

ACCESS NATIONAL CORP  
Form 10-K  
March 16, 2017

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2016**

or

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

**1934**

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

**Commission File Number 000-49929**

**Access National Corporation**

(Exact name of registrant as specified in its charter)

**Virginia**

**82-0545425**

(State or other jurisdiction of (I.R.S. Employer incorporation or organization) Identification Number)

**1800 Robert Fulton Drive, Suite 300, Reston, Virginia 20191**

(Address of principal executive offices) (Zip Code)

**(703) 871-2100**

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
<u>Common Stock \$0.835 par value</u>	<u>The NASDAQ Stock Market LLC</u>

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

(Title of each class) None

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

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

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

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

Indicate by checkmark 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

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

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

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

The aggregate market value of the registrant’s common voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the price at which the stock was last sold on the NASDAQ Global Market as of the last business day of the registrant’s most recently completed second fiscal quarter, was approximately \$157,415,100.

As of March 13, 2017 there were 10,766,678 shares of Common Stock, par value \$0.835 per share, of Access National Corporation issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s Proxy Statement for the Corporation’s Annual Meeting of Shareholders scheduled to be held on May 25, 2017, are incorporated by reference in Part III of this Form 10-K.

**Access National Corporation**

**FORM 10-K**

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**PART I**

In addition to historical information, the following report contains forward-looking statements that are subject to risks and uncertainties that could cause Access National Corporation’s actual results to differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s analysis only as of the date of the report. For discussion of factors that may cause our actual future results to differ materially from those anticipated, please see “Item 1A – Risk Factors” and “Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations” herein.

**ITEM 1 – BUSINESS**

Access National Corporation (the “Corporation” or “Access”) was organized June 15, 2002 under the laws of Virginia to operate as a bank holding company. The Corporation has one active wholly owned subsidiary: Access National Bank (the “Bank” or “ANB”). Effective June 15, 2002, pursuant to an Agreement and Plan of Reorganization dated April 18, 2002 between the Corporation and the Bank, the Corporation acquired all of the outstanding stock of the Bank in a statutory share exchange transaction.

The Bank is the only operating business of the Corporation. The Bank provides credit, deposit, mortgage services and wealth management services to middle market commercial businesses and associated professionals, primarily in the greater Washington, D.C. Metropolitan Area. The Bank was organized under federal law in 1999 as a national banking association to engage in a general banking business to serve the communities in and around Northern Virginia. Deposits with the Bank are insured to the maximum amount provided by the Federal Deposit Insurance Corporation (“FDIC”). The Bank offers a comprehensive range of financial services and products and specializes in providing customized financial services to small and medium sized businesses, professionals, and associated individuals. The Bank provides its customers with personal customized service utilizing the latest technology and delivery channels. The various operating and non-operating entities that support the Corporation’s business directly and indirectly are listed below:

<b>ENTITY / ACTIVITY</b>	<b>PARENT COMPANY / SOLE MEMBER</b>	<b>YEAR ORGANIZED</b>
<b>Access National Corporation</b>	N/A	2002

A Virginia corporation with common stock listed on the NASDAQ Global Market, and serves as the Bank’s holding company. The bank holding company is subject to regulatory oversight by the Board of Governors of the Federal

Reserve System (“Federal Reserve Board”). Its primary purpose is to hold the common stock of the commercial bank subsidiary and support related capital activities.

**Access National Bank** ANC 1999

Primary operating entity holding a national bank charter issued under the laws of the United States. Its principal activities are subject to regulation by the Office of the Comptroller of the Currency (the “Comptroller”). The Bank’s primary business is serving the credit, depository and cash management needs of businesses and associated professionals. Deposits of the Bank are insured by the FDIC.

**Access Real Estate L.L.C. (“ARE”)**ANB 2003

Access Real Estate was formed to acquire and hold title to real estate for the Corporation. Access Real Estate owns a 45,000 square foot, three story office building located at 1800 Robert Fulton Drive in Reston, Virginia that serves as the corporate headquarters for the Corporation, the Bank, the Mortgage Division, Access Real Estate, Capital Fiduciary Advisors, and Access Investment Services. Access Real Estate also owned vacant land in Fredericksburg that was originally purchased for future expansion of the Bank, but was sold in the third quarter of 2016.

**Access Capital Management Holding, L.L.C. (“ACM”)**ANB 2011

ACM is a Virginia limited liability company whose sole member is ANB. ACM is the holding company for Capital Fiduciary Advisors, L.L.C. (“CFA”), Access Investment Services, L.L.C. (“AIS”), and Access Insurance Group, L.L.C. (“AIG”). ACM provides a full range of wealth management services to individuals.

**Capital Fiduciary Advisors, L.L.C. (“CFA”)ACM 2011**

CFA is a registered investment advisor with the Securities and Exchange Commission (“SEC”) and provides wealth management services to high net worth individuals, businesses, and institutions. Activities are supervised by the Bank’s primary regulator, the Comptroller, as well as the SEC.

**Access  
Investment  
Services, L.L.C.  
 (“AIS”)**                      ACM                      2011

AIS is a limited liability company whose sole member is ACM. AIS provides financial planning services to clients along with access to a full range of investment products. Activities are supervised by the Bank’s primary regulator, the Comptroller, as well as the SEC.

**Access Insurance Group, L.L.C. (“AIG”)ACM 2011**

AIG is a limited liability company whose sole member is ACM. AIG is presently inactive and when activated will provide access to a wide variety of insurance products.

**ACME Real Estate, L.L.C. (“ACME” or “ACME Real Estate”)ANB 2007**

ACME is a Virginia limited liability company whose sole member is ANB. ACME is a real estate holding company whose

purpose is to hold title to the properties acquired by the Bank either through foreclosure or property deeded in lieu of foreclosure. Activities are supervised by the Bank’s primary regulator, the Comptroller.

The principal products and services offered by the Bank are listed below:

**BUSINESS BANKING SERVICES**  
**Lending**

**BUSINESS BANKING SERVICES**  
**Cash Management**

**PERSONAL BANKING**  
**SERVICES**

Accounts Receivable Lines of Credit	Online Banking	Personal Checking Accounts
Accounts Receivable Collection Accounts	Checking Accounts	Savings / Money Market Accounts
Growth Capital Term Loans	Money Market Accounts	Certificates of Deposit
Business Acquisition Financing	Sweep Accounts	Residential Mortgage Loans
Partner Buyout Funding	Zero Balance Accounts	Asset Secured Loans
Debt Re-financing	Overnight Investments	Loans for Business Investment
Franchise Financing	Certificates of Deposit	Construction Loans
Equipment Financing	Business Debit Cards	Lot & Land Loans
Commercial Mortgages	Lockbox Payment Processing	Investment Management
Commercial Construction Loans	Payroll Services	Financial Planning
SBA Preferred Lender Loans	Employer Sponsored Retirement Plans	Retirement Account Services
		Qualified Plans

Bank revenues are derived from interest and fees received in connection with loans, deposits, and investments. Major expenses of the Bank consist of personnel, interest paid on deposits and borrowings, and other operating expenses. Revenues from the Mortgage Division consist primarily of gains from the sale of loans and loan origination fees. Major expenses of the Mortgage Division consist of personnel, investor fees, and other operating expenses. Revenue generated by the Bank (excluding the Mortgage Division) totaled \$53.0 million in 2016. The Mortgage Division contributed \$26.5 million; others contributed \$4.4 million prior to inter-company eliminations. In 2016, the Bank's pre-tax earnings amounted to 83.5% of the Corporation's total income before taxes and the Mortgage Division and others contributed the remaining 16.5%.

The economy, interest rates, monetary and fiscal policies of the federal government, and regulatory policies have a significant influence on the Corporation, the Bank, the Mortgage Division, ACM, and the banking industry as a whole. The economy shows continued signs of improvement with the national unemployment rate dropping from 5.0% in December 2015 to 4.7% in December 2016. In December 2016, the federal funds rate increased from 0.50% to 0.75%, the second increase in federal funds rates since December 2008. Although the February 2017 statement of the Federal Open Market Committee ("FOMC") projected the federal funds rate to remain at 0.50% to 0.75% we are anticipating an additional 0.25% rate hike will occur in March 2017. Even with this rate hike, the continued low rate environment will continue to stress net interest margins.



The Bank operates from seven banking centers located in Virginia: Chantilly, Tysons, Reston, Leesburg, Manassas, Arlington, and Alexandria, and online at [www.accessnationalbank.com](http://www.accessnationalbank.com). The Arlington and Alexandria banking centers were opened during the second half of 2016. Additional offices may be added from time to time based upon management’s constant analysis of the market and opportunities.

The Mortgage Division specializes in the origination of conforming and government insured residential mortgages to individuals in the greater Washington, D.C. Metropolitan Area, the surrounding areas of its branch locations, outside of its local markets via direct mail solicitation, and otherwise. The Mortgage Division has established offices throughout Virginia; in Fairfax, Reston, Roanoke, and McLean. Offices outside the state of Virginia include New Smyrna Beach in Florida (closed in January 2016), Indianapolis and Fort Wayne in Indiana, Nashville in Tennessee, Hagerstown in Maryland, Atlanta in Georgia, and Edina in Minnesota (opened in December 2015 and closed in June 2016).

The following table details the geographic distribution of the real estate collateral securing mortgage loans originated by the Mortgage Division in the periods indicated. The individually named states are those in which the Mortgage Division had a physical presence during the periods described. In addition to making loans for purchases within its markets, the Mortgage Division makes loans to borrowers for second homes located elsewhere, as well as utilizes direct mail to solicit loans outside its local markets, which accounts for the “Other States” category. Percentages are of the total dollar value of originations, as opposed to the number of originations.

	Loan Origination By State			
	Year Ended December 31,			
	2016	2015	2014	
COLORADO (production branch closed April 2013)	Not Reported	1.06	% 1.30	%
FLORIDA (production branch closed January 2016)	2.63	% 8.03	% 8.44	%
GEORGIA	13.44	% 11.61	% 11.23	%
INDIANA	17.39	% 22.56	% 26.81	%
MARYLAND	9.66	% 10.06	% 9.16	%
MINNESOTA (production branch opened December 2015 and closed June 2016)	3.10	% 0.42	% Not Reported	
TENNESSEE	9.65	% 8.93	% 2.89	%
TEXAS (production branch closed January 2013)	Not Reported	0.72	% 1.12	%
VIRGINIA	25.75	% 23.83	% 25.47	%
	81.62	% 87.22	% 86.42	%
Other States	18.38	% 12.78	% 13.58	%
	100.00	% 100.00	% 100.00	%

The Mortgage Division’s activities rely on insurance provided by the Department of Housing and Urban Development (“HUD”) and the Veterans Administration. In addition we underwrite mortgage loans in accordance with guidelines for

programs under Fannie Mae and Freddie Mac that make these loans marketable in the secondary market.

The Corporation and its subsidiaries are headquartered in Fairfax County, Virginia and primarily focus on serving the greater Washington, D.C. Metropolitan Area.

### **Our Strategy – Historical and Prospective**

Our view of the financial services marketplace is that community banks must be effective in select market niches that are underserved and should stay clear of competing with large national competitors on a head-to-head basis for broad based consumer business. We started by organizing a de novo national bank in 1999. The focus of the Bank was and is serving the small and medium sized businesses and their associated professionals in the greater Washington, D.C. Metropolitan Area. We find that large national competitors are ineffective at addressing this market; it is difficult to distinguish where a business's financial needs stop and the personal financial needs of that business's professional's start. We believe that emerging businesses and the finances of their owners are best served hand-in-hand.

Our core competency is judgmental discipline of commercial lending based upon our personnel and practices that help our clients strategize and grow their businesses from a financial perspective. As financial success takes hold in the business, personal goals and wealth objectives of the business owners become increasingly important. Our second competency is a derivative of the first. We have the personnel, skills and strategy, and know how to provide private banking services that assist our individual clients to acquire assets, build wealth, and manage their resources. Mortgage banking and the related activities in our model go hand-in-hand with supplying effective private banking services. Unlike most banking companies, the heart of our Mortgage Division is ingrained into our commercial bank, serving the same clients side-by-side in a coordinated and seamless fashion. We believe that lending is not enough in today's environment to attract and retain commercial and professional clients. The credit services must be backed up by competitive deposit and cash management products and operational excellence. We have made significant investments in skilled personnel and the latest technology to ensure we can deliver these services.

We generally expect to have fewer branch locations compared to similar size banking companies. We do not view our branch network as a significant determinant of our growth. Our marketing strategies focus on benefits other than branch location convenience.

The goal was and is to generate at least 80% of the Corporation's net income from the core business of the Bank, with the rest of our consolidated net income to be generated from related fee income activities. During 2016, the Bank accounted for 83.5% of pretax earnings. We will consider entering other related fee income businesses that serve our target market as opportunities, market conditions, and our capacity dictate. See Note 17 to the consolidated financial statements for additional information on segment performance.

We expect to grow our Bank by continuing to hire and train our own skilled personnel. We provide a sound infrastructure that facilitates the success of businesses, their owners and key personnel, not only today but tomorrow and on into the ensuing decades. Growth by acquisition will be considered carefully as was done with the announced merger with Middleburg Financial Corporation.

**Merger with Middleburg Financial Corporation**

On October 24, 2016, the Corporation announced the signing of a definitive agreement and plan of reorganization, dated October 21, 2016 (the “Middleburg Merger Agreement”), to acquire Middleburg Financial Corporation (“Middleburg”), and its wholly-owned subsidiaries, Middleburg Bank and Middleburg Investment Group, Inc. Middleburg Bank is a Virginia-based bank with twelve financial service centers and one limited service facility primarily servicing Northern Virginia. The Middleburg Merger Agreement and the transactions pursuant thereto have been unanimously approved by the Boards of Directors of the Corporation and Middleburg and the merger is expected to close in the second quarter of 2017, subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of each company’s shareholders. At December 31, 2016, Middleburg had total assets of \$1.27 billion, gross loans of \$860.1 million, and total deposits of \$1.05 billion. Under the terms of the Middleburg Merger Agreement, Middleburg shareholders will receive 1.3314 shares of the Corporation’s common stock for each share of Middleburg common stock held immediately prior to the effective date of the merger. As a result of the merger, each option to purchase shares of Middleburg common stock granted under a Middleburg equity-based compensation plan that is outstanding immediately prior to the effective date of the merger will be cancelled for a cash payment equal to the product of (i) the difference between the closing sale price of Middleburg common stock on the trading day immediately preceding the effective date of the merger and the per share exercise price of the stock option, and (ii) the number of shares of Middleburg common stock subject to such stock option. Each restricted share of Middleburg common stock granted under a Middleburg equity compensation plan that is outstanding immediately prior to the effective date of the merger will, pursuant to the terms of each such grant, vest in full immediately prior to the effective date of the merger and be converted into unrestricted shares of the Corporation’s common stock based on the exchange ratio.

The pending merger has caused us to reevaluate our strategy that will be articulated and described in future filings.

## **Lending Activities**

The Bank's lending activities involve commercial real estate loans both owner occupied and non-owner occupied, residential real estate loans, commercial loans, commercial and real estate construction loans, home equity loans, and consumer loans. These lending activities provide access to credit to small and medium sized businesses, professionals, and consumers in the greater Washington, D.C. Metropolitan Area. Loans originated by the Bank are classified as loans held for investment. The Mortgage Division originates residential mortgages and home equity loans that are held on average fifteen to forty-five days pending their sale primarily to mortgage banking subsidiaries of large financial institutions. The Bank is also approved to sell loans directly to Fannie Mae and Freddie Mac and is able to securitize loans that are insured by the Federal Housing Administration. In the past, when the Mortgage Division was a separate subsidiary of the Bank, the Bank would, in certain circumstances, purchase adjustable rate mortgage loans in the Bank's market area directly from the Mortgage Corporation to supplement loan growth in the Bank's portfolio. The Bank did not purchase any loans originated by the Mortgage Division for said purpose in 2016 but may retain additional loans in the future if management believes doing so would assist in achieving the Corporation's strategic goals. Loans held in the Bank's portfolio at December 31, 2016 resulting from the Mortgage Division's inability to sell the loan to a third party totaled \$3.5 million. Each of our principal loan types are described below.

At December 31, 2016 loans held for investment totaled \$1.05 billion compared to \$887.5 million at year end 2015. The Bank experienced growth in all but the consumer loan category reflecting continued improvement in local economic conditions.

The Bank's lending activities are subject to a variety of lending limits imposed by federal law. While differing limits apply in certain circumstances based on the type of loan, in general, the Bank's lending limit to any one borrower is equal to 15% of the Bank's capital and surplus. The Bank has established relationships with correspondent banks to participate in loans when loan amounts exceed the Bank's legal lending limits or internal lending policies. The Bank's primary regulator will allow lending relationships to any one borrower to exceed the 15% threshold if the amount greater than 15% is fully secured by cash or readily marketable securities. At December 31, 2016 unsecured loans were comprised of \$2.5 million in commercial loans and approximately \$446 thousand in consumer loans and collectively equal approximately 0.29% of the loans held for investment portfolio.

We have an established credit policy that includes procedures for underwriting each type of loan and lending personnel have been assigned specific authorities based upon their experience. Loans in excess of an individual loan officer's authority are presented to our Loan Committee for approval. The Loan Committee meets weekly to facilitate a timely approval process for our clients. Loans are approved based on the borrower's capacity for credit, collateral and sources of repayment. Loans are actively monitored to detect any potential performance issues. We manage our loans within the context of a risk grading system developed by management based upon extensive experience in administering loan portfolios in our market. Payment performance is carefully monitored for all loans. When loan repayment is dependent upon an operating business or investment real estate, periodic financial reports, site visits, and select asset verification procedures are used to ensure that we accurately rate the relative risk of our assets. Based

upon criteria that are established by management and the Board of Directors, the degree of monitoring is escalated or relaxed for any given borrower based upon our assessment of the future repayment risk.

The Bank does not currently hold any pay option adjustable rate mortgages, loans with teaser rates, subprime loans, Alt A loans or any other loans considered to be “high-risk loans” in its loans held for investment portfolio, and did not during 2016, 2015, or 2014. The Mortgage Division does not currently originate any subprime loans or Alt A loans, did not originate such loans in 2016, 2015, or 2014, and does not expect to offer these programs in the future.

***Loan Portfolio – Loans Held for Investment.*** The following outlines the composition of loans held for investment.

**Commercial Real Estate Loans-Owner Occupied:** Loans in this category represent 23.87% of our loan portfolio held for investment, as of December 31, 2016. This category represents loans supporting an owner occupied commercial property. Repayment is dependent upon the cash flows generated by operation of the commercial property. Loans are secured by the subject property and underwritten to policy standards. Policy standards approved by the Board of Directors from time to time set forth, among other considerations, loan to value limits, cash flow coverage ratios, and the general creditworthiness of the obligors.

**Commercial Real Estate Loans-Non-Owner Occupied:** Also known as Commercial Real Estate Loans-Income Producing. Loans in this category represent 17.59% of our loan portfolio held for investment, as of December 31, 2016. This category includes loans secured by commercial property that is leased to third parties and loans to non-profit organizations such as churches and schools. Also included in this category are loans secured by farmland and multifamily properties. Repayment is dependent upon the cash flows generated from rents or by the non-profit organization. Loans are secured by the subject property and underwritten to policy standards. Policy standards approved by the Board of Directors from time to time set forth, among other considerations, loan to value limits, cash flow coverage ratios, and the general creditworthiness of the obligors.

**Residential Real Estate Loans:** This category includes loans secured by first or second mortgages on one to four family residential properties, generally extended to existing consumers of other Bank products, and represents 19.47% of the loan portfolio, as of December 31, 2016. Of this amount, the following sub-categories exist as a percentage of the whole Residential Real Estate Loan portfolio: Home Equity Lines of Credit 21.8%; First Trust Mortgage Loans 71.9%; Loans Secured by a Junior Trust 6.3%.

Home Equity Loans are extended to borrowers in our target market. Real estate equity is the largest component of consumer wealth in our marketplace. Once approved, this consumer finance tool allows the borrowers to access the equity in their home or investment property and use the proceeds for virtually any purpose. Home Equity Loans are most frequently secured by a second lien on residential property. One to Four Family Residential First Trust Loan, or First Trust Mortgage Loan, proceeds are used to acquire or refinance the primary financing on owner occupied and residential investment properties. Junior Trust Loans, or Loans Secured by Second Trust Loans, are to consumers wherein the proceeds have been used for a stated consumer purpose. Examples of consumer purposes are education, refinancing debt, or purchasing consumer goods. The loans are generally extended in a single disbursement and repaid over a specified period of time.

Loans in the Residential Real Estate portfolio are underwritten to standards within a traditional consumer framework that is periodically reviewed and updated by our management and Board of Directors and includes analysis of: repayment source and capacity, value of the underlying property, credit history, savings pattern, and stability.

Commercial Loans: Commercial Loans represent 29.67% of our loan portfolio held for investment as of December 31, 2016. These loans are to businesses or individuals within our target market for business purposes. Typically the loan proceeds are used to support working capital and the acquisition of fixed assets of an operating business. These loans are underwritten based upon our assessment of the obligor's(s') ability to generate operating cash flow in the future necessary to repay the loan. To address the risks associated with the uncertainties of future cash flow, these loans are generally well secured by assets owned by the business or its principal shareholders and the principal shareholders are typically required to guarantee the loan.

Real Estate Construction Loans: Real Estate Construction Loans, also known as construction and land development loans, comprise 8.75% of our held for investment loan portfolio as of December 31, 2016. These loans generally fall into one of four circumstances: loans to construct owner occupied commercial buildings, loans to individuals that are ultimately used to acquire property and construct an owner occupied residence, loans to builders for the purpose of acquiring property and constructing homes for sale to consumers, and loans to developers for the purpose of acquiring land that is developed into finished lots for the ultimate construction of residential or commercial buildings. Loans of these types are generally secured by the subject property within limits established by the Board of Directors based upon an assessment of market conditions and up-dated from time to time. The loans typically carry recourse to principal borrowers. In addition to the repayment risk associated with loans to individuals and businesses, loans in this category carry construction completion risk. To address this additional risk, loans of this type are subject to additional administrative procedures designed to verify and ensure progress of the project in accordance with allocated funding, project specifications, and time frames.

Consumer Loans: Consumer Loans make up approximately 0.65% of our loan portfolio as of December 31, 2016. Most loans are well secured with assets other than real estate, such as marketable securities or automobiles. Very few loans are unsecured. As a matter of operation, management discourages unsecured lending. Loans in this category are underwritten to standards within a traditional consumer framework that is periodically reviewed and updated by our

management and Board of Directors: repayment source and capacity, collateral value, credit history, savings pattern, and stability.

***Loans Held for Sale (“LHFS”)***. Loans in this category are originated by the Mortgage Division and comprised of residential mortgage loans extended to consumers and underwritten in accordance with standards set forth by an institutional investor to whom we expect to sell the loan. Loan proceeds are used for the purchase or refinance of the property securing the loan. Loans and servicing are sold concurrently. The LHFS loans are closed in our name and carried on our books until the loan is delivered to and purchased by an investor, generally within fifteen to forty-five days. In 2016, we originated \$545 million of loans processed in this manner, up from \$485 million in 2015. At December 31, 2016 loans held for sale totaled \$35.7 million compared to \$44.1 million at year end 2015. The amount of loans held for sale outstanding at the end of any given month fluctuates with the volume of loans closed during the month and the timing of loans purchased by investors.

### **Brokered Loans**

Brokered loans are underwritten and closed by a third party lender. We are paid a fee for procuring and packaging brokered loans. In 2016, we did not originate residential mortgage loans under this type of delivery method compared to \$3.8 million in 2015. Brokered loans accounted for 0.79% of the total loan volume of the Mortgage Division at December 31, 2015. The risks associated with this activity are limited to losses or claims arising from fraud.

### **Deposits**

Deposits are the primary source of funding loan growth. At December 31, 2016 deposits totaled \$1.054 billion compared to \$913.7 million at December 31, 2015.



## **Market Area**

The Corporation, the Bank, the Mortgage Division, and ACM are headquartered in Fairfax County and primarily serve the Northern Virginia region and the Greater Washington, D.C. Metropolitan Area. We believe that the economic conditions in Fairfax County provide a reasonable proxy for economic conditions across our primary market, the greater Washington, D.C. Metropolitan Area. Fairfax County is a diverse and thriving urban county. The most recent census figures reported by the U.S. Census Bureau show the county at 1,142,234 making it the most populous jurisdiction in the Commonwealth of Virginia, with about 13.6% of Virginia's population. The proximity to Washington, D.C. and the influence of the federal government and its spending provides somewhat of a recession shelter for the area. The Fairfax County government provides the following information about current economic conditions and trends in Fairfax County.

During 2016, the average home sales price in Fairfax County remained constant at \$544 thousand to 2015. Home sales volume increased, from 14,850 in 2015 to 15,755 in 2016 for Fairfax County. Home sale values in the Washington DC area rose 3.4% during 2016 when compared to the same period as reported by Standard & Poor's Case-Shiller Home Price Indices.

According to the Federal Reserve Board's Fifth District – Richmond February 2017 report, Virginia's economy grew moderately according to the most recent data with positive employment reports, stable household conditions, and mostly positive housing market indicators. Overall vacancy rates in Northern Virginia remained steady in 2016 as compared to 2015 at 21.1% which is still above the historical average of 17.0%.

At December 31, 2016 and 2015, the Bank had approximately \$184.7 million and \$147.6 million, respectively, in non-owner occupied income producing commercial real estate loans. The properties securing these loans are generally small office buildings and industrial properties located in our trade area with less than ten tenants. Income producing property loans are underwritten with personal and business guarantees that provide secondary sources of repayment and mitigate market risk factors.

The unemployment rate for Fairfax County was 3.0% in December 2016 compared to 4.1% for the state of Virginia and 4.7% for the nation. Median household income in Fairfax County was \$112,552 compared to Virginia at \$65,015.

## **Competition**

The Bank competes with virtually all banks and financial institutions which offer services in its market area. Much of this competition comes from large financial institutions headquartered outside the state of Virginia, each of which has greater financial and other resources to conduct large advertising campaigns and offer incentives. To attract business in this competitive environment, the Bank relies on personal contact by its officers and directors, local promotional activities, and the ability to provide personalized custom services to small and medium sized businesses and professionals. In addition to providing full service banking, the Bank offers and promotes alternative and modern conveniences such as internet banking, automated clearinghouse transactions, remote deposit capture, and courier services for commercial clients. Because federal regulation of financial institutions changes regularly and is the subject of constant legislative debate, we cannot foresee how federal regulation of financial institutions may change in the future. However, it is possible that current and future governmental regulatory and economic initiatives could impact the competitive landscape in the Bank's markets.

### **Employees**

At December 31, 2016 the Corporation had 276 employees, 148 of whom were employed by the Bank (excluding the Mortgage Division), 113 of whom were employed by the Mortgage Division, and 15 of whom were employed by the Wealth Management subsidiaries. None of the employees of the Corporation are subject to a collective bargaining agreement. Management considers employee relations to be good.

### **Supervision and Regulation**

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

**General.** The financial crisis of 2008, the threat of collapse of numerous financial institutions, and other recent events led to the adoption of numerous new laws and regulations that apply to and focus on financial institutions. The most significant of these laws is the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") which was adopted on July 21, 2010 and, in part, is intended to implement significant structural reforms to the financial services industry. The Dodd-Frank Act is discussed in more detail below.

The Corporation continues to experience a period of rapidly changing regulations and an environment of constant regulatory reform. These regulatory changes could have a significant impact on how the Corporation conducts its business. The specific implications of these new laws and regulations cannot yet be fully predicted and will depend to a large extent on the specific regulations that are adopted in the future.

As a national bank, the Bank is subject to regulation, supervision, and regular examination by 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 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 ("CRA") and fair housing initiatives, 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 Federal Reserve Board and applicable provisions of Virginia law, insofar as they do not conflict with or are not preempted by federal banking law.

The regulations of the FDIC, the Comptroller, and Federal Reserve Board govern most aspects of the Corporation's business, including deposit reserve requirements, investments, loans, certain check clearing activities, issuance of securities, payment of dividends, branching, deposit interest rate ceilings, and numerous other matters. The Federal Reserve Board, the Comptroller and the FDIC have adopted guidelines and released interpretative 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 capital management, internal controls, internal audit system, information systems and cybersecurity, loan documentation, credit underwriting, interest rate exposure and risk management, vendor management, executive management and its compensation, asset growth, asset quality, earnings, liquidity and risk management.

As a consequence of the extensive regulation of commercial banking activities in the United States, the Corporation's business is particularly susceptible to changes in state and federal legislation and regulations, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

***The Bank Holding Company Act.*** The Corporation is a bank holding company within the meaning of the Bank Holding Company Act of 1956, and is registered as such with, and subject to the supervision of, the Federal Reserve Board and the Federal Reserve Bank of Richmond. A bank holding company is required to obtain the approval of the Federal Reserve Board 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.

