policies of the U.S. Government, as well as any regulations or programs implemented pursuant to the Dodd-Frank Act or other legislation and policies of the Comptroller, U.S. Treasury and the Federal Reserve Board.

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

Executive Overview

Headquartered in Hampton, Virginia, the Company is the parent company of Trust and the Bank. Trust is a wealth management services provider. The Bank offers a complete line of consumer, mortgage and business banking services, including loan, deposit, and cash management services to individual and commercial customers. The Bank is an independent community bank and has 19 branches throughout the Hampton Roads localities of Chesapeake, Hampton, Isle of Wight County, Newport News, Norfolk, Virginia Beach, Williamsburg/James City County and York County.

Net income for 2018 was \$4.9 million (\$0.96 per diluted share) compared to a net loss of \$29 thousand ((\$0.01) per diluted share) in 2017. The results of 2017 included a significantly higher level of provision expense and the effect of nonrecurring charges related to the termination of the Company's defined benefit pension plan and the passage of the Tax Act.

In 2018, the Company's net income increased \$4.9 million to net income of \$4.9 million, as compared to a net loss of \$29 thousand in 2017. The increase was primarily attributable to a reduced provision expense in 2018 and the impact of two significant nonrecurring expenses in the fourth quarter of 2017. First, the Company completed the previously announced termination and settlement of its defined benefit pension plan which resulted in \$2.2 million in after-tax compensation expense. Second, the changes to the corporate income tax rate resulting from the passage of the Tax Act precipitated \$1.2 million in tax expenses related to the reevaluation of the Company's net deferred tax asset.

Assets as of December 31, 2018 were \$1.04 billion, an increase of \$56.4 million or 5.74% compared to assets as of December 31, 2017. During 2018, the Company experienced significant growth largely as a result of the Citizens acquisition, which was completed on April 1, 2018. Net loans held for investment grew \$34.8 million, or 4.77%, over the year, while securities available for sale declined \$8.9 million, cash and cash equivalents increased \$27.8 million, and FHLB advances decreased \$7.5 million.

Critical Accounting Policies and Estimates

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

Allowance for Loan Losses

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

The Company's allowance for loan losses is the accumulation of various components that are calculated based on independent methodologies. Management's estimate is based on certain observable, historical data and other factors that management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; discounted cash flow analysis; loan volumes; geographic, borrower and industry concentrations; the findings of internal credit quality assessments; and results from external bank regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, are used in developing estimated loss factors used in the calculations.

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

recognized on loans.

For loans not individually evaluated for impairment, the loan portfolio is segmented into pools, based on the loan classifications as defined by Schedule RC-C of the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income Form 041 (Call Report) and collectively evaluated for impairment. Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on whether the loan's payments are current (including loans 1-29 days past due), 30 – 59 days past due, 60 – 89 days past due, or 90 days or more past due. All other loans, including loans to consumers that are secured by real estate, are segmented by the Company's internally assigned risk grades: substandard, other assets especially mentioned (rated just above substandard), and pass (all other loans). The Company may also assign loans to the risk grades of doubtful or loss, but as of December 31, 2018 and December 31, 2017, the Company had no loans in these categories.

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

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

Loans Acquired in a Business Combination.

Acquired loans are classified as either (i) purchased credit-impaired (PCI) loans or (ii) purchased performing loans and are recorded at fair value on the date of acquisition.

PCI loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. When determining fair value, PCI loans are aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the “nonaccretable difference” and is not recorded. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the “accretable yield” and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

On an annual basis, the estimate of cash flows expected to be collected on PCI loans is evaluated. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan, or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

The Company's PCI loans currently consist of loans acquired in connection with the acquisition of Citizens. PCI loans that were classified as nonperforming loans by Citizens are no longer classified as nonperforming so long as, at re-estimation periods, the Company is expected to fully collect the new carrying value of the pools of loans.

The Company accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required for any deterioration in these loans in future periods.

Other Real Estate Owned (OREO)

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

Income Taxes

The provision for income taxes is based upon the results of operations, adjusted for the effect of certain tax-exempt income and non-deductible expenses. In addition, certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

On December 22, 2017, the Tax Act was signed into law. Among other things, the Tax Act permanently reduced the corporate income tax rate to 21% from the prior maximum rate of 35%, effective for tax years including or commencing January 1, 2018. As a result of the reduction of the corporate income tax rate to 21%, companies were required to revalue their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the fourth quarter of 2017. During 2017, the Company recorded \$1.2 million in additional tax expense based on the Company's analysis of the impact of the Tax Act.

The effective tax rate for the years ended December 31, 2018 and 2017 was 5.37% and (76.98%), respectively. The effective tax rate in 2018 was positively impacted by the Tax Act, a relatively high level of tax-exempt income, and tax credits. The 2017 rate was impacted by the \$3.4 million pension termination charge in 2017 which was partially offset by the revaluation of deferred tax assets and liabilities associated with the Tax Act.

Results of Operations

In 2018, the Company's net income increased \$4.9 million to net income of \$4.9 million, as compared to a net loss of \$29 thousand in 2017. The increase was primarily attributable to a reduced provision for loan losses expense in 2018 and the impact of two significant nonrecurring expenses in the fourth quarter of 2017. First, the Company completed the previously announced termination and settlement of its defined benefit pension plan which resulted in \$2.2 million in after-tax compensation expense in the fourth quarter of 2017. Second, the changes to the corporate income tax rate resulting from the passage of the Tax Act precipitated \$1.2 million in tax expenses related to the reevaluation of the Company's net deferred tax asset. As of December 31, 2018 return on average assets was 0.48% compared to 0.00% in 2017 and the return on average equity was 4.93% at December 31, 2018 compared to (0.03%) in 2017.

Assets as of December 31, 2018 were \$1.04 billion, an increase of \$56.4 million or 5.74% compared to assets as of December 31, 2017. During 2018, the Company experienced significant growth largely as a result of the Citizens acquisition, which was completed on April 1, 2018. Net loans held for investment grew \$34.8 million, or 4.77%, over the year, while securities available for sale declined \$8.9 million, cash and cash equivalents increased \$27.8 million, and FHLB advances decreased \$7.5 million.

Net Interest Income

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

Net interest income, on a fully tax-equivalent basis, was \$33.7 million in 2018, an increase of \$2.8 million from 2017. The net interest margin was 3.62% in 2018 as compared to 3.64% in 2017. The increase in net interest income year-over-year was primarily due to higher average earnings assets with higher average yields outweighing higher funding costs.

When comparing 2018 to 2017, the following changes occurred. Tax equivalent interest income increased \$4.8 million, or 14.03%. Average earning assets increased \$82.1 million, or 9.68%. Total average loans increased \$95.9 million, or 14.26%, and average investment securities decreased \$23.9 million, or 14.04%, as continued loan demand

allowed the Company to shift its assets from securities to loans.

Average interest-bearing liabilities increased \$71.0 million, or 11.63%, due to increases in both interest-bearing deposits and FHLB advances. FHLB advances supplemented modest growth in average deposits and provided funding to support loan growth. Total interest expense increased \$2.0 million, or 64.97%, when comparing 2018 to 2017. The increase was driven by increased deposit and borrowing costs. The average rate on interest-bearing liabilities in 2018 was 0.73%, an increase of 24 basis points from 2017.

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

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

| Years ended December 31, | 2018 | | | 2017 | | |
|---|---|-----------------------------|----------------|-----------------|-----------------------------|----------------|
| | Average Balance (dollars in thousands) | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate |
| ASSETS | | | | | | |
| Loans * | \$768,960 | \$34,504 | 4.49 % | \$673,015 | \$29,318 | 4.36 % |
| Investment securities: | | | | | | |
| Taxable | 95,752 | 2,080 | 2.17 % | 102,644 | 1,964 | 1.91 % |
| Tax-exempt * | 50,426 | 1,547 | 3.07 % | 67,403 | 2,426 | 3.60 % |
| Total investment securities | 146,178 | 3,627 | 2.48 % | 170,047 | 4,390 | 2.58 % |
| Interest-bearing due from banks | 9,358 | 198 | 2.12 % | 1,343 | 15 | 1.12 % |
| Federal funds sold | 1,150 | 21 | 1.83 % | 921 | 8 | 0.87 % |
| Other investments | 4,083 | 291 | 7.13 % | 2,348 | 155 | 6.60 % |
| Total earning assets | 929,729 | 38,641 | 4.16 % | 847,674 | 33,886 | 4.00 % |
| Allowance for loan losses | (10,254) | | | (8,950) | | |
| | 919,475 | | | 838,724 | | |
| Cash and due from banks | 21,518 | | | 20,723 | | |
| Bank premises and equipment, net | 37,531 | | | 38,428 | | |
| Other assets | 42,051 | | | 41,171 | | |
| Total assets | \$1,020,575 | | | \$939,046 | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Time and savings deposits: | | | | | | |
| Interest-bearing transaction accounts | \$28,246 | \$10 | 0.04 % | \$27,909 | \$10 | 0.04 % |
| Money market deposit accounts | 242,025 | 542 | 0.22 % | 233,295 | 291 | 0.12 % |
| Savings accounts | 87,534 | 76 | 0.09 % | 82,872 | 41 | 0.05 % |
| Time deposits | 228,800 | 2,916 | 1.27 % | 208,095 | 2,208 | 1.06 % |
| Total time and savings deposits | 586,605 | 3,544 | 0.60 % | 552,171 | 2,550 | 0.46 % |
| Federal funds purchased, repurchase agreements and other borrowings | 28,427 | 131 | 0.46 % | 25,743 | 38 | 0.15 % |
| Federal Home Loan Bank advances | 66,151 | 1,294 | 1.96 % | 32,301 | 424 | 1.31 % |
| Total interest-bearing liabilities | 681,183 | 4,969 | 0.73 % | 610,215 | 3,012 | 0.49 % |
| Demand deposits | 236,249 | | | 226,951 | | |
| Other liabilities | 3,378 | | | 5,359 | | |
| Total liabilities | 920,810 | | | 842,525 | | |
| Stockholders' equity | 99,765 | | | 96,521 | | |
| Total liabilities and stockholders' equity | \$1,020,575 | | | \$939,046 | | |

| | | | | |
|-----------------------|----------|--------|----------|--------|
| Net interest margin * | \$33,672 | 3.62 % | \$30,874 | 3.64 % |
|-----------------------|----------|--------|----------|--------|

* Computed on a fully tax-equivalent basis using a 21% rate for 2018 and a 34% rate for 2017. The tax-equivalent adjustments to interest income were \$383 thousand and \$951 thousand for 2018 and 2017, respectively.

The tax-equivalent adjustment of income and yields changed in 2018 as a result of the passage of the Tax Act. The benefit of the tax-exemption for interest income from municipal bonds and loans to municipalities declined due to the decrease in the corporate income tax rate to 21%.

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

TABLE II
VOLUME AND RATE ANALYSIS*

| | 2018 vs. 2017 Increase (Decrease) Due to Changes in: | | |
|---|--|-----------|---------|
| | Volume (in thousands) | Rate | Total |
| EARNING ASSETS | | | |
| Loans * | \$4,180 | \$ 1,006 | \$5,186 |
| Investment securities: | | | |
| Taxable | (132) | 248 | 116 |
| Tax-exempt * | (611) | (268) | (879) |
| Total investment securities | (743) | (20) | (763) |
| Federal funds sold | 2 | 11 | 13 |
| Other investments | 449 | (130) | 319 |
| Total earning assets | 3,888 | 867 | 4,755 |
| INTEREST-BEARING LIABILITIES | | | |
| Interest-bearing transaction accounts | - | - | - |
| Money market deposit accounts | 11 | 240 | 251 |
| Savings accounts | 2 | 33 | 35 |
| Time deposits | 220 | 488 | 708 |
| Total time and savings deposits | 233 | 761 | 994 |
| Federal funds purchased, repurchase agreements and other borrowings | 4 | 89 | 93 |
| Federal Home Loan Bank advances | 444 | 426 | 870 |
| Total interest-bearing liabilities | 681 | 1,276 | 1,957 |
| Change in net interest income | \$3,207 | \$ (409) | \$2,798 |

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

Market Risk

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates, and equity prices. The Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will impact the amount of interest income and expense the Company receives or pays on a significant portion of its assets and liabilities and the market value of its interest-earning assets and interest-bearing liabilities, excluding those which have a very short-term until maturity. Management is responsible for reviewing the interest rate sensitivity position of the Company and establishing policies to monitor and limit exposure to this risk.

Three complementary modeling techniques are utilized to measure and monitor the exposure to interest rate risk: static gap analysis, earnings simulation analysis, and economic value of equity (EVE) analysis. Static gap measures the aggregate dollar volume of rate-sensitive assets relative to rate-sensitive liabilities re-pricing over various time horizons. This metric does not effectively capture the re-pricing characteristics or embedded optionality of the Company's assets and liabilities, so it is not relied upon or addressed here. Earnings simulation measures the potential effect of changes in market interest rates on future net interest income. This analysis incorporates management's assumptions for product pricing and pre-payment expectations and is the Company's preferred tool to assess its interest rate sensitivity in the short- to medium-term. The simulation utilizes a "static" balance sheet approach, which assumes that management makes no changes to the composition of the balance sheet to mitigate the impact of interest rate changes. EVE modeling estimates the fair value of assets and liabilities in different interest rate environments using discounted cash flow analysis. The net economic value of equity is the economic value of all assets minus the economic value of all liabilities. This measure provides an indication of the future earnings capacity of the balance sheet, and the change in EVE over different rate scenarios is a measure of long-term interest rate risk. The Company places less emphasis on EVE results due to the inherent imprecision of cash flow estimations and the limited utility of a static balance sheet assumption over the long-term.

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.

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 rate change model assumes that these changes will occur gradually over the course of a year.

The table below shows the Company's interest rate sensitivity for the periods and rate scenarios presented (dollars in thousands):

TABLE III
CHANGE IN NET
INTEREST INCOME

As of December 31,

| | 2018 | | 2017 | |
|--|------|----|------|----|
| | % | \$ | % | \$ |

| | | | | |
|---------------------------|--------|---------|--------|-------|
| Change in Interest Rates: | | | | |
| +300 basis points | 2.57 | 921 | (1.42) | (462) |
| +200 basis points | 1.71 | 612 | (1.02) | (332) |
| +100 basis points | 0.78 | 281 | (0.49) | (160) |
| Unchanged | - | - | - | - |
| -100 basis points | (1.30) | (466) | (0.92) | (297) |
| -200 basis points | (3.03) | (1,086) | (1.98) | (644) |

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

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

Provision for Loan Losses

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

The provision for loan losses was \$2.9 million for the year ended December 31, 2018 as compared to \$4.2 million for 2017. The decline in the provision for loan losses in 2018 versus 2017 was largely due to lower levels of charge-offs and a decline in net loan growth, exclusive of the loans acquired from Citizens, which were recorded at fair value at the acquisition date, and did not carry an associated allowance for loan loss. Charged-off loans totaled \$2.8 million in 2018, compared to \$3.3 million in 2017. Recoveries amounted to \$644 thousand in 2018 and \$330 thousand in 2017. The Company's net loans charged off to average loans were 0.29% in 2018 as compared to 0.44% in 2017.

The state of the local economy can have a significant impact on the level of loan charge-offs. If the economy begins to contract, nonperforming assets could increase as a result of declines in real estate values and home sales or increases in unemployment rates and financial stress on borrowers. Increased nonperforming assets would increase charge-offs and reduce earnings due to larger contributions to the loan loss provision.

Noninterest Income

Unless otherwise noted, all comparisons in this section are between the twelve months ended December 31, 2018 and the twelve months ended December 31, 2017.

Noninterest income decreased \$36 thousand or 0.27% for the year ended December 31, 2018 as compared to the year ended December 31, 2017. In 2018, increases in service charges on deposits (up \$283 thousand or 7.31%) were the primary driver of noninterest income growth, while 2017 noninterest income included a nonrecurring gain recognized on the acquisition of Old Point Mortgage, LLC.

Aside from the increase in service charges on deposits and impact of the nonrecurring gain, the other primary increases in noninterest income were other service charges, commissions and fees (up \$116 thousand or 3.38%), and mortgage banking income (up \$143 thousand or 22.17%). The growth in the service charges on deposit accounts category was related to fees for nonsufficient fund item processing. Other service charges, commissions and fees increased primarily due to growth in merchant processing income. Mortgage banking income increased as a result of the acquisition of Old Point Mortgage.

The Company continues to focus on diversifying noninterest income through efforts to expand Trust, insurance, and mortgage banking activities, and a continued focus on business checking and other corporate services.

Noninterest Expense

Unless otherwise noted, all comparisons in this section are between the twelve months ended December 31, 2018 and the twelve months ended December 31, 2017.

The Company's noninterest expense decreased \$695 thousand or 1.77%. Exclusive of the pension termination charge of \$3.4 million in 2017, noninterest expense was elevated in 2018 due to merger costs, increased salary and employee benefits in part associated with increased staff related to acquisition growth, FDIC insurance costs, data processing and professional services costs related to process improvement initiatives.

Of the remaining categories of noninterest expense, the most significant changes when comparing 2018 to 2017 were in occupancy and equipment and loss (gain) on other real estate owned.

Occupancy and equipment (increased \$157 thousand or 2.68%): Occupancy expense related to the Citizens acquisition and service contracts for equipment costs were the main increases.

Loss (gain) on other real estate owned (increased \$104 thousand or (577.78%)): The Company recorded a small gain on the final sales of OREO previously written down in 2017, as compared to a net loss in 2018 related to one property acquired into OREO and sold in 2018.

The provision for income taxes is based upon the results of operations, adjusted for the effect of certain tax-exempt income, non-deductible expenses, and tax credits. In addition, certain items of income and expense are reported in

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

On December 22, 2017, the Tax Act was signed into law. Among other things, the Tax Act permanently reduced the corporate income tax rate to 21% from the prior maximum rate of 35%, effective for tax years including or commencing January 1, 2018. As a result of the reduction of the corporate income tax rate to 21%, companies were required to revalue their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the fourth quarter of 2017. During 2017, the Company recorded \$1.2 million in additional tax expense based on the Company's analysis of the impact of the Tax Act.

The effective tax rates for the years ended December 31, 2018 and 2017 were 5.4% and (77.0%), respectively. The effective tax rate in 2018 was positively impacted by the Tax Act and a relatively high level of tax-exempt income and tax credits. The 2017 rate was impacted by the \$3.4 million pension charge in 2017 partially offset by the revaluation of deferred tax assets and liabilities associated with the Tax Act.

Balance Sheet Review

At December 31, 2018, the Company had total assets of \$1.04 billion, an increase of \$56.4 million or 5.74% compared to assets as of December 31, 2017.

Asset growth in 2018 was driven primarily by the acquisition of Citizens. Net loans held for investment increased \$34.8 million or 4.77%, from \$729.1 million at December 31, 2017 to \$763.9 million at December 31, 2018. Cash and cash equivalents increased \$27.8 million or 192.93% from December 31, 2017 to December 31, 2018, and securities available for sale decreased \$8.9 million or 5.65% over the same period. Total deposits increased \$59.6 million or 7.60% in 2018.

On April 1, 2018, the Company completed its acquisition of Citizens. Below is a summary of the transaction and related impact on the Company's Consolidated Balance Sheets.

- The fair value of assets acquired equaled \$50.4 million and the fair value of liabilities assumed equaled \$44.3 million.
- Loans held for investment acquired totaled \$42.8 million, as acquired and at fair value.
- Total deposits assumed totaled \$43.8 million with a fair value of \$44.0 million.
- Total goodwill arising from the transaction equaled \$1.0 million.
- Core deposit intangibles acquired totaled \$440 thousand.

Securities Portfolio

When comparing December 31, 2018 to December 31, 2017, securities available-for-sale decreased \$8.9 million, or 5.65%. The vast majority of the decline was due to principal curtailments on mortgage-backed securities and calls and maturities of other securities, principally tax-exempt municipal bonds.

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

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

TABLE IV
SECURITIES PORTFOLIO

| As of December 31, | 2018 | 2017 |
|---|----------------|-----------|
| | (in thousands) | |
| Available-for-sale securities, at fair value: | | |
| U.S. Treasury securities | \$12,328 | \$- |
| Obligations of U.S. Government agencies | 10,714 | 9,435 |
| Obligations of state and political subdivisions | 48,837 | 64,765 |
| Mortgage-backed securities | 71,191 | 74,296 |
| Money market investments | 1,897 | 1,194 |
| Corporate bonds | 3,280 | 7,234 |
| Other marketable equity securities | - | 197 |
| | \$148,247 | \$157,121 |
| Restricted securities: | | |
| Federal Home Loan Bank stock | \$3,429 | \$3,677 |
| Federal Reserve Bank stock | 382 | 169 |
| Community Bankers' Bank stock | 42 | - |
| | \$3,853 | \$3,846 |
| Total | \$152,100 | \$160,967 |

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The following table summarizes the contractual maturity of the securities portfolio and their weighted average yields as of December 31, 2018:

| | 1 year or less (dollars in thousands) | 1-5 years | 5-10 years | Over 10 years | Total |
|---|---|--------------|---------------|------------------|-----------|
| U.S. Treasury securities | \$5,453 | \$6,875 | \$- | \$- | \$12,328 |
| Weighted average yield | 2.65 % | 2.50 % | - | - | 2.57 % |
| Obligations of U.S. Government Agencies | \$2,193 | \$2,472 | \$1,221 | \$4,828 | \$10,714 |
| Weighted average yield | 1.86 % | 2.51 % | 3.03 % | 2.48 % | 2.42 % |
| Obligations of state and political subdivisions | \$3,435 | \$5,517 | \$13,827 | \$26,058 | \$48,837 |
| Weighted average yield | 2.25 % | 2.28 % | 3.02 % | 3.29 % | 3.02 % |
| Mortgage-backed securities | \$- | \$12,274 | \$12,788 | \$46,129 | \$71,191 |
| Weighted average yield | - | 1.79 % | 2.07 % | 2.31 % | 2.18 % |
| Money market investments | \$1,897 | \$- | \$- | \$- | \$1,897 |
| Weighted average yield | 2.39 % | - | - | - | 2.39 % |
| Corporate bonds | \$199 | \$290 | \$2,791 | \$- | \$3,280 |
| Weighted average yield | 2.20 % | 2.43 % | 5.43 % | - | 4.97 % |
| Federal Home Loan Bank stock - restricted | \$- | \$- | \$- | \$3,429 | \$3,429 |
| Weighted average yield | - | - | - | 6.19 % | 6.19 % |
| Federal Reserve Bank stock - restricted | \$- | \$- | \$- | \$382 | \$382 |
| Weighted average yield | - | - | - | 6.00 % | 6.00 % |
| Community Bankers' Bank stock - restricted | \$- | \$- | \$- | \$42 | \$42 |
| Weighted average yield | - | - | - | - | - |
| Total securities | \$13,177 | \$27,428 | \$30,627 | \$80,868 | \$152,100 |
| Weighted average yield | 2.37 % | 2.14 % | 2.84 % | 2.79 % | 2.65 % |

The table above is based on maturity. Therefore, it does not reflect cash flow from principal payments or prepayments prior to maturity. The weighted average life of the \$71.2 million in mortgage-backed securities as of December 31, 2018 was 4.20 years. Yields are calculated on a fully tax-equivalent basis using a 21% rate.

Loan Portfolio

The following table shows a breakdown of total loans by segment at December 31 for years 2014 through 2018:

TABLE V
LOAN PORTFOLIO

| As of December 31, | 2018 | 2017 | 2016 | 2015 | 2014 |
|--------------------------|----------------|-----------|-----------|-----------|-----------|
| | (in thousands) | | | | |
| Commercial | \$63,398 | \$60,398 | \$54,434 | \$43,197 | \$37,698 |
| Real estate-construction | 32,383 | 27,489 | 23,116 | 19,685 | 9,082 |
| Real estate-mortgage (1) | 500,441 | 465,231 | 448,408 | 437,159 | 435,914 |
| Consumer | 169,138 | 174,225 | 58,907 | 50,427 | 30,493 |
| Other | 8,649 | 11,197 | 19,017 | 18,007 | 22,807 |
| Total | \$774,009 | \$738,540 | \$603,882 | \$568,475 | \$535,994 |

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

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

As of December 31, 2018, the total loan portfolio increased by \$35.5 million or 4.80% from December 31, 2017 with the growth of its loan portfolio in 2018 attributed in large part to the Citizens acquisition. The Citizens portfolio mainly focused on commercial real estate, construction, and commercial and industrial lending. 2017 loan growth was aided significantly by growth in the indirect dealer lending division.

The maturity distribution and rate sensitivity of certain categories of the Company's loan portfolio at December 31, 2018 is presented below:

TABLE VI
MATURITY SCHEDULE OF SELECTED LOANS

| December 31, 2018 | Within 1 year | 1 to 5 years | After 5 years | Total |
|----------------------------|------------------|-----------------|------------------|----------|
| | (in thousands) | | | |
| Commercial | \$19,079 | \$24,934 | \$19,385 | \$63,398 |
| Real estate - construction | 21,744 | 10,623 | 16 | 32,383 |
| Total | \$40,823 | \$35,557 | \$19,401 | \$95,781 |

Loans due after 1 year with:

| | | | |
|------------------------|----------|----------|----------|
| Fixed interest rate | \$29,326 | \$13,222 | \$42,548 |
| Variable interest rate | 6,231 | 6,179 | 12,410 |
| Total | \$35,557 | \$19,401 | \$54,958 |

Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and accruing interest, nonperforming restructured loans, and other real estate owned (OREO). Restructured loans are loans with terms that were modified in a troubled debt restructuring (TDR) for borrowers experiencing financial difficulties. Refer to Note 5 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report Form 10-K for more information.

Nonperforming assets decreased by \$1.3 million or 8.36%, from \$16.1 million at December 31, 2017 to \$14.7 million at December 31, 2018. The 2018 total consisted of \$2.5 million in loans still accruing interest but past due 90 days or more and \$12.1 million in nonaccrual loans. Of the \$12.1 million in nonaccrual loans, \$11.8 million was secured by real estate. All of the nonaccrual loans are classified as impaired. Impaired loans are a component of the allowance for loan losses. When a loan changes from "90 days past due but still accruing interest" to "nonaccrual" status, the loan is normally reviewed for impairment. If impairment is identified, then the Company records a charge-off based on the value of the collateral or the present value of the loan's expected future cash flows, discounted at the loan's effective interest rate. If the Company is waiting on an appraisal to determine the collateral's value, management allocates funds to cover the deficiency to the allowance for loan losses based on information available to management at the time.

The recorded investment in impaired loans decreased to \$16.2 million as of December 31, 2018 from \$18.5 million as of December 31, 2017 as detailed in Note 5 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K. The majority of these loans were collateralized.

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

TABLE VII
NONPERFORMING ASSETS

| As of December 31, | 2018 | 2017 | 2016 | 2015 | 2014 |
|--|----------------|----------|----------|----------|----------|
| | (in thousands) | | | | |
| Nonaccrual loans | | | | | |
| Commercial | \$298 | \$836 | \$231 | \$276 | \$- |
| Real estate-construction | 417 | 721 | - | - | 499 |
| Real estate-mortgage (1) | 11,426 | 11,325 | 6,847 | 4,306 | 5,071 |
| Consumer | - | - | 81 | - | - |
| Total nonaccrual loans | 12,141 | 12,882 | 7,159 | 4,582 | 5,570 |
| Loans past due 90 days or more and accruing interest | | | | | |
| Commercial | - | 471 | - | 164 | 10 |
| Real estate-construction | 205 | - | - | - | - |
| Real estate-mortgage (1) | 315 | 306 | 276 | 23 | 107 |
| Consumer (2) | 1,965 | 2,401 | 2,603 | 3,163 | 1,019 |
| Other | 12 | 4 | 5 | 6 | 5 |
| Total loans past due 90 days or more and accruing interest | 2,497 | \$3,182 | 2,884 | 3,356 | 1,141 |
| Restructured loans | | | | | |
| Commercial | 217 | 98 | 144 | - | - |
| Real estate-construction | 92 | 92 | 96 | 99 | 102 |
| Real estate-mortgage (1) | 12,098 | 14,781 | 11,616 | 11,077 | 12,203 |
| Consumer | - | - | - | 12 | 13 |
| Total restructured loans | 12,407 | 14,971 | 11,856 | 11,188 | 12,318 |
| Less nonaccrual restructured loans (included above) | 8,454 | 8,561 | 2,838 | 2,497 | 4,240 |
| Less restructured loans in compliance (3) | 3,953 | 6,410 | 9,018 | 8,691 | 8,078 |
| Net nonperforming restructured loans | - | - | - | - | - |
| Other real estate owned | | | | | |
| Construction, land development, and other land | 83 | - | 940 | 1,090 | 2,138 |
| 1-4 family residential properties | - | - | - | 724 | 884 |
| Former branch sites | - | - | 127 | - | 886 |
| Nonfarm nonresidential properties | - | - | - | 927 | 1,198 |
| | 83 | - | 1,067 | 2,741 | 5,106 |
| Total nonperforming assets | \$14,721 | \$16,064 | \$11,110 | \$10,679 | \$11,817 |
| Interest income that would have been recorded under original loan terms on nonaccrual loans included above | | | | | |
| | \$533 | \$474 | \$318 | \$196 | \$301 |
| Interest income recorded for the period on nonaccrual loans included above | | | | | |
| | \$336 | \$281 | \$269 | \$141 | \$265 |

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

(2) Amounts listed include student loans with principal and interest amounts that are 97 - 98% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$1.7 million at December 31,

2018 and \$2.3 million at December 31, 2017. For additional information, refer to Note 5 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K. (3) Amounts listed represent restructured loans that are in compliance with their modified terms as of the date presented.

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As shown in the table above, as of December 31, 2018 compared to December 31, 2017, the nonaccrual loan category decreased by \$741 thousand or 5.75% and the 90-days past due and still accruing interest category decreased by \$685 thousand or 21.53%.

The majority of the balance of nonaccrual loans at December 31, 2018 was related to a few large credit relationships. Of the \$12.1 million of nonaccrual loans at December 31, 2018, \$9.4 million, or approximately 77.25%, was comprised of four credit relationships. All loans in these relationships have been analyzed to determine whether the cash flow of the borrower and the collateral pledged to secure the loans is sufficient to cover outstanding principal balances. The Company has set aside specific allocations for those loans without sufficient cash flow or collateral and charged off any balance that management does not expect to collect.

The majority of the loans past due 90 days or more and still accruing interest at December 31, 2018 (\$1.7 million) were student loans. The federal government has provided guarantees of repayment of these student loans in an amount ranging from 97% to 98% of the total principal and interest of the loans; as such, management does not expect even a significant increase in past due student loans to have a material effect on the Company.

Management believes the Company has excellent credit quality review processes in place to identify problem loans quickly. For a detailed discussion of the Company's nonperforming assets, refer to Note 5 and Note 6 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

The Allowance for Loan Losses

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

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

The first component of the allowance for loan losses is determined based on specifically identified loans that 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 discounted present value of expected future cash flows or the collateral value is considered sufficient).

The majority of the Company's TDRs and nonperforming loans are collateralized by real estate. When reviewing loans for impairment, the Company obtains current appraisals when applicable. If the Company has not yet received a current appraisal on loans being reviewed for impairment, any loan balance that is in excess of the estimated appraised value is allocated in the allowance. As of December 31, 2018 and December 31, 2017, the impaired loan component of the allowance for loan losses amounted to \$116 thousand and \$95 thousand, respectively. The impaired loan component of the allowance for loan losses is reflected as a valuation allowance related to impaired loans in Note 5 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

The second component of the allowance consists of qualitative factors and includes items such as economic conditions, growth trends, loan concentrations, changes in certain loans, changes in underwriting, changes in management and legal and regulatory changes. For the December 31, 2018 calculation, the qualitative factors which had the most significant impact on the allowance were those affected by changes in the economy and past due and nonaccrual loans. Continued incremental improvements in the economy allowed for a reduction in the allowance. At the same time, past due and nonaccrual loans increased in several categories when comparing December 31, 2018 to December 31, 2017.

Historical loss is the final component of the allowance for loan losses. The calculation of the historical loss component is conducted on loans evaluated collectively for impairment and uses migration analysis with eight migration periods covering twelve quarters each on pooled segments for both 2018 and 2017. 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.

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Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on whether the loan's payments are current (including loans 1 – 29 days past due), 30 – 59 days past due, 60 – 89 days past due, or 90 days or more past due. All other loans, including loans to consumers that are secured by real estate, are segmented by the Company's internally assigned risk grades: substandard, other assets especially mentioned (rated just above substandard), and pass (all other loans). The Company may also assign loans to the risk grades of doubtful or loss, but as of December 31, 2018 and December 31, 2017, the Company had no loans in these categories.

The calculation for December 31, 2018 and 2017 was based on eight migration periods covering twelve quarters each. On a combined basis, the historical loss and qualitative factor components amounted to \$10.0 million and \$9.4 million as of December 31, 2018 and December 31, 2017, respectively. Increases in historical charge-off rates is the major reason for the increase in these combined components when comparing the allowance calculation as of December 31, 2018 to the allowance calculation as of December 31, 2017.

Acquired loans are recorded at their fair value at acquisition date without carryover of the acquiree's previously established ALL, as credit discounts are included in the determination of fair value. The fair value of the loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected on the loans and then applying a market-based discount rate to those cash flows. During evaluation upon acquisition, acquired loans are also classified as either acquired impaired or acquired performing.

Acquired impaired loans reflect credit quality deterioration since origination, as it is probable at acquisition that the Company will not be able to collect all contractually required payments. These acquired impaired loans are accounted for under ASC 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality. The acquired impaired loans are segregated into pools based on loan type and credit risk. Loan type is determined based on collateral type, purpose, and lien position. Credit risk characteristics include risk rating groups, nonaccrual status, and past due status. For valuation purposes, these pools are further disaggregated by maturity, pricing characteristics, and re-payment structure. Acquired impaired loans are written down at acquisition to fair value using an estimate of cash flows deemed to be collectible. Accordingly, such loans are no longer classified as nonaccrual even though they may be contractually past due because the Company expects to fully collect the new carrying values of such loans, which is the new cost basis arising from purchase accounting.

Acquired performing loans are accounted for under ASC 310-20, Receivables – Nonrefundable Fees and Other Costs. The difference between the fair value and unpaid principal balance of the loan at acquisition date (premium or discount) is amortized or accreted into interest income over the life of the loans. If the acquired performing loan has revolving privileges, it is accounted for using the straight-line method otherwise, the effective interest method is used.

Overall Change in Allowance

As a result of management's analysis, the Company added, through the provision, \$2.9 million to the allowance for loan losses for the year ended December 31, 2018. The allowance for loan losses, as a percentage of year-end loans, was 1.31% in 2018 and 1.28% in 2017. Management believes that the allowance has been appropriately funded for losses on existing loans, based on currently available information. The Company will continue to monitor the loan portfolio and levels of nonperforming assets closely and make changes to the allowance for loan losses when necessary.

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

TABLE VIII
ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

| As of December 31, | 2018 | 2017 | 2016 | 2015 | 2014 |
|--|------------------------|-----------|-----------|-----------|-----------|
| | (dollars in thousands) | | | | |
| Balance at the beginning of period | \$9,448 | \$8,245 | \$7,738 | \$7,075 | \$6,831 |
| Charge-offs: | | | | | |
| Commercial | 81 | 807 | 915 | 293 | 286 |
| Real estate-construction | - | - | - | - | 51 |
| Real estate-mortgage (1) | 1,625 | 1,934 | 504 | 321 | 563 |
| Consumer | 769 | 279 | 204 | 92 | 163 |
| Other | 367 | 267 | 147 | 191 | 175 |
| Total charge-offs | 2,842 | 3,287 | 1,770 | 897 | 1,238 |
| Recoveries: | | | | | |
| Commercial | 140 | 37 | 79 | 50 | 55 |
| Real estate-construction | - | 104 | 3 | 1 | 173 |
| Real estate-mortgage (1) | 158 | 45 | 197 | 393 | 524 |
| Consumer | 262 | 56 | 28 | 39 | 64 |
| Other | 84 | 88 | 40 | 52 | 66 |
| Total recoveries | 644 | 330 | 347 | 535 | 882 |
| Net charge-offs | 2,198 | 2,957 | 1,423 | 362 | 356 |
| Provision for loan losses | 2,861 | 4,160 | 1,930 | 1,025 | 600 |
| Balance at end of period | \$10,111 | \$9,448 | \$8,245 | \$7,738 | \$7,075 |
| Selected loan loss statistics | | | | | |
| Loans (net of unearned income): | | | | | |
| End of period balance | \$774,009 | \$738,540 | \$603,882 | \$568,475 | \$535,994 |
| Average balance | \$768,960 | \$673,015 | \$585,206 | \$563,534 | \$517,183 |
| Net charge-offs to average total loans | 0.29 | % 0.44 | % 0.24 | % 0.06 | % 0.07 |
| Provision for loan losses to average total loans | 0.37 | % 0.62 | % 0.33 | % 0.18 | % 0.12 |
| Provision for loan losses to net charge-offs | 130.16 | % 140.68 | % 135.63 | % 283.15 | % 168.54 |
| Allowance for loan losses to period end loans | 1.31 | % 1.28 | % 1.37 | % 1.36 | % 1.32 |
| Earnings to loan loss coverage (2) | 3.67 | 1.36 | 4.14 | 13.02 | 13.80 |
| Allowance for loan losses to nonperforming loans | 69.07 | % 58.81 | % 82.10 | % 97.48 | % 105.42 |

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

(2) Income before taxes plus provision for loan losses, divided by net charge-offs.

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The following table shows the amount of the allowance for loan losses allocated to each category at December 31 of the years presented. Although the allowance for loan losses is allocated into these categories, the entire allowance for loan losses is available to cover loan losses in any category.