Generally, a bank holding company is required to obtain the approval of the Federal Reserve Board 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% of the voting shares of such bank. The Federal Reserve Board's approval is also required for the merger or consolidation of bank holding companies.

The Corporation is required to file periodic reports with the Federal Reserve Board and provide any additional information as the Federal Reserve Board may require. The Federal Reserve Board also has the authority to examine the Corporation and the Bank, as well as any arrangements between the Corporation and the Bank, with the cost of any such examinations to be borne by the Corporation. The Federal Reserve Board 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 Federal Reserve Board 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.

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.

***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 Corporation and the Bank. Provisions of the Dodd-Frank Act that significantly affect the business of the Corporation and the Bank include the following:

Creation of a new agency, Consumer Financial Protection Bureau ("CFPB"), that has rulemaking authority for a wide range of consumer protection laws that would apply to all banks and have broad powers to supervise and enforce consumer protection laws.

Changes in standards for Federal preemption of state laws related to federally chartered institutions, such as the Bank, and their subsidiaries.

Permanent increase of deposit insurance coverage to \$250 thousand and permission for depository institutions to pay interest on business checking accounts.

Changes in the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminates the ceiling on the size of the Deposit Insurance Fund (“DIF”), and increases the floor of the size of the DIF.

Prohibition on banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the “Volker Rule”).

Requires loan originators to retain 5 percent of any loan sold or securitized, unless it is a “qualified residential mortgage”, subject to certain exceptions.

Some of the rules that have been proposed and, in some cases, adopted to comply with the Dodd-Frank Act’s mandates are discussed further below.

**Dividends.** There are both federal and state regulatory restrictions on dividend payments by both the Bank and the Corporation that may affect the Corporation’s ability to pay dividends on its common stock. As a bank holding company, the Corporation is a separate legal entity from the Bank. Virtually all of the Corporation’s income results from dividends paid to the Corporation by the Bank. The amount of dividends that may be paid by the Bank depends upon the Bank’s net income and capital position and is limited by federal and state law, regulations, and policies. In addition to specific regulations governing the permissibility of dividends, the Federal Reserve Board and the Comptroller are generally authorized to prohibit payment of dividends if they determine that the payment of dividends by the Corporation or the Bank, respectively, would be an unsafe and unsound banking practice. The Corporation began paying dividends in February 2006 and, as of March 16, 2017, meets all regulatory requirements to continue doing so. The Corporation declared and paid dividends totaling \$6.3 million in 2016 discussed in more detail under “Item 5 - Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities”.

**Capital Requirements.** The Federal Reserve Board, the Comptroller and the FDIC 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”) that apply to banking organizations they supervise. For the 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 stocks 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 the 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, importantly including applying higher risk weightings to certain commercial real estate loans.

The Basel III Final Rules were effective on January 1, 2015, and the Basel III Final Rules capital conservation buffer (as described below) is being phased in from 2016 to 2019.

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

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, and primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. These deductions from and adjustments to regulatory capital are generally being phased in beginning in 2015 through 2018. The Basel III Final Rules permanently includes in Tier 1 capital trust preferred securities issued prior to May 19, 2010 by bank holding companies with less than \$15 billion in total assets, subject to a limit of 25% of Tier 1 capital.

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%).

**Prompt Corrective Action.** The federal banking agencies have broad powers to take prompt corrective action to resolve problems of insured depository institutions. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), there are five capital categories applicable to 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”, as such terms are defined under uniform regulations issued by each of the federal banking agencies. If the appropriate federal banking agency determines that an insured institution is in an unsafe or unsound condition, it may reclassify the institution to a lower capital category (other than critically undercapitalized) and require the submission of a plan to correct the unsafe or unsound condition.

Failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for a financial institution could subject the Corporation and the Bank 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 cannot 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 payment of such a distribution would cause the Bank to become undercapitalized, it could not pay a dividend to the Corporation.

**Deposit Insurance.** 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, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target “designated reserve ratio” (described in more detail below) of 2 percent for the DIF and established a lower assessment rate schedule when the reserve ratio reaches 1.15 percent and, in lieu of dividends, provides for a lower assessment rate schedule, when the reserve ratio reaches 2 percent and 2.5 percent. An institution’s assessment rate is based on a statistical analysis of financial ratios that estimates the likelihood of failure over a three year period, which considers the institution’s weighted average CAMELS component rating, and is subject to further adjustments including related to levels of unsecured debt and

brokered deposits (not applicable to banks with less than \$10 billion in assets). At December 31, 2016, total base assessment rates for institutions that have been insured for at least five years range from 1.5 to 40 basis points, with rates of 1.5 to 30 basis points applying to banks with less than \$10 billion in assets.

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

***Confidentiality and Required Disclosures of Financial Information.*** The Corporation 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 other regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution’s policies and procedures regarding the handling of customers’ nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer’s personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure. In 2016, the CFPB proposed rules that provide an exception to the requirement to deliver an annual privacy notice if a financial institution only provides nonpublic personal information to unaffiliated third parties under limited exceptions under the Gramm-Leach-Bliley Act and related regulations, and has not changed its policies and practices regarding disclosure of nonpublic personal financial information from those disclosed in the most recent privacy notice provided to the customer.



The Corporation is 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, the financing of terrorism, and imposes recordkeeping and reporting requirements. The USA Patriot Act provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Certain provisions of the USA PATRIOT Act impose the obligation to establish anti-money laundering programs. The Federal Bureau of Investigation (“FBI”) has sent, and will send, our banking regulatory agencies lists of the names of persons suspected of involvement in terrorist activities. The Bank has been requested, and will be requested, to search its records for any relationships or transactions with persons on those lists. If the Bank finds any relationships or transactions, it must file a suspicious activity report and contact the FBI. The Office of Foreign Assets Control (“OFAC”), which is a division of the U.S. Treasury, is responsible for helping to insure 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. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts, and publicly releases information on designations of persons and organizations suspected of engaging in these activities. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds in a blocked account, file a suspicious activity report and notify the FBI.

***Community Reinvestment Act.*** The Bank is subject to the requirements of CRA. The CRA 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 currently are evaluated as part of the examination process pursuant to three performance tests. These factors also are considered in evaluating mergers, acquisitions, and applications to open a branch or facility. In April 2015, the Bank received a “satisfactory” CRA rating.

***Federal Home Loan Bank (“FHLB”) of Atlanta.*** The Bank is a member of the FHLB of Atlanta, which is one of twelve regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development lending. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member the Bank is required to purchase and maintain stock in the FHLB in an amount equal to 4.25% of aggregate outstanding advances and letters of credit in addition to the membership stock requirement of 0.09% of the Bank’s total assets.

***Consumer Protection.*** The Dodd-Frank Act created the CFPB, a federal regulatory agency that is 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 Dodd-Frank Act gives the CFPB authority to supervise and regulate providers of consumer financial products and services, and establishes the CFPB’s power to act against unfair, deceptive or abusive practices, and gives the CFPB 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 Corporation by the Federal Reserve Board and to the Bank by the Comptroller. However, the CFPB may include its own examiners in regulatory examinations by a small 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, could influence how the Federal Reserve Board 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 Corporation and the Bank cannot be determined with certainty.

***Mortgage Banking Regulation.*** The Mortgage Division is subject to the rules and regulations of, and examination by, HUD, the Federal Housing Administration, the Department of Veterans Affairs, and state regulatory authorities with respect to originating, processing, and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers, and, in some cases, restrict certain loan features and fix maximum interest rates and fees. In addition to other federal laws, 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 there under. These laws prohibit discrimination, 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 Mortgage Division's mortgage origination activities are also subject to Regulation Z, which implements the Truth-in-Lending Act. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined as mortgage loans without negative amortization, interest-only payments, balloon payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3% of the total loan amount. Higher-priced qualified mortgages (e.g., subprime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Mortgage Division predominately originates mortgage loans that comply with Regulation Z's "qualified mortgage" rules.

**Consumer Laws and Regulations.** The Bank 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 Expedited Funds Availability 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 Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

**Incentive Compensation.** The Federal Reserve Board, the Comptroller and the FDIC 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 Federal Reserve Board will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Corporation, 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 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.

**Stress Testing.** As required by the Dodd-Frank Act, the federal banking agencies have implemented stress testing requirements for certain financial institutions, including bank holding companies and state chartered banks, with more than \$10 billion in total consolidated assets. Although these requirements do not apply to institutions with \$10 billion or less in total consolidated assets, the federal banking agencies, including the Comptroller, emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential impact of adverse market conditions or outcomes on the organization's financial condition. Based on existing regulatory guidance, the Corporation and the Bank will be expected to consider the institution's interest rate risk management, commercial real estate concentrations and other credit-related information, and funding and liquidity management during this analysis of adverse market conditions or outcomes.

**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 Corporation believes that its financial condition and its operations are not and will not be significantly affected by the Volcker Rule or its implementing regulations.

## **ITEM 1A – RISK FACTORS**

### Risks Related to the Corporation's Business

#### **Our future success will depend on our ability to compete effectively in the highly competitive financial services industry in Northern Virginia.**

We face substantial competition in all phases of our operations from a variety of different competitors. In particular, there is very strong competition for financial services in Northern Virginia and the greater Washington, D.C. Metropolitan Area in which we conduct a substantial portion of our business. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds and other mutual funds, as well as other local and community, super-regional, national and international financial institutions that operate offices in our primary market areas and elsewhere. Our future growth and success will depend on our ability to compete effectively in this highly competitive financial services environment. Many of our competitors are well-established, larger financial institutions and many offer products and services that we do not. Many have substantially greater resources, name recognition and market presence that benefit them in attracting business. Some of our competitors are not subject to the same regulation as is imposed on bank holding companies and federally-insured national banks, including credit unions which do not pay federal income tax, and, therefore, have regulatory advantages over us in accessing funding and in providing various services. While we believe we compete effectively with these other financial institutions in our primary markets, we may face a competitive disadvantage as a result of our smaller size, smaller asset base, lack of geographic diversification and inability to spread our marketing costs across a broader market. If we have to raise interest rates paid on deposits or lower interest rates charged on loans to compete effectively, our net interest margin and income could be negatively affected. Failure to compete effectively to attract new or to retain existing clients may reduce or limit our net income and our market share and may adversely affect our results of operations, financial condition and growth.

#### **Our profitability depends on interest rates generally, and we may be adversely affected by changes in government monetary policy or by fluctuations in interest rates.**

Our profitability depends in substantial part on our net interest margin, which is the difference between the rates we receive on loans and investments and the rates we pay for deposits and other sources of funds. Our net interest margin depends on many factors that are partly or completely outside of our control, including competition, federal economic, monetary and fiscal policies, and economic conditions generally. Our net interest income will be adversely affected if market interest rates change so that the interest we pay on deposits and borrowings increases faster than the interest we earn on loans and investments.

Changes in interest rates, particularly by the Board of Governors of the Federal Reserve Board, which implements national monetary policy in order to mitigate recessionary and inflationary pressures, also affect the value of our loans. In setting its policy, the Federal Reserve Board may utilize techniques such as: (i) engaging in open market transactions in United States government securities; (ii) setting the discount rate on member bank borrowings; and (iii) determining reserve requirements. These techniques may have an adverse effect on our deposit levels, net interest margin, loan demand or our business and operations. In addition, an increase in interest rates could adversely affect borrowers' ability to pay the principal or interest on existing loans or reduce their desire to borrow more money. This may lead to an increase in our non-performing assets, a decrease in loan originations, or a reduction in the value of and income from our loans, any of which could have a material and negative effect on our results of operations. We try to minimize our exposure to interest rate risk, but we are unable to completely eliminate this risk. Fluctuations in market rates and other market disruptions are neither predictable nor controllable and may have a material and negative effect on our business, financial condition and results of operations. In addition, the Federal Reserve Board's Federal Open Market Committee has stated that it expects to keep the federal funds target rate at 0.50% - 0.75% until economic and labor conditions (as indicated by the unemployment rate and the inflation rate) improve; however, we are anticipating another 0.25% rate hike in March 2017. Sustained low interest rates could put further pressure on the yields generated by the Corporation's loan portfolio and on the Corporation's net interest margin.

At December 31, 2016 approximately 54% of the loans held for investment were variable rate loans. A majority of these loans are based on the prime rate and will adjust upwards as the prime rate increases. While the variable rate structure on these loans reduces interest rate risk for the Bank, increases in rates may cause the borrower's required payment to increase which, in turn, may increase the risk of payment default.

**Because we make loans primarily to local small and medium sized businesses, our profitability depends significantly on local economic conditions, particularly real estate values, and the success of those businesses.**

As a lender, we are exposed to the risk that our loan clients may not repay their loans according to their terms and any collateral securing payment may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs we incur disposing of the collateral. Although we have collateral for most of our loans, that collateral can fluctuate in value and may not always cover the outstanding balance on the loan. With most of our loans concentrated in Northern Virginia, a decline in local economic conditions could adversely affect the values of our real estate collateral. Consequently, a decline in local economic conditions may have a greater effect on our net income and capital than on the net income and capital of larger financial institutions whose real estate loan portfolios are more geographically diverse.

In addition to assessing the financial strength and cash flow characteristics of each of our borrowers, the Bank often secures loans with real estate collateral. At December 31, 2016, approximately 70% of our Bank's loans held for investment have real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our net income and capital could be adversely affected.

**Our business strategy includes the continuation of our growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.**

We intend to continue to grow in our existing banking markets (internally and through additional offices) and to expand into new markets as appropriate opportunities arise. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies that are experiencing growth. We cannot assure you we will be able to expand our market presence in our existing markets or successfully enter new markets, or that any expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our growth occurs more slowly than anticipated or declines, our operating results could be materially affected in an adverse way. Our ability to successfully grow will depend on a variety of factors, including the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market areas and our ability to manage our growth. While we believe we have the management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or growth will be successfully managed.

Although we have made a limited number of acquisitions to date, the announced merger with Middleburg could result in a decline in shareholder value for the following reasons:

***If Access and Middleburg do not successfully integrate, the combined company may not realize the expected benefits from the merger.***

Integration in connection with a merger is sometimes difficult, and there is a risk that integrating Access and Middleburg may take more time and resources than we expect. Access's ability to integrate Middleburg and its future success depend in large part on the ability of members of its board of directors and executive officers to work together effectively. After the merger, Access will be governed by a board of directors comprised of 13 directors, of which seven are current directors of Access and the following six are directors of Middleburg: John C. Lee, IV, Childs F. Burden, Gary D. LeClair, Mary Leigh McDaniel, Janet A. Neuharth, and Gary R. Shook. One of the six such Middleburg directors, John C. Lee, IV, current chairman of Middleburg's board of directors, will serve as chairman of Access's board of directors; Michael G. Anzilotti, the current chairman of Access's board, will serve as vice chairman

of Access's board; and the Executive Committee of the Access Board of Directors shall be Mr. Anzilotti, Martin S. Friedman, Michael W. Clarke, Mr. Lee, IV, and Mr. Shook. The executive officers of Access will continue serving in their current positions as executive officers of Access after the merger, and Mr. Shook and Jeffrey H. Culver will also serve as officers of Access after the merger as Chairman and Chief Executive Officer of Middleburg Investment Group and Chairman of Middleburg Trust Company, and as Executive Vice President and Chief Operating Officer, respectively. Disagreements among board members and executive management could arise in connection with integration issues, strategic considerations and other matters. As a result, there is a risk that Access's board of directors and executive officers may not be able to operate effectively, which would affect adversely Access's ability to integrate the operations of Access and Middleburg successfully and Access's future operating results.

*· Access may not be able to effectively integrate the operations of Middleburg Bank into Access National Bank.*

The future operating performance of Access and Access National Bank will depend, in part, on the success of the merger of Middleburg Bank and Access National Bank. After the merger of Access and Middleburg and at a time to be determined by Access, Middleburg Bank will be merged with and into Access National Bank with Access National Bank surviving. After the merger of Access and Middleburg, each director of Access, in addition to Mark Moore, President of Access National Bank, will serve as a director of Access National Bank and as a director of Middleburg Bank, and executive officers of Access National Bank will continue serving in their current positions as officers of Access National Bank. After the merger of Access and Middleburg, Mr. Shook and Mr. Culver will also serve as officers of Access National Bank as President of Middleburg Bank, an operating division of Access National Bank, and as Executive Vice President and Chief Operating Officer, respectively, and all executive officers of Access National Bank will serve in substantially similar positions as officers of Middleburg Bank. The success of the merger of the banks will, in turn, depend on a number of factors, including Access's ability to: (i) integrate the operations and branches of Middleburg Bank and Access National Bank; (ii) retain the deposits and customers of Middleburg Bank and Access National Bank; (iii) control the incremental increase in noninterest expense arising from the merger in a manner that enables the combined bank to improve its overall operating efficiencies; and (iv) retain and integrate the appropriate personnel of Middleburg Bank into the operations of Access National Bank, as well as reducing overlapping bank personnel. The integration of Middleburg Bank and Access National Bank following the subsidiary bank merger will require the dedication of the time and resources of the banks' management and may temporarily distract managements' attention from the day-to-day business of the banks. If Access National Bank is unable to successfully integrate Middleburg Bank, Access National Bank may not be able to realize expected operating efficiencies and eliminate redundant costs.



***Regulatory approvals may not be received, may take longer than expected or may impose conditions that are not presently anticipated or that could have an adverse effect on the surviving corporation following the merger.***

Before the merger of Middleburg into Access, or the merger of Middleburg Bank into Access National Bank, may be completed, Access and Middleburg must obtain approvals from the Federal Reserve, the Virginia SCC and the Office of the Comptroller of the Currency (the "OCC"). Other approvals, waivers or consents from regulators may also be required. In determining whether to grant these approvals the regulators consider a variety of factors, including the regulatory standing of each party, the competitive effects of the contemplated transactions, as well as other factors.

An adverse development in either party's regulatory standing or these factors could result in an inability to obtain approval or delay their receipt. The Community Reinvestment Act of 1977, as amended, and the regulations issued thereunder (which we refer to as the "CRA") also requires that the bank regulatory authorities, in deciding whether to approve the merger and the bank merger, assess the records of performance of Access National Bank and Middleburg Bank in meeting the credit needs of the communities they serve, including low and moderate income neighborhoods. Each of Access National Bank and Middleburg Bank currently maintains a CRA rating of "Satisfactory" from its primary regulator. As part of the review process under the CRA, it is not unusual for the bank regulatory authorities to receive protests and other adverse comments from community groups and others. Any such protests or adverse comments could prolong the period during which the merger and the bank merger are subject to review by the bank regulatory authorities.

These regulators may impose conditions on the completion of the merger or the bank merger or require changes to the terms of the merger or the bank merger. Such conditions or changes could have the effect of delaying or preventing completion of the merger or the bank merger or imposing additional costs on or limiting the revenues of the surviving corporation following the merger and the bank merger, any of which might have an adverse effect on the surviving corporation following the merger.

***The merger may distract management of Access from their other responsibilities.***

The merger could cause the management group of Access to focus their time and energies on matters related to the transaction that otherwise would be directed to their business and operations. Any such distraction on the part of the company's management could affect its ability to service existing business and develop new business and adversely affect the business and earnings of Access before the merger, or the business and earnings of Access after the merger.

***Termination of the merger agreement could negatively impact Access.***

If the merger agreement is terminated, Access's business may be impacted adversely by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger. Additionally, if the merger agreement is terminated, the market price of Access's common stock could decline to the extent that the current market prices reflect a market assumption that the merger

will be completed. Furthermore, costs relating to the merger, such as legal, accounting and financial advisory fees, must be paid even if the merger is not completed. If the merger agreement is terminated under certain circumstances, including circumstances involving a change in recommendation by Access's or Middleburg's board of directors, Access (or Middleburg) may be required to pay to the other party a termination fee of \$9.9 million.

***The fairness opinion received by the board of directors of Access in connection with the merger prior to the signing of the merger agreement has not been updated to reflect changes in circumstances since the signing of the merger agreement.***

The opinion rendered by FBR Capital Markets & Co., financial advisor to Access, orally on October 20, 2016 and subsequently confirmed in writing on October 21, 2016, is based upon information available as of such date. The opinion has not been updated to reflect changes that may occur or may have occurred after the date on which it was delivered, including changes to the operations and prospects of Access, changes in general market and economic conditions, or other changes. Any such changes may alter the relative value of Access or the price of shares of Access common stock by the time the merger is completed. The opinion does not speak as of the date the merger will be completed or as of any date other than the date of such opinions.

***The merger agreement limits the ability of Access to pursue alternatives to the merger and might discourage competing offers for a higher price or premium.***

The merger agreement contains “no-shop” provisions that, subject to limited exceptions, limit the ability of Access to discuss, facilitate or commit to competing third-party proposals to acquire all or a significant part of the company. In addition, under certain circumstances, if the merger agreement is terminated and Access, subject to certain restrictions, consummates a similar transaction other than the merger, the party consummating such transaction must pay to the other a termination fee of \$9.9 million. These provisions might discourage a potential competing acquiror that might have an interest in acquiring all or a significant percentage of ownership of Access from considering or proposing the acquisition even if it were prepared to pay consideration, with respect to Access, with a per share market price that would amount to a premium over the current per share market price of Access.

***Access will be subject to business uncertainties and contractual restrictions while the merger is pending.***

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on Access. These uncertainties may impair Access’s ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with Access to seek to change existing business relationships with Access. Retention of certain employees by Access may be challenging while the merger is pending, as certain employees may experience uncertainty about their future roles with Access. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with Access, Access’s business, or the business of the combined company following the merger, could be harmed. In addition, subject to certain exceptions, Access has agreed to operate its business in the ordinary course prior to closing and refrain from taking certain specified actions until the merger occurs, which may prevent Access from pursuing attractive business opportunities that may arise prior to completion of the merger.

***If the merger is not completed, Access will have incurred substantial expenses without realizing the expected benefits of the merger.***

Access has incurred and will incur substantial expenses in connection with the negotiation and completion of the transactions contemplated by the merger agreement, as well as the costs and expenses of filing, printing and mailing a joint proxy statement/prospectus and all filing and other fees paid to the SEC in connection with the merger. If the merger is not completed, Access would have to incur these expenses without realizing the expected benefits of the merger.

**Access may need additional access to capital, which Access may be unable to obtain on attractive terms or at all.**

Access may need to incur additional debt or equity financing in the future to make strategic acquisitions or investments for future growth or to fund losses or additional provision for loan losses in the future. Access's ability to raise additional capital, if needed, will depend in part on conditions in the capital markets at that time, which are outside of Access's control, and on Access's financial performance. Accordingly, Access may be unable to raise additional capital, if and when needed, on terms acceptable to it, or at all. If Access cannot raise additional capital when needed, its ability to further expand its operations through internal growth and acquisitions could be materially impaired and its stock price negatively affected.

**Access may borrow funds or issue additional debt and equity securities or securities convertible into equity securities, any of which may be senior to Access common stock as to distributions and in liquidation, which could negatively affect the value of Access common stock.**

In the future, Access may attempt to increase its capital resources by entering into debt or debt-like financing that is unsecured or secured by all or up to all of Access's assets, or by issuing additional debt or equity securities, which could include issuances of secured or unsecured commercial paper, medium-term notes, senior notes, subordinated notes, preferred stock, common stock, or securities convertible into or exchangeable for equity securities. In the event of Access's liquidation, its lenders and holders of its debt and preferred securities would receive a distribution of its available assets before distributions to the holders of Access common stock. Because Access's decision to incur debt and issue securities in its future offerings will depend on market conditions and other factors beyond Access's control, Access cannot predict or estimate with certainty the amount, timing or nature of its future offerings and debt financings. Further, market conditions could require Access to accept less favorable terms for the issuance of its securities in the future. In addition, the borrowing of funds or the issuance of debt would increase Access's leverage and decrease its liquidity, and the issuance of additional equity securities would dilute the interests of Access's existing shareholders.

**Sales of a significant number of shares of Access common stock in the public markets, or the perception of such sales, could depress the market price of Access common stock.**

Sales of a substantial number of shares of Access common stock in the public markets, including shares issued to shareholders of acquired institutions, and the availability of those shares for sale could adversely affect the market price of Access common stock. In addition, future issuances of equity securities, including pursuant to outstanding options, could dilute the interests of Access's existing shareholders and could cause the market price of Access common stock to decline. Access may issue such additional equity or convertible securities to raise additional capital. Depending on the amount offered and the levels at which Access offers the stock, issuances of common or preferred stock could be substantially dilutive to holders of Access common stock. Moreover, to the extent that Access issues restricted stock, options or warrants to purchase Access common stock in the future and those options or warrants are exercised or as shares of the restricted stock vest, Access shareholders may experience further dilution. Holders of shares of Access common stock have no preemptive rights that entitle holders to purchase their pro-rata share of any offering of shares of any class or series and, therefore, such sales or offerings could result in increased dilution to Access shareholders. Access cannot predict with certainty the effect that future sales of Access common stock would have on the market price of its common stock.

**Our allowance for loan losses could become inadequate and reduce our net income and capital.**

We maintain an allowance for loan losses that we believe is adequate for absorbing any potential losses in our loan portfolio. Management conducts a periodic review and consideration of the loan portfolio to determine the amount of the allowance for loan losses based upon general market conditions, credit quality of the loan portfolio and performance of our clients relative to their financial obligations with us. The amount of future losses, however, is susceptible to changes in borrowers' circumstances and economic and other market conditions, including changes in interest rates and collateral values that are beyond our control, and these future losses may exceed our current estimates. Our allowance for loan losses at December 31, 2016 was \$16.0 million. Although we believe the allowance for loan losses is adequate to absorb probable losses in our loan portfolio, we cannot predict such losses or guarantee that our allowance will be adequate in the future. Excessive loan losses could have a material impact on our financial performance and reduce our net income and capital.

**Our future liquidity needs could exceed our available liquidity sources, which could limit our asset growth and adversely affect our results of operations and financial condition.**

We rely on dividends from the Bank as our primary source of funds. The primary sources of funds of the Bank are client deposits and loan repayments. While scheduled loan repayments are a relatively stable source of funds, they are subject to the ability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors, including changes in economic conditions, adverse trends or events affecting business industry

groups, reductions in real estate values or markets, business closings or lay-offs, inclement weather, natural disasters, and international instability. Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, regulatory capital requirements, returns available to clients on alternative investments, and general economic conditions. Accordingly, we may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. Such sources include FHLB advances, sales of securities and loans, and federal funds lines of credit from correspondent banks, as well as out-of-market time deposits. While we believe that these sources are currently adequate, there can be no assurance they will be sufficient to meet future liquidity demands, particularly if we continue to grow and experience increasing loan demand. We may be required to slow or discontinue loan growth, capital expenditures or other investments or liquidate assets should such sources not be adequate.

We are subject to extensive regulation that could limit or restrict our activities and adversely affect our net income.

We operate in a highly regulated industry, and both the Corporation and the Bank are subject to extensive regulation and supervision by the Federal Reserve Board, the Comptroller, and the FDIC. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capitalization guidelines established by our regulators, which require us to maintain adequate capital to support our growth. Many of these regulations are intended to protect depositors and the FDIC's DIF rather than our shareholders.

The Sarbanes-Oxley Act of 2002, and the related rules and regulations promulgated by the SEC and NASDAQ that are applicable to us, have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices, including the cost of completing our audit and maintaining our internal controls. As a result, we have experienced and expect to continue to experience greater compliance costs.

Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Corporation in substantial and unpredictable ways. Such changes could subject the Corporation to additional costs, limit the types of financial services and products the Corporation may offer and/or increase the ability of non-banks that are not subject to similar regulation to offer competing financial services and products, which could place these non-banks in stronger, more favorable competitive positions and which could adversely affect the Corporation's growth and ability to operate profitably. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Corporation's business, financial condition and results of operations.

**The Dodd-Frank Act has increased the Corporation's regulatory compliance burden and associated costs, placed restrictions on certain products and services, increases the risk and liability of consumer litigation, and limited its future capital raising strategies.**

A wide range of regulatory initiatives directed at the financial services industry has been proposed and/or implemented in recent years. One of those initiatives, the Dodd-Frank Act, was enacted in 2010 and mandates significant changes in the financial regulatory landscape that have impacted and will continue to impact all financial institutions, including the Corporation and the Bank. Since its enactment, the Dodd-Frank Act has increased, and will likely continue to increase, the Corporation's regulatory compliance burden and may have a material adverse effect on the Corporation by increasing the costs associated with regulatory examinations and compliance measures. However, it is too early to fully assess the impact of the Dodd-Frank Act and subsequent regulatory rulemaking processes on the Corporation's and the Bank's business, financial condition or results of operations.