TABLE IX
ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

| As of December 31, | 2018 | | | 2017 | | | 2016 | | | 2015 | | | 2014 | | |
|-------------------------------------|------------------------|---------------------------|---------|----------|---------------------------|----------|---------|---------------------------|---------|----------|---------------------------|-------|--------|---------------------------|-------|
| | Amount | Percent of Loans to Total | Loans | Amount | Percent of Loans to Total | Loans | Amount | Percent of Loans to Total | Loans | Amount | Percent of Loans to Total | Loans | Amount | Percent of Loans to Total | Loans |
| | (dollars in thousands) | | | | | | | | | | | | | | |
| Commercial Real estate-construction | \$2,340 | 8.19 % | \$1,889 | 8.18 % | \$1,493 | 9.16 % | \$633 | 7.60 % | \$595 | 7.03 % | | | | | |
| Real estate-mortgage (1) | 156 | 4.18 % | 541 | 3.72 % | 846 | 3.83 % | 985 | 3.46 % | 703 | 1.69 % | | | | | |
| Consumer | 5,956 | 64.66 % | 5,217 | 62.99 % | 5,267 | 74.25 % | 5,628 | 76.90 % | 5,347 | 81.33 % | | | | | |
| Other | 1,354 | 21.85 % | 1,644 | 23.59 % | 455 | 9.61 % | 279 | 8.87 % | 219 | 5.69 % | | | | | |
| Total | 305 | 1.12 % | 157 | 1.52 % | 184 | 3.15 % | 213 | 3.17 % | 211 | 4.26 % | | | | | |
| | \$10,111 | 100.00 % | \$9,448 | 100.00 % | \$8,245 | 100.00 % | \$7,738 | 100.00 % | \$7,075 | 100.00 % | | | | | |

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

For the year ended December 31, 2018 as compared to the year ended December 31, 2017, there was an increase in the allowance for loan losses due to increases in the historical charge-off rate in the loan portfolio. The change in the allowance was distributed among the loan segments based on the composition of loans in each segment. See Note 5 of the Notes to Consolidated Financial Statements included in Item 8, “Financial Statements and Supplementary Data” of this report on Form 10-K for further information related to the effect of the change in the calculation method.

Deposits

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

TABLE X
DEPOSITS

| Years ended December 31, | 2018 | | 2017 | |
|---------------------------------------|------------------------|--------------|-----------------|--------------|
| | Average Balance | Average Rate | Average Balance | Average Rate |
| | (dollars in thousands) | | | |
| Interest-bearing transaction accounts | \$28,246 | 0.04 % | \$27,909 | 0.04 % |
| Money market deposit accounts | 242,025 | 0.22 % | 233,295 | 0.12 % |
| Savings accounts | 87,534 | 0.09 % | 82,872 | 0.05 % |
| Time deposits | 228,800 | 1.27 % | 208,095 | 1.06 % |
| Total interest-bearing deposits | 586,605 | 0.60 % | 552,171 | 0.46 % |
| Demand deposits | 236,249 | | 226,951 | |

| | | |
|----------------|-----------|-----------|
| Total deposits | \$822,854 | \$779,122 |
|----------------|-----------|-----------|

The Company's average total deposits were \$822.9 million for the year ended December 31, 2018, an increase of \$43.7 million or 5.61% from average total deposits for the year ended December 31, 2017. Other than time deposits, the demand deposit and money market account categories had the largest increases, totaling \$9.3 million and \$8.7 million, respectively. Average time deposits, which is the Company's most expensive deposit category, increased by a total of \$20.7 million as seen in the table above. The average rate paid on interest-bearing deposits by the Company in 2018 was 0.60% compared to 0.46% in 2017.

As loan growth accelerated, the Company made strategic increases in the rates on time deposits in certain maturities to fund loan growth and manage its interest-rate risk. Selected money market deposit rates were also raised in 2018 to attract and retain desirable customers relationships as market and competitors' rates increased. The Company remains focused on increasing lower-cost deposits by actively targeting new noninterest-bearing deposits and savings deposits.

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

TABLE XI
TIME DEPOSITS OF \$100,000 OR MORE

| As of December 31, | 2018 | 2017 |
|------------------------|----------------|-----------|
| | (in thousands) | |
| Maturing in: | | |
| Within 3 months | \$19,121 | \$25,136 |
| 3 through 6 months | 8,699 | 11,192 |
| 6 through 12 months | 25,820 | 8,830 |
| Greater than 12 months | 75,689 | 76,418 |
| | \$129,329 | \$121,576 |

Capital Resources

Total stockholders' equity as of December 31, 2018 was \$102.0 million, up 5.83% from \$96.4 million on December 31, 2017 as the increase in retained earnings and capital acquired in the Citizens acquisition offset increases in accumulated other comprehensive loss, net.

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

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

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

| | 2018 | | 2018 | 2017 |
|------------------------------|------------|---|--------|--------|
| | Regulatory | | | |
| | Minimums | | | |
| Common Equity Tier 1 Capital | 4.50 | % | 11.44% | 11.18% |
| Tier 1 Capital | 6.00 | % | 11.44% | 11.18% |
| Total Capital | 8.00 | % | 12.59% | 12.28% |
| Tier 1 Leverage | 4.00 | % | 9.77% | 9.98% |

Year-end book value per share was \$19.68 in 2018 and \$19.20 in 2017. The common stock of the Company has not been extensively traded. The stock is quoted on the NASDAQ Capital Market under the symbol "OPOF." There were 1,635 stockholders of record of the Company as of March 12, 2019. This stockholder count does not include stockholders who hold their stock in a nominee registration.

Liquidity

Liquidity is the ability of the Company to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments in securities and loans maturing within one year.

In addition, secondary sources are available through the use of borrowed funds if the need should arise. The Company's sources of funds include a large stable deposit base and secured advances from the Federal Home Loan Bank of Atlanta (FHLB). As of December 31, 2018, the Company had \$245.9 million in FHLB borrowing availability. As of year-end 2018 and 2017, the Company had \$55.0 million and \$45.0 million available in federal funds lines of credit to address any short-term borrowing needs.

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

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

The following table sets forth information relating to the Company's sources of liquidity and the outstanding commitments for use of liquidity at December 31, 2018 and December 31, 2017. Dividing the total short-term sources of liquidity by the outstanding commitments for use of liquidity derives the liquidity coverage ratio.

LIQUIDITY SOURCES AND USES

| | December 31, 2018 | | | December 31, 2017 | | |
|--|-------------------|--------|-----------|-------------------|----------|-----------|
| | Total | In Use | Available | Total | In Use | Available |
| (dollars in thousands) | | | | | | |
| SOURCES | | | | | | |
| Federal funds lines of credit | \$55,000 | \$- | \$55,000 | \$55,000 | \$10,000 | \$45,000 |
| Federal Home Loan Bank advances | 305,937 | 60,000 | 245,937 | 284,513 | 67,500 | 217,013 |
| Federal funds sold & balances at the Federal Reserve | | | 20,673 | | | 586 |
| Securities, available-for-sale and unpledged at fair value | | | 88,350 | | | 90,536 |
| Total short-term funding sources | | | 409,960 | | | 353,135 |
| USES | | | | | | |
| Unfunded loan commitments and lending lines of credit | | | 71,186 | | | 68,152 |
| Letters of credit | | | 2,469 | | | 999 |
| Commitments to purchase assets | | | - | | | - |
| Total potential short-term funding uses | | | 73,655 | | | 69,151 |
| Liquidity coverage ratio | | | 556.6 | % | | 510.7 |
| | | | | | | % |

The fair value of unpledged available-for-sale securities decreased from December 31, 2017 to December 31, 2018 primarily due to declining balances in the securities portfolio. Unpledged available-for-sale securities also declined

due to a \$5.1 million increase in customer repurchase agreements. The increase in repurchase agreements from December 31, 2017 to December 31, 2018 was primarily a result of balance fluctuations in the account of a single customer.

Management is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on the liquidity, capital resources or operations of the Company. Nor is management aware of any current recommendations by regulatory authorities that would have a material effect on liquidity or operations. The Company's internal sources of liquidity are deposits, loan and investment repayments and securities available-for-sale. The Company's primary external source of liquidity is advances from the FHLB.

The Company's operating activities provided \$12.2 million of cash during the year ended December 31, 2018, compared to \$9.4 million provided during 2017. The Company's investing activities provided \$12.0 million of cash during 2018, compared to \$98.4 million used during 2017, principally due to lower loan growth. The Company's financing activities provided \$3.6 million of cash during 2018 compared to \$77.5 million of cash provided during 2017. This change is principally due to increases in FHLB advances in 2017.

Effects of Inflation

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

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

Off-Balance Sheet Lending Related Commitments

The Company had \$147.2 million in consumer and commercial commitments at December 31, 2018. As of the same date, the Company also had \$8.2 million in letters of credit that the Company will fund if certain future events occur. It is expected that only a portion of these commitments will ever actually be funded.

Management believes that the Company has the liquidity and capital resources to handle these commitments in the normal course of business. See Note 16 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

Contractual Obligations

In the normal course of business, there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, that may or may not require future cash outflows. The following table provides the Company's contractual obligations as of December 31, 2018:

Payments due by period

| | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years |
|---|----------------|------------------------|-----------|--------------|----------------------------|
| | (in thousands) | | | | |
| Contractual Obligations | | | | | |
| Short-Term Debt Obligations | \$38,775 | \$38,775 | \$- | \$- | \$ - |
| Long-Term Debt Obligations | 49,550 | 20,600 | 28,800 | 150 | - |
| Operating Lease Obligations | 781 | 331 | 450 | - | - |
| Total contractual cash obligations excluding deposits | 89,106 | 59,706 | 29,250 | 150 | - |

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| | | | | | |
|----------|-----------|-----------|-----------|----------|------|
| Deposits | 843,144 | 714,483 | 91,919 | 36,742 | - |
| Total | \$932,250 | \$774,189 | \$121,169 | \$36,892 | \$ - |

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Short-term debt obligations include federal funds purchased, overnight repurchase agreements and Federal Home Loan Bank advances maturing within a year of origination. Long-term debt obligations consist of Federal Home Loan Bank advances with original maturities greater than one year.

Short-Term Borrowings

Certain short-term borrowings at December 31, 2018 and 2017 are presented below. Information is presented only on those categories whose average balance at December 31 exceeded 30 percent of total stockholders' equity at the same date.

TABLE XII
SHORT-TERM BORROWINGS

| | 2018 | | 2017 | |
|---|------------------------|-------|----------|-------|
| | Balance | Rate | Balance | Rate |
| | (dollars in thousands) | | | |
| Balance at December 31, | | | | |
| Federal funds purchased | \$- | - | \$10,000 | 1.62% |
| Repurchase agreements | 25,775 | 0.10% | 20,693 | 0.10% |
| Federal Home Loan Bank advances | 13,000 | 2.58% | 47,500 | 1.51% |
| Average daily balance for the year ended December 31, | | | | |
| Federal funds purchased | \$358 | 1.75% | \$854 | 1.52% |
| Repurchase agreements | 26,163 | 0.10% | 24,889 | 0.10% |
| Federal Home Loan Bank advances | 36,356 | 1.83% | 27,589 | 1.24% |
| Maximum month-end outstanding balance: | | | | |
| Federal funds purchased | \$10,000 | | \$10,000 | |
| Repurchase agreements | 36,141 | | 36,809 | |
| Federal Home Loan Bank advances | 68,500 | | 47,500 | |

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not required.

Item 8. Financial Statements and Supplementary Data

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

Report of Independent Registered Public Accounting Firm

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Old Point Financial Corporation and Subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 18, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

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

We have served as the Company's auditor since 2004.

Winchester, Virginia

March 18, 2019

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Report of Independent Registered Public Accounting Firm

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

Opinion on the Internal Control Over Financial Reporting

We have audited Old Point Financial Corporation and Subsidiaries' (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements of the Company, and our report dated March 18, 2019 expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Management's Report of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that

transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, 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.

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

Winchester, Virginia
March 18, 2019

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Old Point Financial Corporation and Subsidiaries
Consolidated Balance Sheets

| | December 31, | |
|--|--|-----------|
| | 2018 | 2017 |
| | (dollars in thousands, except per share data) | |
| Assets | | |
| Cash and due from banks | \$19,915 | \$13,420 |
| Interest-bearing due from banks | 20,000 | 908 |
| Federal funds sold | 2,302 | 84 |
| Cash and cash equivalents | 42,217 | 14,412 |
| Securities available-for-sale, at fair value | 148,247 | 157,121 |
| Restricted stock, at cost | 3,853 | 3,846 |
| Loans held for sale | 479 | 779 |
| Loans, net | 763,898 | 729,092 |
| Premises and equipment, net | 36,738 | 37,197 |
| Bank-owned life insurance | 26,763 | 25,981 |
| Other real estate owned, net | 83 | - |
| Goodwill | 1,650 | 621 |
| Core deposit intangible, net | 407 | - |
| Other assets | 13,848 | 12,777 |
| Total assets | \$1,038,183 | \$981,826 |
| Liabilities & Stockholders' Equity | | |
| Deposits: | | |
| Noninterest-bearing deposits | \$246,265 | \$225,716 |
| Savings deposits | 367,915 | 345,053 |
| Time deposits | 228,964 | 212,825 |
| Total deposits | 843,144 | 783,594 |
| Federal funds purchased | - | 10,000 |
| Overnight repurchase agreements | 25,775 | 20,693 |
| Federal Home Loan Bank advances | 60,000 | 67,500 |
| Other borrowings | 2,550 | - |
| Accrued expenses and other liabilities | 4,708 | 3,651 |
| Total liabilities | 936,177 | 885,438 |
| Commitments and contingencies (Note 15) | | |
| Stockholders' equity: | | |
| Common stock, \$5 par value, 10,000,000 shares authorized; 5,184,289 and 5,019,703 shares outstanding (includes 13,689 and 2,245 unvested restricted shares, respectively) | 25,853 | 25,087 |
| Additional paid-in capital | 20,698 | 17,270 |
| Retained earnings | 57,611 | 54,738 |
| Accumulated other comprehensive loss, net | (2,156) | (707) |
| Total stockholders' equity | 102,006 | 96,388 |
| Total liabilities and stockholders' equity | \$1,038,183 | \$981,826 |

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Operations

| | Years Ended December 31, | |
|--|--|----------|
| | 2018 | 2017 |
| | (dollars in thousands, except per share data) | |
| Interest and Dividend Income: | | |
| Loans, including fees | \$34,446 | \$29,191 |
| Due from banks | 198 | 15 |
| Federal funds sold | 21 | 8 |
| Securities: | | |
| Taxable | 2,080 | 1,964 |
| Tax-exempt | 1,221 | 1,601 |
| Dividends and interest on all other securities | 291 | 155 |
| Total interest and dividend income | 38,257 | 32,934 |
| Interest Expense: | | |
| Savings deposits | 628 | 342 |
| Time deposits | 2,916 | 2,208 |
| Federal funds purchased, securities sold under agreements to repurchase and other borrowings | 131 | 38 |
| Federal Home Loan Bank advances | 1,294 | 424 |
| Total interest expense | 4,969 | 3,012 |
| Net interest income | 33,288 | 29,922 |
| Provision for loan losses | 2,861 | 4,160 |
| Net interest income, after provision for loan losses | 30,427 | 25,762 |
| Noninterest Income: | | |
| Fiduciary and asset management fees | 3,726 | 3,786 |
| Service charges on deposit accounts | 4,157 | 3,874 |
| Other service charges, commissions and fees | 3,547 | 3,431 |
| Bank-owned life insurance income | 782 | 774 |
| Mortgage banking income | 788 | 645 |
| Gain on sale of available-for-sale securities, net | 120 | 96 |
| Gain on acquisition of Old Point Mortgage | - | 550 |
| Other operating income | 151 | 151 |
| Total noninterest income | 13,271 | 13,307 |
| Noninterest Expense: | | |
| Salaries and employee benefits | 22,580 | 20,863 |
| Pension termination settlement | - | 3,350 |
| Occupancy and equipment | 6,021 | 5,864 |
| Data processing | 1,327 | 1,032 |
| FDIC insurance | 701 | 478 |
| Customer development | 611 | 575 |
| Professional services | 2,296 | 2,069 |
| Employee professional development | 749 | 794 |
| Other taxes | 580 | 563 |

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| | | |
|--|---------|---------|
| ATM and other losses | 407 | 667 |
| Loss (gain) on other real estate owned | 86 | (18) |
| Merger expenses | 655 | 241 |
| Other operating expenses | 2,487 | 2,717 |
| Total noninterest expense | 38,500 | 39,195 |
| Income (loss) before income taxes | 5,198 | (126) |
| Income tax expense (benefit) | 279 | (97) |
| Net income (loss) | \$4,919 | \$(29) |

Basic earnings (loss) per share:

| | | |
|---|-----------|-----------|
| Weighted average shares outstanding | 5,141,364 | 4,991,060 |
| Net income (loss) per share of common stock | \$0.96 | \$(0.01) |

Diluted earnings (loss) per share:

| | | |
|---|-----------|-----------|
| Weighted average shares outstanding | 5,141,429 | 4,991,060 |
| Net income (loss) per share of common stock | \$0.96 | \$(0.01) |

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive IncomeYears Ended
December 31,
2018 2017
(dollars in
thousands)

| | | |
|--|---------|---------|
| Net income (loss) | \$4,919 | \$(29) |
| Other comprehensive income (loss), net of tax | | |
| Net unrealized gain (loss) on available-for-sale securities | (1,233) | 1,032 |
| Changes in defined benefit plan assets and benefit obligations | - | 2,469 |
| Other comprehensive income (loss), net of tax | (1,233) | 3,501 |
| Comprehensive income | \$3,686 | \$3,472 |

See Notes to Consolidated Financial Statements.