Among the Dodd-Frank Act's significant regulatory changes, the Act created the Consumer Financial Protection Bureau, a financial consumer protection agency that has the authority to impose new regulations and include its examiners in routine regulatory examinations conducted by the Comptroller. The CFPB may reshape the consumer financial laws through rulemaking and enforcement of the Dodd-Frank Act's prohibitions against unfair, deceptive and abusive business practices, which may directly impact the business operations of financial institutions offering consumer financial products or services, including the Corporation and the Bank. This agency's broad rulemaking authority includes identifying practices or acts that are unfair, deceptive or abusive in connection with any consumer financial transaction or consumer financial product or service. Although the CFPB generally has jurisdiction over banks with \$10 billion or greater in assets, rules, regulations and policies issued by the CFPB may also apply to the Corporation, the Bank and/or the Mortgage Division by virtue of the adoption of such policies and best practices by the Federal Reserve Board, Comptroller and FDIC. The costs and limitations related to this additional regulatory agency and the limitations and restrictions that may be placed upon the Corporation with respect to its consumer product and service offerings have yet to be determined. However, these costs, limitations and restrictions may produce significant, material effects on the Corporation's business, financial condition and results of operations.

The Dodd-Frank Act also increases regulatory supervision and examination of bank holding companies and their banking and non-banking subsidiaries. These and other regulations included in the Dodd-Frank Act could increase the Corporation's regulatory compliance burden and costs, restrict the financial products and services the Corporation can offer to its customers and restrict the Corporation's ability to generate revenues from non-banking operations. The Dodd-Frank Act imposes more stringent capital requirements on bank holding companies, which may cause the Corporation to reevaluate elements of its business focus and shape future capital strategies.

In January 2014, the Qualified Mortgage (QM) and Qualified Residential Mortgage (QRM) rules became effective under the Dodd Frank Act and may impact the willingness and ability of community banks and secondary market participants to make mortgage loans. Among other requirements, these rules require lenders to show that borrowers met an "ability to repay" test – which can be challenged in court for the entire life of the loan, raising the risk of litigation. Failure to prove the ability to repay can result in the lender's obligation to reimburse the borrower for all payments made. Together with newly imposed timeline restrictions covering the liquidation of problem consumer mortgage loans, litigation over "ability to repay" may delay the time to collect on soured consumer mortgages and result in elevated problem assets and increased loss rates.

**The Basel III Final Rules require higher levels of capital and liquid assets, which could adversely affect the Corporation's net income and return on equity.**

The Basel III Final Rules represent the most comprehensive overhaul of the U.S. banking capital framework in over two decades. This new capital framework and related changes to the standardized calculations of risk-weighted assets are complex and create additional compliance burdens, especially for community banks. The Basel III Final Rules require bank holding companies and their subsidiaries, such as the Corporation and the Bank, to maintain significantly more capital as a result of higher required capital levels and more demanding regulatory capital risk weightings and calculations. As a result of the Basel III Final Rules, many community banks could be forced to limit banking operations, activities and growth of loan portfolios, in order to focus on retention of earnings to improve capital levels. The Corporation believes that it maintains sufficient levels of Tier 1 and Common Equity Tier 1 capital to comply with the Basel III Final Rules. However, the Corporation can offer no assurances with regard to the ultimate effect of the Basel III Final Rules, and satisfying increased capital requirements imposed by the Basel III Final Rules may require the Corporation to limit its banking operations, retain net income or reduce dividends to improve regulatory capital levels, which could negatively affect our business, financial condition and results of operations.



If the Corporation were to require additional capital as a result of phasing in 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 banks raising capital that significantly dilutes existing shareholders. Additionally, the Corporation could 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 Corporation's return on equity.

**Our hedging strategies do not completely eliminate risks associated with interest rates and we may incur losses due to changes in interest rates that are not effectively hedged.**

We use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely, and we cannot assure you that our hedging strategy and use of derivatives will offset the risks related to changes in interest rates. When rates change, we expect to record a gain or loss on derivatives that would be offset by an inverse change in the value of loans held for sale and mortgage-related securities. We utilize a third party consulting firm to manage our hedging activities and we typically hedge 80% of our loan pipeline and 100% of our loans being warehoused. The derivative financial instruments used to hedge the interest rate risk of our loan pipeline and warehoused loans are forward sales of 15 year and 30 year mortgage backed securities. The notional amount and fair value of these derivatives are disclosed in Note 8 of the financial statements.

The primary risks related to our hedging activities relate to incorrect assumptions regarding pull through and the amount of the pipeline being hedged. A hedging policy and hedging management committee are in place to control, monitor and manage risks associated with our hedging activity. The hedging policy quantifies risk tolerance thresholds that ensure the economic risk taken is not material to the Corporation's financial condition or operating performance. See "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies" and "Item 7A - Quantitative and Qualitative Disclosures About Market Risk."

The profitability of the Mortgage Division will be significantly reduced if we are not able to sell mortgages.

Currently, we generally sell all of the mortgage loans originated by the Mortgage Division. We only underwrite mortgages that we reasonably expect will have more than one potential purchaser. The profitability of our Mortgage Division depends in large part upon our ability to originate or purchase a high volume of loans and to quickly sell them in the secondary market. Thus, we are dependent upon (i) the existence of an active secondary market and (ii) our ability to sell loans into that market.

The Mortgage Division's ability to sell mortgage loans readily is dependent upon the availability of an active secondary market for single-family mortgage loans, which in turn depends in part upon the continuation of programs

currently offered by Fannie Mae and Freddie Mac and other institutional and non-institutional investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Some of the largest participants in the secondary market, including Fannie Mae and Freddie Mac, are government-sponsored enterprises with substantial market influence whose activities are governed by federal law. Any future changes in laws that significantly affect the activity of these government-sponsored enterprises and other institutional and non-institutional investors or any impairment of our ability to participate in such programs could, in turn, adversely affect our operations.

Fannie Mae and Freddie Mac have reported past substantial losses and a need for substantial amounts of additional capital. Such losses were due to these entities' business models being tied extensively to the U.S. housing market which severely contracted during the recent economic downturn. In response to the deteriorating financial condition of Fannie Mae and Freddie Mac from the U.S. housing market contraction, Congress and the U.S. Treasury undertook a series of actions to stabilize these entities. The Federal Housing Finance Agency, or FHFA, was established in July 2008 pursuant to the Regulatory Reform Act in an effort to enhance regulatory oversight over Fannie Mae and Freddie Mac. FHFA placed Fannie Mae and Freddie Mac into federal conservatorship in September 2008. Both Fannie Mae and Freddie Mac have returned to profitability as a result of the housing market recovery, but their long-term financial viability is highly dependent on governmental support. If the governmental support is inadequate, these companies could fail to offer programs necessary to an active secondary market. In addition, future policies that change the relationship between Fannie Mae and Freddie Mac and the U.S. government, including those that result in their winding down, nationalization, privatization, or elimination may have broad adverse implications for the residential mortgage market, the mortgage-backed securities market and the Mortgage Division's business, operations and financial condition. If this were to occur, the Mortgage Division's ability to sell mortgage loans readily could be hampered, and the profitability of the Bank could be significantly reduced.

**Our net income may be adversely affected if representations and warranties related to loans sold by the Mortgage Division are breached and we must pay related claims.**

The Mortgage Division makes representations and warranties that loans sold to investors meet their program's guidelines and that the information provided by the borrowers is accurate and complete and that the loan documents are complete and executed by the borrowers. In the event of a default on a loan sold, the investor may make a claim for losses due to document deficiencies, program compliance, early payment default, and fraud or borrower misrepresentations. The Mortgage Division maintains a reserve in other liabilities for potential losses on mortgage loans sold. Net income may be impacted if this reserve is insufficient to cover claims from the investors.

**Our net income, capital, and reputation may be adversely affected if our efforts to protect or authenticate customers' information or customers' transactions fails.**

Identity theft and data breaches are on the rise. To date, our losses have been immaterial due in part to our client awareness program, systems and controls. While we regularly review activity and adopt new practices when warranted to control exposure, we have no way of predicting when a compromise may occur and the magnitude or liability arising from such a compromise. In particular, the occurrence of identity theft or data breaches could expose the Corporation to risks of data loss or data misuse, could damage the Corporation's reputation and result in the loss of customers and business, could subject the Corporation to additional regulatory scrutiny or could expose the Corporation to civil litigation, possible financial liability and costly remedial measures. Any of these occurrences could have a material adverse effect on the Corporation's financial condition and results of operations.

**An economic downturn may adversely affect our operating results and financial condition because our small to medium sized business target market may have fewer financial resources to weather an economic downturn.**

We target our commercial development and marketing strategy primarily to serve the banking and financial services needs of small and medium sized businesses. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and, therefore, may be more vulnerable in an economic downturn. If general economic conditions negatively impact this economic sector in the markets in which we operate, our results of operations and financial condition may be adversely affected. In addition, the success of a small or medium sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse effect on the business and its ability to repay a loan.

**Negative public opinion could damage our reputation and the strength of our Access National brand and adversely impact our business, client relationships and net income.**

Reputation risk, or the risk to our businesses' (including our primary commercial banking business and secondary mortgage lending business) net income and capital from negative public opinion, is inherent in our business. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract clients and employees or our access to the capital markets and can expose us to litigation and regulatory action.

Virtually all of our businesses operate under the "Access National" brand. Any actual or alleged conduct by one of our businesses could result in negative public opinion about our other businesses under the Access National brand. Because our businesses rely on and leverage the strength of the Access National brand any negative public opinion that tarnishes our Access National brand may negatively impact our business, client relationships and financial performance. Although we take steps to minimize our reputation risk in dealing with our clients and communities, due to the nature of the commercial banking and mortgage lending businesses we will always face some measure of reputational risk.

**If the U.S. financial system were to destabilize again, the financial condition of our target markets may suffer, which could adversely affect our business.**

In response to the financial crises beginning in 2008 that affected the banking system and financial markets and going concern threats to investment banks and other financial institutions, various branches and agencies of the U.S. government put in place laws, regulations, and programs to address capital and liquidity issues in the banking system. There can be no assurance, however, as to the actual long-term impact that such laws, regulations, and programs will have on the financial markets.

Among many other contributing factors, the recent recession was triggered by instability of financial institutions and large measures of volatility and fear in the financial markets. This financial instability led to an economic downturn and current stagnant recovery which, in turn, has harmed the financial condition and performance of our small to medium sized business target market. If despite such laws, regulations, and programs the financial markets again destabilize, or recent financial market conditions deteriorate rather than continuing to improve or remain steady, the financial condition of our small to medium sized business target market would suffer and could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock.

**Significant reductions in U.S. government spending may have an adverse effect on our local economy and customer base.**

The Corporation's success depends significantly on the general economic conditions in the markets in which it operates. The economy of our primary market, the greater Washington, D.C. Metropolitan Area is significantly affected by federal government spending. In particular, Fairfax County, Virginia receives more federal procurement dollars than any other county in Virginia. Some of our customers may be particularly sensitive to the level of federal government spending, which is affected by many factors, including macroeconomic conditions, administrative and congressional priorities and the ability of the federal government to enact relevant appropriations bills and other legislation. Any of these or other factors could result in future cuts in, or uncertainty with respect to, federal spending, which could have a severe negative impact on individuals and businesses in our primary market areas. Any related increase in unemployment rates or reduction in business development activities in the greater Washington, D.C. Metropolitan Area could lead to increases in loan delinquencies, problem assets and foreclosures and reductions in loan collateral values, as well as other adverse implications that we cannot predict, all of which could have a material adverse effect on our financial performance and financial condition.

**We have substantial counterparty risk due to our transactions with financial institution counterparties and the soundness of such counterparties could adversely affect us.**

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers, dealers, commercial banks, investment banks, and government sponsored enterprises. Many of these transactions expose us to credit risk in the event of default of our counterparty. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or other obligation due us. There is no assurance that any such losses would not materially and adversely affect our financial condition and results of operations.

## **Risks Associated With The Corporation's Common Stock**

### **Our ability to pay dividends is subject to regulatory restrictions, and we may be unable to pay future dividends.**

Our ability to pay dividends is subject to regulatory restrictions and the need to maintain sufficient consolidated capital. Also, our only source of funds with which to pay dividends to our shareholders is dividends we receive from our Bank, and the Bank's ability to pay dividends to us is limited by its own obligations to maintain sufficient capital and regulatory restrictions. If these regulatory requirements are not satisfied, we will be unable to pay dividends on our common stock. We have paid quarterly cash dividends since our first cash dividend on February 24, 2006. We cannot guarantee that dividends will not be reduced or eliminated in future periods.

### **Certain provisions under our articles of incorporation and applicable law may make it difficult for others to obtain control of our Corporation even if such a change in control may be favored by some shareholders.**

Certain provisions in our articles of incorporation and applicable Virginia corporate and banking law may have the effect of discouraging a change of control of our company even if such a transaction is favored by some of our shareholders and could result in shareholders receiving a substantial premium over the current market price of our shares. The primary purpose of these provisions is to encourage negotiations with our management by persons interested in acquiring control of our Corporation. These provisions may also tend to perpetuate present management and make it difficult for shareholders owning less than a majority of the shares to be able to elect even a single director.

### **The ownership position of certain shareholders, directors and officers may permit them to exert a major influence on the election of directors and other corporate actions that require a shareholder vote, including change in control transactions.**

As of December 31, 2016, our chairman of the board, executive officers and directors and one other principal shareholder collectively beneficially owned approximately 29.7% of the outstanding shares of our common stock. Our executive officers and directors collectively beneficially owned approximately 23.6% of our common stock and one other individual shareholder has declared beneficial ownership of an additional 6.1% of our common stock. This concentration of ownership may allow our directors, acting in their role as substantial shareholders, to exert a major influence over the election of their nominees as directors, especially if voting together with our officers and other significant shareholders. Our directors, officers, and major shareholders could exercise similar influence over other corporate actions that require a shareholder vote, including change in control transactions.

**The trading volume in the corporation's common stock is less than that of other larger financial services companies.**

Although the Corporation's common stock is listed for trading on the NASDAQ Stock Exchange, the trading volume in its common stock is less than that of other, larger financial services companies. 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 Corporation's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Corporation has no control. Given the lower trading volume of the Corporation's common stock, significant sales of the Corporation's common stock, or the expectation of these sales, could cause the Corporation's stock price to fall.

#### **ITEM 1B - UNRESOLVED STAFF COMMENTS**

None.

#### **ITEM 2 - PROPERTIES**

The Bank leases offices that are used in the normal course of business. The principal executive office of the Corporation, Bank, Access Real Estate, ACM and Mortgage Division is owned by Access Real Estate, a subsidiary of the Bank, and is located at 1800 Robert Fulton Drive, Reston, Virginia. The Bank leases offices in Chantilly, Tysons, Leesburg, Manassas, Alexandria, and Arlington, Virginia. The Mortgage Division leases offices in Fairfax, McLean, and Reston in Virginia as well as Hagerstown, Maryland. The Mortgage Division also leases offices in Indiana, Georgia, and Tennessee. All of the Mortgage Division's leases are month to month leases and can be terminated with thirty days notice. Access Real Estate had owned an undeveloped commercial lot in Fredericksburg that was purchased for future expansion of the Bank. During the third quarter 2014, management decided to sell the land in Fredericksburg and listed the property for sale. The land was transferred from premises and equipment to other assets, at which time the carrying value of the land was written down to its appraised value less costs to sell. The property was sold in 2016.

All of the owned and leased properties are in good operating condition and are adequate for the Corporation's present and anticipated future needs.

#### **ITEM 3 - LEGAL PROCEEDINGS**

The Corporation, and the Bank are from time to time parties to legal proceedings arising in the ordinary course of business. Management is of the opinion that these legal proceedings will not have a material adverse effect on the Corporation's financial condition or results of operations. From time to time the Bank and the Corporation may initiate legal actions against borrowers in connection with collecting defaulted loans. Such actions are not considered material by management unless otherwise disclosed.

**ITEM 4 – MINE SAFETY DISCLOSURES**

None.



**PART II****ITEM 5 – MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

In July 2004, the Corporation’s common stock became listed on the NASDAQ Global Market of the NASDAQ Stock Market LLC and is quoted under the symbol of “ANCX”. Set forth below is certain financial information relating to the Corporation’s common stock price history. Prices reflect transactions executed on NASDAQ.

	2016			2015		
	High	Low	Dividends	High	Low	Dividends
First Quarter	\$20.41	\$16.26	\$ 0.15	\$19.75	\$16.80	\$ 0.49
Second Quarter	21.24	18.11	0.15	23.29	18.35	0.15
Third Quarter	23.97	18.75	0.15	21.64	18.27	0.15
Fourth Quarter	\$28.91	\$22.73	\$ 0.15	\$22.22	\$19.58	\$ 0.15

As of March 13, 2017, the Corporation had 10,766,678 outstanding shares of Common Stock, par value \$0.835 per share, held by approximately 460 registered shareholders of record and the price for the Corporation’s common stock on the NASDAQ Global Market was \$27.11. Included in the above shares numbers are 37,722 shares of unregistered, restricted stock issued since 2014.

The Corporation paid its forty-fifth consecutive quarterly cash dividend on February 24, 2017 to shareholders of record as of February 3, 2017. Payment of dividends is at the discretion of the Corporation’s Board of Directors, and is also subject to various federal and state regulatory limitations. Future dividends are dependent upon the overall performance and capital requirements of the Corporation. See “Item 1 - Business - Supervision and Regulation - Dividends” for a discussion of regulatory requirements related to dividends.

In addition to the ordinary quarterly dividends paid in 2014, on December 19, 2014, the Corporation declared a special non-routine cash dividend of \$0.35 per share to shareholders of record as of December 30, 2014, which was paid on January 16, 2015.

The Corporation’s dividend strategy is to pay routine quarterly dividends equal to 40% to 50% of core earnings, provided a minimum tangible common equity ratio of 8.00% is maintained. Special dividends are excluded from this

target. Special dividends may be considered when the tangible common equity to asset ratio exceeds 10.50%.

**Issuer Purchases of Equity Securities for the Quarter Ended December 31, 2016**

The following table details the Corporation's purchases of its common stock during the fourth quarter pursuant to a Share Repurchase Program announced on March 20, 2007. On June 22, 2010 the number of shares authorized for repurchase under the Share Repurchase Program was increased from 2,500,000 to 3,500,000 shares. The Share Repurchase Program does not have an expiration date.

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plan	(d) Maximum Number of Shares that may yet be Purchased Under the Plan
October 1 - October 31, 2016	-	\$ -	-	768,781
November 1 - November 30, 2016	-	-	-	768,781
December 1 - December 31, 2016	-	-	-	768,781
	-	\$ -	-	768,781

**Stock Performance**

The following graph compares the Corporation's cumulative total shareholder return on its common stock for the five year period ended December 31, 2016 with the cumulative return of a broad equity market index and the Standard & Poor's 500 Index ("S&P 500 Index"). This presentation assumes \$100 was invested in shares of the Corporation and each of the indices on December 31, 2011, and that dividends, if any, were immediately reinvested in additional shares. The graph plots the value of the initial \$100 investment at one-year intervals from December 31, 2011 through December 31, 2016.

Index	<i>Period Ending</i>					
	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Access National Corporation	100.00	158.24	195.78	233.48	291.00	406.36
S&P 500	100.00	116.00	153.57	174.60	177.01	198.18
SNL Bank Index	100.00	134.95	185.28	207.12	210.65	266.16

**ITEM 6 – SELECTED FINANCIAL DATA**

The following consolidated selected financial data is derived from the Corporation's audited financial statements for the five years ended December 31, 2016. This information should be read in conjunction with the following Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes thereto.

	Selected Financial Data					
	Year Ended December 31,					
	2016	2015	2014	2013	2012	
	(In Thousands, Except for Share and Per Share Data)					
<b>Income Statement Data:</b>						
Net interest income	\$43,711	\$39,547	\$35,228	\$32,164	\$31,551	
Provision for loan losses	2,120	150	-	675	1,515	
Noninterest income	31,803	26,065	19,300	28,150	54,794	
Noninterest expense	47,790	41,866	33,018	39,198	56,399	
Income taxes	9,200	8,177	7,585	7,234	10,708	
Net Income	\$16,404	\$15,419	\$13,925	\$13,207	\$17,723	
<b>Per Share Data:</b>						
<b>Earnings per share</b>						
Basic	1.55	1.46	1.33	1.28	1.73	
Diluted	1.54	1.46	1.33	1.27	1.71	
Cash dividends paid <sup>(1)</sup>	0.60	0.95	0.50	1.11	0.95	
Book value at period end	11.33	10.35	9.45	8.79	8.85	
<b>Balance Sheet Data:</b>						
Total assets	\$1,430,708	\$1,178,548	\$1,052,880	\$847,182	\$863,914	
Loans held for sale	35,676	44,135	45,026	24,353	111,542	
Loans held for investment	1,049,698	887,478	776,603	687,055	616,978	
Total investment securities	203,290	174,449	139,389	92,829	80,711	
Total deposits	1,054,327	913,744	755,443	572,972	671,496	
Shareholders' equity	\$120,530	\$109,138	\$98,904	\$91,134	\$91,267	
Average shares outstanding, basic	10,586,394	10,513,008	10,424,067	10,319,802	10,253,656	
Average shares outstanding, diluted	10,677,561	10,581,871	10,466,841	10,403,155	10,363,267	
<b>Performance Ratios:</b>						
Return on average assets	1.27	% 1.39	% 1.45	% 1.55	% 2.15	%
Return on average equity	14.11	% 14.83	% 14.47	% 14.00	% 19.68	%
Dividend payout ratio <sup>(2)</sup>	38.71	% 41.10	% 63.91	% 86.72	% 54.91	%
Equity to assets ratio	8.42	% 9.34	% 10.04	% 11.04	% 10.90	%
Net interest margin <sup>(3)</sup>	3.52	% 3.68	% 3.80	% 3.85	% 3.94	%

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Efficiency Ratios:

Access National Bank	49.59	%	50.41	%	48.96	%	49.50	%	51.71	%
Access National Mortgage Division	72.79	%	78.08	%	67.57	%	79.79	%	70.19	%
Access National Corporation	63.53	%	63.81	%	60.55	%	64.99	%	65.32	%

Asset Quality Ratios:

Allowance to period end loans	1.53	%	1.53	%	1.73	%	1.91	%	2.03	%
Allowance to non-performing loans	231.26	%	182.86	%	826.08	%	518.19	%	455.71	%
Net charge-offs to average loans	-0.03	%	0.00	%	-0.04	%	0.01	%	0.13	%

(1) Cash dividends paid includes the \$0.35 special dividend declared at December 31, 2014 and paid in January 2015.

(2) Adjusted for the special dividend payment of \$0.35 declared in 2014 but paid in 2015.

(3) Net interest income divided by total average earning assets.

Table continued on next page

**ITEM 6 – SELECTED FINANCIAL DATA continued**

	Year Ended December 31,					
	2016	2015	2014	2013	2012	
	(In Thousands, Except for Share and Per Share Data)					
Average Balance Sheet Data:						
Total assets	\$1,288,582	\$1,112,470	\$958,067	\$854,572	\$826,233	
Investment securities	189,585	156,010	128,446	97,260	105,520	
Loans held for sale	47,060	42,076	31,288	42,667	78,543	
Loans held for investment	939,837	824,288	721,863	648,744	583,724	
Allowance for loan losses	14,079	13,456	13,221	12,924	11,994	
Total deposits	1,021,623	866,695	715,385	678,531	672,693	
Junior subordinated debentures	-	-	-	3,135	6,186	
Total shareholders' equity	116,296	103,948	96,227	94,352	90,047	
Capital Ratios:						
Tier 1 risk-based capital	10.25	% 11.14	% 11.16	% 12.05	% 14.10	%
Common equity tier 1 capital	10.25	% 11.14	% Not Reported			
Total risk-based capital	11.51	% 12.39	% 12.41	% 13.30	% 15.35	%
Leverage capital ratio	8.90	% 9.34	% 9.70	% 10.93	% 11.50	%
Tangible common equity ratio	8.31	% 9.12	% 9.25	% 10.76	% 10.56	%

**ITEM 7 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis is intended to provide an overview of the significant factors affecting the Corporation and its subsidiaries financial condition at December 31, 2016 and 2015 and the results of operations for the years ended December 31, 2016, 2015, and 2014. The consolidated financial statements and accompanying notes should be read in conjunction with this discussion and analysis.

**Forward-Looking Statements**

In addition to historical information, this Annual Report on Form 10-K may contain forward-looking statements. For this purpose, any statements contained herein, including documents incorporated by reference, that are not statements of historical fact may be deemed to be forward-looking statements. Examples of forward-looking statements include discussions as to our expectations, beliefs, plans, goals, objectives and future financial or other performance or assumptions concerning matters discussed in this document. Forward-looking statements often use words such as “believes,” “expects,” “plans,” “may,” “will,” “should,” “projects,” “contemplates,” “anticipates,” “forecasts,” “intends” or

similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements in this Annual Report on Form 10-K include, without limitation, statements regarding the Corporation's beliefs regarding the future strength of the economy and labor markets and anticipated interest rates and the effect of such rates on the Corporation's performance and net interest margin and the volume of future mortgage refinancing, as well as the Corporation's expectations concerning operating losses and the profitability of its mortgage segment. 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. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in: collateral values, especially in the real estate market; stagnation, continued challenging conditions or deterioration in general business and economic conditions and in the financial markets; mergers and acquisitions, including merger integration risk in connection with the Corporation's pending merger with Middleburg such as potential deposit attrition, higher than expected costs, customer loss and business disruption associated with the integration of Middleburg, including, without limitation, potential difficulties in maintaining relationships with key personnel and other integration-related matters; the impact of any policies or programs implemented pursuant to the Dodd-Frank Act or other legislation or regulation; unemployment levels; branch expansion plans; interest rates; general economic conditions; monetary and fiscal policies of the U.S. Government, including policies of the Comptroller, U.S. Treasury and the Federal Reserve Board; the economy of Northern Virginia, including governmental spending and real estate markets; the quality or composition of the loan or investment portfolios; demand for loan products; deposit flows; competition; the liquidity of the Corporation and accounting principles, policies, and guidelines. 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 we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. For additional discussion of risk factors that may cause our actual future results to differ materially from the results indicated within forward-looking statements, please see "Item 1A – Risk Factors" herein.

## **CRITICAL ACCOUNTING POLICIES**

The Corporation's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. In preparing the Corporation's financial statements management makes estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. Our significant accounting policies are presented in Note 1 to the consolidated financial statements. Management believes that the most significant subjective judgments that it makes include the following:

### **Allowance for Loan Losses**

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) *Accounting Standards Codification (ASC) No. 450-10 Contingencies*, which requires that losses be accrued when they are probable of occurring and estimable and (ii) *ASC 310-10, Receivables*, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

An allowance for loan losses is established through a provision for loan losses based upon industry standards, known risk characteristics, and management's evaluation of the risk inherent in the loan portfolio and changes in the nature and volume of loan activity. Such evaluation considers, among other factors, the estimated market value of the underlying collateral and current economic conditions. For further information about our practices with respect to allowance for loan losses, please see the subsection "Allowance for Loan Losses" below.

### **Other Than Temporary Impairment of Investment Securities**

Securities in the Bank's investment portfolio are classified as either held-to-maturity or available-for-sale. Securities classified as held-to-maturity are recorded at cost or amortized cost. Available-for-sale securities are carried at fair value. The estimated fair value of the available-for-sale portfolio fluctuates due to changes in market interest rates and other factors. Changes in estimated fair value are recorded in shareholders' equity as a component of other comprehensive income. Securities are monitored to determine whether a decline in their value is other than temporary. Management evaluates the investment portfolio on a quarterly basis to determine the collectability of amounts due per the contractual terms of the investment security. A decline in the fair value of an investment below its amortized cost attributable to factors that indicate the decline will not be recovered over the anticipated holding period of the investment will cause the security to be considered other than temporarily impaired. Other than temporary impairments result in reducing the security's carrying value by the amount of the estimated credit loss. The credit component of the other than temporary impairment loss is realized through the statement of income and the remainder



of the loss remains in other comprehensive income. At December 31, 2016 there were no securities in the securities portfolio with other than temporary impairment.

### **Income Taxes**

The Corporation uses the liability method of accounting for income taxes. This method results in the recognition of deferred tax assets and liabilities that are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable results in the income tax expense for the current year. Our evaluation of the deductibility or taxability of items included in the Corporation's tax returns has not resulted in the identification of any material uncertain tax positions.

### **Fair Value**

Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments. For additional information about our financial assets carried at fair value, refer to Note 16 to the consolidated financial statements.

## **Executive Summary**

The Corporation completed its seventeenth year of operation and recorded net income of \$16.4 million or \$1.54 per diluted common share in 2016 compared to \$15.4 million or \$1.46 per diluted common share and \$13.9 million or \$1.33 per diluted common share in 2015 and 2014, respectively. The increase in net interest income before provision over last year of \$4.2 million reflects the continued growth in both the loans held for investment portfolio and the investment securities portfolio. During 2016, loan origination volumes in the Mortgage Division increased, from \$485 million in 2015 to \$545 million in 2016, which led to higher gain on sale of loans, from \$19.6 million in 2015 to \$25.2 million in 2016. The increased income in the Mortgage Division when comparing 2015 to 2014 were the gains recognized on hedging activities as well as the fair value marks, from a loss of \$690 thousand in 2014 to a gain of \$333 thousand in 2015.

At December 31, 2016, assets totaled \$1.43 billion compared to \$1.18 billion at December 31, 2015, an overall increase of \$252.2 million. An increase in loans held for investment of \$162.2 million, a \$57.3 million growth in interest-bearing balances and federal funds sold, a \$28.8 million growth in investment securities, and a \$13.6 million growth in other assets accounted for the increase and was mainly offset by an \$8.5 million decrease in loans held for sale. During 2016, loan growth was reflected in all but the consumer category of the loans held for investment portfolio. During 2015, loan origination volumes in the Mortgage Division increased, from \$408 million in 2014 to \$485 million in 2015, which led to higher gain on sale of loans, from \$15.1 million in 2014 to \$19.6 million in 2015. The largest dollar growth occurred in the commercial loan portfolio due in part to our focus on small to medium sized businesses.

Investment securities totaled \$203.3 million at December 31, 2016 compared to \$174.4 million at December 31, 2015 as the Corporation continues to build its portfolio judiciously in a manner that is consistent with the Corporation's planned liquidity and asset management goals.

Deposits totaled \$1.054 billion at December 31, 2016 compared to \$913.7 million at December 31, 2015. The \$140.6 million increase was due mainly to increases in savings and money market deposits of \$120.3 million, demand deposits of \$54.2 million, and time deposits of \$27.2 million, and was offset by a net decrease in wholesale funding of \$59.3 million. Management continues to focus on expanding business banking relationships as evidenced by the 12.0% annual growth in demand deposits.

Non-performing assets ("NPA") totaled approximately \$6.9 million or 0.48% of total assets at December 31, 2016, down from \$7.4 million or 0.63% of total assets at December 31, 2015. NPAs are comprised of non-accrual loans solely at December 31, 2016, and 2015, as the Bank did not have any other real estate owned. Included in non-accrual

loans at December 31, 2016 is a restructured residential lot loan, categorized as a construction loan, to one borrower with an outstanding balance of \$940 thousand as well as two commercial loans to one borrower with an outstanding balance of \$2.0 million. The allowance for loan losses totaled \$16.0 million or 1.5% of total loans held for investment as of December 31, 2016, compared to \$13.6 million or 1.5% at December 31, 2015.

During 2014, ARE transferred an undeveloped commercial lot in Fredericksburg, that was originally purchased for possible banking center expansion to other real estate owned when management decided to market the land for sale. The land, originally purchased for \$1.2 million was written down to its appraised value less costs to sell and is included in other assets at \$500 thousand at December 31, 2015. During 2016 the property was sold.

The economy continues to show signs of improvement with unemployment rates declining, and we are continuing to see price appreciation in the local residential real estate market. Notwithstanding the foregoing, there is no guarantee that these positive trends will continue. Although we believe that the credit quality of our primary business and professional customers has stabilized and improved, we will continue to focus on improving the credit quality of our loan portfolio with special attention paid to the non-performing assets. The Corporation is optimistic going into 2017 with a strong capital base and being positioned for continued growth.

## **RESULTS OF OPERATIONS**

Net income for 2016 totaled \$16.4 million, or \$1.54 per diluted common share compared to \$15.4 million or \$1.46 per diluted common share in 2015. Net income in 2016 was favorably impacted by an increase in net interest income of \$4.2 million as average earning assets increased \$167.6 million, from \$1.08 billion to \$1.24 billion as of December 31, 2015 and 2016, respectively. The increase in noninterest income of \$5.7 million from \$26.1 million to \$31.8 million as of December 31, 2015 and 2016, respectively, was offset by an increase in noninterest expense of \$5.9 million, from \$41.9 million to \$47.8 million as of December 31, 2015 and 2016, respectively.

Net income for 2015 totaled \$15.4 million, or \$1.46 per diluted common share compared to \$13.9 million or \$1.33 per diluted common share in 2014. Net income in 2015 was favorably impacted by an increase in net interest income of \$4.3 million as average earning assets increased \$147 million, from \$928 million to \$1.08 billion as of December 31, 2014 and 2015, respectively. The increase in noninterest income from \$19.3 million to \$26.1 million as of December 31, 2014 and 2015, respectively, was offset by an increase in noninterest expense of \$8.9 million, from \$33.0 million to \$41.9 million as of December 31, 2014 and 2015, respectively. The increase in noninterest expense, such as compensation due to the increased mortgage production volume, coupled with the mortgage reserve release in 2014 of \$3.25 million, worked to offset the \$6.8 million or 35.1% increase in noninterest income between 2015 and 2014.

### **Net Interest Income**

Net interest income is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities (primarily deposits) used to fund earning assets. Net interest income and margin are influenced by many factors, primarily the volume and mix of earning assets, funding sources, yields on earning assets and interest rate fluctuations. Net interest income totaled \$43.7 million in 2016, up from \$39.5 million in 2015. Average noninterest-bearing deposits increased \$55.8 million in 2016. Net interest margin was 3.52% in 2016 and 3.68% in 2015, with the decrease primarily due to the weighted average rate paid on interest-bearing deposits and borrowings increasing 19 basis points to 0.78% in 2016 from 0.59% in 2015.

During 2016, average earning assets increased \$167.6 million or 15.6%. Average loans held for investment increased by \$115.5 million or 14.0%, average securities increased \$32.4 million or 20.7%, average loans held for sale increased \$5.0 million or 11.8%, and average interest-bearing balances increased \$14.7 million or 28.0%. On the funding side total average interest-bearing deposits increased by \$99.2 million or 17.6%.

Net interest income totaled \$39.5 million in 2015, up from \$35.2 million in 2014. Average noninterest-bearing deposits increased \$65.5 million in 2015. Net interest margin was 3.68% in 2015 and 3.80% in 2014, with the

decrease primarily due to the weighted average rate earned on interest-earning assets decreasing 9 basis points to 4.06% in 2015 from 4.15% in 2014.

The table below, Yield on Average Earning Assets and Rates on Average Interest-Bearing Liabilities, summarizes the major components of net interest income for the past three years and also provides yields, rates, and average balances.

Yield on Average Earning Assets and Rates on Average Interest-Bearing Liabilities  
For the Year Ended

	December 31, 2016			December 31, 2015			December 31, 2014		
	Average	Income	Yield	Average	Income	Yield	Average	Income	Yield
	Balance	/	/	Balance	/	/	Balance	/	/
		Expense	Rate		Expense	Rate		Expense	Rate
	(Dollars In Thousands)								

Assets:

Interest earning

assets:

Securities	\$188,569	\$4,039	2.14 %	\$156,204	\$3,482	2.23 %	\$129,755	\$2,697	2.08 %
Loans held for sale	47,060	1,767	3.75 %	42,076	1,650	3.92 %	31,288	1,297	4.15 %
Loans <sup>(1)</sup>	939,837	43,872	4.67 %	824,288	38,405	4.66 %	721,863	34,405	4.77 %

Interest-bearing

balances and federal funds sold	67,457	337	0.50 %	52,716	129	0.24 %	44,939	102	0.23 %
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Total interest earning assets	1,242,923	50,015	4.02 %	1,075,284	43,666	4.06 %	927,845	38,501	4.15 %
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Noninterest earning

assets:

Cash and due from banks	12,732			10,650			8,925		
Premises, land and equipment	6,834			6,882			7,995		
Other assets	40,172			33,110			26,523		
Less: allowance for loan losses	(14,079 )			(13,456 )			(13,221 )		
Total noninterest earning assets	45,659			37,186			30,222		
Total Assets	\$1,288,582			\$1,112,470			\$958,067		

Liabilities and

Shareholders'

Equity:

Interest-bearing

deposits:

Interest-bearing demand deposits	\$132,734	\$486	0.37 %	\$119,732	\$265	0.22 %	\$114,853	\$256	0.22 %
Money market deposit accounts	204,897	846	0.41 %	126,850	264	0.21 %	115,192	232	0.20 %
Savings accounts	37,950	196	0.52 %	13,606	66	0.49 %	3,884	14	0.36 %
Time deposits	286,690	3,622	1.26 %	302,924	3,053	1.01 %	243,338	2,479	1.02 %

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Total interest-bearing deposits	662,271	5,150	0.78 %	563,112	3,648	0.65 %	477,267	2,981	0.62 %
Borrowings:									
FHLB Advances	56,522	386	0.68 %	91,992	231	0.25 %	115,471	271	0.23 %
Securities sold under agreements to repurchase and federal funds purchased	16,270	16	0.10 %	22,017	21	0.10 %	21,129	21	0.10 %
FHLB Long-term borrowings	68,525	752	1.10 %	18,890	219	1.16 %	-	-	0.00 %
Total borrowings	141,317	1,154	0.82 %	132,899	471	0.35 %	136,600	292	0.21 %
Total interest-bearing deposits and borrowings	803,588	6,304	0.78 %	696,011	4,119	0.59 %	613,867	3,273	0.53 %
Noninterest-bearing liabilities:									
Demand deposits	359,352			303,583			238,118		
Other liabilities	9,346			8,928			9,855		
Total liabilities	1,172,286			1,008,522			861,840		
Shareholders' Equity	116,296			103,948			96,227		
Total Liabilities and Shareholders' Equity	\$1,288,582			\$1,112,470			\$958,067		
Interest Spread <sup>(2)</sup>			3.24 %			3.47 %			3.62 %
Net Interest Margin <sup>(3)</sup>		\$43,711	3.52 %		\$39,547	3.68 %		\$35,228	3.80 %

(1) Loans placed on nonaccrual status are included in loan balances

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

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

The following table shows fluctuations in net interest income attributable to changes in the average balances of assets and liabilities and the yields earned or rates paid for the years ended December 31:

	Years Ended December 31,								
	2016 compared to 2015			2015 compared to 2014			2014 compared to 2013		
	Change Due To:			Change Due To:			Change Due To:		
	Increase			Increase			Increase		
	/	/	/	/	/	/	/	/	/
	(Decrease)	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)	Volume	Rate
	(In Thousands)								
<b>Interest Earning Assets:</b>									
Investments	\$557	\$702	\$(145)	\$785	\$580	\$205	\$769	\$643	\$126
Loans	5,584	5,555	29	4,353	5,250	(897)	1,861	2,952	(1,091)
Interest-bearing deposits	208	43	165	27	22	5	(5)	(3)	(2)
<b>Total increase (decrease) in interest income</b>	<b>6,349</b>	<b>6,300</b>	<b>49</b>	<b>5,165</b>	<b>5,852</b>	<b>(687)</b>	<b>2,625</b>	<b>3,592</b>	<b>(967)</b>
<b>Interest-Bearing Liabilities:</b>									
Interest-bearing demand deposits	221	32	189	9	9	-	108	85	23
Money market deposit accounts	582	228	354	32	21	11	(50)	(12)	(38)
Savings accounts	130	126	4	52	45	7	9	4	5
Time deposits	569	(171)	740	574	599	(25)	(572)	(452)	(120)
Total interest-bearing deposits	1,502	215	1,287	667	674	(7)	(505)	(375)	(130)
FHLB Advances	155	(117)	272	(40)	(60)	20	174	170	4
Securities sold under agreements to repurchase and federal funds purchased	(5)	(5)	-	-	-	-	(5)	(4)	(1)
Long-term borrowings	533	545	(12)	219	219	-	-	-	-
Trust preferred	-	-	-	-	-	-	(103)	(52)	(51)
<b>Total (decrease) increase in interest expense</b>	<b>2,185</b>	<b>638</b>	<b>1,547</b>	<b>846</b>	<b>833</b>	<b>13</b>	<b>(439)</b>	<b>(261)</b>	<b>(178)</b>
<b>Increase (decrease) in net interest income</b>	<b>\$4,164</b>	<b>\$5,662</b>	<b>\$(1,498)</b>	<b>\$4,319</b>	<b>\$5,019</b>	<b>\$700</b>	<b>\$3,064</b>	<b>\$3,853</b>	<b>\$(789)</b>

### **Provision for Loan Losses**

In 2016, the Bank charged \$2.1 million to operating expenses for the loan loss reserve compared to \$150 thousand for loan losses in 2015, and no loan loss provision in 2014. The amount of the provision is determined by management to



ensure the allowance for loan losses is at a level believed to be adequate to absorb inherent losses in the loan portfolio based on evaluations as of December 31, 2016.

### **Noninterest Income**

Noninterest income consists of revenue generated from gains on sale of loans, service fees on deposit accounts, and other charges and fees. The Mortgage Division provides the most significant contributions towards noninterest income and is subject to wide fluctuations due to the general interest rate environment and economic conditions. Total noninterest income was \$31.8 million in 2016 compared to \$26.1 million in 2015. Gains on the sale of loans originated by the Mortgage Division totaled \$25.2 million in 2016 compared to \$19.6 million in 2015 due to the mortgage loan volume increase in 2016, from \$485 million in 2015 to \$545 million in 2016. Offsetting this increase in revenue were the losses recognized on hedging activities as well as the fair value marks associated with the origination of mortgage loans held for sale. In 2016, the Mortgage Division recorded a loss of \$429 thousand compared to a gain of \$333 thousand in 2015.

Total noninterest income was \$26.1 million in 2015 compared to \$19.3 million in 2014. Gains on the sale of loans originated by the Mortgage Division totaled \$19.6 million in 2015 compared to \$15.1 million in 2014 due to the mortgage loan volume increase in 2015, from \$408 million in 2014 to \$485 million in 2015. Adding to this increase in revenue were the gains recognized on hedging activities as well as the fair value marks associated with the origination of mortgage loans held for sale. In 2015, the Mortgage Division recorded a gain of \$333 thousand compared to a loss of \$690 thousand in 2014 increasing other income by \$1.0 million when comparing 2015 to 2014.

### **Noninterest Expense**

Noninterest expense totaled \$47.8 million in 2016 compared to \$41.9 million in 2015. Compensation and employee benefits, the largest component of noninterest expense, totaled \$31.8 million in 2016 compared to \$27.0 million in 2015, an increase of \$4.8 million or 17.8% due mainly to the addition of staffing in the Banking Division as well as increased variable compensation paid in the Mortgage Division as a direct result of the increased mortgage volumes between 2016 and 2015. Other operating expense totaled \$13.0 million in 2016, up from \$11.9 million for the year ended December 31, 2015. A further breakdown of other operating expenses is provided for in Note 15 of the consolidated financial statements.

Noninterest expense totaled \$41.9 million in 2015 compared to \$33.0 million in 2014. Compensation and employee benefits, the largest component of noninterest expense, totaled \$27.0 million in 2015 compared to \$22.7 million in 2014, an increase of \$4.3 million or 19.0% due mainly to the addition of staffing in the Banking Division and increased group health costs as well as increased variable compensation paid in the Mortgage Division as a direct result of the increased mortgage volumes between 2015 and 2014. Other operating expense totaled \$11.9 million in 2015, up from \$7.5 million for the year ended December 31, 2014, due in part to increased activity in the Mortgage Division as a direct result of the increase in mortgage production volume as well as the \$3.25 million mortgage reserve release recognized in 2014 and included in other noninterest expense.

### **Income Taxes**

Income tax expense totaled \$9.2 million in 2016 compared to \$8.2 million in 2015 and \$7.6 million in 2014, an increase of \$1.0 million and \$600 thousand, respectively. The increase in taxes between 2016 and 2015 as well as 2015 to 2014 was due to the increase in pre-tax earnings for those years. Note 7 to the consolidated financial statements shows the components of federal income tax.

**Quarterly Results (unaudited)**

The following is a summary of the results of operations for each quarter of 2016, 2015, and 2014.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total YTD
	(In Thousands, Except for Per Share Data)				
2016					
Total interest income	\$11,981	\$12,336	\$12,778	\$12,920	\$50,015
Total interest expense	1,431	1,575	1,635	1,663	6,304
Net interest income	10,550	10,761	11,143	11,257	43,711
Provision for loan losses	-	120	750	1,250	2,120
Net interest income after provision for loan losses	10,550	10,641	10,393	10,007	41,591
Total noninterest income	6,819	9,173	8,685	7,126	31,803
Total noninterest expense	11,129	12,303	12,169	12,189	47,790
Income tax expense	2,145	2,633	2,484	1,938	9,200
Net income	\$4,095	\$4,878	\$4,425	\$3,006	\$16,404
Earnings Per Share:					
Basic	\$0.39	\$0.46	\$0.42	\$0.28	\$1.55
Diluted	\$0.39	\$0.46	\$0.41	\$0.28	\$1.54

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total YTD
	(In Thousands, Except for Per Share Data)				
2015					
Total interest income	\$10,276	\$10,787	\$11,156	\$11,447	\$43,666
Total interest expense	834	980	1,059	1,246	4,119
Net interest income	9,442	9,807	10,097	10,201	39,547
Provision for loan losses	-	150	-	-	150
Net interest income after provision for loan losses	9,442	9,657	10,097	10,201	39,397
Total noninterest income	6,305	7,081	6,412	6,267	26,065
Total noninterest expense	10,246	10,654	10,479	10,487	41,866
Income tax expense	1,928	2,100	2,086	2,063	8,177
Net income	\$3,573	\$3,984	\$3,944	\$3,918	\$15,419
Earnings Per Share:					
Basic	\$0.34	\$0.38	\$0.37	\$0.37	\$1.46
Diluted	\$0.34	\$0.38	\$0.37	\$0.37	\$1.46

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	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total YTD
	(In Thousands, Except for Per Share Data)				
2014					
Total interest income	\$8,945	\$9,502	\$9,915	\$10,139	\$38,501
Total interest expense	804	839	831	799	3,273
Net interest income	8,141	8,663	9,084	9,340	35,228
Net interest income after provision for loan losses	8,141	8,663	9,084	9,340	35,228
Total noninterest income	3,256	5,316	5,213	5,515	19,300
Total noninterest expense	7,657	9,218	6,683	9,460	33,018
Income tax expense	1,326	1,697	2,682	1,880	7,585
Net income	\$2,414	\$3,064	\$4,932	\$3,515	\$13,925
Earnings Per Share:					
Basic	\$0.23	\$0.29	\$0.47	\$0.34	\$1.33
Diluted	\$0.23	\$0.29	\$0.47	\$0.34	\$1.33

## **FINANCIAL CONDITION**

### **Summary**

Total assets at December 31, 2016 were \$1.43 billion compared to \$1.18 billion at December 31, 2015, an increase of \$252.2 million. An increase in loans held for investment of \$162.2 million, a \$57.3 million growth in interest-bearing balances and federal funds sold, and a \$28.8 million growth in investment securities accounted for the majority of this increase and was partially offset by an \$8.5 million decrease in loans held for sale.

The following discussions by major categories explain the changes in financial condition.

### **Cash and Due From Banks**

Cash and due from banks represents cash and noninterest-bearing balances at other banks and cash letters in process of collection at the Federal Reserve Bank. At December 31, 2016 cash and due from banks totaled \$9.2 million compared to \$11.3 million at December 31, 2015. The balance fluctuates depending on the volume of cash letters in process of collection at the Federal Reserve Bank.

### **Interest-Bearing Deposits in Other Banks and Federal Funds Sold**

At December 31, 2016 interest-bearing balances in other banks totaled \$81.9 million compared to \$24.6 million at December 31, 2015. These balances are maintained at the FRB and the FHLB of Atlanta and provide liquidity for managing daily cash inflows and outflows from deposits and loans.

### **Investment Securities**

The Corporation's investment securities portfolio is comprised of U.S. Government Agency securities, municipal securities, CRA mutual fund, mortgage backed securities issued by U.S. government sponsored agencies, corporate bonds, certificates of deposit, and other asset backed securities. The investment portfolio is used to provide liquidity

and as a tool for managing interest sensitivity in the balance sheet, while generating income.

At December 31, 2016, securities totaled \$203.3 million compared to \$174.4 million at December 31, 2015, an increase of \$28.9 million. The increase is in response to management's planned liquidity and asset management goals. The securities portfolio at December 31, 2016 is comprised of \$194.1 million in securities classified as available-for-sale and \$9.2 million in securities classified as held-to-maturity. Securities classified as available-for-sale are carried at fair market value. Unrealized gains and losses are recorded directly to a separate component of shareholders' equity. Held-to-maturity securities are carried at cost or amortized cost.

The following tables present the types, amounts and maturity distribution of the investment securities portfolio.

Maturity Schedule of Investment Securities

Year Ended December 31, 2016

	Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years		After Ten Years and Over		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
(Dollars In Thousands)										
<b>Investment securities available-for-sale <sup>(1)</sup></b>										
US Government Agency	\$-	-	\$-	-	\$4,994	1.82 %	\$-	-	\$4,994	1.82 %
Mortgage backed Corporate bonds	-	-	24,916	2.06 %	24,895	2.29 %	69,996	1.88 %	119,807	2.00 %
Asset backed securities	4,144	1.67 %	4,522	2.25 %	-	-	-	-	8,666	1.97 %
Certificates of deposit	-	-	-	-	3,001	1.66 %	9,863	1.61 %	12,864	1.62 %
Municipals - nontaxable	-	-	2,009	2.23 %	-	-	-	-	2,009	2.23 %
	-	-	3,500	2.22 %	4,888	2.14 %	35,971	3.17 %	44,358	2.98 %
	\$4,144	1.67 %	\$34,947	2.11 %	\$37,778	2.16 %	\$115,830	2.26 %	\$192,698	2.20 %
<b>Investment securities Held-to-maturity</b>										
US Government Agency	\$-	-	\$5,000	1.75 %	\$-	-	\$-	-	\$5,000	1.75 %
Municipals	-	-	431	3.03 %	1,617	3.55 %	555	4.11 %	2,603	3.58 %
Municipals - nontaxable	-	-	1,597	1.91 %	-	-	-	-	1,597	1.91 %
	\$-	-	\$7,028	1.86 %	\$1,617	3.55 %	\$555	4.11 %	\$9,200	2.30 %

<sup>(1)</sup> Excludes FRB Stock, and FHLB Stock, and CRA Mutual Fund



**Loans**

Loans held for investment totaled \$1.05 billion at December 31, 2016 compared to \$887.5 million at December 31, 2015. During 2016, loan demand increased over 2015 as local economic conditions improved. Commercial loans increased \$69.0 million during 2016 while commercial real estate – non-owner occupied loans increased \$37.1 million, commercial real estate – owner occupied loans increased \$30.6 million, and real estate construction loans increased \$25.8 million from year end 2015.

The Bank concentrates on providing banking services to small and medium sized businesses and professionals in our market area. As of December 31, 2016 the exposure to builders or developers in our commercial real estate portfolio was immaterial to the portfolio as a whole. Our loan officers maintain a professional relationship with our clients and are responsive to their financial needs. They are directly involved in the community, and it is this involvement and commitment that leads to referrals and continued growth. The composition and growth of our loan portfolio reflects our success in deployment of this strategy.

Loans held for sale totaled \$35.7 million at December 31, 2016 compared to \$44.1 million at December 31, 2015, a decrease of \$8.4 million. The level of loans held for sale fluctuates with the volume of loans originated during the month and the timing of loans purchased by investors. Loan origination volume totaled \$544.9 million in 2016 compared to \$484.7 million in 2015 as interest rates on residential mortgage loans continued to remain at historic lows.

The following tables present the major classifications and maturity distribution of loans held for investment at December 31:

Composition of Loan Portfolio											
Year Ended December 31,											
	2016		2015		2014		2013		2012		
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	
	(Dollars In Thousands)										
Commercial real estate - owner occupied	\$250,440	23.87 %	\$219,877	24.77 %	\$199,442	25.68 %	\$196,804	28.65 %	\$182,655	29.60 %	
Commercial real estate -	184,688	17.59	147,580	16.63	125,442	16.15	90,676	13.20	107,213	17.38	



non-owner occupied Residential real estate	204,413	19.47	201,447	22.70	194,213	25.01	173,639	25.27	144,521	23.43
Commercial Real estate construction	311,486	29.67	242,527	27.33	210,278	27.08	182,220	26.52	149,389	24.21
Consumer	91,822	8.75	66,003	7.44	41,080	5.29	38,842	5.65	30,038	4.87
Total loans	6,849	0.65	10,044	1.13	6,148	0.79	4,874	0.71	3,162	0.51
	\$1,049,698	100.00%	\$887,478	100.00%	\$776,603	100.00%	\$687,055	100.00%	\$616,978	100.00%

Loan Maturity Distribution  
Year Ended December 31, 2016

	Three Months or Less	Over Three Months Through One Year	Over One Year Through Five Years	Over Five Years	Total
	(In Thousands)				
Commercial real estate - owner occupied	\$7,372	\$ 11,542	\$ 52,940	\$ 178,586	\$250,440
Commercial real estate - non-owner occupied	3,967	16,872	66,489	97,360	184,688
Residential real estate	8,056	13,206	53,132	130,019	204,413
Commercial	40,761	75,499	121,845	73,381	311,486
Real estate construction	24,909	53,965	11,373	1,575	91,822
Consumer and other	86	739	1,874	4,150	6,849
Total	\$85,151	\$ 171,823	\$ 307,653	\$ 485,071	\$1,049,698
Loans with fixed interest rates	\$35,229	\$ 45,301	\$ 171,306	\$ 234,914	\$486,750
Loans with floating interest rates	49,922	126,522	136,347	250,157	562,948
Total	\$85,151	\$ 171,823	\$ 307,653	\$ 485,071	\$1,049,698

**Allowance for Loan Losses**

The allowance for loan losses totaled \$16.0 million at December 31, 2016 compared to \$13.6 million at year end 2015. The allowance for loan losses was equivalent to 1.53% of total loans held for investment at December 31, 2016 and December 31, 2015. Adequacy of the allowance is assessed and increased as determined necessary by management by provisions for loan losses charged to expense no less than quarterly. Charge-offs are taken when a loan is identified as uncollectible.

The methodology by which we systematically determine the amount of our allowance is set forth by the Board of Directors in our Loan Policy and implemented by management. The results of the analysis are documented, reviewed and approved by the Board of Directors no less than quarterly.



The level of the allowance for loan losses is determined by management through an ongoing, detailed analysis of historical loss rates and risk characteristics. During each quarter, management evaluates the collectability of all loans in the portfolio and ensures an accurate risk rating is assigned to each loan. The risk rating scale and definitions jointly adopted by the Federal banking regulators are used within the framework prescribed by the Bank's Loan Policy. Any loan that is deemed to have potential or well defined weaknesses that may jeopardize collection in full is then analyzed to ascertain its level of weakness. If appropriate, the loan may be charged-off or a specific reserve may be assigned if the loan is deemed to be impaired.

During the risk rating verification process, each loan identified as inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged is considered impaired and is placed on non-accrual status. On these loans, management analyzes the potential impairment of the individual loan and may set aside a specific reserve. Any amounts deemed uncollectible during that analysis are charged-off.

For the remaining loans in each segment, management calculates the probability of loss as a group using the risk rating for each of the following loan types: Commercial Real Estate – owner occupied, Commercial Real Estate – non-owner occupied, Residential Real Estate, Commercial, Real Estate Construction, and Consumer. Management calculates the historical loss rate in each group by risk rating using a period of at least six years. This historical loss rate may then be adjusted based on management's assessment of internal and external environmental factors. This adjustment is meant to account for changes between the historical economic environment and current conditions and for changes in the ongoing management of the portfolio which affects the loans' potential losses.

Once complete, management compares the condition of the portfolio using several different characteristics as well as its experience to the experience of other banks in its peer group in order to determine if it is directionally consistent with others' experiences in our area and line of business. Based on that analysis, management aggregates the probabilities of loss of the remaining portfolio based on the specific and general allowances and may provide additional amounts to the allowance for loan losses as needed. Since this process involves estimates, the allowance for loan losses may also contain an immaterial amount that is not allocated to a specific loan or to a group of loans but is deemed necessary to absorb additional losses in the portfolio.

Management and the Board of Directors subject the reserve adequacy and methodology to review on a regular basis to internal auditors and bank regulators, and such reviews have not resulted in any material adjustment to the reserve.

The following tables present an analysis of the allowance for loan losses for the periods indicated.