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

| | Shares of Common Stock (dollars in thousands, except per share data) | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|--|---|-----------------|----------------------------------|----------------------|---|------------|
| Balance at December 31, 2016 | 4,961,258 | \$ 24,806 | \$ 16,427 | \$ 56,965 | \$ (4,208) | \$ 93,990 |
| Net loss | - | - | - | (29) | - | (29) |
| Other comprehensive income, net of tax | - | - | - | - | 3,501 | 3,501 |
| Exercise of stock options | 58,105 | 290 | 875 | - | - | 1,165 |
| Employee Stock Purchase Plan share issuance | 3,548 | 18 | 81 | - | - | 99 |
| Repurchase of common stock related to stock option exercises | (5,453) | (27) | (130) | - | - | (157) |
| Stock-based compensation expense | - | - | 17 | - | - | 17 |
| Cash dividends (\$0.44 per share) | - | - | - | (2,198) | - | (2,198) |
| Balance at December 31, 2017 | 5,017,458 | \$ 25,087 | \$ 17,270 | \$ 54,738 | \$ (707) | \$ 96,388 |
| Net income | - | - | - | 4,919 | - | 4,919 |
| Other comprehensive loss, net of tax | - | - | - | - | (1,233) | (1,233) |
| Issuance of common stock related to acquisition | 149,625 | 748 | 3,199 | - | - | 3,947 |
| Reclassification of the stranded income tax effects of the Tax Cuts and Jobs Act from AOCI | - | - | - | 139 | (139) | - |
| Reclassification of net unrealized gains on equity securities from AOCI per ASU 2016-01 | - | - | - | 77 | (77) | - |
| Employee Stock Purchase Plan share issuance | 3,517 | 18 | 69 | - | - | 87 |
| Stock-based compensation expense | - | - | 160 | - | - | 160 |
| Cash dividends (\$0.44 per share) | - | - | - | (2,262) | - | (2,262) |
| Balance at December 31, 2018 | 5,170,600 | \$ 25,853 | \$ 20,698 | \$ 57,611 | \$ (2,156) | \$ 102,006 |

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows

| Years Ended December 31, | 2018 | 2017 |
|---|------------------------|-----------|
| | (dollars in thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 4,919 | \$ (29) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,469 | 2,742 |
| Accretion related to acquisition, net | (341) | - |
| Provision for loan losses | 2,861 | 4,160 |
| Gain on sale of securities, net | (120) | (96) |
| Net amortization of securities | 1,687 | 2,247 |
| (Increase) decrease in loans held for sale, net | 300 | (779) |
| Net (gain) loss on disposal of premises and equipment | 9 | 4 |
| Net (gain) loss on write-down/sale of other real estate owned | 86 | (18) |
| Income from bank owned life insurance | (782) | (774) |
| Stock compensation expense | 160 | 17 |
| Deferred tax benefit | (164) | (117) |
| (Increase) decrease in other assets | 338 | 458 |
| Increase (decrease) in accrued expenses and other liabilities | 732 | 3,177 |
| Pension plan contribution | - | (1,554) |
| Net cash provided by operating activities | 12,154 | 9,438 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of available-for-sale securities | (26,002) | (23,095) |
| Proceeds from redemption (cash used in purchases) of restricted securities, net | 270 | (2,876) |
| Proceeds from maturities and calls of available-for-sale securities | 10,990 | 50,290 |
| Proceeds from sales of available-for-sale securities | 12,536 | 4,480 |
| Paydowns on available-for-sale securities | 10,183 | 9,981 |
| Proceeds from sale of loans held for investment | 8,746 | - |
| Net increase in loans held for investment | (3,568) | (137,615) |
| Proceeds from sales of other real estate owned | 210 | 1,084 |
| Purchases of premises and equipment | (478) | (619) |
| Cash paid in acquisition | (3,164) | - |
| Cash acquired in acquisition | 2,304 | - |
| Net cash provided by (used in) investing activities | 12,027 | (98,370) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Increase (decrease) in noninterest-bearing deposits | 14,236 | (2,925) |
| Increase in savings deposits | 15,487 | 601 |
| Increase (decrease) in time deposits | (14,056) | 1,416 |
| Increase (decrease) in federal funds purchased, repurchase agreements and other borrowings, net | (2,368) | 11,989 |
| Increase in Federal Home Loan Bank advances | 140,500 | 167,500 |
| Repayment of Federal Home Loan Bank advances | (148,000) | (100,000) |
| Proceeds from exercise of stock options and ESPP issuance | 87 | 1,264 |
| Repurchase and retirement of common stock | - | (157) |
| Cash dividends paid on common stock | (2,262) | (2,198) |
| Net cash provided by (used in) financing activities | 3,624 | 77,490 |

| | | |
|--|-----------|-----------|
| Net increase (decrease) in cash and cash equivalents | 27,805 | (11,442) |
| Cash and cash equivalents at beginning of period | 14,412 | 25,854 |
| Cash and cash equivalents at end of period | \$ 42,217 | \$ 14,412 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash payments for:

| | | |
|------------|----------|----------|
| Interest | \$ 4,735 | \$ 2,880 |
| Income tax | - | 600 |

SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS

| | | |
|---|-------------|----------|
| Unrealized gain (loss) on securities available-for-sale | \$ (1,560) | \$ 1,563 |
| Loans transferred to other real estate owned | 203 | - |
| Decrease in pension liability | - | 3,741 |

TRANSACTIONS RELATED TO ACQUISITIONS

| | | |
|------------------------------------|-----------|------|
| Assets acquired | \$ 50,406 | \$ - |
| Liabilities assumed | 44,324 | - |
| Common stock issued in acquisition | 3,947 | - |

See Notes to Consolidated Financial Statements.

NOTE 1. Significant Accounting Policies

THE COMPANY

Headquartered in Hampton, Virginia, 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 December 31, 2018, the Bank had 19 branch offices. The Bank offers a full range of deposit and loan products to its retail and commercial customers, including mortgage loan products offered through its Old Point Mortgage division. A full array of insurance products is also offered through Old Point Insurance, LLC in partnership with Morgan Marrow Company. Trust offers a full range of services for individuals and businesses. Products and services include retirement planning, estate planning, financial planning, estate and trust administration, retirement plan administration, tax services and investment management services.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Old Point Financial Corporation (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.

USE OF ESTIMATES

In preparing Consolidated Financial Statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, accounting for acquired loans, and the valuation allowance on other real estate owned.

BUSINESS COMBINATIONS

Business combinations are accounted for under ASC 805, Business Combinations, using the acquisition method of accounting. The acquisition method of accounting requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. To determine the fair values, the Company utilizes third party valuations, appraisals, and internal valuations based on discounted cash flow analysis or other valuation techniques. Under the acquisition method of accounting, the Company will identify the acquiree and the closing date and apply applicable recognition principles and conditions. If they are necessary to implement its plan to exit an activity of an acquiree, costs that the Company expects, but is not obligated, to incur in the future are not liabilities at the acquisition date, nor are costs to terminate the employment or relocate an acquiree's employees. The Company does not recognize these costs as part of applying the acquisition method. Instead, the Company recognizes these costs as expenses in its post-combination financial statements in accordance with other applicable GAAP.

Merger-related costs are costs the Company incurs to effect a business combination. Those costs include advisory, legal, accounting, valuation, and other professional or consulting fees. Some other examples of costs to the Company include systems conversions, integration planning consultants, contract terminations, and advertising costs. The Company will account for merger-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities will be recognized in accordance with other applicable accounting guidance. These merger-related costs are included on the Company's Consolidated Statements of Operations classified within the noninterest expense caption.

On April 1, 2018, the Company acquired Citizens National Bank (Citizens) based in Windsor, Virginia. Refer to Note 2 for further discussion.

SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Company's activities are with customers located within the Hampton Roads region. The types of securities that the Company invests in are included in Note 4. The types of lending that the Company engages in are included in Note 5. The Company has significant concentrations in the following industries: construction, lessors of real estate, activities related to real estate, ambulatory health care and religious organizations. The Company does not have any significant concentrations to any one customer.

At December 31, 2018 and 2017, there were \$347.9 million and \$317.2 million, or 44.94% and 42.95%, respectively, of total loans concentrated in commercial real estate. Commercial real estate for purposes of this note includes all construction loans, loans secured by multifamily residential properties, loans secured by farmland and loans secured by nonfarm, nonresidential properties. Refer to Note 5 for further detail.

CASH AND CASH EQUIVALENTS

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash and balances due from banks and federal funds sold, all of which mature within 90 days.

INTEREST-BEARING DEPOSITS IN BANKS

Interest-bearing deposits in banks mature within one year and are carried at cost.

SECURITIES

Certain debt securities that management has the positive intent and ability to hold until maturity are classified as “held-to-maturity” and recorded at amortized cost. Securities not classified as held-to-maturity, excluding equity securities with readily determinable fair values which are recorded at fair value through the income statement, are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company employs a systematic methodology that considers available evidence in evaluating potential impairment of its investments. In the event that the cost of an investment exceeds its fair value, the Company evaluates, among other factors, the magnitude and duration of the decline in fair value; the expected cash flows of the securities; the financial health of and business outlook for the issuer; the performance of the underlying assets for interests in securitized assets; and the Company’s intent and ability to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in investment income and a new cost basis in the investment is established.

RESTRICTED STOCK, AT COST

The Company, as a member of the Federal Reserve Bank (FRB) and the Federal Home Loan Bank of Atlanta (FHLB), is required to maintain an investment in the capital stock of both the FRB and the FHLB. As a result of the acquisition of Citizens, the Company also has an investment in the capital stock of Community Bankers' Bank (CBB). Based on the redemption provisions of these investments, the stocks have no quoted market value, are carried at cost and are listed as restricted securities. The Company reviews its holdings for impairment based on the ultimate recoverability of the cost basis in the FRB, FHLB, and CBB stock.

LOANS HELD FOR SALE

The Company records loans held for sale using the lower of cost or fair value. In addition, the Company requires a firm purchase commitment from a permanent investor before a loan can be closed, thus limiting interest rate risk. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. The change in fair value of loans held for sale is recorded as a component of “Mortgage banking income” within the Company’s Consolidated Statements of Operations.

LOANS

The Company extends loans to individual consumers and commercial customers for various purposes. Most of the Company’s loans are secured by real estate, including real estate construction loans and real estate mortgage loans (i.e., residential 1-4 family mortgages, commercial real estate loans, second mortgages and equity lines of credit). Other loans are secured by collateral that is not real estate, which may include inventory, accounts receivable, equipment or other personal property. A substantial portion of the loan portfolio is represented by real estate mortgage loans

throughout Hampton Roads. The ability of the Company's debtors to honor their contracts is dependent in part upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for unearned income, the allowance for loan losses and any unamortized deferred fees or costs on originated loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

NONACCRUALS, PAST DUES AND CHARGE-OFFS

The accrual of interest on commercial loans (including construction loans and commercial loans secured and not secured by real estate) is generally discontinued at the time the loan is 90 days past due unless the credit is well-secured and in the process of collection. Consumer loans not secured by real estate and consumer real estate secured loans (i.e., residential 1-4 family mortgages, second mortgages and equity lines of credit) are generally placed on nonaccrual status when payments are 120 days past due. Past due status is based on the contractual terms of the loan, and loans are considered past due when a payment of principal and/or interest is due but not paid. Regular payments not received within the payment cycle are considered to be 30, 60, or 90 or more days past due accordingly. In all cases, loans are placed on nonaccrual status or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost recovery method, until qualifying for return to accrual status or charged off. Loans are generally 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.

Loans are generally fully charged off or partially charged down to the fair value of collateral securing the asset when:

- Management determines the asset to be uncollectible;
- Repayment is deemed to be protracted beyond reasonable time frames;
- The asset has been classified as a loss by either the internal loan review process or external examiners;
- The borrower has filed for bankruptcy protection and the loss becomes evident due to a lack of borrower assets; or
- The loan is 120 days or more past due unless the loan is both well secured and in the process of collection.

ALLOWANCE FOR LOAN LOSSES

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired, such as a loan that is considered a troubled debt restructuring (TDR) (discussed in detail below). These loans are excluded from pooled loss forecasts and a separate reserve is provided under the accounting guidance for loan impairment. All loans, including consumer loans, whose terms have been modified in a TDR are also individually analyzed for estimated impairment. Impairment is measured on a loan-by-loan basis for construction loans and commercial loans (i.e., commercial mortgage loans on real estate and commercial loans not secured by real estate) by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. For those loans that are classified as impaired, an allowance is established when the discounted value of expected future cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Management determines

the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired.

The general component covers loans that are not classified as impaired. Loans collectively evaluated for impairment are pooled, with a historical loss rate, based on migration analysis, applied to each pool, segmented by risk grade or days past due, depending on the type of loan. Based on credit risk assessments and management's analysis of qualitative factors, additional loss factors are applied to loan balances. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and consumer loans secured by real estate (i.e., residential 1-4 family mortgages, second mortgages and equity lines of credit) for impairment disclosures, unless the terms of such loans have been modified in a TDR due to financial difficulties of the borrower.

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, 2018 and 2017 management used eight twelve-quarter migration periods.

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

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

Acquired loans are recorded at their fair value at acquisition date without carryover of the acquiree's previously established ALL, as credit discounts are included in the determination of fair value. The fair value of the loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected on the loans and then applying a market-based discount rate to those cash flows. During evaluation upon acquisition, acquired loans are also classified as either purchased credit-impaired (PCI) or purchased performing.

PCI loans reflect credit quality deterioration since origination, as it is probable at acquisition that the Company will not be able to collect all contractually required payments. These PCI loans are accounted for under ASC 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality. The PCI loans are segregated into pools based on loan type and credit risk. Loan type is determined based on collateral type, purpose, and lien position. Credit risk characteristics include risk rating groups, nonaccrual status, and past due status. For valuation purposes, these pools are further disaggregated by maturity, pricing characteristics, and re-payment structure. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the “nonaccretable difference” and is not recorded. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the “accretable yield” and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

On an annual basis, the estimate of cash flows expected to be collected on PCI loans is evaluated. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan, or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

The Company's PCI loans currently consist of loans acquired in connection with the acquisition of Citizens. PCI loans that were classified as nonperforming loans by Citizens are no longer classified as nonperforming so long as, at re-estimation periods, it is expected to fully collect the new carrying value of the pools of loans.

The Company accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required for any deterioration in these loans in future periods.

TROUBLED DEBT RESTRUCTURINGS

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management grants a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a TDR. Management strives to identify borrowers in financial difficulty before their loans reach nonaccrual status and works with them to grant appropriate concessions, if necessary, and modify their loans to more affordable terms. These modified terms 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. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

TRANSFERS OF FINANCIAL ASSETS

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company (i.e., put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership); (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

OTHER REAL ESTATE OWNED (OREO)

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance (direct write-downs) are included in loss (gain) on other real estate owned.

BANK-OWNED LIFE INSURANCE

The Company owns insurance on the lives of a certain group of key employees. The cash surrender value of these policies is included as an asset on the consolidated balance sheets, and the increase in cash surrender value is recorded as noninterest income on the Consolidated Statements of Operations. In the event of the death of an insured individual under these policies, the Company would receive a death benefit payment. Any excess in the amount received over the recorded cash surrender value would be recorded as other operating income on the Consolidated Statements of

Operations.

PREMISES AND EQUIPMENT

Land is carried at cost. Buildings and equipment are stated at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets. Buildings and equipment are depreciated over their estimated useful lives ranging from 3 to 39 years; leasehold improvements are amortized over the lives of the respective leases or the estimated useful life of the leasehold improvement, whichever is less. Software is amortized over its estimated useful life ranging from 3 to 5 years.

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OFF-BALANCE SHEET CREDIT RELATED FINANCIAL INSTRUMENTS

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial letters of credit and lines of credit. Such financial instruments are recorded when they are funded.

PENSION PLAN

The Company had a non-contributory defined benefit pension plan, which was frozen by the Company in 2006 and terminated in 2017. This plan was terminated in the fourth quarter of 2017.

STOCK COMPENSATION PLANS

Stock compensation accounting guidance (FASB ASC 718, "Compensation -- Stock Compensation") requires that the compensation cost related to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black Scholes model is used to estimate the fair value of the stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards.

INCOME TAXES

The Company accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, "Income Taxes"). The Company adopted the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability or balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the difference between the book and tax basis of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more-likely-than-not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more-likely-than-not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense. No uncertain tax positions were recorded in 2018 or 2017.

On December 22, 2017, the Tax Act was signed into law. Refer to Note 14 "Income Taxes" for additional information.

EARNINGS PER COMMON SHARE

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional potential common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to shares to be issued as part of the employee stock purchase plan and are determined using the treasury stock method.

TRUST ASSETS AND INCOME

Securities and other property held by Trust in a fiduciary or agency capacity are not assets of the Company and are not included in the accompanying Consolidated Financial Statements.

ADVERTISING EXPENSES

Advertising expenses are expensed as incurred. Advertising expense for the years ended 2018 and 2017 was \$255 thousand and \$249 thousand, respectively.

COMPREHENSIVE INCOME

Comprehensive income consists of net income and other comprehensive income, net of tax. Other comprehensive income (loss), net of tax includes unrealized gains and losses on securities available-for-sale and unrealized losses related to changes in the funded status of the pension plan which are also recognized as separate components of equity.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The FASB made subsequent amendments to Topic 842 in July 2018 through ASU 2018-10 ("Codification Improvements to Topic 842, Leases") and ASU 2018-11 ("Leases (Topic 842): Targeted Improvements"). Among these amendments is the provision in ASU 2018-11 that provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). The Company adopted ASU 2018-11 on January 2, 2019 using the optional transition method. As the Company owns the majority of its buildings, management does not anticipate that the ASU will have a material impact on its consolidated financial statements.

The Company plans to elect the package of practical expedients permitted under the transition guidance within the new standard, which allows the Company to carry forward historical lease classifications. In addition, the Company will elect the short-term lease exemption practical expedient in which leases with an initial term of twelve months or less are not capitalized and are not recorded on the balance sheet. Lastly, the Company plans to elect the practical expedient related to accounting for lease and non-lease components as a single lease component.

While the Company has evaluated this ASU 2018-11 and the effect of related disclosures, the Company expects that the primary effect of adoption will be to require recording right-of-use assets and corresponding lease obligations for current operating leases, which is estimated at approximately \$751 thousand, as of the adoption of this standard, which is based on the Company's current outstanding lease population detailed in Note 7. Upon adoption, the Company implemented a new system of record and new accounting policies and internal controls related to the standard.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This ASU replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The CECL model will replace the Company's current accounting for PCI and impaired loans. This ASU also amends the AFS debt securities OTTI model. This ASU is effective for fiscal years beginning after December 15, 2019. The Company has formed a committee to oversee the adoption of the new standard, has engaged a third party to assist with implementation, and is continuing to evaluate the impact ASU No. 2016-13 will have on its consolidated financial statements. This ASU contains significant differences from existing GAAP, and the implementation of this ASU may result in increases to the Company's reserves for credit losses of financial instruments; however, the Company is still finalizing its estimate of the quantitative impact of this standard.

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

In March 2017, the FASB issued ASU No. 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company does not expect the adoption of ASU 2017-08 to have a material impact on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, "Compensation- Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting." The amendments expand the scope of Topic 718 to include share-based payments issued to non-employees for goods or services, which were previously excluded. The amendments will align the accounting for share-based payments to non-employees and employees more similarly. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-07 to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-13 to have a material impact on its consolidated financial statements.

ACCOUNTING STANDARDS ADOPTED IN 2018

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU requires an entity to, among other things: (i) measure equity investments at fair value through net income, with certain exceptions (ii) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option (iii) present financial assets and financial liabilities by measurement category and form of financial asset (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. The ASU provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The ASU also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company adopted ASU No. 2016-01 on January 1, 2018, and during the first quarter of 2018, measured its equity investments at fair value through net income and reclassified \$77 thousand of AOCI to retained earnings, with no effect on total stockholders' equity. During the second quarter of 2018, the Company sold the equity investments, recognizing an additional gain on sale of \$24 thousand, net of tax. The Company also measured the fair value of its loan portfolio and time deposits at December 31, 2018 using an exit price notion (see Note 16. Fair Value Measurements).

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

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

Fiduciary and Asset Management Fees

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

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, and other deposit account related fees. The Company's performance

obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Other Service Charges, Commissions and Fees

Other service charges, commissions and fees are primarily comprised of debit card income, ATM fees, merchant services income, investment services income, and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks. During the third quarter of the 2018, the Company entered into a renewal vendor contract and determined, based on an agent capacity, to retrospectively reclassify debit card expenses against debit card revenue creating a net presentation. For the years ended December 31, 2018 and 2017, the amounts reclassified were \$711 thousand and \$751 thousand, respectively. These reclassifications had no impact on net income for the reporting periods. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Investment services income relates to commissions earned on brokered trades of investment securities. Other service charges include revenue from processing wire transfers, safe deposit box rentals, cashier's checks, and other services. The Company's performance obligation for other service charges, commission and fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Other Operating Income

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

NOTE 2. Acquisitions

On April 1, 2018, the Company acquired Citizens. Under the terms of the merger agreement, Citizens stockholders received 0.1041 shares of the Company's common stock and \$2.19 in cash for each share of Citizens common stock, resulting in the Company issuing 149,625 shares of the Company's common stock at a fair value of \$3.9 million, for a total purchase price of \$7.1 million.