#### Allowance for Loan Losses

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	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(In Thousands)				
Balance, beginning of year	\$13,563	\$13,399	\$13,136	\$12,500	\$11,738
Provision for loan losses	2,120	150	-	675	1,515
Charge-offs:					
Commercial real estate - owner occupied	-	-	-	-	429
Commercial real estate - non-owner occupied	-	-	-	-	103
Residential real estate	-	-	21	97	790
Commercial	-	185	22	444	808
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	35
Total charge-offs	-	185	43	541	2,165
Recoveries:					
Commercial real estate - owner occupied	-	-	-	-	-
Commercial real estate - non-owner occupied	-	-	-	199	416
Residential real estate	40	61	213	111	410
Commercial	285	102	93	179	566
Real estate construction	-	36	-	-	-
Consumer	-	-	-	13	20
Total recoveries	325	199	306	502	1,412
Net (charge-offs) recoveries	325	14	263	(39 )	(753 )
Balance, end of year	\$16,008	\$13,563	\$13,399	\$13,136	\$12,500
Ratio of net charge-offs during the period to average loans outstanding during the period	-0.03 %	0.00 %	-0.04 %	0.01 %	0.13 %

Allocation of the Allowance for Loan Losses											
Year Ended December 31,											
	2016	Percentage of total	2015	Percentage of total	2014	Percentage of total	2013	Percentage of total	2012	Percentage of total	
(Dollars In Thousands)											
Commercial real estate - owner occupied	\$2,943	18.38 %	\$3,042	22.43 %	\$3,229	24.10 %	\$3,763	28.65 %	\$3,701	29.61 %	
Commercial real estate - non-owner occupied	2,145	13.40	1,862	13.73	1,894	14.14	1,734	13.20	2,173	17.39	
Residential real estate	2,510	15.68	2,862	21.10	3,308	24.69	3,320	25.27	2,924	23.39	
Commercial Real estate construction	7,053	44.06	4,612	34.00	4,284	31.97	3,484	26.52	3,028	24.22	
Consumer	1,277	7.98	1,056	7.79	596	4.45	743	5.66	610	4.88	
Total	80	0.50	129	0.95	88	0.65	92	0.70	64	0.51	
	\$16,008	100.00%	\$13,563	100.00%	\$13,399	100.00%	\$13,136	100.00%	\$12,500	100.00%	

### Non-performing Assets And Loans Past Due

The following table presents information with respect to non-performing assets and 90 day delinquencies as of the dates indicated.

Non-performing Assets and Accruing Loans Past Due 90 Days or More					
Year Ended December 31,					
	2016	2015	2014	2013	2012
(Dollars In Thousands)					
Non-accrual loans:					
Commercial real estate - owner occupied	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate - non-owner occupied	-	5,486	-	-	-
Residential real estate	431	163	129	871	922
Commercial Real estate construction	5,551	722	1,493	1,664	1,821
Consumer	940	1,046	-	-	-
Total non-accrual loans	-	-	-	-	-
	6,922	7,417	1,622	2,535	2,743
Other real estate owned ("OREO")	-	-	-	-	-

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Total non-performing assets	\$ 6,922	\$ 7,417	\$ 1,622	\$ 2,535	\$ 2,743
Restructured loans included above in non-accrual loans	\$ 2,940	\$ 1,046	\$ 698	\$ 931	\$ 759
Ratio of non-performing assets to:					
Total loans plus OREO	0.66 %	0.84 %	0.21 %	0.37 %	0.44 %
Total assets	0.48 %	0.63 %	0.15 %	0.30 %	0.32 %
Accruing past due loans:					
90 or more days past due	\$ -	\$ -	\$ -	\$ -	\$ -

Non-accrual loans totaled \$6.9 million at December 31, 2016 and were comprised of seven borrowers. The loans are carried at the current net realizable value after consideration of \$3.0 million in specific reserves. Included in non-accrual loans at December 31, 2016 is a restructured construction loan in the amount of \$940 thousand as well as two commercial loans totaling \$2.0 million. There were no restructured loans prior to 2010. The Bank considers restructurings of loans to troubled borrowers when it is deemed to be beneficial to the borrower and improves the prospects for complete recovery of the debt.

The accrual of interest is discontinued at the time a loan is 90 days delinquent unless the credit is well-secured and in process of collection. When a loan is placed on non-accrual, accrued and unpaid interest is reversed from interest income. Subsequent receipts on non-accrual loans are recorded as a reduction to the principal balance. Interest income is recorded only after principal recovery is complete.

The loss potential for each loan has been evaluated, and in management's opinion, the risk of loss is adequately reserved against. Management actively works with the borrowers to maximize the potential for repayment and reports on the status to the Board of Directors monthly.

During 2014, ARE transferred an undeveloped commercial lot that was originally purchased for possible future banking center expansion to other assets available for sale when management listed the property for sale. The land, originally purchased for \$1.2 million, was recorded at its appraised value less costs to sell. As such, ARE recorded an impairment charge of \$707 thousand in the third quarter of 2014. The property was sold in 2016.

## **Deposits**

Deposits totaled \$1.05 billion at December 31, 2016 and were comprised of noninterest-bearing demand deposits in the amount of \$362.0 million, savings and interest-bearing deposits in the amount of \$440.6 million, and time deposits in the amount of \$251.7 million. Total deposits increased \$140.6 million from December 31, 2015.

Noninterest-bearing deposits increased \$54.2 million from \$307.8 million at December 31, 2015 to \$362.0 million at December 31, 2016. This increase in noninterest-bearing accounts is due to a combination of new accounts and increased balances in existing commercial accounts at year end. Savings and interest-bearing deposit accounts increased \$146.9 million from \$293.7 million at December 31, 2015 to \$440.6 million at December 31, 2016. This increase was due to targeted marketing campaigns initiated in 2016. Time deposits decreased \$60.5 million and totaled \$251.7 million at December 31, 2016 compared to \$312.2 million in 2015 due to a decrease in wholesale funding.

We use wholesale funding or brokered deposits to supplement traditional customer deposits for liquidity and to maintain our desired interest rate risk position. Together with FHLB borrowings we use brokered deposits to fund the short-term cash needs associated with the LHFS activities discussed under “Loans” as well as other funding needs. Brokered deposits totaled \$132.6 million at December 31, 2016, which included \$75.2 million in CDARS/ICS deposits as compared to \$191.9 million at December 31, 2015, which included \$88.5 million in CDARS/ICS deposits.

Through CDARS our depositors are able to obtain FDIC insurance of up to \$50 million. The FDIC currently classifies CDARS deposits as brokered deposits, even though the deposits originate from our customers. These deposits are placed at other participating financial institutions to obtain FDIC insurance, and we receive a reciprocal amount in return from these financial institutions.

True brokered deposits have decreased from \$103.4 million at December 31, 2015 to \$57.4 million at December 31, 2016. Brokered deposits are viewed by many as being volatile and unstable; however, unlike retail certificates of deposit, there are no early withdrawal options on brokered certificates of deposit for any reason other than death of the underlying depositors. Brokered deposits provide funding flexibility and can be renewed at maturity, allowed to roll off or increased or decreased without any impact on core deposit relationships.

We manage the roll over risk of all deposits by maintaining liquid assets in the form of interest-bearing balances at the FRB and FHLB as well as investment securities available-for-sale and loans held for sale. In addition we also maintain lines of credit with the FHLB, FRB, and correspondent banks. At December 31, 2016 there was \$212.1 million available under these lines of credit.

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Depositors have been reluctant to extend maturities on certificates of deposits due to the low interest rate environment which has resulted in an increase in certificates of deposits maturing in the one year or less category. We anticipate that we will renew these certificates of deposits depending on our current funding needs. Our Asset Liability Committee monitors the level of re-pricing assets and liabilities and establishes pricing guidelines to maintain net interest margins.

The daily average balances and weighted average rates paid on deposits for each of the years ended December 31, 2016, 2015, and 2014 are presented below.

	Average Deposits and Average Rates Paid Year Ended December 31,								
	2016			2015			2014		
	Average	Income	Yield	Average	Income	Yield	Average	Income	Yield
	Balance	Expense	Rate	Balance	Expense	Rate	Balance	Expense	Rate
	(Dollars In Thousands)								
Interest-bearing demand deposits	\$ 132,734	\$ 486	0.37 %	\$ 119,732	\$ 265	0.22 %	\$ 114,853	\$ 256	0.22 %
Money market deposit accounts	204,897	846	0.41 %	126,850	264	0.21 %	115,192	232	0.20 %
Savings accounts	37,950	196	0.52 %	13,606	66	0.49 %	3,884	14	0.36 %
Time deposits	286,690	3,622	1.26 %	302,924	3,053	1.01 %	243,338	2,479	1.02 %
Total interest-bearing deposits	\$ 662,271	\$ 5,150	0.78 %	\$ 563,112	\$ 3,648	0.65 %	\$ 477,267	\$ 2,981	0.62 %
Noninterest-bearing demand deposits	359,352			303,583			238,118		
Total deposits	\$ 1,021,623			\$ 866,695			\$ 715,385		



The table below presents the maturity distribution of time deposits at December 31, 2016.

Certificate of Deposit Maturity Distribution Year Ended December 31, 2016				
	Three months or less	Over three through twelve months	Over twelve months	Total
(In Thousands)				
Less than \$100,000	\$ 5,152	\$ 35,365	\$ 39,327	\$ 79,844
Greater than or equal to \$100,000	15,097	103,925	52,840	171,862
	\$ 20,249	\$ 139,290	\$ 92,167	\$ 251,706

### **Borrowings**

Borrowed funds generally consist of advances from the FHLB, securities sold under agreements to repurchase, and federal funds purchased. At December 31, 2016 borrowed funds totaled \$246.0 million, compared to \$146.1 million at December 31, 2015.

Securities sold under agreements to repurchase represent overnight investment of funds from commercial checking accounts pursuant to sweep agreements which enable our corporate clients to receive interest on their excess funds.

The following table provides a breakdown of all borrowed funds.

	Borrowed Funds Distribution Year Ended December 31,		
	2016	2015	2014
(Dollars In Thousands)			
Borrowings:			
At Period End			
FHLB short-term borrowings	\$ 129,000	\$ 70,000	\$ 160,000
Securities sold under agreements to repurchase	17,009	21,129	25,635
FHLB long-term borrowings	60,000	55,000	-
Federal funds purchased	40,000	-	-
Total at period end	\$ 246,009	\$ 146,129	\$ 185,635

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	Year Ended December 31,		
	2016	2015	2014
	(Dollars In Thousands)		
Borrowings:			
Average Balances			
FHLB short-term borrowings	\$56,522	\$91,992	\$115,471
Securities sold under agreements to repurchase	16,038	21,853	21,071
FHLB long-term borrowings	68,525	18,890	-
Federal funds purchased	232	164	58
Total average balance	\$141,317	\$132,899	\$136,600
Average rate paid on all borrowed funds	0.82 %	0.35 %	0.21 %

	Year Ended December 31,					
	2016			2015		
	(Dollars In Thousands)					
Average rate paid on all borrowed funds	Average Balances	Expense	Yield	Average Balances	Expense	Yield
FHLB advances and other borrowings	\$125,047	\$ 1,138	0.91 %	\$110,882	\$ 450	0.41 %
Securities sold under agreements to repurchase	16,038	16	0.10 %	21,853	20	0.09 %
Fed funds purchased	232	-	0.00 %	164	1	0.01 %
	\$141,317	\$ 1,154	0.82 %	\$132,899	\$ 471	0.35 %

Maximum balances at any given month-end during the periods of analysis are reflected in the following table:

	Year Ended December 31,					
	2016		2015		2014	
	Maximum Balance at any month-end		Maximum Balance at any month-end		Maximum Balance at any month-end	
	(Dollars In Thousands)					
FHLB short term borrowings	\$129,000	December	\$160,000	January	\$161,000	November
Securities sold under agreements to repurchase	20,701	November	26,242	January	33,980	April
FHLB long term borrowings	80,000	February	-		-	
Fed funds purchased	40,000	December	-		10,000	September

### **Shareholders' Equity**

Shareholders' equity totaled \$120.5 million at December 31, 2016, compared to \$109.1 million at December 31, 2015. Major changes in shareholders' equity during 2016 include net income of \$16.4 million, \$532 thousand from proceeds of stock options exercised, and stock based compensation of \$335 thousand, an unrealized comprehensive loss on available-for-sale securities of \$564 thousand, and cash dividends paid of \$6.4 million.

Banking regulators have defined minimum regulatory capital ratios that the Corporation and the Bank are required to maintain. These risk-based capital guidelines take into consideration risk factors, as defined by the banking regulators, associated with various categories of assets, both on and off the balance sheet. Both the Corporation and Bank are classified as well capitalized, which is the highest rating. The Corporation's capital strategy is to remain well capitalized under regulatory standards and maintain a minimum tangible common equity to asset ratio of 8.00% but less than 10.50%.

The table below presents an analysis of risk-based capital and outlines the regulatory components of capital and risk-based capital ratios for the Corporation.

	Risk Based Capital Analysis		
	Year Ended December 31,		
	2016	2015	2014
	(Dollars In Thousands)		
Tier 1 Capital:			
Common stock	\$8,881	\$8,805	\$8,742
Additional paid in capital	21,779	19,953	18,538

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Retained earnings	91,439	81,385	72,168		
Less: Disallowed goodwill and other disallowed intangible assets	(1,432 )	(1,380 )	(1,491 )		
Less: Disallowed servicing assets and loss on equity security	(350 )	(280 )	(244 )		
Total Tier 1 Capital	\$120,317	\$108,483	\$97,713		
Allowance for loan losses	14,692	12,200	10,980		
Total Risk Based Capital	\$135,009	\$120,683	\$108,693		
Risk weighted assets	\$1,173,330	\$973,908	\$875,862		
Quarterly average assets	\$1,351,708	\$1,161,080	\$1,007,628		
Risk-Based Capital Ratios:					
Common equity tier 1 capital ratio	10.25	%	11.14	%	NA
Tier 1 capital ratio	10.25	%	11.14	%	11.16 %
Total capital ratio	11.51	%	12.39	%	12.41 %
Leverage Capital Ratio:					
Tier 1 leverage ratio	8.90	%	9.34	%	9.70 %

### **Liquidity Management**

Liquidity is the ability of the Corporation to meet current and future cash flow requirements. The liquidity of a financial institution reflects its ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining the Corporation's ability to meet the daily cash flow requirements of both depositors and borrowers.

Asset and liability management functions not only serve to assure adequate liquidity in order to meet the needs of the Corporation's customers, but also to maintain an appropriate balance between interest sensitive assets and interest sensitive liabilities so that the Corporation can earn an appropriate return for its shareholders.

The asset portion of the balance sheet provides liquidity primarily through loan principal repayments and maturities of investment securities. Other short-term investments such as federal funds sold and interest-bearing deposits with other banks are additional sources of liquidity funding. At December 31, 2016, overnight interest-bearing balances totaled \$81.9 million and securities available-for-sale totaled \$194.1 million.

The liability portion of the balance sheet provides liquidity through various interest-bearing and noninterest-bearing deposit accounts, federal funds purchased, securities sold under agreement to repurchase and other short-term borrowings. At December 31, 2016, the Bank had a line of credit with the FHLB totaling \$408.7 million with short-term borrowings of \$129.0 million, long-term borrowings of \$60.0 million, and a FHLB letter of credit for \$35.0 million leaving approximately \$184.7 million available on the line. In addition to the line of credit at the FHLB, the Bank issues repurchase agreements. As of December 31, 2016, outstanding repurchase agreements totaled \$17.0 million. The interest rate on these instruments is variable and subject to change daily. The Bank also maintains federal funds lines of credit with its correspondent banks and, at December 31, 2016, available credit under these lines amounted to \$22.4 million as \$40.0 million was advanced upon at year end.

The Bank relies on deposits and other short and long-term resources for liquidity from a variety of sources that substantially reduces reliance upon any single provider. The Corporation expects its short and long-term sources of liquidity and capital to remain adequate to support expected growth.

### **Contractual Obligations**

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The following table summarizes the Corporation's significant fixed and determinable contractual obligations to make future payments as of December 31, 2016.

	December 31, 2016			
	Less Than 1 Year	1 - 3 Years	More Than 3 Years	Total
	(In Thousands)			
Certificates of deposit	\$159,539	\$75,585	\$ 16,582	\$251,706
FHLB Advances	129,000	50,000	10,000	189,000
Securities sold under agreements to repurchase	17,009	-	-	17,009
Federal funds purchased	40,000	-	-	40,000
Leases	431	838	2,131	3,400
Total	\$345,979	\$126,423	\$ 28,713	\$501,115

The Corporation generates sufficient cash flows and has adequate resources to meet its contractual obligations. We anticipate that substantially all of the maturing certificates of deposit will be renewed with the exception of certain brokered deposits that we intentionally will not be renewing. Securities sold under agreements to repurchase are likely to remain substantially the same as this item represents funds from overnight sweep agreements with our commercial checking customers.

### **Off Balance Sheet Items**

During the ordinary course of business, the Bank issues commitments to extend credit and, at December 31, 2016, these commitments amounted to \$364.7 million. Included in this balance are \$9.6 million in performance standby letters of credit. These commitments do not necessarily represent cash requirements, since many commitments are expected to expire without being drawn on.

The Mortgage Division had open forward contracts at December 31, 2016 with notional values totaling \$54.3 million. See Notes 8 and 9 to the consolidated financial statements for further information.

The Mortgage Division has agreements with a variety of counterparties to whom mortgage loans are sold on a non-recourse basis. As customary in the industry, the agreements require the Mortgage Division to extend representations and warranties with respect to program compliance, borrower misrepresentation, fraud, and early payment performance. Under the agreements, the counterparties are entitled to make loss claims and repurchase requests of the Mortgage Division for loans that contain covered deficiencies. The Mortgage Division has adopted a reserve methodology whereby provisions are made to an expense account to fund a reserve maintained as a liability account on the balance sheet for potential losses. The amount of the provision and adequacy of the reserve is recommended by management and approved by the Board no less than quarterly. Management estimates the reserve based upon an analysis of historical loss experiences and actual settlements with our counterparties. A schedule of expected losses on loans with claims or indemnifications is maintained to ensure the reserve equals or exceeds the estimate of loss. Claims in process are recognized in the period received, actively monitored and subject to validation prior to payment. Often times, claims are not factually validated and the claim is rescinded. Once claims are validated and the actual or potential loss is agreed upon with the counterparty, the reserve is charged and a cash payment is made to settle the claim. The loan performance data of sold loans is not always made available to the Mortgage Division by the counterparties, thereby making it difficult to estimate the timing and amount of claims until such time as claims are actually presented. Through careful monitoring and conservative estimates, the balance of the reserve has adequately provided for all claims since established. At December 31, 2016 and 2015 the balance in this reserve totaled approximately \$1.0 million and is included in "Other liabilities and accrued expenses" on the balance sheet.

### **Recent Accounting Pronouncements**

Refer to Note 1 to the consolidated financial statements.

## **ITEM 7A – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Corporation's market risk is composed primarily of interest rate risk. The Asset Liability Committee is responsible for reviewing the interest rate sensitivity position and establishes policies to monitor and coordinate the Corporation's sources, uses, and pricing of funds.

### **Interest Rate Sensitivity Management**

The Corporation uses a simulation model to analyze, manage and formulate operating strategies that address net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on various interest rate scenarios over a twelve month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and liabilities. The model incorporates certain assumptions which management believes to be reasonable regarding the impact of changing interest rates and the prepayment assumption of certain assets and liabilities as of December 31, 2016. The model assumes changes in interest rates without any management intervention to change the composition of the balance sheet. According to the model run for the period ended December 31, 2016, over a twelve month period an immediate 100 basis points increase in interest rates would result in an increase in net interest income by 0.90%. An immediate 200 basis points increase in interest rates would result in an increase in net interest income by 1.8%. A 100 basis points decrease in interest rates would result in a negative variance in net interest income and is considered unlikely given current interest rate levels. While management carefully monitors the exposure to changes in interest rates and takes actions as warranted to decrease any adverse impact, there can be no assurance about the actual effect of interest rate changes on net interest income.

The Corporation's net interest income and the fair value of its financial instruments are influenced by changes in the level of interest rates. The Corporation manages its exposure to fluctuations in interest rates through policies established by its Asset Liability Committee. The Asset Liability Committee meets monthly and has responsibility for formulating and implementing strategies to improve balance sheet positioning and net income and reviewing interest rate sensitivity.

The Mortgage Division is party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed (locked) by both the Mortgage Division and the borrower for specified periods of time. When the borrower locks his or her interest rate, the Mortgage Division effectively extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Mortgage Division must honor the interest rate for the specified time period. The Mortgage Division is exposed to interest rate risk during the accumulation of interest rate lock commitments and loans prior to sale. The Mortgage Division utilizes either a best efforts sell forward or a mandatory sell forward commitment to economically hedge the changes in fair value of the loan due to changes in market interest rates. Failure to effectively monitor, manage, and hedge the interest rate risk associated with the mandatory commitments subjects the Mortgage Division to potentially significant market risk.



Throughout the lock period the changes in the market value of interest rate lock commitments, best efforts and mandatory sell forward commitments are recorded as unrealized gains and losses and are included in the consolidated statement of income under other noninterest income. The Mortgage Division utilizes a third party and its proprietary simulation model to assist in identifying and managing the risk associated with this activity.

### **Impact of Inflation and Changing Prices**

A bank's asset and liability structure is substantially different from that of a non-financial company in that virtually all assets and liabilities of a bank are monetary in nature. The impact of inflation on financial results depends upon the Bank's ability to react to changes in interest rates and, by such reaction, reduce the inflationary impact on performance. Interest rates do not necessarily move in the same direction, or at the same magnitude, as the prices of other goods and services. Management seeks to manage the relationship between interest-sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

**ITEM 8 – FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders

Access National Corporation

Reston, Virginia

We have audited the accompanying consolidated balance sheets of Access National Corporation as of December 31, 2016 and 2015 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Access National Corporation at December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Access National Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 16, 2017 expressed an unqualified opinion thereon.

/S/ BDO USA, LLP

BDO USA, LLP  
Richmond, Virginia  
March 16, 2017

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## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Access National Corporation

Reston, Virginia

We have audited Access National Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Access National Corporation'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, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether 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.

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.

In our opinion, Access National Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Access National Corporation as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016, and our report dated March 16, 2017 expressed an unqualified opinion thereon.

/S/ BDO USA, LLP

BDO USA, LLP  
Richmond, Virginia  
March 16, 2017

**ACCESS NATIONAL CORPORATION**

## Consolidated Balance Sheets

(In Thousands, Except for Share and Per Share Data)

	December 31,	
	2016	2015
<b>Assets</b>		
Cash and due from banks	\$9,186	\$11,291
Interest-bearing deposits in other banks and federal funds sold	81,873	24,598
Total cash and cash equivalents	91,059	35,889
Securities available-for-sale, at fair value	194,090	160,162
Securities held-to-maturity, at amortized cost (fair value of \$9,293 and \$14,314)	9,200	14,287
Total investment securities	203,290	174,449
Restricted stock	10,092	7,259
Loans held for sale	35,676	44,135
Loans, net of allowance for loan losses 2016 - \$16,008; 2015 - \$13,563	1,033,690	873,915
Premises, equipment and land, net	7,084	6,689
Accrued interest receivable and other assets	49,817	36,212
Total assets	\$1,430,708	\$1,178,548
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest-bearing deposits	\$362,036	\$307,797
Savings and interest-bearing deposits	440,585	293,711
Time deposits	251,706	312,236
Total deposits	1,054,327	913,744
Short-term borrowings	186,009	91,129
Long-term borrowings	60,000	55,000
Other liabilities and accrued expenses	9,842	9,537
Total liabilities	1,310,178	1,069,410
<b>Shareholders' Equity</b>		
Common stock, par value \$0.835, authorized 60,000,000 shares, issued and outstanding, 2016 - 10,636,242 and 2015 - 10,544,751	8,881	8,805
Additional paid-in capital	21,779	19,953
Retained earnings	91,439	81,385

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Accumulated other comprehensive loss, net	(1,569 )	(1,005 )
Total shareholders' equity	120,530	109,138
Total liabilities and shareholders' equity	\$1,430,708	\$1,178,548

See accompanying notes to consolidated financial statements.

**ACCESS NATIONAL CORPORATION**

## Consolidated Statements of Income

(In Thousands, Except for Share and Per Share Data)

	Year Ended December 31,		
	2016	2015	2014
Interest and Dividend Income			
Loans	\$45,639	\$40,055	\$35,702
Interest-bearing deposits and federal funds sold	337	129	102
Securities	4,039	3,482	2,697
Total interest and dividend income	50,015	43,666	38,501
Interest Expense			
Deposits	5,150	3,648	2,981
Short-term borrowings	402	252	292
Long-term borrowings	752	219	-
Total interest expense	6,304	4,119	3,273
Net interest income	43,711	39,547	35,228
Provision for loan losses	2,120	150	-
Net interest income after provision for loan losses	41,591	39,397	35,228
Noninterest Income			
Service fees on deposit accounts	971	903	695
Gain on sale of loans	25,164	19,633	15,146
Other income	5,668	5,529	3,459
Total noninterest income	31,803	26,065	19,300
Noninterest Expense			
Compensation and employee benefits	31,778	26,966	22,654
Occupancy	1,685	1,594	1,602
Furniture and equipment	1,359	1,446	1,219
Other	12,968	11,860	7,543
Total noninterest expense	47,790	41,866	33,018
Income before income taxes	25,604	23,596	21,510
Provision for income taxes	9,200	8,177	7,585
Net Income	\$16,404	\$15,419	\$13,925
Earnings per common share:			
Basic	\$1.55	\$1.46	\$1.33
Diluted	\$1.54	\$1.46	\$1.33



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Average outstanding shares:

Basic	10,586,394	10,513,008	10,424,067
Diluted	10,677,561	10,581,871	10,466,841

See accompanying notes to consolidated financial statements.

**ACCESS NATIONAL CORPORATION**

**Consolidated Statements of Comprehensive Income**

(In Thousands)

	Year Ended December 31,		
	2016	2015	2014
Net income	\$ 16,404	\$ 15,419	\$ 13,925
Other comprehensive income:			
Unrealized gains (losses) on securities			
Unrealized holding gains (losses) arising during period	(816 )	(528 )	2,206
Less: reclassification adjustment for gains included in net income	(52 )	(188 )	(18 )
Tax effect	304	255	(766 )
Net of tax amount	(564 )	(461 )	1,422
Comprehensive income	\$ 15,840	\$ 14,958	\$ 15,347

See accompanying notes to consolidated financial statements.

## ACCESS NATIONAL CORPORATION

## Consolidated Statements of Changes in Shareholders' Equity

(In Thousands, Except for Share and Per Share Data)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total
Balance, December 31, 2013	\$ 8,659	\$ 17,320	\$ 67,121	\$ (1,966 )	\$ 91,134
Comprehensive income:					
Net income	-	-	13,925	-	13,925
Other comprehensive loss	-	-	-	1,422	1,422
Stock options exercised (76,132 shares)	63	617	-	-	680
Repurchase of common stock under share repurchase program (24,017 shares)	20	365	-	-	385
Cash dividends (\$0.50 per share)	-	-	(5,214 )	-	(5,214 )
Cash dividend declared (\$0.35 per share)	-	-	(3,664 )	-	(3,664 )
Stock-based compensation expense recognized in earnings	-	236	-	-	236
Balance, December 31, 2014	\$ 8,742	\$ 18,538	\$ 72,168	\$ (544 )	\$ 98,904
Comprehensive income:					
Net income	-	-	15,419	-	15,419
Other comprehensive income	-	-	-	(461 )	(461 )
Stock options exercised (29,975 shares)	26	354	-	-	380
Issuance of restricted common stock (7,500 shares)	6	122	-	-	128
Dividend reinvestment plan shares issued from reserve (37,707 shares)	31	607	-	-	638
Cash dividends (\$0.58 per share)	-	-	(6,202 )	-	(6,202 )
Stock-based compensation expense recognized in earnings	-	332	-	-	332
Balance, December 31, 2015	\$ 8,805 #	\$ 19,953 #	\$ 81,385 #	\$ (1,005 )#	\$ 109,138
Comprehensive income:					
Net income	-	-	16,404	-	16,404
Other comprehensive loss	-	-	-	(564 )	(564 )
Stock options exercised (43,801 shares)	36	496	-	-	532
Issuance of restricted common stock (6,205 shares)	5	123	-	-	128

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Dividend reinvestment plan shares issued from reserve (41,485 shares)	35	872	-	-	907
Cash dividends (\$0.60 per share)	-	-	(6,350 )	-	(6,350 )
Stock-based compensation expense recognized in earnings	-	335	-	-	335
Balance, December 31, 2016	\$ 8,881	\$ 21,779	\$ 91,439	\$ (1,569 )	\$ 120,530

See accompanying notes to consolidated financial statements.

## ACCESS NATIONAL CORPORATION

## Consolidated Statements of Cash Flows

(In Thousands)

	Years Ended December 31		
	2016	2015	2014
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 16,404	\$ 15,419	\$ 13,925
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan losses	2,120	150	-
Provision for (recapture of provision for) losses on mortgage loans sold	-	-	(3,250 )
Provision for off balance sheet losses	-	109	5
Writedown of other real estate owned	-	-	707
Income from bank-owned life insurance	(558 )	(460 )	(332 )
(Gain) loss on sale of securities	(109 )	89	47
Loss on sale of other real estate owned	35	-	-
Deferred tax (benefit) expense	(698 )	(534 )	866
Stock-based compensation	335	332	236
Valuation (allowance) release on derivatives	(394 )	(383 )	205
Net amortization on securities	2,051	1,077	790
Depreciation and amortization	515	507	485
Loss on disposal of assets	-	-	2
Changes in assets and liabilities:			
Decrease (increase) in valuation of loans held for sale carried at fair value	669	240	(1,210 )
Originations of loans held for sale	(537,076)	(484,747)	(408,346)
Proceeds from sales of loans held for sale	544,866	485,398	388,883
Increase in other assets	(2,113 )	(1,470 )	(3,342 )
Increase in other liabilities	230	382	1,944
Net cash provided by (used in) operating activities	26,277	16,109	(8,385 )
<b>Cash Flows from Investing Activities</b>			
Proceeds from maturities and calls of securities available-for-sale	15,883	18,180	8,940
Proceeds from sale of available-for-sale securities	13,200	31,151	26,613
Purchases of securities available-for-sale	(65,734 )	(86,264 )	(82,708 )
Proceeds from maturities and calls of securities held-to-maturity	5,000	-	5,000
Purchase of securities held-to-maturity	-	-	(3,055 )
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(9,761 )	(13,843 )	(16,470 )
Proceeds from redemption of Federal Reserve and Federal Home Loan Bank Stock	6,928	15,545	16,068
Purchase of bank owned life insurance	(10,000 )	-	(15,000 )
Net increase in loans	(161,895)	(110,861)	(89,285 )
Proceeds from sale of equipment	-	-	1
Proceeds from the settlement of other real estate owned	463	-	-

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Purchases of premises and equipment	(871 )	(232 )	(211 )
Net cash used in investing activities	(206,787)	(146,324)	(150,107)
Cash Flows from Financing Activities			
Net increase in demand, interest-bearing demand and savings deposits	201,113	114,860	96,544
Net (decrease) increase in time deposits	(60,530 )	43,441	85,927
Net increase (decrease) in securities sold under agreement to repurchase	35,880	(4,506 )	(2,220 )
Net increase (decrease) in other short-term borrowings	59,000	(90,000 )	15,000
Net increase in long-term borrowings	5,000	55,000	-
Proceeds from issuance of common stock	1,567	1,146	1,065
Dividends paid	(6,350 )	(9,866 )	(5,214 )
Net cash provided by financing activities	235,680	110,075	191,102
Increase (decrease) in cash and cash equivalents	55,170	(20,140 )	32,610
Cash and Cash Equivalents			
Beginning	35,889	56,029	23,419
Ending	\$91,059	\$35,889	\$56,029
Supplemental Disclosures of Cash Flow Information			
Cash payments for interest	\$6,324	\$4,094	\$3,202
Cash payments for income taxes	\$10,020	\$8,769	\$6,089
Supplemental Disclosures of Noncash Investing Activities			
Unrealized (loss) gain on securities available for sale	\$(868 )	\$(709 )	\$2,188
Transfers of loans held for investment to other real estate owned	\$129	\$-	\$-
Other real estate owned transferred to other assets due to FHA guarantee	\$(129 )	\$-	\$-
Purchased land transferred to other assets held for sale	\$-	\$-	\$1,207

See accompanying notes to consolidated financial statements.

## ACCESS NATIONAL CORPORATION

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies

**Nature of Operations** - Access National Corporation (the "Corporation") is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The holding company was formed on June 15, 2002. The Corporation owns all of the stock of its subsidiary Access National Bank (the "Bank"), which is an independent commercial bank chartered under federal laws as a national banking association.

The Bank has three active wholly-owned subsidiaries: Access Real Estate LLC ("Access Real Estate"), a real estate company; ACME Real Estate LLC, a real estate holding company of foreclosed property; and Access Capital Management Holding, LLC ("ACM"), a holding company for Capital Fiduciary Advisors, L.L.C., Access Investment Services, L.L.C. and Access Insurance Group, L.L.C.

**Basis of Presentation** - The accompanying consolidated financial statements include the accounts of Access National Corporation and its wholly-owned subsidiary, Access National Bank. All significant inter-company accounts and transactions have been eliminated in consolidation. The accounting and reporting policies of the Corporation and its subsidiaries conform to accounting principles generally accepted in the United States of America and to predominant practices within the banking industry.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the fair values and impairments of financial instruments, the status of contingencies and the valuation of deferred tax assets.

**Cash Flow Reporting** - For purposes of the statements of cash flows, cash and cash equivalents consists of cash and due from banks, federal funds sold and interest-bearing deposits at other banks.

**Restrictions on Cash and Cash Equivalents** - As a member of the Federal Reserve System, the Bank is required to maintain certain average reserve balances. Those balances include usable vault cash and amounts on deposit with the Federal Reserve Bank of Richmond (“FRB”). At December 31, 2016 and 2015, the amount of daily average required balances was approximately \$43.6 million and \$38.7 million, respectively. The Mortgage Division held escrow deposits in conjunction with mortgage loans totaling \$196 thousand and \$269 thousand at December 31, 2016 and 2015, respectively.

**Securities** - Debt securities that management has both the positive intent and ability to hold to maturity are classified as “held-to-maturity” and are recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from net income and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the effective interest method over the terms of the securities or call dates if applicable. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in net income as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

**Restricted Stock** - Restricted stock consists of Federal Home Loan Bank of Atlanta (“FHLB”) stock and FRB stock. These stocks are classified as restricted stocks because their ownership is restricted to certain types of entities and they lack a market. Restricted stock is carried at cost on the Corporation's financial statements. Dividends are paid semiannually on FRB stock and quarterly on FHLB stock.



## Notes to Consolidated Financial Statements

### Note 1. Summary of Significant Accounting Policies (continued)

**Other Than Temporary Impairment of Investment Securities** – Securities are evaluated quarterly for potential other than temporary impairment. Management considers the facts of each security including the nature of the security, the amount and duration of the loss, credit quality of the issuer, the expectations for that security's performance, and the Corporation's intent and ability to hold the security until recovery. Declines in equity securities that are considered to be other than temporary are recorded as a charge to net income in the Consolidated Statements of Income. Declines in debt securities that are considered to be other than temporary are separated into (1) the amount of the total impairment related to credit loss and (2) the amount of the total impairment related to all other factors. The amount of the total other than temporary impairment related to the credit loss is recognized in net income. The amount of the total impairment related to all other factors is recognized in other comprehensive income.

**Loans** - The Corporation grants commercial, real estate, and consumer loans to customers in the community in and around the Greater Washington D.C. Metropolitan Area. The loan portfolio is well diversified and generally collateralized by assets of the customers. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers. The ability of the Corporation's debtors to honor their contracts is dependent upon the real estate and general economic conditions in the Corporation's market 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 less the allowance for loan losses and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective interest method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 180 days past due. In all cases, loans are placed on non-accrual 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 non-accrual 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. Loans are returned to accrual status when all of the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Interest Income on Loans** - Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed.

**Loans Held for Sale** - The Corporation accounts for all one to four unit residential loans originated and intended for sale in the secondary market in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 825-10. Loans held for sale are recorded at fair value, determined individually, as of the balance sheet date.

**Allowance for Loan Losses** - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to net income. 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 represents an amount that, in management’s judgment, will be adequate to absorb any losses on existing loans that may become uncollectible. Management’s judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans while taking into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions which may affect a borrower’s ability to repay, overall portfolio quality, and review of specific potential losses. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

## Notes to Consolidated Financial Statements

### Note 1. Summary of Significant Accounting Policies (continued)

A loan is considered impaired when, based on current information and events, it is probable that the Corporation 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. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. 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. Impairment is measured on a loan by loan basis by either the present value of the 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.

**Derivative Financial Instruments** - The Mortgage Division enters into commitments to fund residential mortgage loans with the intention of selling them in the secondary market. The Mortgage Division also enters into forward sales agreements for certain funded loans and loan commitments. The Mortgage Division records unfunded commitments intended for loans held for sale and forward sales agreements at fair value with changes in fair value recorded as a component of other income. Loans originated and intended for sale in the secondary market are carried at fair value. For pipeline loans which are not pre-sold to an investor, the Mortgage Division manages the interest rate risk on rate lock commitments by entering into forward sale contracts of mortgage backed securities, whereby the Mortgage Division obtains the right to deliver securities to investors in the future at a specified price. Such contracts are accounted for as derivatives and are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in other income.

The Mortgage Division has determined these derivative financial instruments do not meet the hedging criteria required by FASB ASC 815 and has not designated these derivative financial instruments as hedges. Accordingly, changes in fair value are recognized currently in income.

**Premises and Equipment** - Premises and equipment are stated at cost less accumulated depreciation. Premises and equipment are depreciated over their estimated useful lives; leasehold improvements are amortized over the lives of the respective leases or the estimated useful life of the leasehold improvement, whichever is less. Depreciation is computed using the straight-line method over the estimated useful lives of 39 years for office buildings and 3 to 15 years for furniture, fixtures, and equipment. Costs of maintenance and repairs are expensed as incurred; improvements and betterments are capitalized. When items are retired or otherwise disposed of, the related costs and accumulated

depreciation are removed from the accounts and any resulting gains or losses are included in the determination of net income.

**Real Estate Owned** - Real estate properties acquired through loan foreclosures are recorded initially at fair value, less expected sales costs. Subsequent valuations are performed by management, and the carrying amount of a property is adjusted by a charge to expense to reflect any subsequent declines in estimated fair value. Fair value estimates are based on recent appraisals and current market conditions. Gains or losses on sales of real estate owned are recognized upon disposition. Real estate owned is included in other assets. At December 31, 2016 and 2015 the Corporation did not have any real estate owned due to foreclosure. The Corporation did have one property at December 31, 2015 which had previously been included in premises and equipment reclassified to other real estate owned when it was determined by management the land, originally purchased for potential banking center expansion, would not be used for those purposes. The property was subsequently sold in 2016.

**Income Taxes** - Income tax expense is the total of the current year income tax due or refundable, the change in deferred tax assets and liabilities, and any adjustments related to unrecognized tax benefits. Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Corporation has not identified any material uncertain tax positions.

**Stock-Based Compensation Plans** –In accordance with FASB ASC 718-10, the Corporation measures the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date. That cost is recognized over the period during which the employee is required to provide service in exchange for the award, the requisite service period. No compensation expense is recognized for equity instruments for which employees do not render the requisite service. The Corporation determines the fair value of the employee stock options using the Black-Scholes option pricing model.

## Notes to Consolidated Financial Statements

### Note 1. Summary of Significant Accounting Policies (continued)

**Earnings Per Share** - Basic earnings per share represents income available to common shareholders divided by the weighted-average number of shares outstanding during the period. Diluted earnings per share reflect additional 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. Common equivalent shares are excluded from the computation if their effect is anti-dilutive.

**Fair Value Measurements** - The Corporation records certain of its assets and liabilities at fair value. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value measurements are classified within one of three levels in a valuation hierarchy based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices

in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. See Note 16 - Fair Value Measurements.

**Securities Sold Under Agreements to Repurchase** - Securities sold under agreements to repurchase are accounted for as collateralized financing transactions and are recorded at the amounts at which the securities were sold plus accrued interest. Securities, generally U.S. government and federal agency securities, pledged as collateral under these financing arrangements cannot be sold or re-pledged by the secured party.

**Advertising Costs** - The Corporation charges the costs of advertising to expense as incurred.

### **Recent Accounting Pronouncements**

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)”. This ASU supersedes the revenue recognition requirements in Topic 605, “Revenue Recognition” as well as most industry-specific guidance. The amendments also create a new Subtopic 340-40 “Other Assets and Deferred Costs – Contracts with Customers”. In summary, entities are to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The provisions of ASU 2014-09 are effective for annual periods beginning after December 15, 2017 and interim periods within 2018. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In February 2015, the FASB issued ASU 2015-02, “Consolidation (Topic 810)”. This ASU focuses on the consolidation evaluation for reporting organizations that are required to evaluate consolidation of certain legal entities by reducing the number of consolidation models from four to two and is intended to improve current GAAP. The amendments in the ASU are effective beginning after December 15, 2016. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In September 2015, the FASB issued ASU 2015-16, “Business Combinations (Topic 805)”. This ASU requires an acquirer retrospectively adjust provisional amounts recognized in a business combination during the measurement period, in the reporting period in which the adjustment is determined as well as present separately on the face of the income statement or as a disclosure in the notes to the financial statements the portion of the amount recorded in current period earnings that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The amendments in the ASU are effective beginning after December 15, 2015. The adoption of this guidance did not have a material effect on the Corporation’s financial condition or results of operations.

## Notes to Consolidated Financial Statements

### Note 1. Summary of Significant Accounting Policies (continued)

#### Recent Accounting Pronouncements (continued)

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10)”. This ASU requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The amendments in the ASU are effective beginning after December 15, 2017. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”. This ASU specifies the accounting for leases in an effort to increase transparency and comparability among organizations. The amendments in the ASU are effective beginning after December 15, 2018. While the adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations, management has yet to quantify the impact of this ASU.

In March 2016, the FASB issued ASU 2016-07, “Investments - Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting.” The amendments affect all entities that have an investment that becomes qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. This ASU simplifies the transition to the equity method of accounting by eliminating retroactive adjustment of the investment when an investment qualifies for use of the equity method, among other things. The amendments in the ASU are effective beginning after December 15, 2016 and for interim periods within that year. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” This ASU was issued to clarify certain principal versus agent considerations within the implementation guidance of ASC Topic 606, “Revenue from Contracts with Customers.” The effective date and transition of ASU 2016-08 is the same as the effective date and transition of ASU 2014-09, Revenue from Contracts with Customers (Topic 606), as discussed above. We are currently evaluating the potential impact of ASU 2016-08 on our financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” Under this ASU all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. The amendments in the ASU are effective beginning after December 15, 2016 and for interim periods within that year. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In April 2016, the FASB issued ASU No. 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” This ASU was issued to clarify ASC Topic 606, “Revenue from Contracts with Customers” related to (i) identifying performance obligations; and (ii) the licensing implementation guidance. The effective date and transition of ASU 2016-10 is the same as the effective date and transition of ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” as discussed above. We are currently evaluating the potential impact of ASU 2016-10 on our financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This ASU amends guidance on reporting credit losses for assets held at amortized cost basis and available-for-sale debt securities by eliminating the probable initial recognition threshold (incurred loss methodology) and requiring entities to reflect its current estimate of all expected credit losses. The amendments in the ASU are effective beginning after December 15, 2019 and for interim periods within that year. Early adoption is permitted beginning after December 15, 2018. Entities will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings in the first period effective. Management is currently evaluating the potential impact of ASU 2016-13 on its financial statements.



## Notes to Consolidated Financial Statements

### Note 1. Summary of Significant Accounting Policies (continued)

#### Recent Accounting Pronouncements (continued)

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” This ASU was issued to reduce diversity in how certain cash receipts and cash payments are being presented and classified in the statement of cash flows. Guidance provided in the ASU are specific to eight cash flow issues being: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt or other debt instruments with interest rates that are insignificant to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds received from the settlement of life insurance claims; proceeds received from the settlement of bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and application of the predominance principle. The amendments in the ASU are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The amendments should be applied using a retrospective transition method to each period presented. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory.” Under current GAAP, recognition of current and deferred income taxes for an intra-entity asset transfer is prohibited until the asset has been sold to a third party. The amendments in this ASU eliminate the exception for an intra-entity transfer of an asset other than inventory thereby requiring an entity to recognize the income tax consequences when the transfer occurs. The amendments in the ASU are effective beginning after December 15, 2017 and for interim periods within that year. Early adoption is permitted. Entities will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings in the first period effective. The adoption of this guidance should not have a material effect on the Corporation’s financial condition or results of operations.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The ASU was issued with the intent to simplify goodwill impairment testing by eliminating the second step of the analysis under which the implied fair value of goodwill is determined as if the reporting unit were being acquired in a business combination. The update instead requires entities to compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for any amount by which the carrying amount exceeds the reporting unit’s fair value, to the extent that the loss recognized does not exceed the amount of goodwill allocated to that reporting unit. ASU 2017-04 must be applied prospectively and is effective for the Company on January 1, 2020. Early adoption is permitted. The Company does not expect the new guidance to

have a material impact on its Consolidated Financial Statements.

## Notes to Consolidated Financial Statements

## Note 2. Securities

The following table provides the amortized cost and fair value for the categories of available-for-sale securities and held-to-maturity securities at December 31, 2016 and 2015. Held-to-maturity securities are carried at amortized cost, which reflects historical cost, adjusted for amortization of premiums and accretion of discounts. Available-for-sale securities are carried at estimated fair value with net unrealized gains or losses reported on an after tax basis as a component of accumulated other comprehensive income in shareholders' equity. The estimated fair value of available-for-sale securities is impacted by interest rates, credit spreads, market volatility, and liquidity.

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. Government agencies	\$5,106	\$ -	\$ (112)	) \$ 4,994
Mortgage backed securities	120,794	177	(1,164)	) 119,807
Corporate bonds	8,631	35	-	8,666
Asset Backed Securities	13,105	17	(258)	) 12,864
Certificates of deposit	1,976	33	-	2,009
Municipals - nontaxable	45,392	172	(1,205)	) 44,359
CRA Mutual fund	1,500	-	(109)	) 1,391
	\$ 196,504	\$ 434	\$ (2,848)	) \$ 194,090
Held-to-maturity:				
U.S. Government agencies	\$5,000	\$ 46	\$ -	\$ 5,046
Municipals - nontaxable	1,597	18	-	1,615
Municipals	2,603	48	(19)	) 2,632
	\$9,200	\$ 112	\$ (19)	) \$ 9,293
	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. Government agencies	\$19,124	\$ 5	\$ (225)	) \$ 18,904
Mortgage backed securities	97,270	31	(1,224)	) 96,077

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Corporate bonds	8,967	20	(28	)	8,959
Asset Backed Securities	14,312	17	(299	)	14,030
Certificates of deposit	1,976	1	(9	)	1,968
Municipals - nontaxable	18,559	287	(32	)	18,814
CRA Mutual fund	1,500	-	(90	)	1,410
	\$161,708	\$ 361	\$ (1,907	)	\$ 160,162
Held-to-maturity:					
U.S. Government agencies	\$9,987	\$ 50	\$ (32	)	\$ 10,005
Municipals - nontaxable	\$1,686	\$ -	\$ (20	)	\$ 1,666
Municipals	2,614	43	(14	)	2,643
	\$14,287	\$ 93	\$ (66	)	\$ 14,314

## Notes to Consolidated Financial Statements

## Note 2. Securities (continued)

The amortized cost and estimated fair value of securities as of December 31, 2016 by contractual maturities are shown below. Actual maturities may differ from contractual maturities because the securities may be called or prepaid without any penalties.

	December 31, 2016	
	Amortized Cost	Estimated Fair Value
	(In Thousands)	
Available-for-sale:		
US Treasury and Agencies:		
Due after five through ten years	\$5,106	\$4,994
Municipals - nontaxable:		
Due after one through five years	3,442	3,500
Due after five through ten years	5,025	4,888
Due after ten through fifteen years	20,463	20,300
Due after fifteen years	16,462	15,671
Asset Backed Securities:		
Due after five through ten years	3,080	3,001
Due after fifteen years	10,025	9,863
Certificates of deposit:		
Due after one through five years	1,976	2,009
Corporate bonds:		
Due in one year or less	4,141	4,144
Due after one through five years	4,490	4,522
Mortgage backed securities:		
Due after one through five years	24,959	24,916
Due after five through ten years	24,996	24,895
Due after ten through fifteen years	12,861	12,555
Due after fifteen years	57,978	57,441
CRA Mutual fund	1,500	1,391
	\$196,504	\$194,090
Held-to-maturity:		
US Treasury and Agencies:		

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Due after one through five years	\$5,000	\$5,046
Municipals:		
Due after one through five years	431	447
Due after five through ten years	1,617	1,649
Due after ten through fifteen years	555	536
Municipals - nontaxable:		
Due after one through five years	1,597	1,615
	\$9,200	\$9,293

The estimated fair value of securities pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes amounted to \$178.7 million and \$147.9 million at December 31, 2016 and 2015, respectively.

### Restricted Stock

The Corporation's restricted stock consists of FHLB stock and FRB stock. The amortized costs of the restricted stock as of December 31, 2016 and 2015 are as follows:

	December 31, 2016	December 31, 2015
	(In Thousands)	
Restricted Stock:		
FRB stock	\$ 999	\$ 999
FHLB stock	9,093	6,260
	\$ 10,092	\$ 7,259

## Notes to Consolidated Financial Statements

## Note 2. Securities (continued)

Investment securities available-for-sale and held-to-maturity that had an unrealized loss position at December 31, 2016 and December 31, 2015 are detailed below.

December 31, 2016	Securities in a loss Position for less than 12 Months Estimated		Securities in a loss Position for 12 Months or Longer Estimated		Total Estimated	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

(In Thousands)

## Investment securities available-for-sale:

Mortgage backed securities	\$62,145	\$ (541 )	\$19,768	\$ (623 )	\$81,913	\$ (1,164 )
U.S. Government agencies	4,994	(112 )	-	-	4,994	(112 )
Municipals	28,147	(1,205 )	-	-	28,147	(1,205 )
Asset backed securities	1,286	(37 )	7,077	(221 )	8,363	(258 )
CRA Mutual fund	-	-	1,391	(109 )	1,391	(109 )
Total	\$96,572	\$ (1,895 )	\$28,236	\$ (953 )	\$124,808	\$ (2,848 )

## Investment securities held-to-maturity:

Municipals	\$536	\$ (19 )	\$-	\$ -	\$536	\$ (19 )
Total	\$536	\$ (19 )	\$-	\$ -	\$536	\$ (19 )

December 31, 2015	Securities in a loss Position for less than 12 Months Estimated		Securities in a loss Position for 12 Months or Longer Estimated		Total Estimated	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

(In Thousands)

## Investment securities available-for-sale:

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Mortgage backed securities	\$63,327	\$ (774 )	\$29,375	\$ (450 )	\$92,702	\$ (1,224 )
U.S. Government agencies	5,040	(85 )	9,858	(140 )	14,898	(225 )
Municipals - nontaxable	1,452	(13 )	2,244	(19 )	3,696	(32 )
Corporate bonds	-	-	7,066	(28 )	7,066	(28 )
Asset backed securities	247	(2 )	9,531	(299 )	9,778	(301 )
Certificates of deposit	1,720	(7 )	-	-	1,720	(7 )
CRA Mutual fund	-	-	1,410	(90 )	1,410	(90 )
Total	\$71,786	\$ (881 )	\$59,484	\$ (1,026 )	\$131,270	\$ (1,907 )

Investment securities held-to-maturity:

U.S. Government agencies	\$-	\$ -	\$4,954	\$ (32 )	\$4,954	\$ (32 )
Municipals - nontaxable	-	-	3,266	(34 )	3,266	(34 )
Total	\$-	\$ -	\$8,220	\$ (66 )	\$8,220	\$ (66 )

The Corporation evaluates securities for other than temporary impairment (“OTTI”) on a quarterly basis and more frequently when economic or market conditions warrant such evaluation. Consideration is given to various factors in determining whether the Corporation anticipates a recovery in fair value such as: the length of time and extent to which the fair value has been less than cost, and the financial condition and underlying credit quality of the issuer. When analyzing an issuer’s financial condition, the Corporation may consider whether the securities are issued by the federal government or its agencies, the sector or industry trends affecting the issuer, and whether any recent downgrades by bond rating agencies have occurred.

*Mortgage-backed*

The Corporation’s unrealized losses on available-for-sale mortgage backed securities were caused by interest rate fluctuations. At December 31, 2016, thirty-two securities had unrealized losses of \$1.2 million. All thirty-two securities are backed by the United States Government or a Government Sponsored Entity. The Corporation’s intent is to hold these securities until a market price recovery or maturity, and it has been determined that it is more likely than not that the Corporation will not be required to sell these securities before their anticipated recovery. As such, the Corporation does not consider these investments other than temporarily impaired.

*US Government agencies*

The Corporation’s unrealized loss on its U.S. Government Agency obligation was caused by interest rate fluctuations. On December 31, 2016, one available for sale security had an unrealized loss of \$112 thousand. The severity and duration of this unrealized loss will fluctuate with interest rates in the economy. Based on the credit quality of the agency, the Corporation’s intent to hold this security until a market price recovery or maturity, and the determination that it is more likely than not that the Corporation will not be required to sell the security before its anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.



## Notes to Consolidated Financial Statements

### Note 2. Securities (continued)

#### *Asset backed securities*

The Corporation's unrealized losses on its other investments were caused by interest rate fluctuations. At December 31, 2016, five securities had unrealized losses of \$258 thousand. Based on the credit quality of the issuers, the Corporation's intent to hold these securities until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell the securities before their anticipated recoveries, the Corporation does not consider these investments other than temporarily impaired.

#### *Municipals*

The Corporation's unrealized losses on its municipal investments were caused by interest rate fluctuations. At December 31, 2016, one held-to-maturity municipal had an unrealized loss of \$19 thousand while twenty-six available-for-sale municipals had unrealized losses of \$1.2 million. Based on the credit quality of the issuers, the Corporation's intent to hold these securities until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these investments other than temporarily impaired.

#### *Mutual fund*

The Corporation's unrealized loss on its CRA mutual fund investment was caused by interest rate fluctuations. At December 31, 2016, one security had an unrealized loss of \$109 thousand. Based on the credit quality of the issuer, the Corporation's intent to hold this security until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell the security before its anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.

### **Securities Sold Under Agreements to Repurchase (Repurchase Agreements)**

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured

borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Corporation's consolidated balance sheets, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Corporation be in default (e.g., fails to make an interest payment to the counterparty). The collateral is held by a third-party financial institution in the Corporation's custodial account. The Corporation has the right to sell or repledge the investment securities. The risks and rewards associated with the investment securities pledged as collateral (e.g. a decline or rise in the fair value of the investments) remains with the Corporation. As of December 31, 2016 and 2015, the obligations outstanding under these repurchase agreements totaled \$17.0 million and \$21.1 million, respectively, and were comprised of overnight sweep accounts. The fair value of the securities pledged in connection with these repurchase agreements at December 31, 2016 was \$21.4 million in total and consisted of \$4.7 million in municipal securities, \$6.9 million in mortgage-backed securities, \$5.9 million in corporate bonds, \$2.5 million in asset-backed securities, and \$1.4 million in CRA mutual funds. The fair value of the securities pledged in connection with these repurchase agreements at December 31, 2015 was \$24.3 million in total and consisted of \$6.7 million in municipal securities, \$4.9 million in mortgage backed securities, \$6.2 million in corporate bonds, and \$6.5 million in asset-backed securities.

**Notes to Consolidated Financial Statements****Note 3. Loans and the Allowance for Loan Losses**

The composition of net loans is summarized as follows:

(Dollars In Thousands)	Year Ended December 31,		2015	Percentage of Total	
	2016	Percentage of Total		2015	Percentage of Total
Commercial real estate - owner occupied	\$250,440	23.87	% \$219,877	24.77	%
Commercial real estate - non-owner occupied	184,688	17.59	147,580	16.63	
Residential real estate	204,413	19.47	201,447	22.70	
Commercial	311,486	29.67	242,527	27.33	
Real estate construction	91,822	8.75	66,003	7.44	
Consumer	6,849	0.65	10,044	1.13	
Total loans	\$1,049,698	100.00	% \$887,478	100.00	%
Less allowance for loan losses	16,008		13,563		
Net loans	\$1,033,690		\$873,915		

Unearned income and net deferred loan fees and costs totaled \$2.4 million and \$2.0 million at December 31, 2016 and 2015, respectively. Loans pledged to secure borrowings at the FHLB totaled \$266.6 million and \$247.9 million at December 31, 2016 and 2015, respectively.

**Allowance for Loan Losses**

The allowance for loan losses totaled \$16.0 million and \$13.6 million at year end December 31, 2016 and 2015, respectively. The allowance for loan losses was equivalent to 1.53% of total loans held for investment at December 31, 2016 and 2015. Adequacy of the allowance is assessed and the allowance is increased by provisions for loan losses charged to expense no less than quarterly. Charge-offs are taken when a loan is identified as uncollectible.

The methodology by which the Corporation systematically determines the amount of its allowance is set forth by the Board of Directors in its Loan Policy and implemented by management. The results of the analysis are documented, reviewed, and approved by the Board of Directors no less than quarterly.