The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition, in accordance with ASC 350, Intangibles-Goodwill and Other. The following table provides a preliminary assessment of the consideration transferred, assets acquired, and liabilities assumed as of the date of the acquisition (dollars in thousands):

| | As Recorded by Citizens | Fair Value Adjustments | As Recorded by the Company |
|--------------------------------|----------------------------------|---------------------------|-------------------------------------|
| Consideration paid: | | | |
| Cash | | | \$ 3,164 |
| Company common stock | | | 3,947 |
| Total purchase price | | | \$ 7,111 |
| Identifiable assets acquired: | | | |
| Cash and cash equivalents | \$ 2,304 | \$ - | \$ 2,304 |
| Securities available for sale | 1,959 | - | 1,959 |
| Restricted securities, at cost | 278 | - | 278 |
| Loans, net | 42,824 | (34) | 42,790 |
| Premises and equipment | 1,070 | 450 | 1,520 |
| Other real estate owned | 237 | (61) | 176 |

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| | | | |
|--------------------------|-----------|--------|-----------|
| Core deposit intangibles | - | 440 | 440 |
| Other assets | 1,055 | (116) | 939 |
| Total assets | \$ 49,727 | \$ 679 | \$ 50,406 |

Identifiable liabilities assumed:

| | | | |
|-------------------|-----------|--------|-----------|
| Deposits | \$ 43,754 | \$ 246 | \$ 44,000 |
| Other liabilities | 324 | - | 324 |
| Total liabilities | \$ 44,078 | \$ 246 | \$ 44,324 |

| | | |
|----------------------|--|----------|
| Net assets acquired | | \$ 6,082 |
| Preliminary goodwill | | \$ 1,029 |

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Goodwill and intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. Purchased intangible assets subject to amortization, such as the core deposit intangible asset, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The acquired loans were recorded at fair value at the acquisition date without carryover of Citizens' allowance for loan losses. The fair value of the loans was determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected on the loans and then applying a market-based discount rate to those cash flows. In this regard, the acquired loans were segregated into pools based on call code with other key inputs identified such as payment structure, rate type, remaining maturity, and credit risk characteristics including risk rating groups (pass rated loans and adversely classified loans), and past due status.

The acquired loans were divided into loans with evidence of credit quality deterioration which are accounted for under ASC 310-30, Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality, (purchased credit-impaired) and loans that do not meet these criteria, which are accounted for under ASC 310-20, Receivables - Nonrefundable Fees and Other Costs, (purchased performing). The fair values of the purchased performing loans were \$42.1 million and the fair value of the purchased credit-impaired loans were \$710 thousand.

The following table presents the purchased credit-impaired loans receivable at the acquisition date (dollars in thousands):

| | |
|--|---------|
| Contractually required principal and interest payments | \$1,031 |
| Nonaccretable difference | (211) |
| Cash flows expected to be collected | 820 |
| Accretable yield | (110) |
| Fair value of purchased credit-impaired loans | \$710 |

The amortization and accretion of premiums and discounts associated with the Company's acquisition accounting adjustments related to the Citizens acquisition had the following impact on the Consolidated Statements of Operations during the year ended December 31, 2018 (dollars in thousands). The acquisition occurred on April 1, 2018, therefore the comparative 2017 period had no impact.

| | |
|--|-------|
| Purchased performing loans | \$181 |
| Purchased credit-impaired loans | 77 |
| Certificate of deposit valuation | 116 |
| Amortization of core deposit intangible | (33) |
| Net impact to income before income taxes | \$341 |

NOTE 3, Restrictions on Cash and Amounts Due from Banks

The Company is subject to reserve balance requirements determined by applying the reserve ratios specified in the Federal Reserve Board's Regulation D. At December 31, 2018 and 2017, the Company had no balance requirements on any of its accounts. The Company had approximately \$5.1 million and \$0.5 million in deposits in financial institutions in excess of amounts insured by the FDIC at December 31, 2018 and December 31, 2017, respectively.

NOTE 4. Securities Portfolio

The amortized cost and fair value, with gross unrealized gains and losses, of securities available-for-sale were:

| | Amortized Cost (in thousands) | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------------------------|------------------------------|-------------------------------|---------------|
| December 31, 2018 | | | | |
| U.S. Treasury securities | \$12,323 | \$ 6 | \$ (1) | \$12,328 |
| Obligations of U.S. Government agencies | 10,868 | 2 | (156) | 10,714 |
| Obligations of state and political subdivisions | 49,194 | 155 | (512) | 48,837 |
| Mortgage-backed securities | 73,444 | 93 | (2,346) | 71,191 |
| Money market investments | 1,897 | - | - | 1,897 |
| Corporate bonds and other securities | 3,250 | 42 | (12) | 3,280 |
| Total | \$150,976 | \$ 298 | \$ (3,027) | \$148,247 |
| December 31, 2017 | | | | |
| Obligations of U.S. Government agencies | \$9,530 | \$ 27 | \$ (122) | \$9,435 |
| Obligations of state and political subdivisions | 64,413 | 489 | (137) | 64,765 |
| Mortgage-backed securities | 75,906 | - | (1,610) | 74,296 |
| Money market investments | 1,194 | - | - | 1,194 |
| Corporate bonds and other securities | 7,049 | 195 | (10) | 7,234 |
| Other marketable equity securities | 100 | 97 | - | 197 |
| Total | \$158,192 | \$ 808 | \$ (1,879) | \$157,121 |

Securities with a fair value of \$59.9 million and \$66.6 million at December 31, 2018 and 2017, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, FHLB advances and for other purposes required or permitted by law.

At December 31, 2018, the Company held no securities of any single issuer (excluding U.S. Government agencies) with a book value that exceeded 10 percent of stockholders' equity.

The amortized cost and fair value of securities by contractual maturity are shown below.

| | December 31, 2018 | |
|--|--------------------------------------|------------|
| | Available-for-Sale Amortized Cost | Fair Value |
| | (in thousands) | |
| Due in one year or less | \$11,285 | \$11,281 |
| Due after one year through five years | 27,800 | 27,427 |
| Due after five years through ten years | 31,214 | 30,628 |
| Due after ten years | 78,780 | 77,014 |
| Total debt securities | 149,079 | 146,350 |
| Other securities without stated maturities | 1,897 | 1,897 |
| Total securities | \$150,976 | \$148,247 |

The following table provides information about securities sold in the years ended December 31:

| | 2018 | 2017 |
|-----------------------|----------------|---------|
| | (in thousands) | |
| Proceeds from sales | \$12,536 | \$4,480 |
| Gross realized gains | \$131 | \$96 |
| Gross realized losses | \$11 | \$- |

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 and is 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.

The Company did not record impairment charges on securities for the years ended December 31, 2018 and 2017.

The following table shows the number of securities with unrealized losses, 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:

December 31, 2018

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| | Less Than Twelve Months | | More Than Twelve Months | | Total | | Number of Securities |
|---|-------------------------------|---------------|-------------------------------|---------------|-------------------------------|---------------|----------------------------|
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | |
| Securities Available-for-Sale | | | | | | | |
| U.S. Treasury securities | \$1 | \$2,484 | \$- | \$- | \$1 | \$2,484 | 1 |
| Obligations of U.S. Government agencies | 47 | 6,014 | 109 | 3,206 | 156 | 9,220 | 15 |
| Obligations of state and political subdivisions | 10 | 5,829 | 502 | 23,727 | 512 | 29,556 | 45 |
| Mortgage-backed securities | - | - | 2,346 | 63,930 | 2,346 | 63,930 | 24 |
| Corporate bonds and other securities | 1 | 100 | 11 | 389 | 12 | 489 | 3 |
| Total securities available-for-sale | \$59 | \$14,427 | \$2,968 | \$91,252 | \$3,027 | \$105,679 | 88 |

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| | December 31, 2017 | | | | | | |
|---|---|-----------|---|-----------|--|------------|----------------------------|
| | Less Than Twelve Months Gross Unrealized Losses Value | | More Than Twelve Months Gross Unrealized Losses Value | | Total Gross Unrealized Losses Value | | Number of Securities |
| Securities Available-for-Sale | | | | | | | |
| Obligations of U. S. Government agencies | \$ 11 | \$ 3,189 | \$ 111 | \$ 3,089 | \$ 122 | \$ 6,278 | 13 |
| Obligations of state and political subdivisions | 32 | 11,141 | 105 | 10,999 | 137 | 22,140 | 29 |
| Mortgage-backed securities | 67 | 9,742 | 1,543 | 64,554 | 1,610 | 74,296 | 24 |
| Corporate bonds and other securities | 2 | 1,098 | 8 | 792 | 10 | 1,890 | 11 |
| Total securities available-for-sale | \$ 112 | \$ 25,170 | \$ 1,767 | \$ 79,434 | \$ 1,879 | \$ 104,604 | 77 |

Certain investments within the Company's portfolio had unrealized losses at December 31, 2018 and December 31, 2017, as shown in the tables above. The unrealized losses were caused by increases in market interest rates. The Company purchases only highly-rated securities, including U.S. government agencies and mortgage-backed securities guaranteed by government-sponsored entities. The municipal and corporate securities portfolios are reviewed regularly to ensure that ratings of individual securities have not deteriorated below the threshold established by the Company's policy.

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 at maturity, the Company does not consider the investments to be other-than-temporarily impaired at December 31, 2018 or December 31, 2017.

As of December 31, 2018, there were 65 individual available-for-sale securities with a total fair value of \$91.3 million that had been in a continuous loss position for more than 12 months. These securities had an unrealized loss of \$3.0 million and consisted of municipal obligations, mortgage-backed securities, and other securities. As of December 31, 2017, there were 40 individual available-for-sale securities with a fair value totaling \$79.4 million that had been in a continuous loss position for more than 12 months. These securities had an unrealized loss of \$1.8 million and consisted of municipal obligations, mortgage-backed securities, corporate bonds, and other securities. The Company has determined that these securities are temporarily impaired at December 31, 2018 and 2017 for the reasons set out below:

Mortgage-backed securities. This category's unrealized losses are primarily the result of interest rate fluctuations. Because the decline in market value is attributable to changes in interest rates and not credit quality, the Company does not intend to sell the investments, and it is not likely 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 those investments to be other-than-temporarily impaired. Also, the majority of the Company's mortgage-backed securities are agency-backed securities, which have a government guarantee.

Obligations of state and political subdivisions. This category's unrealized losses are primarily the result of interest rate fluctuations and also a certain few ratings downgrades brought about by the impact of the credit crisis on states and political subdivisions. The contractual terms of the investments do not permit the issuer to settle the securities at a price less than the cost basis of each investment. Because the Company does not intend to sell any of the investments and the accounting standard of "more likely than not" has not been met for the Company to be required to sell any of the investments before recovery of its amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired.

Corporate bonds. The Company's unrealized losses in corporate debt securities are related to both interest rate fluctuations and ratings downgrades for a limited number of securities. The majority of the securities remain investment grade and the Company's analysis did not indicate the existence of a credit loss. The contractual terms of the investments do not permit the issuer to settle the securities at a price less than the cost basis of each investment. Because the Company does not intend to sell any of the investments and the accounting standard of "more likely than not" has not been met for the Company to be required to sell any of the investments before recovery of its amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired.

Restricted Stock

The restricted stock category is comprised of FHLB, Federal Reserve Bank, and CBB stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and the securities lack a market. Therefore, these investments are 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 5. Loans and 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:

| | December 31, 2018 | December 31, 2017 |
|---|-------------------------|-------------------------|
| | (in thousands) | |
| Mortgage loans on real estate: | | |
| Residential 1-4 family | \$ 110,009 | \$ 101,021 |
| Commercial - owner occupied | 155,245 | 159,268 |
| Commercial - non-owner occupied | 131,287 | 107,514 |
| Multifamily | 28,954 | 22,900 |
| Construction | 32,383 | 27,489 |
| Second mortgages | 17,297 | 17,918 |
| Equity lines of credit | 57,649 | 56,610 |
| Total mortgage loans on real estate | 532,824 | 492,720 |
| Commercial and industrial loans | 63,398 | 60,398 |
| Consumer automobile loans | 120,796 | 119,251 |
| Other consumer loans | 48,342 | 54,974 |
| Other (1) | 8,649 | 11,197 |
| Total loans | 774,009 | 738,540 |
| Less: Allowance for loan losses | (10,111) | (9,448) |
| Loans, net of allowance and deferred fees (2) | \$ 763,898 | \$ 729,092 |

(1) Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts, excluding internal use accounts, totaled \$628 thousand and \$424 thousand at December 31, 2018 and December 31, 2017, respectively.

(2) Net deferred loan costs totaled \$864 thousand and \$916 thousand at December 31, 2018 and December 31, 2017, respectively.

ACQUIRED LOANS

The Company had no acquired loans as of December 31, 2017. The outstanding principal balance and the carrying amount of total acquired loans included in the consolidated balance sheet as of December 31, 2018 are as follows:

| | |
|-------------------------------|---|
| | December 31, 2018 (in thousands) |
| Outstanding principal balance | \$ 31,940 |

Carrying amount 31,497

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The outstanding principal balance and related carrying amount of acquired impaired loans, for which the Company applies FASB ASC 310-30 to account for interest earned, as of December 31, 2018 are as follows:

| | December 31, 2018 (in thousands) |
|-------------------------------|---|
| Outstanding principal balance | \$ 246 |
| Carrying amount | 91 |

The following table presents changes in the accretible yield on acquired impaired loans, for which the Company applies FASB ASC 310-30, at December 31, 2018:

| | December 31, 2018 (in thousands) |
|--|---|
| Balance at January 1, 2018 | \$ - |
| Additions from acquisition of Citizens | 110 |
| Accretion | (98) |
| Other changes, net | - |
| Ending balance | \$ 12 |

CREDIT QUALITY INFORMATION

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

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

·Pass: Loans are of acceptable risk.

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

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

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

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

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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 December 31, 2018 | | | | |
| | Pass | OAEM | Substandard | Total |
| | (in thousands) | | | |
| Mortgage loans on real estate: | | | | |
| Residential 1-4 family | \$ 108,274 | \$- | \$ 1,735 | \$ 110,009 |
| Commercial - owner occupied | 140,664 | 4,067 | 10,514 | 155,245 |
| Commercial - non-owner occupied | 121,523 | 3,937 | 5,827 | 131,287 |
| Multifamily | 28,954 | - | - | 28,954 |
| Construction | 31,896 | 71 | 416 | 32,383 |
| Second mortgages | 17,007 | - | 290 | 17,297 |
| Equity lines of credit | 56,893 | - | 756 | 57,649 |
| Total mortgage loans on real estate | 505,211 | 8,075 | 19,538 | 532,824 |
| Commercial and industrial loans | 60,967 | 1,987 | 444 | 63,398 |
| Consumer automobile loans | 120,365 | - | 431 | 120,796 |
| Other consumer loans | 48,298 | - | 44 | 48,342 |
| Other | 8,649 | - | - | 8,649 |
| Total | \$743,490 | \$ 10,062 | \$ 20,457 | \$ 774,009 |

| Credit Quality Information | | | | |
|-------------------------------------|----------------|-----------|-------------|------------|
| As of December 31, 2017 | | | | |
| | Pass | OAEM | Substandard | Total |
| | (in thousands) | | | |
| Mortgage loans on real estate: | | | | |
| Residential 1-4 family | \$98,656 | \$- | \$ 2,365 | \$ 101,021 |
| Commercial - owner occupied | 142,778 | 4,944 | 11,546 | 159,268 |
| Commercial - non-owner occupied | 98,597 | 5,582 | 3,335 | 107,514 |
| Multifamily | 22,900 | - | - | 22,900 |
| Construction | 26,694 | 74 | 721 | 27,489 |
| Second mortgages | 17,211 | 431 | 276 | 17,918 |
| Equity lines of credit | 56,318 | - | 292 | 56,610 |
| Total mortgage loans on real estate | 463,154 | 11,031 | 18,535 | 492,720 |
| Commercial and industrial loans | 58,091 | 1,469 | 838 | 60,398 |
| Consumer automobile loans | 119,211 | - | 40 | 119,251 |
| Other consumer loans | 54,926 | - | 48 | 54,974 |
| Other | 11,197 | - | - | 11,197 |
| Total | \$706,579 | \$ 12,500 | \$ 19,461 | \$ 738,540 |

As of December 31, 2018 and 2017 the Company did not have any loans internally classified as Loss or Doubtful.

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 December 31, 2018

| | 30 - 59 Days Past Due (in thousands) | 60 - 89 Days Past Due | 90 or More Days Past Due | Acquired Impaired | Total Current Loans (1) | Total Loans | Recorded Investment > 90 Days Past Due and Accruing |
|-------------------------------------|--|--------------------------------|--------------------------------------|----------------------|-------------------------------|----------------|--|
| Mortgage loans on real estate: | | | | | | | |
| Residential 1-4 family | \$1,165 | \$553 | \$536 | \$ - | \$107,755 | \$110,009 | \$ 179 |
| Commercial - owner occupied | 1,059 | 83 | - | 91 | 154,012 | 155,245 | - |
| Commercial - non-owner occupied | - | - | 2,970 | - | 128,317 | 131,287 | - |
| Multifamily | - | - | - | - | 28,954 | 28,954 | - |
| Construction | - | - | 622 | - | 31,761 | 32,383 | 205 |
| Second mortgages | 65 | - | 135 | - | 17,097 | 17,297 | 136 |
| Equity lines of credit | 60 | - | - | - | 57,589 | 57,649 | - |
| Total mortgage loans on real estate | 2,349 | 636 | 4,263 | 91 | 525,485 | 532,824 | 520 |
| Commercial and industrial loans | 1,595 | - | - | - | 61,803 | 63,398 | - |
| Consumer automobile loans | 1,645 | 291 | 114 | - | 118,746 | 120,796 | 113 |
| Other consumer loans | 1,333 | 621 | 1,852 | - | 44,536 | 48,342 | 1,852 |
| Other | 133 | 8 | 12 | - | 8,496 | 8,649 | 12 |
| Total | \$7,055 | \$1,556 | \$6,241 | \$ 91 | \$759,066 | \$774,009 | \$ 2,497 |

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

In the table above, the past due totals include student and small business loans with principal and interest amounts that are 97 - 100% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$4.0 million at December 31, 2018.

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

| | 30 - 59 Days Past Due (in thousands) | 60 - 89 Days Past Due | 90 or More Days Past Due | Total Current Loans (1) | Total Loans | Recorded Investment > 90 Days Past Due and Accruing |
|-------------------------------------|--|--------------------------------|--------------------------------------|-------------------------------|----------------|--|
| Mortgage loans on real estate: | | | | | | |
| Residential 1-4 family | \$229 | \$153 | \$1,278 | \$99,361 | \$101,021 | \$ 261 |
| Commercial - owner occupied | 194 | 595 | 1,753 | 156,726 | 159,268 | - |
| Commercial - non-owner occupied | - | 176 | - | 107,338 | 107,514 | - |
| Multifamily | - | - | - | 22,900 | 22,900 | - |
| Construction | - | - | 721 | 26,768 | 27,489 | - |
| Second mortgages | 15 | - | 163 | 17,740 | 17,918 | 45 |
| Equity lines of credit | 75 | 19 | 53 | 56,463 | 56,610 | - |
| Total mortgage loans on real estate | 513 | 943 | 3,968 | 487,296 | 492,720 | 306 |
| Commercial and industrial loans | 709 | - | 1,060 | 58,629 | 60,398 | 471 |
| Consumer automobile loans | 517 | 122 | 41 | 118,571 | 119,251 | 41 |
| Other consumer loans | 2,222 | 544 | 2,360 | 49,848 | 54,974 | 2,360 |
| Other | 84 | 9 | 4 | 11,100 | 11,197 | 4 |
| Total | \$4,045 | \$1,618 | \$7,433 | \$725,444 | \$738,540 | \$ 3,182 |

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

In the table above, the other consumer category includes student loans with principal and interest amounts that are 97 - 100% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$4.2 million at December 31, 2017.