The level of the allowance for loan losses is determined by management through an ongoing, detailed analysis of historical loss rates and risk characteristics. During each quarter, management evaluates the collectability of all loans in the portfolio and ensures an accurate risk rating is assigned to each loan. The risk rating scale and definitions commonly adopted by the Federal Banking Agencies is contained within the framework prescribed by the Bank's Loan Policy. Any loan that is deemed to have potential or well defined weaknesses that may jeopardize collection in full is then analyzed to ascertain its level of weakness. If appropriate, the loan may be charged-off or a specific reserve may be assigned if the loan is deemed to be impaired.

During the risk rating verification process, each loan identified as inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged is considered impaired and is placed on non-accrual status. On these loans, management analyzes the potential impairment of the individual loan and may set aside a specific reserve. Any amounts deemed uncollectible during that analysis are charged-off.

For the remaining loans in each segment, the Bank calculates the probability of loss as a group using the risk rating for each of the following loan types: Commercial Real Estate - Owner Occupied, Commercial Real Estate - Non-Owner Occupied, Residential Real Estate, Commercial, Real Estate Construction, and Consumer. Management calculates the historical loss rate in each group by risk rating using a period of at least six years. This historical loss rate may then be adjusted based on management's assessment of internal and external environmental factors. While management may consider other factors, the analysis generally includes factors such as unemployment, office vacancy rates, and any concentrations that exist within the portfolio. This adjustment is meant to account for changes between the historical economic environment and current conditions and for changes in the ongoing management of the portfolio which affects the loans' potential losses.

Once complete, management compares the condition of the portfolio using several different characteristics, as well as its experience, to the experience of other banks in its peer group in order to determine if it is directionally consistent with others' experience in our area and line of business. Based on that analysis, management aggregates the probabilities of loss of the remaining portfolio based on the specific and general allowances and may provide additional amounts to the allowance for loan losses as needed. Since this process involves estimates, the allowance for loan losses may also contain an amount that is non-material which is not allocated to a specific loan or to a group of loans but is deemed necessary to absorb additional losses in the portfolio.

## Notes to Consolidated Financial Statements

## Note 3. Loans and the Allowance for Loan Losses (continued)

Management and the Board of Directors subject the reserve adequacy and methodology to a review on a regular basis by internal auditors and bank regulators, and such reviews have not resulted in any material adjustment to the allowance.

The following provides detailed information about the changes in the allowance for loan losses for the years ended December 31, 2016, 2015 and 2014 as well as the recorded investment in loans at December 31, 2016 and 2015.

Twelve months ended December 31, 2016	Commercial real estate - owner occupied		Commercial real estate	Commercial	Real estate construction	Consumer	Total
	real estate - owner occupied	real estate - non-owner occupied					
Allowance for credit losses:							
Beginning Balance	\$3,042	\$ 1,862	\$ 2,862	\$ 4,612	\$ 1,056	\$ 129	\$13,563
Charge-offs	-	-	-	-	-	-	-
Recoveries	-	-	40	285	-	-	325
Provisions	(99 )	283	(392 )	2,156	221	(49 )	2,120
Ending Balance	\$2,943	\$ 2,145	\$ 2,510	\$ 7,053	\$ 1,277	\$ 80	\$16,008
Twelve months ended December 31, 2015	Commercial real estate - owner occupied		Residential real estate	Commercial	Real estate construction	Consumer	Total
	real estate - owner occupied	real estate - non-owner occupied					
Allowance for credit losses:							
Beginning Balance	\$3,229	\$ 1,894	\$ 3,308	\$ 4,284	\$ 596	\$ 88	\$13,399
Charge-offs	-	-	-	(186 )	-	-	(186 )
Recoveries	-	-	61	102	37	-	200
Provisions	(187 )	(32 )	(507 )	412	423	41	150
Ending Balance	\$3,042	\$ 1,862	\$ 2,862	\$ 4,612	\$ 1,056	\$ 129	\$13,563

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Twelve months ended December 31, 2014	Commercial real estate - owner occupied (In Thousands)	Commercial real estate - non-owner occupied (In Thousands)	Residential real estate	Commercial	Real estate construction	Consumer	Total
Allowance for credit losses:							
Beginning Balance	\$3,763	\$ 1,734	\$ 3,320	\$ 3,484	\$ 743	\$ 92	\$13,136
Charge-offs	-	-	(21 )	(22 )	-	-	(43 )
Recoveries	-	-	213	93	-	-	306
Provisions	(534 )	160	(204 )	729	(147 )	(4 )	-
Ending Balance	\$3,229	\$ 1,894	\$ 3,308	\$ 4,284	\$ 596	\$ 88	\$13,399

December 31, 2016	Commercial real estate - owner occupied (In Thousands)	Commercial real estate - non-owner occupied (In Thousands)	Residential real estate	Commercial	Real estate construction	Consumer	Total
Allowance							
Ending balance:	\$2,943	\$ 2,145	\$2,510	\$ 7,053	\$ 1,277	\$ 80	\$16,008
Ending balance: individually evaluated for impairment	\$-	\$ -	\$-	\$ 2,805	\$ 221	\$ -	\$3,026
Ending balance: collectively evaluated for impairment	\$2,943	\$ 2,145	\$2,510	\$ 4,248	\$ 1,056	\$ 80	\$12,982
Ending balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$-	\$ -	\$ -	\$ -	\$-
Loans							
Ending balance	\$250,440	\$ 184,688	\$204,413	\$ 311,486	\$ 91,822	\$ 6,849	\$1,049,698
Ending balance: individually evaluated for impairment	\$335	\$ -	\$ 606	\$ 6,182	\$ 940	\$ -	\$8,063
Ending balance: collectively evaluated for impairment	\$250,105	\$ 184,688	\$203,807	\$ 305,304	\$ 90,882	\$ 6,849	\$1,041,635
Ending balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$-	\$ -	\$ -	\$ -	\$-

December 31, 2015	Commercial real estate - owner occupied	Commercial real estate - non-owner occupied	Residential real estate	Commercial	Real estate construction	Consumer	Total
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(In Thousands)

Allowance							
Ending balance:	\$3,042	\$ 1,862	\$2,862	\$4,612	\$ 1,056	\$ 129	\$13,563
Ending balance:							
individually evaluated for impairment	\$-	\$ -	\$-	\$ -	\$ 200	\$ -	\$200
Ending balance: collectively evaluated for impairment	\$3,042	\$ 1,862	\$2,862	\$4,612	\$ 856	\$ 129	\$13,363
Ending balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$-	\$ -	\$ -	\$ -	\$-
Loans							
Ending balance:	\$219,877	\$ 147,580	\$201,447	\$242,527	\$ 66,003	\$ 10,044	\$887,478
Ending balance:							
individually evaluated for impairment	\$349	\$ 5,487	\$346	\$ 1,389	\$ 1,046	\$ -	\$8,617
Ending balance: collectively evaluated for impairment	\$219,528	\$ 142,093	\$201,101	\$241,138	\$ 64,957	\$ 10,044	\$878,861
Ending balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$-	\$ -	\$ -	\$ -	\$-

## Notes to Consolidated Financial Statements

### Note 3. Loans and the Allowance for Loan Losses (continued)

#### Identifying and Classifying Portfolio Risks by Risk Rating

At origination, loans are categorized into risk categories based upon original underwriting. Subsequent to origination, management evaluates the collectability of all loans in the portfolio and assigns a proprietary risk rating on a quarterly basis as of the 15<sup>th</sup> of the last month in the quarter. Ratings range from the highest to lowest quality based on factors including measurements of ability to pay, collateral type and value, borrower stability, management experience, and credit enhancements. These ratings are consistent with the bank regulatory rating system.

A loan may have portions of its balance in one rating and other portions in a different rating. The Bank may use these “split ratings” when factors cause loan loss risk to exist for part but not all of the principal balance. Split ratings may also be used where cash collateral or a government agency has provided a guaranty that partially covers a loan.

For clarity of presentation, the Corporation’s loan portfolio is profiled below in accordance with the risk rating framework that has been commonly adopted by the federal banking agencies. The definitions of the various risk rating categories are as follows:

Pass - The condition of the borrower and the performance of the loan is satisfactory or better.

Special mention - A special mention asset has one or more potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution’s credit position at some future date.

Substandard - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.



Doubtful - An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss - Assets classified loss are considered uncollectible and their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, and a partial recovery may be effected in the future.

The Bank did not have any loans classified as loss or doubtful at December 31, 2016 and 2015. It is the Bank's policy to charge-off any loan once the risk rating is classified as loss.

The profile of the loan portfolio, as indicated by risk rating, as of December 31, 2016 and 2015 is shown below.

Credit Risk Profile by Risk Rating	December 31, 2016					Unearned Income	Total Loans
	Pass	Special Mention	Substandard	Doubtful	Loss		
	(In Thousands)						
Commercial real estate - owner occupied	\$247,001	\$ 1,213	\$ 2,807	\$ -	\$ -	\$(581 )	\$250,440
Commercial real estate - non-owner occupied	185,020	300	-	-	-	(632 )	184,688
Residential real estate	202,762	932	878	-	-	(159 )	204,413
Commercial	287,978	4,544	19,561	-	-	(597 )	311,486
Real estate construction	91,296	-	940	-	-	(414 )	91,822
Consumer	6,848	-	-	-	-	1	6,849
Total	\$1,020,905	\$ 6,989	\$ 24,186	\$ -	\$ -	\$(2,382 )	\$1,049,698

Credit Risk Profile by Risk Rating	December 31, 2015					Unearned Income	Total Loans
	Pass	Special Mention	Substandard	Doubtful	Loss		
	(In Thousands)						
Commercial real estate - owner occupied	\$214,613	\$ 2,506	\$ 3,245	\$ -	\$ -	\$(487 )	\$219,877
Commercial real estate - non-owner occupied	142,146	316	5,487	-	-	(369 )	147,580
Residential real estate	201,308	-	346	-	-	(207 )	201,447
Commercial	213,559	11,653	17,732	-	-	(417 )	242,527
Real estate construction	65,476	-	1,046	-	-	(519 )	66,003
Consumer	10,042	-	-	-	-	2	10,044
Total	\$847,144	\$ 14,475	\$ 27,856	\$ -	\$ -	\$(1,997 )	\$887,478



## Notes to Consolidated Financial Statements

### Note 3. Loans and the Allowance for Loan Losses (continued)

Loans listed as non-performing are also placed on non-accrual status. The accrual of interest is discontinued at the time a loan is 90 days delinquent or when the credit deteriorates and there is doubt that the credit will be paid as agreed, unless the credit is well-secured and in process of collection. Once the loan is on non-accrual status, all accrued but unpaid interest is also charged-off, and all payments are used to reduce the principal balance. Once the principal balance is repaid in full, additional payments are taken into income. A loan may be returned to accrual status if the borrower shows renewed willingness and ability to repay under the term of the loan agreement. The risk profile based upon payment activity is shown below.

Credit Risk Profile Based on Payment Activity	December 31, 2016		Total Loans
	Performing	Non-Performing	
	(In Thousands)		
Commercial real estate - owner occupied	\$250,440	\$ -	\$ 250,440
Commercial real estate - non-owner occupied	184,688	-	184,688
Residential real estate	203,982	431	204,413
Commercial	305,935	5,551	311,486
Real estate construction	90,882	940	91,822
Consumer	6,849	-	6,849
Total	\$1,042,776	\$ 6,922	\$ 1,049,698

Credit Risk Profile Based on Payment Activity	December 31, 2015		Total Loans
	Performing	Non-Performing	
	(In Thousands)		
Commercial real estate - owner occupied	\$219,877	\$ -	\$ 219,877
Commercial real estate - non-owner occupied	142,094	5,486	147,580
Residential real estate	201,284	163	201,447
Commercial	241,805	722	242,527
Real estate construction	64,957	1,046	66,003
Consumer	10,044	-	10,044
Total	\$880,061	\$ 7,417	\$ 887,478

Loans are considered past due if a contractual payment is not made by the calendar day after the payment is due. For reporting purposes, however, loans past due 1 to 29 days are excluded. The delinquency status of the loans in the portfolio is shown below as of December 31, 2016 and 2015. Loans that were on non-accrual status are not included in any past due amounts.

## Age Analysis of Past Due Loans

December 31, 2016

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Past Non-accrual Loans	Current Loans	Total Loans
Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$ -	\$ -	\$250,440	\$250,440
Commercial real estate - non-owner occupied	-	-	-	-	-	184,688	184,688
Residential real estate	-	97	-	97	431	203,885	204,413
Commercial	438	-	-	438	5,551	305,497	311,486
Real estate construction	-	-	-	-	940	90,882	91,822
Consumer	-	-	-	-	-	6,849	6,849
Total	\$438	\$ 97	\$ -	\$ 535	\$ 6,922	\$1,042,241	\$1,049,698

December 31, 2015

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Past Non-accrual Loans	Current Loans	Total Loans
Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$ -	\$ -	\$219,877	\$219,877
Commercial real estate - non-owner occupied	-	-	-	-	5,486	142,094	147,580
Residential real estate	-	-	-	-	163	201,284	201,447
Commercial	-	-	-	-	722	241,805	242,527
Real estate construction	-	-	-	-	1,046	64,957	66,003
Consumer	-	-	-	-	-	10,044	10,044
Total	\$-	\$ -	\$ -	\$ -	\$ 7,417	\$880,061	\$887,478

## Notes to Consolidated Financial Statements

### Note 3. Loans and the Allowance for Loan Losses (continued)

#### Impaired Loans

A loan is classified as impaired when it is deemed probable by management's analysis that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, or the recorded investment in the impaired loan is greater than the present value of expected future cash flows, discounted at the loan's effective interest rate. In the case of an impaired loan, management conducts an analysis which identifies if a quantifiable potential loss exists, and takes the necessary steps to record that loss when it has been identified as uncollectible.

As the ultimate collectability of the total principal of an impaired loan is in doubt, the loan is placed on nonaccrual status with all payments applied to principal under the cost-recovery method. As such, the Bank did not recognize any interest income on its impaired loans for the years ended December 31, 2016, 2015 and 2014.

The table below shows the results of management's analysis of impaired loans as of December 31, 2016 and 2015.

	Impaired Loans December 31, 2016		Related allowance	December 31, 2015		Related allowance
	Recorded investment (In Thousands)	Unpaid principal balance		Recorded investment	Unpaid principal balance	
With no specific related allowance recorded:						
Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$-	\$ -	\$ -
Commercial real estate - non-owner occupied	-	-	-	5,486	5,783	-
Residential real estate	431	431	-	163	163	-
Commercial	2,748	3,771	-	722	1,743	-
Real estate construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
With a specific related allowance recorded:						
Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$-	\$ -	\$ -
	-	-	-	-	-	-

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Commercial real estate - non-owner occupied						
Residential real estate	-	-	-	-	-	-
Commercial	2,803	1,400	2,805	-	-	-
Real estate construction	940	994	221	1,046	1,046	200
Consumer	-	-	-	-	-	-
Total:						
Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$-	\$ -	\$ -
Commercial real estate - non-owner occupied	-	-	-	5,486	5,783	-
Residential real estate	431	431	-	163	163	-
Commercial	5,551	5,171	2,805	722	1,743	-
Real estate construction	940	994	221	1,046	1,046	200
Consumer	-	-	-	-	-	-
	\$6,922	\$ 6,596	\$ 3,026	\$7,417	\$ 8,735	\$ 200

The table below shows the average recorded investment in impaired loans for the years ended December 31, 2016, 2015 and 2014.

	Twelve Months Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
	Average Recorded Investment (In Thousands)	Average Recorded Investment	Average Recorded Investment
Commercial real estate - owner occupied	\$59	\$ -	\$ 360
Commercial real estate - non-owner occupied	2,099	5,572	-
Residential real estate	120	163	324
Commercial	4,885	917	1,590
Real estate construction	1,009	1,086	-
Consumer	-	-	-
	\$8,172	\$ 7,738	\$ 2,274

## Notes to Consolidated Financial Statements

### Note 3. Loans and the Allowance for Loan Losses (continued)

#### Troubled Debt Restructurings

A troubled debt restructuring ("TDR") is a formal restructure of a loan when the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to a borrower. The Bank classifies these transactions as a TDR if the transaction meets the following conditions: an existing credit agreement must be formally renewed, extended and/or modified; the borrower must be experiencing financial difficulty; and the Bank has granted a concession that it would not otherwise consider.

Once identified as a TDR, a loan is considered to be impaired, and an impairment analysis is performed for the loan individually, rather than under a general loss allowance based on the loan type and risk rating. Any resulting shortfall is charged off. This method is used consistently for all segments of the portfolio.

Normally, loans identified as TDRs would be placed on non-accrual status and considered non-performing until sufficient history of timely collection or payment has occurred that allows them to return to performing status, generally 6 months.

During 2016, two commercial loans to one borrower totaling \$2.0 million at December 31, 2016 were modified in connection with a troubled debt restructuring. The modification granted the borrower an extension of the maturity date and was deemed to have no material financial effects as a direct result of this modification. One construction loan totaling \$1.0 million at the time of restructure was modified in connection with a troubled debt restructuring during the year ended December 31, 2015. The modification granted the borrower reduced payments for a period of two years as well as a reduction in the interest rate. There were no material financial effects as a direct result of this modification.

No payment defaults occurred during the year ended December 31, 2016 or December 31, 2015 for loans restructured during the preceding 12 month period.

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The table below shows the results of management's analysis of troubled debt restructurings as of December 31, 2016 and 2015.

	Troubled Debt Restructurings					
	December 31, 2016			December 31, 2015		
	Number of loans	Outstanding balance	Recorded investment	Number of loans	Outstanding balance	Recorded investment
	(Dollars in Thousands)					
<b>Performing</b>						
Commercial real estate - owner occupied	-	\$ -	\$ -	1	\$ 349	\$ 349
Commercial real estate - non-owner occupied	-	-	-	-	-	-
Residential real estate	1	217	175	1	225	183
Commercial	2	967	967	1	667	667
Real estate construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
<b>Non-Performing</b>						
Commercial real estate - owner occupied	-	\$ -	\$ -	-	\$ -	\$ -
Commercial real estate - non-owner occupied	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-
Commercial	2	2,000	2,000	-	-	-
Real estate construction	1	994	940	1	1,046	1,046
Consumer	-	-	-	-	-	-
<b>Total</b>	<b>6</b>	<b>\$ 4,178</b>	<b>\$ 4,082</b>	<b>4</b>	<b>\$ 2,287</b>	<b>\$ 2,245</b>



## Notes to Consolidated Financial Statements

### Note 4. Premises and Equipment

Premises and equipment, net, are summarized as follows:

	December 31,	
	2016	2015
	(In Thousands)	
Land	\$1,342	\$1,342
Premises	5,832	5,832
Leasehold improvements	1,351	1,228
Furniture and equipment	4,661	3,914
	13,186	12,316
Less accumulated depreciation	(6,102 )	(5,627 )
	\$7,084	\$6,689

Depreciation and amortization expense included in operating expenses for the years ended December 31, 2016, 2015, and 2014, was \$515 thousand, \$507 thousand, and \$485 thousand, respectively.

### Note 5. Deposits

The composition of deposits is summarized as follows at December 31:

	2016		2015		
	Amount	Percentage of Total	Amount	Percentage of Total	
	(Dollars In Thousands)				
Interest-bearing demand deposits	\$126,189	11.97	% \$127,980	14.00	%
Savings and money market	270,310	25.64	150,021	16.42	
CDARS - time deposits	34,290	3.25	73,017	7.99	
CDARS/ICS non-maturity deposits	40,925	3.88	15,517	1.70	
Brokered deposits	57,389	5.44	103,390	11.31	
Time deposits	163,188	15.48	136,022	14.89	

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Total interest-bearing deposits	692,291	65.66	605,947	66.31	
Noninterest-bearing demand deposits	362,036	34.34	307,797	33.69	
Total deposits	\$ 1,054,327	100.00	% \$913,744	100.00	%

The aggregate amount of time deposits with a minimum denomination of \$250,000 was \$96 million for 2016 and \$161 million for 2015.

At December 31, 2016, the scheduled maturities of time deposits were as follows:

Year	Amount (In Thousands)
2017	\$ 159,539
2018	61,483
2019	14,102
2020	6,510
2021	2,883
Later years	7,189
	\$ 251,706

Brokered deposits totaled \$133 million and \$192 million at December 31, 2016 and 2015, respectively, which includes \$75 million and \$89 million, respectively, in CDARS deposits.

## Notes to Consolidated Financial Statements

### Note 6. Borrowings

The Bank is a member of the FHLB and may borrow funds based on criteria established by the FHLB. The FHLB may call these borrowings if the adjusted collateral balance falls below the borrowing level. The borrowing arrangements available from the FHLB could be either short-term or long-term borrowings, depending upon the Bank's related cost and needs.

Advances from the FHLB for the years ended December 31, 2016 and 2015 are summarized below:

	2016	2015
	(Dollars In Thousands)	
Balance outstanding at end of year	\$ 189,000	\$ 125,000
Average balance outstanding	\$ 125,047	\$ 110,882
Maximum outstanding at any month-end	\$ 189,000	\$ 160,000
Average interest rate during the year	0.91 %	0.41 %
Average interest rate at end of year	0.91 %	0.75 %

The scheduled maturity dates and related fixed interest rates on advances from the FHLB at December 31, 2016 are summarized as follows (dollars in thousands):

Maturity Date	Interest Rate	Outstanding Amount
DRC	0.80	% \$ 69,000
2/27/2017	0.74	% 25,000
3/20/2017	0.69	% 20,000
10/2/2017	0.72	% 15,000
3/27/2018	1.22	% 10,000
10/2/2018	1.02	% 10,000
4/4/2019	1.13	% 20,000
10/2/2019	1.32	% 10,000
10/2/2020	1.54	% 10,000
		\$ 189,000

Information concerning securities sold under agreements to repurchase and federal funds purchased for the years ended December 31, 2016 and 2015 is summarized below:

	2016	2015	
	(Dollars In Thousands)		
Balance outstanding at end of year	\$ 57,009	\$ 21,129	
Average balance outstanding	\$ 16,270	\$ 22,017	
Maximum outstanding at any month-end	\$ 57,009	\$ 26,242	
Average interest rate during the year	0.10	%	0.10 %
Average interest rate at end of year	0.68	%	0.10 %

Repurchase agreements totaled \$17.0 million and \$21.1 million at December 31, 2016 and 2015, respectively. They are classified as secured borrowings and generally mature within one business day from the transaction date. They are reflected as the amount of cash received in connection with the transaction. In addition, \$40.0 million in federal funds lines with other financial institutions were outstanding at December 31, 2016, leaving \$22.4 million available for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

The Bank has remaining lines of credit available with the FHLB which totaled \$184.7 million at December 31, 2016. The FHLB advances are secured by a blanket floating lien on certain 1-4 family residential, HELOCS, second mortgages, commercial mortgages and investment securities with carrying values of \$224.6 million at December 31, 2016.

**Notes to Consolidated Financial Statements****Note 7. Income Taxes**

Net deferred tax assets consisted of the following components as of December 31, 2016 and 2015:

	December 31,	
	2016	2015
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	\$5,760	\$4,838
Deferred fees	857	713
Allowance for loan losses on mortgage loans sold	557	573
Allowance for off balance sheet losses	270	268
Stock options	79	52
Securities available for sale	869	551
Land impairment	-	252
Other	197	141
	\$8,589	\$7,388
Deferred tax liability:		
Depreciation	\$147	\$173
Other	88	58
	\$235	\$231
Net deferred tax assets included in other assets	\$8,354	\$7,157

The provision for income taxes charged to operations for the years ended December 31, 2016, 2015, and 2014 consisted of the following:

	Year Ended December 31,		
	2016	2015	2014
	(In Thousands)		
Current tax expense	\$9,898	\$8,711	\$6,691
Deferred tax (benefit)	(698 )	(534 )	894
	\$9,200	\$8,177	\$7,585

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The income tax provision differs from the amount of income tax determined by applying the U.S. Federal income tax rate to pretax income for the years ended December 31, 2016, 2015, and 2014 as follows:

	Year Ended December 31,		
	2016	2015	2014
	(In Thousands)		
Computed "expected" tax expense	\$8,961	\$8,259	\$7,529
Increase (decrease) in income taxes resulting from:			
State income taxes	117	92	62
Tax exempt income and interest	(409 )	(257 )	(164 )
Merger related expenses	344	-	-
Other	187	83	158
	\$9,200	\$8,177	\$7,585

As of December 31, 2016 and 2015, the Corporation did not have any unrecognized tax benefits. The Corporation does not expect a significant increase or decrease in the next 12 months of unrecognized tax benefits. The Corporation recognizes interest and penalties related to unrecognized tax benefits as Interest Expense and Other Noninterest Expense, respectively, and not as part of the tax provision. The Corporation did not recognize a material amount of interest expense or penalties for the years ended December 31, 2016, 2015 and 2014. In addition, there were no interest or penalties accrued at December 31, 2016 or 2015. The Corporation is no longer subject to examination for federal and state purposes for tax years prior to 2013.

## Notes to Consolidated Financial Statements

### Note 8. Commitments and Contingent Liabilities

The Corporation is committed under non-cancelable and month-to-month operating leases for its office locations. Rent expense associated with these operating leases for the years ended December 31, 2016, 2015, and 2014 totaled \$878 thousand, \$807 thousand, and \$850 thousand, respectively.

The following is a schedule of future minimum lease payments required under operating leases that have initial or remaining lease terms in excess of one year.

Year	Amount (In Thousands)
2017	\$ 431
2018	428
2019	410
2020	329
2021	317
Thereafter	1,485
	\$ 3,400

In the normal course of business, there are outstanding various commitments and contingent liabilities, which are not reflected in the accompanying financial statements. The Corporation does not anticipate any material loss as a result of these transactions. See Note 9 for additional information.

As part of its mortgage banking activities, the Mortgage Division enters into interest rate lock commitments, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Mortgage Division then either locks the loan and rate in with an investor and commits to deliver the loan if settlement occurs (“Best Efforts”) or commits to deliver the locked loan in a binding (“Mandatory”) delivery program with an investor. Certain loans under rate lock commitments are covered under forward sales contracts of mortgage backed securities (“MBS”). Forward sales contracts of MBS are recorded at fair value with changes in fair value recorded in noninterest income. Interest rate lock commitments and commitments to deliver loans to investors are considered derivatives. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Mortgage Division determines the fair value of rate lock commitments and delivery contracts by measuring the fair value of the underlying asset, which is impacted by current interest rates and taking into

consideration the probability that the rate lock commitments will close or will be funded.

Since the Mortgage Division's derivative instruments are not designated as hedging instruments, the fair value of the derivatives are recorded as a freestanding asset or liability with the change in value being recognized in current net income during the period of change.

At December 31, 2016 and 2015 the Mortgage Division had open forward contracts with notional values of \$54.3 million and \$49.0 million, respectively. At December 31, 2016 and 2015, the Mortgage Division did not have any open mandatory delivery contracts. The open forward delivery contracts are composed of forward sales of MBS. The fair value of these open forward contracts was \$102 thousand and (\$54) thousand at December 31, 2016 and 2015, respectively. Certain additional risks arise from these forward delivery contracts in that the counterparties to the contracts may not be able to meet the terms of the contracts. The Mortgage Division does not expect any counterparty to fail to meet its obligation. Additional risks inherent in mandatory delivery programs include the risk that if the Mortgage Division does not close the loans subject to interest rate risk lock commitments, they will be obligated to deliver MBS to the counterparty under the forward sales agreement. Should this be required, the Mortgage Division could incur significant costs in acquiring replacement loans or MBS and such costs could have an adverse effect on mortgage banking operations in future periods.

Interest rate lock commitments totaled \$37.9 million and \$26.6 million at December 31, 2016 and 2015, respectively, and included \$7.3 million and \$6.2 million that were made on a Best Efforts basis at December 31, 2016 and 2015, respectively. Fair values of these best efforts commitments were \$82 thousand and \$53 thousand at December 31, 2016 and 2015, respectively. The remaining hedged interest rate lock commitments totaling \$30.6 million and \$20.4 million at December 31 2016 and 2015 had a fair value of \$484 thousand and \$275 thousand, respectively.



**Notes to Consolidated Financial Statements****Note 8. Commitments and Contingent Liabilities (continued)**

The Mortgage Division makes representations and warranties that loans sold to investors meet their program's guidelines and that the information provided by the borrowers is accurate and complete. In the event of a default on a loan sold, the investor may make a claim for losses due to document deficiencies, program compliance, early payment default, and fraud or borrower misrepresentations. The Mortgage Division maintains a reserve in other liabilities for potential losses on mortgage loans sold. At December 31, 2016 and 2015 the balance in this reserve totaled \$1.0 million.