NONACCRUAL LOANS

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

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

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

When management places a loan in nonaccrual status, the accrued unpaid interest receivable is reversed against interest income and the loan is accounted for by the cash basis or cost recovery method, until it qualifies for return to

accrual status or is charged off. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, or when the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments for at least six months.

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

Nonaccrual Loans by Class

| | December | |
|-------------------------------------|----------------|----------------------|
| | 31, 2018 | December 31, 2017 |
| | (in thousands) | |
| Mortgage loans on real estate: | | |
| Residential 1-4 family | \$ 1,386 | \$ 1,447 |
| Commercial - owner occupied | 5,283 | 7,824 |
| Commercial - non-owner occupied | 4,371 | 1,644 |
| Construction | 417 | 721 |
| Second mortgages | 155 | 118 |
| Equity lines of credit | 231 | 292 |
| Total mortgage loans on real estate | 11,843 | 12,046 |
| Commercial and industrial loans | 298 | 836 |
| Consumer loans | - | - |
| Total | \$ 12,141 | \$ 12,882 |

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:

| | Years Ended | |
|---|-------------------|--------|
| | December | |
| | 31, 2018 | 2017 |
| | (in thousands) | |
| Interest income that would have been recorded under original loan terms | \$ 533 | \$ 474 |
| Actual interest income recorded for the period | 336 | 281 |
| Reduction in interest income on nonaccrual loans | \$ 197 | \$ 193 |

TROUBLED DEBT RESTRUCTURINGS

The Company's loan portfolio includes certain loans classified as TDRs, 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 discussed further below under Impaired Loans.

The following tables present TDRs during the periods indicated, by class of loan:

Troubled Debt Restructurings by Class
For the Year Ended December 31, 2018

| | Recorded Number of Modifications | Investment Prior to Modification | Recorded Investment After Modification | Current Investment on December 31, 2018 |
|-------------------------------------|---|--|---|---|
| (dollars in thousands) | | | | |
| Mortgage loans on real estate: | | | | |
| Residential 1-4 family | 1 | \$ 296 | \$ 187 | \$ 188 |
| Equity lines of credit | 1 | 248 | 231 | 231 |
| Total mortgage loans on real estate | 2 | 544 | 418 | 419 |
| Commercial and industrial loans | 1 | 146 | 138 | 139 |
| Total | 3 | \$ 690 | \$ 556 | \$ 558 |

Troubled Debt Restructurings by Class
For the Year Ended December 31, 2017

| | Recorded Number of Modifications | Investment Prior to Modification | Recorded Investment After Modification | Current Investment on December 31, 2017 |
|---------------------------------|---|--|---|---|
| (dollars in thousands) | | | | |
| Mortgage loans on real estate: | | | | |
| Residential 1-4 family | 1 | \$ 142 | \$ 142 | \$ 140 |
| Commercial - owner occupied | 2 | 3,663 | 3,663 | 3,663 |
| Commercial - non-owner occupied | 1 | 1,469 | 1,469 | 1,469 |
| Total | 4 | \$ 5,274 | \$ 5,274 | \$ 5,272 |

Of the loans restructured in 2018, one was given a below-market rate for debt with similar risk characteristics and two were granted terms that the Company would not otherwise extend to borrowers with similar risk characteristics. Two of the loans restructured in 2017 were given below-market rates for debt with similar risk characteristics and two were granted terms that the Company would not otherwise extend to borrowers with similar risk characteristics.

At December 31, 2018 and 2017, the Company had no outstanding commitments to disburse additional funds on any TDR. There were no loans secured by residential 1 - 4 family real estate that were in the process of foreclosure at December 31, 2018. At December 31, 2017, the Company had \$77 thousand in loans secured by residential 1 - 4 family real estate that were in the process of foreclosure.

In the years ended December 31, 2018 and 2017 there were no defaulting TDRs where the default occurred within twelve months of restructuring. The Company considers a TDR in default when any of the following occurs: the loan, as restructured, becomes 90 days or more past due; the loan is moved to nonaccrual status following the restructure; the loan is restructured again under terms that would qualify it as a TDR if it were not already so classified; or any portion of the loan is charged off.

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

IMPAIRED LOANS

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

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

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

Impaired Loans by Class

| | As of December 31, 2018 | | | | For the Year Ended December 31, 2018 | |
|-------------------------------------|--------------------------------|-----------------------------------|--------------------------------|-------------------------|---|------------------------|
| | Unpaid Principal Balance | Without Valuation Allowance | With Valuation Allowance | Associated Allowance | Average Recorded Investment | Interest Recognized |
| Mortgage loans on real estate: | | | | | | |
| Residential 1-4 family | \$2,057 | \$1,686 | \$ 239 | \$ 51 | \$2,073 | \$ 66 |
| Commercial | 15,254 | 12,721 | - | - | 14,232 | 455 |
| Construction | 509 | 417 | 92 | 18 | 665 | 7 |
| Second mortgages | 496 | 347 | 148 | 33 | 508 | 15 |
| Equity lines of credit | 232 | - | 232 | 3 | 301 | 1 |
| Total mortgage loans on real estate | \$18,548 | \$15,171 | \$ 711 | \$ 105 | \$17,779 | \$ 544 |
| Commercial and industrial loans | 384 | 78 | 220 | 11 | 446 | 5 |
| Consumer loans | 38 | - | - | - | 43 | - |
| Total | \$18,970 | \$15,249 | \$ 931 | \$ 116 | \$18,268 | \$ 549 |

Impaired Loans by Class

| | As of December 31, 2017 | | | | For the Year Ended December 31, 2017 | |
|--|-------------------------|---------|------|------------|---|----------|
| | Unpaid | Without | With | Associated | Average | Interest |
| | | | | | | |

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| | Principal Balance (in thousands) | Valuation Allowance | Valuation Allowance | Allowance | Recorded Investment | Income Recognized |
|-------------------------------------|--|------------------------|------------------------|-----------|------------------------|----------------------|
| Mortgage loans on real estate: | | | | | | |
| Residential 1-4 family | \$2,873 | \$2,499 | \$ 316 | \$ 52 | \$2,525 | \$ 90 |
| Commercial | 15,262 | 11,622 | 1,644 | 1 | 13,541 | 579 |
| Construction | 814 | 721 | 92 | 18 | 406 | 23 |
| Second mortgages | 473 | 318 | 135 | 14 | 464 | 20 |
| Equity lines of credit | 293 | 53 | 239 | 10 | 261 | - |
| Total mortgage loans on real estate | \$19,715 | \$15,213 | \$ 2,426 | \$ 95 | \$17,197 | \$ 712 |
| Commercial and industrial loans | 1,115 | 836 | - | - | 1,388 | 30 |
| Consumer loans | - | - | - | - | 41 | - |
| Total | \$20,830 | \$16,049 | \$ 2,426 | \$ 95 | \$ 18,626 | \$ 742 |

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ALLOWANCE FOR LOAN LOSSES

Loans are either individually evaluated for impairment or pooled with like loans and collectively evaluated for impairment. Also, various qualitative factors are applied to each segment of the loan portfolio. The allowance for loan losses is the accumulation of these components. Management's estimate is based on certain observable, historical data and other factors that management believes are most reflective of the underlying credit losses being estimated.

Management provides an allocated component of the allowance for loans that are individually evaluated 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. This allocation represents the sum of management's estimated losses on each loan.

Loans collectively evaluated for impairment are pooled, with a historical loss rate, based on migration analysis, applied to each pool, segmented by risk grade or days past due, depending on the type of loan. Based on credit risk assessments and management's analysis of qualitative factors, additional loss factors are applied to loan balances. These additional qualitative factors include: economic conditions, trends in growth, loan concentrations, changes in certain loans, changes in underwriting, changes in management and changes in the legal and regulatory environment.

ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The 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)

| | | | Real Estate - | Real Estate - | | | |
|---|------------|--------------|------------------|------------------|----------|------------|--|
| For the Year Ended December 31, 2018 | Commercial | Construction | Mortgage | Consumer | Other | Total | |
| Allowance for Loan Losses: | | | | | | | |
| Balance at the beginning of period | \$ 1,889 | \$ 541 | \$ 5,217 | \$ 1,644 | \$ 157 | \$ 9,448 | |
| Charge-offs | (81) | - | (1,625) | (769) | (367) | (2,842) | |
| Recoveries | 140 | - | 158 | 262 | 84 | 644 | |
| Provision for loan losses | 392 | (385) | 2,206 | 217 | 431 | 2,861 | |
| Ending balance | 2,340 | 156 | 5,956 | 1,354 | 305 | 10,111 | |
| Ending balance individually evaluated for impairment | 11 | 18 | 87 | - | - | 116 | |
| Ending balance collectively evaluated for impairment | 2,329 | 138 | 5,869 | 1,354 | 305 | 9,995 | |
| Ending balance acquired impaired loans | - | - | - | - | - | - | |
| Ending balance | 2,340 | 156 | 5,956 | 1,354 | 305 | 10,111 | |
| Loan Balances: | | | | | | | |
| Ending balance individually evaluated for impairment | 298 | 509 | 15,373 | - | - | 16,180 | |
| Ending balance collectively evaluated for impairment | 63,009 | 31,874 | 485,068 | 169,138 | 8,649 | 757,738 | |
| Ending balance acquired impaired loans | 91 | - | - | - | - | 91 | |
| Ending balance | \$ 63,398 | \$ 32,383 | \$ 500,441 | \$ 169,138 | \$ 8,649 | \$ 774,009 | |

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

NOTE 6. Other Real Estate Owned (OREO)

The Company holds certain parcels of real estate due to completed foreclosure proceedings on defaulted loans or the closing of former branches. An analysis of the balance in OREO is as follows:

| | Years Ended | |
|--|----------------|---------|
| | December 31, | |
| | 2018 | 2017 |
| | (in thousands) | |
| Balance at beginning of year | \$- | \$2,093 |
| Transfers to OREO due to foreclosure | 203 | - |
| Other additions to foreclosed properties | 176 | - |
| Properties sold | (296) | (2,093) |
| Balance at end of year | \$83 | \$- |

Other additions to foreclosed properties in the table above are for properties acquired from Citizens.

OREO is presented net of a valuation allowance for losses. As the fair values of OREO change, adjustments are made to the recorded investment in the properties through the valuation allowance to ensure that all properties are recorded at the lower of cost or fair value. Properties written down in previous periods can be written back up if a current property valuation warrants the change, though never above the original cost of the property. An analysis of the valuation allowance on OREO is as follows:

| | Years Ended | |
|---|-------------|---------|
| | December | |
| | 31, | |
| | 2018 | 2017 |
| | (in | |
| | thousands) | |
| Balance at beginning of year | \$- | \$1,026 |
| Additions and write-downs | - | - |
| Reductions due to sales or increases in value | - | (1,026) |
| Balance at end of year | \$- | \$- |

Expenses applicable to OREO include the following:

| | Years | |
|---|------------|--------|
| | Ended | |
| | December | |
| | 31, | |
| | 2018 | 2017 |
| | (in | |
| | thousands) | |
| Net loss (gain) on sales of real estate | \$86 | \$(18) |
| Provision for losses (net write-downs) | - | - |
| Operating expenses, net of income (1) | (1) | 10 |
| Total Expenses | \$85 | \$(8) |

(1) Included in other operating income and other operating expense on the Consolidated Statements

of Operations.

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NOTE 7. Premises and Equipment

Premises and equipment consisted of the following at December 31:

| | 2018 | 2017 |
|--|----------------|----------|
| | (in thousands) | |
| Land | \$8,098 | \$7,663 |
| Buildings | 39,132 | 37,944 |
| Construction in process | 161 | 137 |
| Leasehold improvements | 861 | 861 |
| Furniture, fixtures and equipment | 18,904 | 19,675 |
| | 67,156 | 66,280 |
| Less accumulated depreciation and amortization | 30,418 | 29,083 |
| | \$36,738 | \$37,197 |

Depreciation expense for the years ended December 31, 2018 and 2017 amounted to \$2.5 million and \$2.7 million, respectively.

The Company has noncancellable leases on premises and equipment expiring at various dates, not including extensions, to the year 2020. Certain leases provide for increased annual payments based on increases in real estate taxes and the Consumer Price Index.

The total approximate minimum rental commitment at December 31, 2018 under noncancellable leases is \$781 thousand which is due as follows (in thousands):

| | |
|-------|-------|
| 2019 | \$331 |
| 2020 | 256 |
| 2021 | 111 |
| 2022 | 83 |
| Total | \$781 |

The aggregate rental expense of premises and equipment was \$349 thousand and \$345 thousand for years ended December 31, 2018 and 2017, respectively.

NOTE 8. Low-Income Housing Tax Credits

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

The investments in these funds were recorded as other assets on the consolidated balance sheets and were \$3.2 million and \$3.5 million at December 31, 2018 and December 31, 2017, respectively. The expected terms of these investments and the related tax benefits run through 2033. Additional committed capital calls expected for the funds totaled \$248 thousand and \$1.1 million at December 31, 2018 and December 31, 2017, respectively, and are recorded in accrued expenses and other liabilities on the corresponding consolidated balance sheets. During the years ended December 31, 2018 and 2017, the Company recognized amortization expense of \$320 thousand and \$340 thousand, respectively, which was included within noninterest expense on the Consolidated Statements of Operations.

The table below summarizes the tax credits and other tax benefits recognized by the Company and related to these investments, as of the periods indicated:

| | Years Ended December 31, 2018 2017 | |
|-------------------------|--|-------|
| Tax credits received | \$496 | \$412 |
| Tax benefit from losses | 67 | 116 |
| Total tax benefit | \$563 | \$528 |

NOTE 9. Deposits

The aggregate amount of time deposits in denominations of \$250 thousand or more at December 31, 2018 and 2017 was \$43.4 million and \$39.9 million, respectively. As of December 31, 2018, no single customer relationship exceeded 5 percent of total deposits.

At December 31, 2018 the scheduled maturities of time deposits (in thousands) are as follows:

| | |
|-------|-----------|
| 2019 | \$100,140 |
| 2020 | 64,152 |
| 2021 | 27,930 |
| 2022 | 17,051 |
| 2023 | 19,691 |
| Total | \$228,964 |

NOTE 10. Borrowings

Short-Term Borrowings

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

The Company maintains federal funds lines with several correspondent banks to address short-term borrowing needs. At December 31, 2018 and December 31, 2017 the remaining credit available from these lines totaled \$55.0 million and \$45.0 million, respectively. The Company has a collateral dependent line of credit with the FHLB with remaining credit availability of \$245.9 million and \$217.0 million as of December 31, 2018 and December 31, 2017, respectively.

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The following table presents total short-term borrowings as of the dates indicated (dollars in thousands):

| | December 31, 2018 | December 31, 2017 | | |
|---|----------------------|----------------------|---|---|
| Federal funds purchased | \$ - | \$ 10,000 | | |
| Overnight repurchase agreements | 25,775 | 20,693 | | |
| Federal Home Loan Bank Advances | 13,000 | 47,500 | | |
| Total short-term borrowings | \$ 38,775 | \$ 78,193 | | |
| Maximum month-end outstanding balance | \$ 99,898 | \$ 79,819 | | |
| Average outstanding balance during the period | \$ 62,877 | \$ 53,165 | | |
| Average interest rate during the period | 1.11 | % 0.72 | % | % |
| Average interest rate at end of period | 0.93 | % 1.27 | % | % |

Long-Term Borrowings

At December 31, 2018, the Company had the following long-term FHLB advances outstanding (dollars in thousands).

| Long-term Type | Interest | | Advance |
|-------------------|----------|---------------|-----------|
| | Rate | Maturity Date | Amount |
| Fixed Rate Hybrid | 1.54 | % 2/28/2019 | \$ 10,000 |
| Fixed Rate Hybrid | 1.90 | % 11/15/2019 | 10,000 |
| Fixed Rate Hybrid | 2.92 | % 4/17/2020 | 10,000 |
| Fixed Rate Hybrid | 2.77 | % 6/19/2020 | 10,000 |
| Fixed Rate Hybrid | 2.79 | % 8/28/2020 | 3,500 |
| Fixed Rate Hybrid | 2.89 | % 8/27/2021 | 3,500 |
| | | | \$47,000 |

At December 31, 2017, the Company had the following long-term FHLB advances outstanding (dollars in thousands).

| Long-term Type | Interest | | Advance |
|-------------------|----------|---------------|-----------|
| | Rate | Maturity Date | Amount |
| Fixed Rate Hybrid | 1.54 | % 2/28/2019 | \$ 10,000 |
| Fixed Rate Hybrid | 1.90 | % 11/15/2019 | 10,000 |
| | | | \$20,000 |

The Company also obtained a loan maturing on April 1, 2023 from a correspondent bank during the second quarter of 2018 to provide partial funding for the Citizens acquisition. The terms of the loan include a LIBOR based interest rate that adjusts monthly and quarterly principal curtailments. At December 31, 2018 the outstanding balance was \$2.6 million, and the then-current interest rate was 4.85%.

The loan agreement with the lender contains financial covenants including minimum return on average asset ratio and Bank capital leverage ratio, maintenance of a well-capitalized position as defined by regulatory guidance and a maximum level of non-performing assets as a percentage of capital plus the allowance for loan losses. The Company was in compliance with each covenant at December 31, 2018.

NOTE 11. Share-Based Compensation

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

The 2016 Incentive Stock Plan (the Incentive Stock Plan) permits the issuance of up to 300,000 shares of common stock for awards to key employees and non-employee directors of the Company and its subsidiaries in the form of stock options, restricted stock, restricted stock units, stock appreciation rights, stock awards and performance units. As of December 31, 2018, only restricted stock has been granted under the Incentive Stock Plan.

Restricted stock activity for the year ended December 31, 2018 is summarized below.

| | Shares | Weighted Average Grant Date Fair Value |
|------------------------------|--------|--|
| Nonvested, January 1, 2018 | 2,245 | \$ 33.60 |
| Issued | 11,444 | 26.32 |
| Vested | - | - |
| Forfeited | - | - |
| Nonvested, December 31, 2018 | 13,689 | \$ 27.51 |

The weighted average period over which nonvested awards are expected to be recognized in compensation expense is 1.25 years.

The fair value of restricted stock granted during the year ended December 31, 2018 was \$301 thousand.

The remaining unrecognized compensation expense for the shares granted during the year ended December 31, 2018 totaled \$200 thousand as of December 31, 2018.

Stock-based compensation expense was \$160 thousand and \$17 thousand for the years ended December 31, 2018 and 2017, respectively.

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

Total stock purchases under the ESPP amounted to 3,517 shares during 2018 and 3,548 shares during 2017. At December 31, 2018, the Company had 241,936 remaining shares reserved for issuance under this plan.

NOTE 12. Stockholders' Equity and Earnings per Common Share

STOCKHOLDERS' EQUITY--OTHER COMPREHENSIVE INCOME (LOSS)

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

| | Years Ended December 31, | | Affected Line Item on Consolidated Statement of Income |
|--|--------------------------------|---------|---|
| | 2018 | 2017 | |
| | (in thousands) | | |
| Available-for-sale securities | | | |
| Realized gains (losses) on sales of securities | \$ 120 | \$ 96 | Gain on sale of available-for-sale securities, net |
| Tax effect | 25 | 33 | Income tax expense (benefit) |
| | \$ 95 | \$ 63 | |
| Defined-benefit pension plan | | | |
| Amortization of actuarial loss | \$- | \$(490) | Salaries and employee benefits |
| Tax effect | - | (167) | Income tax expense (benefit) |
| | \$- | \$(323) | |
| Total reclassifications for the period | \$ 95 | \$(260) | |

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

| | Unrealized Gains (Losses) on Available-for-Sale Securities | Defined Benefit Pension Plans (1) | Accumulated Other Comprehensive Loss |
|---|--|---|---|
| Balance at December 31, 2016 | \$ (1,739 |) \$(2,469 |) \$ (4,208 |
| Net change for the year ended December 31, 2017 | 1,032 | 2,469 | 3,501 |
| Balance at December 31, 2017 | \$ (707 |) \$- | \$ (707 |
| Net other comprehensive loss | (1,233 |) - | (1,233 |
| Reclassification of the income tax effects of the Tax Cuts and Jobs Act from AOCI | (139 |) - | (139 |
| Reclassification of net unrealized gains on equity securities from AOCI per ASU 2016-01 | (77 |) - | (77 |
| Net change for the year ended December 31, 2018 | (1,449 |) - | (1,449 |
| Balance at December 31, 2018 | \$ (2,156 |) \$- | \$ (2,156 |

(1) Net change reflects termination and settlement of the pension plan during year ended December 31, 2017.

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

| | Year Ended December 31, 2018 | | |
|--|---------------------------------|---------------|-------------|
| | Pretax | Tax Effect | Net-of-Tax |
| | (in thousands) | | |
| Unrealized losses on available-for-sale securities: | | | |
| Unrealized holding losses arising during the period | \$(1,440) | \$(302) | \$ (1,138) |
| Reclassification adjustment for gains recognized in income | (120) | (25) | (95) |
| Total change in accumulated other comprehensive loss, net | \$(1,560) | \$(327) | \$ (1,233) |
| | | | |
| | Year Ended December 31, 2017 | | |
| | Pretax | Tax Effect | Net-of-Tax |
| | (in thousands) | | |
| Unrealized gains on available-for-sale securities: | | | |
| Unrealized holding gains arising during the period | \$1,659 | \$564 | \$ 1,095 |
| Reclassification adjustment for gains recognized in income | (96) | (33) | (63) |
| Net change | 1,563 | 531 | 1,032 |
| Defined benefit pension plans: | | | |
| Net actuarial loss for the period | (99) | (34) | (65) |
| Amortization of actuarial loss from prior period | 490 | 167 | 323 |
| Net change | 3,741 | 1,272 | 2,469 |
| Total change in accumulated other comprehensive loss, net | \$5,304 | \$1,803 | \$ 3,501 |

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 the employee stock purchase program.

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

| | Net Income Available to Common Stockholders (Numerator) (in thousands except per share data) | Weighted Average Common Shares (Denominator) | Per Share Amount |
|--|---|--|------------------------|
| Year Ended December 31, 2018 | | | |
| Net income, basic | \$4,919 | 5,141 | \$ 0.96 |
| Potentially dilutive common shares - employee stock purchase program | - | - | - |
| Diluted | \$4,919 | 5,141 | \$ 0.96 |
| Year Ended December 31, 2017 | | | |
| Net loss, basic | \$(29) | 4,991 | \$ (0.01) |
| Potentially dilutive common shares - employee stock purchase program | - | - | - |
| Diluted | \$(29) | 4,991 | \$ (0.01) |

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

NOTE 13, Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal stockholders, executive officers and directors and their affiliates. These loans were made on substantially the same terms and conditions, including interest rates, collateral and repayment terms, as those prevailing at the same time for comparable transactions with unrelated persons, and, in the opinion of management and the Company's board of directors, do not involve more than normal risk or present other unfavorable features. None of the principal stockholders, executive officers or directors had direct or indirect loans exceeding 10 percent of stockholders' equity at December 31, 2018.

Annual activity consisted of the following:

| | 2018 | 2017 |
|----------------------------|----------------|---------|
| | (in thousands) | |
| Balance, beginning of year | \$4,287 | \$4,354 |
| Additions | 25 | 351 |
| Reductions | (300) | (418) |
| Balance, end of year | \$4,012 | \$4,287 |

Deposits from related parties held by the Company at December 31, 2018 and 2017 amounted to \$12.5 million and \$12.5 million, respectively.

NOTE 14. Income Taxes

On December 22, 2017, the Tax Act was signed into law. The Company applied the guidance in Staff Accounting Bulletin 118 when accounting for the enactment-date effects of the Tax Act in 2017 and throughout 2018. Among other things, the Tax Act permanently reduced the corporate income tax rate to 21% from the prior maximum rate of 35%, effective for tax years including or commencing January 1, 2018. As a result of the reduction of the corporate income tax rate to 21%, companies were required to revalue their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the fourth quarter of 2017. During 2017, the Company recorded \$1.2 million in additional tax expense based on the Company's analysis of the impact of the Tax Act. As of December 31, 2018, the Company completed our accounting for all of the enactment-date income tax effects of the Tax Act. No additional adjustments related the Tax Act were recorded in 2018.

The components of income tax expense for the current and prior year-ends are as follows:

| | 2018 | 2017 |
|---------------------------------------|----------------|--------|
| | (in thousands) | |
| Current income tax expense | \$443 | \$20 |
| Deferred income tax benefit | (164) | (117) |
| Reported income tax expense (benefit) | \$279 | \$(97) |

A reconciliation of the expected federal income tax expense on income before income taxes with the reported income tax expense for the same periods follows:

| | Years Ended | |
|---------------------------------------|----------------|--------|
| | December 31, | |
| | 2018 | 2017 |
| | (in thousands) | |
| Expected tax (benefit) expense | \$1,092 | \$(43) |
| Interest expense on tax-exempt assets | 18 | 23 |
| Low-income housing tax credits | (496) | (412) |
| Tax-exempt interest, net | (303) | (628) |
| Bank-owned life insurance | (164) | (263) |
| Impact of Tax Act | - | 1,221 |
| Other, net | 132 | 5 |
| Reported income tax expense | \$279 | \$(97) |

The effective tax rates for 2018 and 2017 were 5.4% and (77.0%), respectively.

The components of the net deferred tax asset, included in other assets, are as follows:

| | December 31, | |
|--------------------------------------|----------------|---------|
| | 2018 | 2017 |
| | (in thousands) | |
| Deferred tax assets: | | |
| Allowance for loan losses | \$2,123 | \$1,984 |
| Nonaccrual loans | 112 | 82 |
| Acquisition accounting | 120 | - |
| Other real estate owned | 21 | - |
| Net operating losses | 712 | - |
| Investments in pass-through entities | 113 | 162 |
| Bank owned life insurance benefit | 59 | 55 |
| Securities available-for-sale | 573 | 225 |
| Stock awards | 55 | - |
| Alternative minimum tax | 292 | 1,344 |
| Deferred compensation | 236 | 139 |
| Other | 63 | 19 |
| | \$4,479 | \$4,010 |
| Deferred tax liabilities: | | |
| Premises and equipment | \$389 | \$404 |
| Acquisition accounting | 86 | |
| Deferred loan fees and costs | 181 | 295 |
| | 656 | 699 |
| Net deferred tax assets | \$3,823 | \$3,311 |

The Company files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2015.

NOTE 15. Commitments and Contingencies

CREDIT-RELATED FINANCIAL INSTRUMENTS

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

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

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The following financial instruments whose contract amounts represent credit risk were outstanding at December 31:

| | 2018 | 2017 |
|---|----------------|-----------|
| | (in thousands) | |
| Commitments to extend credit: | | |
| Home equity lines of credit | \$61,014 | \$56,486 |
| Commercial real estate, construction and development loans committed but not funded | 12,165 | 19,526 |
| Other lines of credit (principally commercial) | 74,058 | 68,101 |
| Total | \$147,237 | \$144,113 |
| | | |
| Letters of credit | \$8,230 | \$3,331 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extensions of credit is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Unfunded commitments under commercial lines of credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are not collateralized and usually do not contain a specified maturity date, and ultimately may or may not be drawn upon to the total extent to which the Company is committed.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year, with the exception of one letter of credit which expires in 2020. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds various collateral supporting those commitments for which collateral is deemed necessary.

LEGAL CONTINGENCIES

Various legal claims arise from time to time in the normal course of business, which, in the opinion of management, will not have a material effect on the Company's Consolidated Financial Statements.

NOTE 16. Fair Value Measurements

DETERMINATION OF FAIR VALUE

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, and FASB ASU 2016-01, the fair value of a financial instrument is the price that would be received in the sale of an asset or transfer of a liability (an exit price) in the principal or most advantageous market for the asset or 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 the principal or most advantageous market for the asset or liability 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 1 – 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.

ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

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

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

| Description | Balance (in thousands) | Fair Value Measurements at December 31, 2018 Using | | |
|---|---------------------------|---|--|--|
| | | Quoted Prices in Active Markets for Significant Identifiable Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Available-for-sale securities | | | | |
| U.S. Treasury securities | \$12,328 | \$- | \$12,328 | \$ - |
| Obligations of U.S. Government agencies | 10,714 | - | 10,714 | - |
| Obligations of state and political subdivisions | 48,837 | - | 48,837 | - |
| Mortgage-backed securities | 71,191 | - | 71,191 | - |
| Money market investments | 1,897 | - | 1,897 | - |
| Corporate bonds | 3,280 | - | 3,280 | - |
| Total available-for-sale securities | \$148,247 | \$- | \$148,247 | \$ - |

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

ASSETS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

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

Impaired loans

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

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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 Operations.

Other Real Estate Owned (OREO)

Loans are transferred to OREO when the collateral securing them is foreclosed on. The measurement of loss associated with OREO 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 OREO below the original book value are recorded in the period incurred and expensed against current earnings.

Loans Held For Sale

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

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

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| Description | Carrying Value at December 31, 2018 Using Quoted Prices in Active Markets for Significant | | | |
|--------------------------------|---|-------------------------------------|-------------------------------------|---|
| | Fair Value | Other Identifiable Assets (Level 1) | Other Unobservable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | | | | |
| Mortgage loans on real estate: | | | | |
| Residential 1-4 family | \$188 | \$- | \$ - | \$ 188 |
| Construction | 74 | - | - | 74 |
| Equity lines of credit | 229 | - | - | 229 |
| Total | \$491 | \$- | \$ - | \$ 491 |
| Loans held for sale | \$479 | \$- | \$ 479 | \$ - |
| Other real estate owned | | | | |
| Construction | \$83 | \$- | \$ - | \$ 83 |
| Total | \$83 | \$- | \$ - | \$ 83 |

| Description | Carrying Value at December 31, 2017 Using Quoted Prices in Active Markets for Significant | | | |
|--------------------------------|---|-------------------------------------|-------------------------------------|---|
| | Fair Value | Other Identifiable Assets (Level 1) | Other Unobservable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | | | | |
| Mortgage loans on real estate: | | | | |
| Residential 1-4 family | \$264 | \$- | \$ - | \$ 264 |
| Construction | 74 | - | - | 74 |
| Equity lines of credit | 229 | - | - | 229 |
| Total | \$567 | \$- | \$ - | \$ 567 |
| Loans held for sale | \$779 | \$- | \$ 779 | \$ - |

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

Quantitative Information About Level 3 Fair Value Measurements

| Description | Fair Value at December 31, 2018 (dollars in thousands) | Valuation Techniques | Unobservable Input | Range (Average) | |
|------------------------------------|---|----------------------|----------------------|--------------------|---|
| Impaired loans | | | | | |
| Residential 1-4 family real estate | \$ 188 | Market comparables | Selling costs | 7.25 | % |
| | | | Liquidation discount | 4.00 | % |
| Construction | 74 | Market comparables | Selling costs | 7.25 | % |
| | | | Liquidation discount | 4.00 | % |
| Equity lines of credit | 229 | Market comparables | Selling costs | 7.25 | % |
| | | | Liquidation discount | 4.00 | % |
| Other real estate owned | | | | | |
| Construction | 83 | Market comparables | Selling costs | 7.25 | % |
| | | | Liquidation discount | 4.00 | % |

Quantitative Information About Level 3 Fair Value Measurements

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

FASB ASC 825, "Financial Instruments," requires disclosure about fair value of financial instruments 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 presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2018 and December 31, 2017. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between origination of the instrument and its expected realization. For non-marketable equity securities such as Federal Home Loan Bank and Federal Reserve Bank stock, the carrying amount is a reasonable estimate of fair value as these securities can only be redeemed or sold at their par value and only to the respective issuing government-supported institution or to another member institution. For financial liabilities such as noninterest-bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity. Fair values for December 31, 2018 are estimated under the exit price

notion in accordance with the prospective adoption of ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities."

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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:

| Description | Carrying Value (in thousands) | Fair Value Measurements at December 31, 2018 Using | | |
|--|----------------------------------|--|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets | | | | |
| Cash and cash equivalents | \$42,217 | \$42,217 | \$ - | \$ - |
| Securities available-for-sale | 148,247 | - | 148,247 | - |
| Restricted securities | 3,853 | - | 3,853 | - |
| Loans held for sale | 479 | - | 479 | - |
| Loans, net of allowances for loan losses | 763,898 | - | - | 749,848 |
| Bank owned life insurance | 26,763 | - | 26,763 | - |
| Accrued interest receivable | 3,095 | - | 3,095 | - |
| Liabilities | | | | |
| Deposits | \$843,144 | \$- | \$ 843,818 | \$ - |
| Overnight repurchase agreements | 25,775 | - | 25,775 | - |
| Federal Home Loan Bank advances | 60,000 | - | 59,975 | - |
| Other borrowings | 2,550 | - | 2,550 | - |
| Accrued interest payable | 594 | - | 594 | - |

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

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| | | | | |
|-----------------------------|--------|---|--------|---|
| Bank owned life insurance | 25,981 | - | 25,981 | - |
| Accrued interest receivable | 3,254 | - | 3,254 | - |

Liabilities

| | | | | |
|---------------------------------|-----------|-----|------------|------|
| Deposits | \$783,594 | \$- | \$ 782,539 | \$ - |
| Federal funds purchased | 10,000 | - | 10,000 | - |
| Overnight repurchase agreements | 20,693 | - | 20,693 | - |
| Federal Home Loan Bank advances | 67,500 | - | 67,329 | - |
| Accrued interest payable | 360 | - | 360 | - |

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In accordance with the adoption of ASU 2016-01, the fair values as of December 31, 2018 were measured using an exit price notion. The fair values as of December 31, 2017 were measured using an entry price notion.

NOTE 17, Regulatory Matters

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can cause certain mandatory and possibly additional discretionary actions to be initiated by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, Tier 1, and common equity tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. The terms Tier 1 and common equity tier 1 capital, risk-weighted assets and average assets, as used in this note, are as defined in the applicable regulations. Management believes, as of December 31, 2018 and 2017, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

In July 2013, the Federal Reserve issued final rules to include technical changes to its market risk capital rules to align them with the Basel III regulatory capital framework and meet certain requirements of the Dodd-Frank Act. Effective January 1, 2015, the final rules require the Bank to comply with the following minimum capital ratios: (i) a new common equity Tier 1 capital (CET1) ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets (increased from the prior requirement); (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from the prior requirement); and (iv) a leverage ratio of 4.0% of total assets (unchanged from the prior requirement). The Basel III Final Rules establish a capital conservation buffer of 2.5%, which is added to the 4.5% CET1 to risk-weighted assets to increase the ratio to at least 7%. The Basel III Final Rules also establish risk weighting that applied to many classes of assets held by community banks, importantly including applying higher risk weightings to certain commercial real estate loans. The Basel III Final Rules became effective January 1, 2015 and the Basel III Final Rules capital conservation buffer became fully phased-in as of January 1, 2019.

As fully phased in, the Basel III Final Rules require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5%), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio, effectively resulting in a minimum total capital ratio of 10.5%) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

In August 2018, the Federal Reserve updated the Small Bank Holding Company Policy Statement ("the Statement"), in compliance with The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 ("EGRRCPA"). The Statement, among other things, exempts bank holding companies that fall below a certain asset threshold from reporting consolidated regulatory capital ratios and from minimum regulatory capital requirements. The interim final rule expands the exemption to bank holding companies with consolidated total assets of less than \$3 billion. Prior to August 2018, the statement exempted bank holding companies with consolidated assets of less than \$1 billion. As a result of the interim final rule, the Company expects that it will be treated as a small bank holding company and will

no longer be subject to regulatory capital requirements on a consolidated basis.

As of December 31, 2018, the most recent notification from the Comptroller categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2018 and 2017 are presented in the table below.

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| | Capital | | Minimum Capital Requirement | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|------------------------|--------|-----------------------------|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (dollars in thousands) | | | | | |
| December 31, 2018: | | | | | | |
| Total Capital to Risk Weighted Assets | 106,651 | 12.06% | 70,756 | 8.00% | \$88,444 | 10.00% |
| Tier 1 Capital to Risk Weighted Assets | 96,428 | 10.90% | 53,067 | 6.00% | 70,756 | 8.00% |
| Common Equity Tier 1 Capital to Risk Weighted Assets | 96,428 | 10.90% | 39,800 | 4.50% | 57,489 | 6.50% |
| Tier 1 Capital to Average Assets | 96,428 | 9.34% | 41,217 | 4.00% | 51,521 | 5.00% |
| December 31, 2017: | | | | | | |
| Total Capital to Risk Weighted Assets | 97,194 | 11.30% | 68,803 | 8.00% | \$86,004 | 10.00% |
| Tier 1 Capital to Risk Weighted Assets | 87,639 | 10.19% | 51,602 | 6.00% | 68,803 | 8.00% |
| Common Equity Tier 1 Capital to Risk Weighted Assets | 87,639 | 10.19% | 38,702 | 4.50% | 55,902 | 6.50% |
| Tier 1 Capital to Average Assets | 87,639 | 9.09% | 38,575 | 4.00% | 48,218 | 5.00% |

The approval of the Comptroller is required if the total of all dividends declared by a national bank in any calendar year exceeds the bank's net profits for that year combined with its retained net profits for the preceding two calendar years. Under this formula, the Bank and Trust can distribute as dividends to the Company in 2019, without approval of the Comptroller, \$2.2 million plus an additional amount equal to the Bank's and Trust's retained net profits for 2019 up to the date of any dividend declaration.

NOTE 18. Segment Reporting

The Company operates in a decentralized fashion in three principal business segments: the Bank, the Trust, and 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 and asset management fees. The Parent company'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 years ended December 31 follows:

| 2018 | Bank (in thousands) | Trust | Unconsolidated Parent | Eliminations | Consolidated |
|-------------------------------------|------------------------|---------|--------------------------|---------------|--------------|
| Revenues | | | | | |
| Interest and dividend income | \$38,160 | \$95 | \$ 6,116 | \$ (6,114) | \$ 38,257 |
| Fiduciary and asset management fees | - | 3,726 | - | - | 3,726 |
| Other income | 8,551 | 1,026 | 230 | (262) | 9,545 |
| Total operating income | 46,711 | 4,847 | 6,346 | (6,376) | 51,528 |
| Expenses | | | | | |
| Interest expense | 4,870 | - | 99 | - | 4,969 |
| Provision for loan losses | 2,861 | - | - | - | 2,861 |
| Salaries and employee benefits | 19,150 | 2,977 | 453 | - | 22,580 |
| Other expenses | 14,078 | 1,086 | 1,018 | (262) | 15,920 |
| Total operating expenses | 40,959 | 4,063 | 1,570 | (262) | 46,330 |
| Income (loss) before taxes | 5,752 | 784 | 4,776 | (6,114) | 5,198 |
| Income tax expense (benefit) | 256 | 166 | (143) | - | 279 |
| Net income (loss) | \$5,496 | \$618 | \$ 4,919 | \$ (6,114) | \$ 4,919 |
| Capital expenditures | \$478 | \$- | \$ - | \$ - | \$ 478 |
| Total assets | \$1,032,676 | \$6,226 | \$ 104,592 | \$ (105,311) | \$ 1,038,183 |
| 2017 | Bank (in thousands) | Trust | Unconsolidated Parent | Eliminations | Consolidated |
| Revenues | | | | | |
| Interest and dividend income | \$32,861 | \$71 | \$ 667 | \$ (665) | \$ 32,934 |
| Fiduciary and asset management fees | - | 3,786 | - | - | 3,786 |
| Other income | 8,638 | 944 | 200 | (261) | 9,521 |
| Total operating income | 41,499 | 4,801 | 867 | (926) | 46,241 |
| Expenses | | | | | |
| Interest expense | 3,010 | - | - | 2 | 3,012 |
| Provision for loan losses | 4,160 | - | - | - | 4,160 |
| Salaries and employee benefits | 20,968 | 2,800 | 445 | - | 24,213 |
| Other expenses | 13,358 | 1,075 | 811 | (262) | 14,982 |
| Total operating expenses | 41,496 | 3,875 | 1,256 | (260) | 46,367 |
| Income (loss) before taxes | 3 | 926 | (389) | (666) | (126) |
| Income tax expense (benefit) | (65) | 328 | (360) | - | (97) |
| Net income (loss) | \$68 | \$598 | \$ (29) | \$ (666) | \$ (29) |

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| | | | | | |
|----------------------|-----------|---------|-----------|--------------|------------|
| Capital expenditures | \$613 | \$6 | \$ - | \$ - | \$ 619 |
| Total assets | \$975,991 | \$6,126 | \$ 96,406 | \$ (96,697) | \$ 981,826 |

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The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from operations before income taxes not including nonrecurring gains or losses.

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

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

NOTE 19. Condensed Financial Statements of Parent Company

Financial information pertaining to Old Point Financial Corporation (parent company only) is as follows:

| Balance Sheets | December 31, | |
|---|----------------|----------|
| | 2018 | 2017 |
| | (in thousands) | |
| Assets | | |
| Cash and cash equivalents | \$1,352 | \$2,622 |
| Securities available-for-sale | - | 197 |
| Investment in common stock of subsidiaries | 103,035 | 93,533 |
| Other assets | 205 | 54 |
| Total assets | \$104,592 | \$96,406 |
| Liabilities and Stockholders' Equity | | |
| Other borrowings | \$2,550 | \$- |
| Other liabilities | 36 | 18 |
| Common stock | 25,853 | 25,087 |
| Additional paid-in capital | 20,698 | 17,270 |
| Retained earnings | 57,611 | 54,738 |
| Accumulated other comprehensive loss | (2,156) | (707) |
| Total liabilities and stockholders' equity | \$104,592 | \$96,406 |
| Statements of Operations | | |
| | Years Ended | |
| | December 31, | |
| | 2018 | 2017 |
| | (in thousands) | |
| Income: | | |
| Dividends from subsidiaries | \$2,500 | \$2,050 |
| Other income | 233 | 200 |
| Total income | 2,733 | 2,250 |
| Expenses: | | |
| Salaries and benefits | 453 | 445 |
| Legal expenses | 143 | 285 |
| Service fees | 166 | 210 |
| Merger expenses | 655 | 241 |
| Other operating expenses | 153 | 75 |
| Total expenses | 1,570 | 1,256 |
| Income before income taxes and equity in undistributed net income of subsidiaries | 1,163 | 994 |

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| | | |
|---|---------|---------|
| Income tax benefit | (143) | (360) |
| | 1,306 | 1,354 |
| Equity in undistributed net income (loss) of subsidiaries | 3,613 | (1,383) |
| Net income (loss) | \$4,919 | \$(29) |

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| Statements of Cash Flows | Years Ended | |
|---|----------------|----------|
| | 2018 | 2017 |
| | (in thousands) | |
| Cash flows from operating activities: | | |
| Net income (loss) | \$4,919 | \$(29) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Equity in undistributed net (income) loss of subsidiaries | (3,613) | 1,383 |
| Gain on sale of securities, net | (30) | - |
| Stock compensation expense | 11 | 17 |
| Increase in other assets | (13) | (34) |
| Increase in other liabilities | 18 | 10 |
| Net cash provided by operating activities | 1,292 | 1,347 |
| Cash flows from investing activities: | | |
| Proceeds from sale of investment securities | 227 | - |
| Cash paid in acquisition | (3,164) | - |
| Cash acquired in acquisition | 2,304 | - |
| Cash distributed to subsidiary | (2,304) | - |
| Net cash used in investing activities | (2,937) | - |
| Cash flows from financing activities: | | |
| Proceeds from sale of stock | 87 | 1,107 |
| Proceeds from borrowings | 3,000 | - |
| Repayment of borrowings | (450) | - |
| Cash dividends paid on common stock | (2,262) | (2,198) |
| Net cash provided by (used in) financing activities | 375 | (1,091) |
| Net increase (decrease) in cash and cash equivalents | (1,270) | 256 |
| Cash and cash equivalents at beginning of year | 2,622 | 2,366 |
| Cash and cash equivalents at end of year | \$ 1,352 | \$ 2,622 |
| Supplemental schedule of noncash transactions: | | |
| Unrealized gain on securities available-for-sale | \$- | \$33 |

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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.

Management's Report on 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) of the Exchange Act.

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.

Management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. In conducting this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework in 2013. Based on this evaluation, using those criteria, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2018.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2018 has been audited by Yount, Hyde & Barbour, PC, the independent registered public accounting firm which also audited the Company's consolidated financial statements included in this Annual Report on Form 10-K. Yount, Hyde & Barbour's attestation report on the Company's internal control over financial reporting is included in Item 8 "Financial Statements and Supplementary Data" of this Form 10-K.

Changes in Internal Control over Financial Reporting. There was no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

Part III

Except as otherwise indicated, information called for by the following items under Part III is contained in the Proxy Statement for the Company's 2019 Annual Meeting of Stockholders (the 2019 Proxy Statement) to be held on May 28, 2019.

Item 10. Directors, Executive Officers and Corporate Governance

The information with respect to the directors of the Company is set forth under the caption "Election of Directors" in the 2019 Proxy Statement and is incorporated herein by reference.

The information regarding the Section 16(a) reporting requirements of the directors and executive officers is set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2019 Proxy Statement and is incorporated herein by reference.

The information concerning the executive officers of the Company required by this item is included in Part I of this report on Form 10-K under the caption “Executive Officers of the Registrant.”

The information regarding the Company’s Audit Committee and its Audit Committee Financial Expert is set forth under the caption “Board Committees and Attendance” in the 2019 Proxy Statement and is incorporated herein by reference.

The Company has a Code of Ethics which details principles and responsibilities governing ethical conduct for all Company directors, officers, employees and principal stockholders.

A copy of the Code of Ethics will be provided free of charge, upon written request made to the Company's secretary at 1 West Mellen Street, Hampton, Virginia 23663 or by calling (757) 728-1200. The Code of Ethics is also posted on the Company's website at www.oldpoint.com in the "Community" section, under "Investor Relations" and then "Governance Documents." The Company intends to satisfy the disclosure requirements of Form 8-K with respect to waivers of or amendments to the Code of Ethics with respect to certain officers of the Company by posting such disclosures on its website under "Waivers of or amendments to the Code of Ethics." The Company may, however, elect to disclose any such amendment or waiver in a report on Form 8-K filed with the SEC either in addition to or in lieu of the website disclosure.

Item 11. Executive Compensation

The information set forth under the captions "Compensation and Benefits Committee Interlocks and Insider Participation" and "Executive Compensation" in the 2019 Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information set forth under the caption "Securities Authorized for Issuance Under Equity Compensation Plans" in the 2019 Proxy Statement is incorporated herein by reference.

The information set forth under the caption "Security Ownership of Certain Beneficial Owners and Management" in the 2019 Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information set forth under the caption "Interest of Management in Certain Transactions" in the 2019 Proxy Statement is incorporated herein by reference.

The information regarding director independence set forth under the caption "Board Committees and Attendance" in the 2019 Proxy Statement is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information set forth under the captions "Principal Accountant Fees" and "Audit Committee Pre-Approval Policy" in the 2019 Proxy Statement is incorporated herein by reference.

Part IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Consolidated Financial Statements

The following Consolidated Financial Statements and reports are included in Part II, Item 8, of this report on Form 10-K.

Report of Independent Registered Public Accounting Firm (Yount, Hyde & Barbour, P.C.)

Consolidated Balance Sheets – December 31, 2018 and 2017

Consolidated Statements of Operations – Years Ended December 31, 2018 and 2017

Consolidated Statements of Comprehensive Income – Years Ended December 31, 2018 and 2017

Consolidated Statements of Changes in Stockholders' Equity – Years Ended December 31, 2018 and 2017

Consolidated Statements of Cash Flows – Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

(a)(2) Consolidated Financial Statement Schedules

All schedules are omitted since they are not required, are not applicable, or the required information is shown in the Consolidated Financial Statements or notes thereto.

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(a)(3) Exhibits

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

| Exhibit No. | Description |
|-------------|--|
| 2.1 | <u>Agreement and Plan of Reorganization, dated as of October 27, 2017, by and among Old Point Financial Corporation, The Old Point National Bank of Phoebus, and Citizens National Bank (incorporated by reference to Exhibit 2.1 to Form 8-K filed November 2, 2017)</u> |
| 3.1 | <u>Articles of Incorporation of Old Point Financial Corporation, as amended June 22, 2000 (incorporated by reference to Exhibit 3.1 to Form 10-K filed on March 12, 2009)</u> |
| 3.1.1 | <u>Articles of Amendment to Articles of Incorporation of Old Point Financial Corporation, effective May 26, 2016 (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed May 31, 2016)</u> |
| 3.2 | <u>Bylaws of Old Point Financial Corporation, as amended and restated August 9, 2016 (incorporated by reference to Exhibit 3.2 to Form 10-Q filed August 10, 2016)</u> |
| 10.4* | <u>Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with The Northwestern Mutual Life Insurance Company entered into with each of Robert F. Shuford, Sr., Laurie D. Grabow and Eugene M. Jordan, II (incorporated by reference to Exhibit 10.4 to Form 10-K filed March 30, 2005)</u> |
| 10.5* | <u>Directors' Compensation</u> |
| 10.7* | <u>Summary of Old Point Financial Corporation Incentive Plan (incorporated by reference to Exhibit 10.7 to Form 10-K filed March 30, 2015)</u> |
| 10.8* | <u>Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with Ohio National Life Assurance Corporation entered into with each of Laurie D. Grabow and Eugene M. Jordan, II (incorporated by reference to Exhibit 10.8 to Form 10-K filed March 14, 2008)</u> |

- 10.9 Memorandum of Understanding between The Old Point National Bank of Phoebus and Tidewater Mortgage Services, Inc., dated September 10, 2007 (incorporated by reference to Exhibit 10.8 to Form 10-Q filed November 9, 2007)
- 10.10* Form of 162 Insurance Plan (incorporated by reference to Exhibit 10.10 to Form 10-K filed March 12, 2009)
- 10.11* Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with Ohio National Life Assurance Corporation entered into with Joseph R. Witt (incorporated by reference to Exhibit 10.11 to Form 10-K filed March 12, 2010)
- 10.12* Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with New York Life Insurance and Annuity Corporation entered into with Eugene M. Jordan, II, Robert F. Shuford, Jr., and Joseph R. Witt (incorporated by reference to Exhibit 10.12 to Form 10-K filed March 30, 2012)
- 10.14 Settlement Agreement dated March 16, 2016 among Old Point Financial Corporation, Financial Edge Fund, L.P., Financial Edge-Strategic Fund, L.P., PL Capital/Focused Fund, L.P., PL Capital, LLC, PL Capital Advisors, LLC, Goodbody/PL Capital, L.P., Goodbody/PL Capital, LLC, Mr. John W. Palmer and Mr. Richard J. Lashley, as Managing Members of PL Capital, LLC, PL Capital Advisors, LLC and Goodbody/PL Capital, LLC and Mr. William F. Keefe (incorporated by reference to Exhibit 10.1 to Form 8-K filed March 17, 2016)
- 10.15* Old Point Financial Corporation 2016 Incentive Stock Plan (incorporated by reference to Exhibit 10.15 to Form 8-K filed May 31, 2016)
- 10.16 Membership Interest Purchase Agreement dated January 13, 2017 between Tidewater Mortgage Services, Inc. and The Old Point National Bank of Phoebus (incorporated by reference to Exhibit 10.1 to Form 8-K filed January 20, 2017)
- 10.17* Retirement Agreement, Waiver and General Release by and among Laurie D. Grabow and Old Point Financial Corporation, The Old Point National Bank of Phoebus and Old Point Trust & Financial Services, N.A., dated March 10, 2017 (incorporated by reference to Exhibit 10.17 to Form 10-K filed March 15, 2017)
- 10.18* Additional Employment Arrangement by and among Laurie D. Grabow and Old Point Financial Corporation and The Old Point National Bank of Phoebus dated as of May 23, 2017 (incorporated by reference to Exhibit 10.18 to Form 8-K filed May 23, 2017)
- 10.19* Time-Based Restricted Stock Agreement, dated July 11, 2017, between Old Point Financial Corporation and Jeffrey W. Farrar (incorporated by reference to Exhibit 10.19 to Form 8-K filed July 13, 2017)
- 10.20 Form of Support and Non-Competition Agreement, by and among Old Point Financial Corporation and certain shareholders of Citizens National Bank (incorporated by reference to Annex A to Appendix A to the proxy statement/prospectus included in Amendment No. 1 to Form S-4 filed January 26, 2018)
- 10.21 Form of Warrant Cancellation Agreement, by and among Old Point Financial Corporation, Citizens National Bank and holders of warrants to acquire shares of common stock of Citizens National Bank (incorporated by reference to Annex B to Appendix A to the proxy statement/prospectus included in Amendment No. 1 to Form S-4 filed January 26, 2018)
- 10.22* Employment Agreement, dated as of February 22, 2018, by and between Old Point Financial Corporation and The Old Point National Bank of Phoebus and Robert F. Shuford, Jr. (incorporated by reference to Exhibit

10.22 to Form 8-K filed February 28, 2018)

10.23* Employment Agreement, dated as of February 22, 2018, by and between Old Point Financial Corporation and The Old Point National Bank of Phoebus and Jeffrey W. Farrar (incorporated by reference to Exhibit 10.23 to Form 8-K filed February 28, 2018)

10.24* Employment Agreement, dated as of February 22, 2018, by and between Old Point Financial Corporation and The Old Point National Bank of Phoebus and Joseph R. Witt (incorporated by reference to Exhibit 10.24 to Form 8-K filed February 28, 2018)

10.25* Employment Agreement, dated as of February 22, 2018, by and between Old Point Financial Corporation and Old Point Trust & Financial Services, N.A. and Eugene M. Jordan, II (incorporated by reference to Exhibit 10.25 to Form 8-K filed February 28, 2018)

10.26* Change of Control Severance Agreement, dated as of February 22, 2018, by and between The Old Point National Bank of Phoebus and Donald S. Buckless (incorporated by reference to Exhibit 10.26 to Form 10-K filed March 16, 2018)

10.27* Form of Time-Based Restricted Stock Agreement (installment vesting) (approved March 29, 2018) for awards to certain employees under the Old Point Financial Corporation 2016 Incentive Stock Plan (incorporated by reference to Exhibit 10.27 to Form 8-K filed April 3, 2018)

10.28* Form of Time-Based Restricted Stock Agreement (cliff vesting) (approved March 29, 2018) for awards to certain employees under the Old Point Financial Corporation 2016 Incentive Stock Plan (incorporated by reference to Exhibit 10.28 to Form 8-K filed April 3, 2018)

10.29* Form of Time-Based Restricted Stock Agreement (cliff vesting) (approved March 29, 2018) for awards to certain non-employee directors under the Old Point Financial Corporation 2016 Incentive Stock Plan (incorporated by reference to Exhibit 10.29 to Form 8-K filed April 3, 2018)

21 Subsidiaries of the Registrant (incorporated by reference to Exhibit 21 to Form 10-K filed March 30, 2005)

23 Consent of Yount, Hyde & Barbour, P.C.

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

The following materials from Old Point Financial Corporation's annual report on Form 10-K for the year ended December 31, 2018, formatted in XBRL (Extensible Business Reporting Language), filed herewith: (i) 101 Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements

* Denotes management contract.

Item 16. Form 10-K Summary

Not applicable.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OLD POINT FINANCIAL CORPORATION

/s/Robert F. Shuford, Sr.
Robert F. Shuford, Sr.,
Chairman, President & Chief Executive Officer

Date: March 18, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/Robert F. Shuford, Sr. Chairman, President & Chief Executive Officer and Director
Robert F. Shuford, Sr. Principal Executive Officer

Date: March 18, 2019

/s/Jeffrey W. Farrar Chief Financial Officer & Senior Vice President/Finance
Jeffrey W. Farrar Principal Financial & Accounting Officer

Date: March 18, 2019

/s/Stephen C. Adams Director
Stephen C. Adams

Date: March 18, 2019

/s/James Reade Chisman Director
James Reade Chisman

Date: March 18, 2019

/s/Russell S. Evans, Jr. Director
Russell S. Evans, Jr.

Date: March 18, 2019

/s/Michael A. Glasser Director
Michael A. Glasser

Date: March 18, 2019

/s/Dr. Arthur D. Greene Director
Dr. Arthur D. Greene

Date: March 18, 2019

/s/John Cabot Ishon Director
John Cabot Ishon

Date: March 18, 2019

/s/William F. Keefe Director
William F. Keefe

Date: March 18, 2019

/s/Tom B. Langley Director
Tom B. Langley

Date: March 18, 2019

/s/Dr. H. Robert Schappert Director
Dr. H. Robert Schappert

Date: March 18, 2019

/s/Robert F. Shuford, Jr. Director
Robert F. Shuford, Jr.

Date: March 18, 2019

/s/Ellen Clark Thacker Director
Ellen Clark Thacker

Date: March 18, 2019

/s/Joseph R. Witt Director
Joseph R. Witt

Date: March 18, 2019