**Allowance For Losses on Mortgage Loans Sold**

	Year Ended December 31,	
	2016	2015
	(In Thousands)	
Balance at beginning of year	\$ 1,029	\$ 1,198
Provision charged to operating expense	-	-
Recoveries	-	-
Charge-offs	-	(169 )
Balance at end of year	\$ 1,029	\$ 1,029

**Note 9. Financial Instruments with Off-Balance-Sheet Risk**

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

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 by the customer. 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 Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, deemed necessary by the Corporation upon extension of credit is based on management's credit evaluation of the counterparty. Collateral normally consists of real property, liquid assets or business assets. The Corporation had approximately \$25.1 million and \$53.2 million in outstanding commitments at December 31, 2016 and 2015, respectively.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The Corporation had approximately \$330.0 million and \$304.9 million in unfunded lines of credit whose contract amounts represent credit risk at December 31, 2016 and 2015, respectively.

Standby letters of credit are conditional commitments issued by the Corporation 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. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary. The Corporation had standby letters of credit outstanding in the amount of \$9.6 million and \$7.6 million at December 31, 2016 and 2015, respectively.

In August 2016, the Bank entered into a letter of credit agreement with the Commonwealth of Virginia Treasury Board pertaining to its public deposits program. Under the terms of the letters of credit agreement, the Commonwealth of Virginia Treasury Board in accordance with the Security for Public Deposits Act has approved the use of a letter of credit issued by the FHLB as collateral by the Bank. The maximum amount available under the letter of credit is \$35 million. The letter of credit expires in August 2017 with an automatic one year extension until August 2018.

In addition to the above, the Corporation is subject to risks related to the mortgage origination operations of the Mortgage Division of the Bank. See Note 8 for a discussion of those risks.

## Notes to Consolidated Financial Statements

### Note 10. Related Party Transactions

The Corporation has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal shareholders (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with parties not related to the Corporation and which did not present more than the normal risk of collectability or other unfavorable terms. These related parties were indebted to the Corporation for loans totaling \$10.8 million at December 31, 2016, and \$11.4 million at December 31, 2015. During 2016, total principal additions were \$132 thousand and total principal payments and changes in related parties' debt were \$691 thousand. The Corporation also has outstanding unused commitments to related parties amounting to \$150 thousand at December 31, 2016. The aggregate amount of deposits at December 31, 2016 and 2015 from directors and officers or their immediate family members was \$35.6 million and \$36.4 million, respectively.

### Note 11. Stock Option Plan

The Corporation established the Access National Corporation 2009 Stock Option Plan ("the Plan") and it was approved by shareholders on May 19, 2009. The Plan reserves 975,000 shares of the Corporation's common stock, \$0.835 par value, for issuance under the Plan. The Plan allows for stock options to be granted with an exercise price equal to the fair market value at the date of grant. The expiration dates on options granted under this plan are generally five years from the grant date.

Total compensation cost for share-based payment arrangements recognized in 2016, 2015, and 2014 was \$335 thousand, \$332 thousand, and \$236 thousand, respectively.

Cash received from option exercises under share-based payment arrangements for 2016, 2015, and 2014 was \$532 thousand, \$380 thousand, and \$680 thousand, respectively.

Changes in the stock options outstanding under the Plan, for the years ended December 31, 2016, 2015 and 2014 are summarized as follows:

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	Year Ended December 31, 2016		2015		2014	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at beginning of year	407,832	\$ 15.33	316,423	\$ 14.02	281,380	\$ 11.77
Granted	129,550	18.77	125,434	18.03	123,000	15.96
Exercised	(43,801 )	12.15	(29,975 )	12.62	(76,132 )	8.95
Lapsed or canceled	(12,200 )	16.54	(4,050 )	16.40	(11,825 )	13.34
Outstanding at end of year	481,381	\$ 16.52	407,832	\$ 15.33	316,423	\$ 14.02
Options exercisable at end of year	173,781	\$ 14.49	105,889	\$ 12.99	43,697	\$ 11.88

Options outstanding at year end 2016 were as follows:

Range of Exercise Price	Options Outstanding				Options Exercisable			
	Number Outstanding	Weighted- Average Contractual Life (in yrs)	Weighted Average Exercise Price	Intrinsic Value	Number Exercisable	Weighted- Average Contractual Life (in yrs)	Weighted Average Exercise Price	Intrinsic Value
\$7.55-\$9.58	38,963	0.08	\$ 9.24	\$721,595	38,963	0.08	\$ 9.24	\$721,595
\$9.59-\$25.00	442,418	2.71	16.99	4,690,548	134,818	1.83	16.01	1,584,336
	481,381	2.50	\$ 16.52	\$5,412,143	173,781	1.44	\$ 14.49	\$2,305,931

**Notes to Consolidated Financial Statements****Note 11. Stock Option Plan (continued)**

The fair value of stock options granted was estimated using the Black Scholes option pricing model with the following weighted average assumptions:

	Year Ended December 31,					
	2016		2015		2014	
Expected life of options granted	4.12	Years	4.09	Years	4.07	Years
Risk-free interest rate	1.25	%	1.06	%	0.69	%
Expected volatility of stock	30	%	30	%	36	%
Annual expected dividend yield	3	%	3	%	3	%
Fair value of granted options	\$ 473,272		\$ 357,456		\$ 305,143	
Nonvested Options	307,600		301,943		272,726	

The total intrinsic value of options exercised during the years ended December 31, 2016, 2015, and 2014 was \$340 thousand, \$239 thousand, and \$525 thousand, respectively. The weighted average grant date fair value of options granted during the years 2016, 2015, and 2014 were \$4.12, \$2.85, and \$2.48, respectively.

The total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the plan as of December 31, 2016 was \$553 thousand. The cost is expected to be recognized over a weighted average period of 2.41 years.

**Notes to Consolidated Financial Statements**

**Note 12. Capital Requirements**

The Corporation (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 initiate certain mandatory - possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of the Corporation's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Corporation's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and Bank to maintain minimum amounts and ratios (set forth in the table below) of total Tier 1, and Common Equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2016 and 2015, that the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

At December 31, 2016 the Corporation and Bank exceeded the minimum required ratios for "well capitalized" as defined by the federal banking regulators. To be categorized as well capitalized, the Bank 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 table. There are no conditions or events that management believes have changed the institutions' category.

The Corporation's and Bank's actual capital amounts and ratios as of December 31, 2016 and 2015 are presented in the table below:

Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars In Thousands)					

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December 31, 2016

Total Capital

(to Risk-Weighted Assets)

Corporation	\$ 135,009	11.51 %	\$ 93,866	8.625 %	\$ 117,333	10.00 %
Bank	\$ 124,149	10.58 %	\$ 93,866	8.625 %	\$ 117,332	10.00 %

Tier 1 Capital

(to Risk-Weighted Assets)

Corporation	\$ 120,317	10.25 %	\$ 70,400	6.625 %	\$ 93,866	8.00 %
Bank	\$ 109,457	9.33 %	\$ 70,399	6.625 %	\$ 93,866	8.00 %

Tier 1 Capital

(to Average Assets)

Corporation	\$ 120,317	8.90 %	\$ 52,800	5.125 %	\$ 58,667	5.00 %
Bank	\$ 109,457	8.11 %	\$ 60,793	5.125 %	\$ 67,547	5.00 %

Common Equity Tier 1 Capital

(to Risk-Weighted Assets)

Corporation	\$ 120,317	10.25 %	\$ 54,068	4.00 %	\$ 87,861	6.50 %
Bank	\$ 109,457	9.33 %	\$ 46,933	4.00 %	\$ 76,266	6.50 %

December 31, 2015

Total Capital

(to Risk-Weighted Assets)

Corporation	\$ 120,682	12.39 %	\$ 77,913	8.00 %	\$ 97,391	10.00 %
Bank	\$ 111,031	11.41 %	\$ 77,865	8.00 %	\$ 97,331	10.00 %

Tier 1 Capital

(to Risk-Weighted Assets)

Corporation	\$ 108,482	11.14 %	\$ 38,956	6.00 %	\$ 58,434	8.00 %
Bank	\$ 98,838	10.15 %	\$ 38,932	6.00 %	\$ 77,865	8.00 %

Tier 1 Capital

(to Average Assets)

Corporation	\$ 108,482	9.34 %	\$ 46,443	4.50 %	\$ 58,054	5.00 %
Bank	\$ 98,838	8.53 %	\$ 46,371	4.50 %	\$ 57,964	5.00 %

Common Equity Tier 1 Capital

(to Risk-Weighted Assets)

Corporation	\$ 108,482	11.14 %	\$ 38,956	4.00 %	\$ 63,304	6.50 %
Bank	\$ 98,838	10.15 %	\$ 38,932	4.00 %	\$ 63,265	6.50 %

**Notes to Consolidated Financial Statements****Note 13. Earnings Per Share**

The following table shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of potential diluted common stock. Potential dilutive common stock has no effect on income available to common shareholders.

	Year Ended December 31, 2016			2015			2014		
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
	(In Thousands, Except for Per Share Data)								
Earnings per share									
Basic	\$ 16,404	10,586	\$ 1.55	\$ 15,419	10,513	\$ 1.46	\$ 13,925	10,424	\$ 1.33
Effect of dilutive securities:									
Stock options and warrants	-	92	-	-	69	-	-	43	-
Diluted	-	-	1.54	-	-	1.46	-	-	1.33
Diluted earnings per share	\$ 16,404	10,678	\$ 1.54	\$ 15,419	10,582	\$ 1.46	\$ 13,925	10,467	\$ 1.33

**Note 14. Employee Benefits**

The Corporation maintains a Defined Contribution 401(k) Profit Sharing Plan (the "401(k) Plan"), which authorizes a maximum voluntary salary deferral of up to IRS limitations. All full-time employees are eligible to participate after 6 months of employment. The Corporation reserves the right to make an annual discretionary contribution to the account of each eligible employee based in part on the Corporation's profitability for a given year, and on each participant's yearly earnings. Approximately \$759 thousand, \$638 thousand, and \$540 thousand were charged to expense under the 401(k) Plan for 2016, 2015, and 2014, respectively.



**Notes to Consolidated Financial Statements****Note 15. Other Expenses**

The Corporation had the following other expenses for the years ended December 31, 2016, 2015, and 2014:

	2016	2015	2014
	(In Thousands)		
Management fees	\$1,187	\$1,151	\$799
Merger related costs	984	-	-
Business and franchise tax	953	875	806
Data processing	947	1,029	676
FDIC insurance	789	634	444
Investor fees	759	570	453
Advertising and promotional expense	735	754	873
Consulting fees	681	618	481
Accounting and auditing service	613	612	612
Telephone	385	346	309
Director fees	352	395	492
Stock option expense	335	332	236
Business development, meals, and travel	293	260	270
Regulatory examinations	282	257	217
Credit report	281	197	208
Publication and subscription	280	249	251
Early payoff	260	133	58
Insurance	255	206	182
Disaster recovery	199	190	241
Stationary and supplies	197	294	308
Employee education and development	186	198	96
FRB and Bank analysis charges	163	147	121
Verification fees	150	106	89
SBA guarantee fee	145	160	183
Postage	97	93	97
Dues and memberships	95	108	104
Common stock expense	95	97	89
Legal fees	79	363	277
Donations	64	73	16
Courier	57	59	93
Impairment of long lived asset	-	-	707
Provision release for LHFS	-	-	(3,250)

Other	1,070	1,354	1,005
	\$12,968	\$11,860	\$7,543

**Note 16. Fair Value Measurements**

FASB ASC 820-10 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820-10 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Transfers between levels of the fair value hierarchy are recognized on the actual dates of the event or circumstances that caused the transfer, which generally coincides with the Corporation's monthly and or quarterly valuation process. The standard describes three levels of inputs that may be used to measure fair values:

## Notes to Consolidated Financial Statements

### Note 16. Fair Value Measurements (continued)

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods to determine the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities are determined by quoted market prices for similar securities from active markets (Level 2) or by independent valuations (Level 3) for securities not traded in active markets.

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Derivative financial instruments: Derivative instruments are used to hedge residential mortgage loans held for sale and the related interest-rate lock commitments and include forward commitments to sell mortgage loans and mortgage backed securities. The fair values of derivative financial instruments are based on derivative market data inputs as of the valuation date and the underlying value of mortgage loans for rate lock commitments (Level 3).

Impaired loans: The fair values of impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans on a non-recurring basis. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The use of discounted cash flow models and management's best judgment are significant inputs in arriving at the fair value measure of the underlying collateral (Level 3).

Other real estate owned: The fair value of other real estate owned, which is included in other assets on the balance sheet, consists of real estate that has been foreclosed. Foreclosed real estate is recorded at the lower of fair value less selling expenses or the book balance prior to foreclosure. Write downs are provided for subsequent declines in value and are recorded in other noninterest expense (Level 2).

## Notes to Consolidated Financial Statements

## Note 16. Fair Value Measurements (continued)

Assets and liabilities measured at fair value under FASB ASC 820-10 on a recurring and non-recurring basis, including financial assets and liabilities for which the Corporation has elected the fair value option, are summarized below:

Description	Fair Value Measurement at December 31, 2016 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In Thousands)			
Financial Assets-Recurring				
Available-for-sale investment securities				
US Government agency	\$4,994	\$ -	\$ 4,994	\$ -
Mortgage backed	119,807	-	119,807	-
Corporate bonds	8,666	-	8,666	-
Asset backed securities	12,864	-	8,364	4,500
Certificates of deposit	2,009	-	2,009	-
Municipals - nontaxable	44,359	-	44,359	-
CRA Mutual fund	1,391	-	1,391	-
Total available-for-sale investment securities	194,090	-	189,590	4,500
Residential loans held for sale	35,676	-	35,676	-
Derivative assets	993	-	-	993
Total Financial Assets-Recurring	\$230,759	\$ -	\$ 225,266	\$ 5,493
Financial Liabilities-Recurring				
Derivative liabilities	\$325	\$ -	\$ -	\$ 325
Total Financial Liabilities-Recurring	\$325	\$ -	\$ -	\$ 325
Financial Assets-Non-Recurring				
Impaired loans <sup>(1)</sup>	\$6,922	\$ -	\$ -	\$ 6,922
Total Financial Assets-Non-Recurring	\$6,922	\$ -	\$ -	\$ 6,922

<sup>(1)</sup> Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral, if collateral dependent, or the present value of expected future cash flows, discounted at the loan's effective interest rate.

Description	Fair Value Measurement at December 31, 2015 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In Thousands)			
Financial Assets-Recurring				
Available-for-sale investment securities				
US Government agency	\$ 18,904	\$ -	\$ 18,904	\$ -
Mortgage backed	96,077	-	96,077	-
Corporate bonds	8,959	-	8,959	-
Asset backed securities	15,998	-	15,998	-
Municipals - nontaxable	12,005	-	12,005	-
Municipals	6,809	-	6,809	-
CRA Mutual fund	1,410	-	1,410	-
Total available-for-sale investment securities	160,162	-	160,162	-
Residential loans held for sale	44,135	-	44,135	-
Derivative assets	523	-	-	523
Total Financial Assets-Recurring	\$ 204,820	\$ -	\$ 204,297	\$ 523
Financial Liabilities-Recurring				
Derivative liabilities	\$ 250	\$ -	\$ -	\$ 250
Total Financial Liabilities-Recurring	\$ 250	\$ -	\$ -	\$ 250
Financial Assets-Non-Recurring				
Impaired loans <sup>(1)</sup>	\$ 7,417	\$ -	\$ -	\$ 7,417
Total Financial Assets-Non-Recurring	\$ 7,417	\$ -	\$ -	\$ 7,417

<sup>(1)</sup> Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral, if collateral dependent, or the present value of expected future cash flows, discounted at the loan's effective interest rate.

## Notes to Consolidated Financial Statements

### Note 16. Fair Value Measurements (continued)

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows for the twelve month period ended December 31, 2016 and 2015.

	Net Derivatives	Securities Available-For- Sale	Total
	(In Thousands)		
Balance January 1, 2016	\$273	\$ -	\$273
Realized and unrealized gains included in earnings	395	-	395
Unrealized gains (losses) included in other comprehensive income	-	-	-
Purchases, settlements, paydowns, and maturities	-	-	-
Transfer into Level 3	-	4,500	4,500
Balance December 31, 2016	\$668	\$ 4,500	\$5,168

	Net Derivatives
	(In Thousands)
Balance January 1, 2015	\$ (110 )
Realized and unrealized gains included in earnings	383
Unrealized gains (losses) included in other comprehensive income	-
Purchases, settlements, paydowns, and maturities	-
Transfer into Level 3	-
Balance December 31, 2015	\$ 273

During the fourth quarter of 2016, management transferred two asset backed securities into Level 3 from Level 2 due to the lack of readily available pricing information on these particular securities. Pricing for these securities is now obtained through an independent valuation service.

## Notes to Consolidated Financial Statements

## Note 16. Fair Value Measurements (continued)

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value at December 31, 2016 and 2015:

2016				
Description	Fair Value Estimate (In Thousands)	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Financial Assets - Recurring				
Asset-backed securities	\$4,500	Valuation service	Discounted cash flows	3% - 6% (5.0%)
Derivative assets	\$993	Market pricing (3)	Estimated pullthrough	75% - 90% (89.0%)
Derivative liabilities	\$325	Market pricing (3)	Estimated pullthrough	75% - 90% (89.0%)
Financial Assets - Non-recurring				
Impaired loans - Real estate secured	\$1,371	Appraisal of collateral (1)	Liquidation expenses (2)	0% - 15% (10%)
Impaired loans - Non-real estate secured	\$5,551	Cash flow basis	Liquidation expenses (2)	0% - 10% (5%)

- (1) Fair value is generally determined through independent appraisals of the underlying collateral on real estate secured loans, which generally include various level 3 inputs which are not identifiable.
- (2) Valuations of impaired loans may be adjusted by management for qualitative factors such as liquidation expenses. The range and weighted average of liquidation expense adjustments are presented as a percent of the appraisal. Market pricing on derivative assets and liabilities is adjusted by management for the anticipated percent of
- (3) derivative assets and liabilities that will create a realized gain or loss. The range and weighted average of estimated pull-through is presented.

2015				
Description	Fair Value Estimate (In Thousands)	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Financial Assets - Recurring				
Derivative assets	\$523	Market pricing (3)	Estimated pullthrough	75% - 90% (86.2%)
Derivative liabilities	\$250	Market pricing (3)	Estimated pullthrough	75% - 90% (86.2%)



Financial Assets - Non-recurring

Impaired loans - Real estate secured	\$6,695	Appraisal of collateral (1)	Liquidation expenses (2)	0% - 15% (14%)
Impaired loans - Non-real estate secured	\$722	Cash flow basis	Liquidation expenses (2)	0% - 10% (4%)

- (1) Fair value is generally determined through independent appraisals of the underlying collateral on real estate secured loans, which generally include various level 3 inputs which are not identifiable.
- (2) Valuations of impaired loans may be adjusted by management for qualitative factors such as liquidation expenses. The range and weighted average of liquidation expense adjustments are presented as a percent of the appraisal. Market pricing on derivative assets and liabilities is adjusted by management for the anticipated percent of
- (3) derivative assets and liabilities that will create a realized gain or loss. The range and weighted average of estimated pull-through is presented.

**Notes to Consolidated Financial Statements****Note 16. Fair Value Measurements (continued)****Financial instruments recorded using FASB ASC 825-10**

Under FASB ASC 825-10, the Corporation may elect to report most financial instruments and certain other items at fair value on an instrument-by-instrument basis with changes in fair value reported in net income. After the initial adoption, the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election, with respect to an item, may not be revoked once an election is made.

The following tables reflect the difference between the fair value carrying amount of residential mortgage loans held for sale, measured at fair value under FASB ASC 825-10, and the aggregate unpaid principal amount the Corporation is contractually entitled to receive at maturity.

(In Thousands)	December 31, 2016		
	Fair Value	Difference	Contractual Principal
Residential mortgage loans held for sale	\$35,676	\$ 1,004	\$ 34,672

(In Thousands)	December 31, 2015		
	Fair Value	Difference	Contractual Principal
Residential mortgage loans held for sale	\$44,135	\$ 1,673	\$ 42,462

The Corporation has elected to account for residential loans held for sale at fair value to eliminate the mismatch that would occur by recording changes in market value on derivative instruments used to hedge loans held for sale while carrying the loans at the lower of cost or market.

The following methods and assumptions not previously presented were used in estimating the fair value of financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis:

### **Cash and Short-Term Investments**

For those short-term instruments, the carrying amount is a reasonable estimate of fair value. As such they are classified as Level 1 for noninterest-bearing deposits and Level 2 for interest-bearing deposits due from banks or federal funds sold.

### **Restricted Stock**

It is not practical to determine the fair value of restricted stock due to the restrictions placed on its transferability.

### **Loans, Net of Allowance**

For certain homogeneous categories of loans, such as some residential mortgages, and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics resulting in a Level 3 classification. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities resulting in a Level 3 classification.

### **Deposits and Borrowings**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date resulting in a Level 1 classification. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities also resulting in a Level 1 classification. The fair value of all other deposits and borrowings is determined using the discounted cash flow method thereby resulting in a Level 2 classification. The discount rate was equal to the rate currently offered on similar products.

**Notes to Consolidated Financial Statements**

**Note 16. Fair Value Measurements (continued)**

**Accrued Interest**

The carrying amounts of accrued interest approximate fair value resulting in a Level 2 or Level 3 classification depending upon the level of the asset or liability, with which, the accrual is associated.

**Off-Balance-Sheet Financial Instruments**

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

At December 31, 2016 and 2015, the majority of off-balance-sheet items are variable rate instruments or convert to variable rate instruments if drawn upon. Therefore, the fair value of these items is largely based on fees, which are nominal and immaterial.

The carrying amounts and estimated fair values of financial instruments at December 31, 2016 and 2015 were as follows:

December 31, 2016		2015	
Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(In Thousands)			

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Financial assets:				
Cash and short-term investments	\$91,059	\$91,059	\$35,889	\$35,889
Securities available-for-sale	194,090	194,090	160,162	160,162
Securities held-to-maturity	9,200	9,293	14,287	14,314
Restricted stock	10,092	10,092	7,259	7,259
Loans, net of allowance	1,069,366	1,080,820	918,050	982,811
Derivatives	993	993	523	523
Total financial assets	\$1,374,800	\$1,386,347	\$1,136,170	\$1,200,958
Financial liabilities:				
Deposits	\$1,054,327	\$1,040,402	\$913,744	\$905,951
Short-term borrowings	186,009	185,910	91,129	90,269
Long-term borrowings	60,000	59,954	55,000	54,324
Derivatives	325	325	250	250
Total financial liabilities	\$1,300,661	\$1,286,591	\$1,060,123	\$1,050,794

## Notes to Consolidated Financial Statements

### Note 16. Fair Value Measurements (continued)

Current accounting pronouncements require disclosure of the estimated fair value of financial instruments. Effective January 1, 2008, fair value is defined in accordance with FASB ASC 820-10 as disclosed above. Given the current market conditions, a portion of our loan portfolio is not readily marketable and market prices do not exist. We have not attempted to market our loans to potential buyers, if any exist, to determine the fair value of those instruments in accordance with the definition of FASB ASC 820-10. Since negotiated prices in illiquid markets depends upon the then present motivations of the buyer and seller, it is reasonable to assume that actual sales prices could vary widely from any estimate of fair value made without the benefit of negotiations. Additionally, changes in market interest rates can dramatically impact the value of financial instruments in a short period of time. Accordingly, the fair value measurements for loans included in the table above are unlikely to represent the instruments' liquidation values.

### Note 17. Segment Reporting

The Corporation has three reportable segments: traditional commercial banking, a mortgage banking business and a wealth management business. Revenues from commercial banking operations consist primarily of interest earned on loans and investment securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage loans held for sale, gains on sales of loans in the secondary mortgage market, and loan origination fee income. Wealth management operating revenues consist of transactional fees charged to clients as well as fees for portfolio asset management.

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on a premium over their cost to borrow funds. These transactions are eliminated in the consolidation process.

## Notes to Consolidated Financial Statements

## Note 17. Segment Reporting (continued)

The following table presents segment information for the years ended December 31, 2016, 2015, and 2014.

	Commercial Banking	Mortgage Banking	Wealth Management	Other	Eliminations	Consolidated Totals
	(In Thousands)					
<b>2016</b>						
Revenues:						
Interest income	\$49,063	\$ 1,767	\$ -	\$20	\$ (835)	) \$ 50,015
Gain on sale of loans	-	25,164	-	-	-	) 25,164
Other revenues	3,893	(424 )	3,034	1,401	(1,265)	) 6,639
Total operating income	52,956	26,507	3,034	1,421	(2,100)	) 81,818
Expenses:						
Interest expense	6,324	548	-	267	(835)	) 6,304
Salaries and employee benefits	16,015	13,541	2,222	-	-	) 31,778
Other expenses	9,232	5,354	1,034	3,777	(1,265)	) 18,132
Total operating expenses	31,571	19,443	3,256	4,044	(2,100)	) 56,214
Income (loss) before income taxes	\$21,385	\$ 7,064	\$ (222)	) \$(2,623)	\$ -	) \$ 25,604
Total assets	\$1,394,061	\$ 39,356	\$ 2,841	\$ 18,037	\$ (23,587)	) \$ 1,430,708
Capital expenditures	\$826	\$ 3	\$ 2	\$40	\$ -	) \$ 871
<b>2015</b>						
Revenues:						
Interest income	\$42,763	\$ 1,650	\$ -	\$16	\$ (763)	) \$ 43,666
Gain on sale of loans	-	19,633	-	-	-	) 19,633
Other revenues	3,229	388	2,671	1,391	(1,247)	) 6,432
Total operating income	45,992	21,671	2,671	1,407	(2,010)	) 69,731

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Expenses:

Interest expense	4,135	467	-	280	(763	)	4,119
Salaries and employee benefits	13,519	11,470	1,977	-	-		26,966
Other expenses	7,732	5,087	1,116	2,362	(1,247	)	15,050
Total operating expenses	25,386	17,024	3,093	2,642	(2,010	)	46,135

Income (loss) before income taxes \$20,606 \$ 4,647 \$ (422 ) \$(1,235 ) \$ - \$ 23,596

Total assets \$1,133,916 \$46,077 \$ 3,205 \$16,837 \$ (21,487 ) \$1,178,548

Capital expenditures \$252 \$ 15 \$ 24 \$9 \$ - \$ 300

Commercial Mortgage Wealth  
Banking Banking Management Other Eliminations Consolidated  
(In Thousands) Totals

2014

Revenues:

Interest income	\$37,816	\$ 1,297	\$ -	\$13	\$ (625	)	\$ 38,501
Gain on sale of loans	-	15,146	-	-	-		15,146
Other revenues	2,454	(614 )	2,126	1,388	(1,200	)	4,154
Total operating income	40,270	15,829	2,126	1,401	(1,825	)	57,801

Expenses:

Interest expense	3,264	281	21	332	(625	)	3,273
Salaries and employee benefits	11,897	9,212	1,545	-	-		22,654
Other expenses	6,220	1,293	910	3,141	(1,200	)	10,364
Total operating expenses	21,381	10,786	2,476	3,473	(1,825	)	36,291

Income (loss) before income taxes \$18,889 \$ 5,043 \$ (350 ) \$(2,072 ) \$ - \$ 21,510

Total assets \$1,006,576 \$47,160 \$ 1,624 \$17,791 \$ (20,271 ) \$ 1,052,880

Capital expenditures \$251 \$ 2 \$ - \$8 \$ - \$ 261

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**Notes to Consolidated Financial Statements****Note 18. Parent Corporation Only Statements****ACCESS NATIONAL CORPORATION****(Parent Corporation Only)****Balance Sheets**

	Year Ended December 31,	
	2016	2015
	(In Thousands)	
Assets		
Cash	\$ 11,339	\$ 9,469
Investment in subsidiaries	109,825	99,520
Other assets	585	586
Total assets	\$ 121,749	\$ 109,575
Liabilities		
Other liabilities	\$ 1,219	\$ 437
Total liabilities	1,219	437
Shareholders' Equity		
Common stock	8,881	8,805
Capital surplus	21,779	19,953
Retained earnings	91,439	81,385
Accumulated other comprehensive loss	(1,569 )	(1,005 )
Total shareholders' equity	120,530	109,138
Total liabilities and shareholders' equity	\$ 121,749	\$ 109,575

**Notes to Consolidated Financial Statements****Note 18. Parent Corporation Only Statements (continued)****ACCESS NATIONAL CORPORATION****(Parent Corporation Only)****Statements of Income**

	Year Ended December 31,		
	2016	2015	2014
	(In Thousands)		
Income			
Dividends from subsidiaries	\$8,000	\$8,625	\$9,390
Interest	20	15	13
Other	134	113	199
	8,154	8,753	9,602
Expenses			
Other expenses	3,079	1,660	1,704
Total expenses	3,079	1,660	1,704
Income before income taxes and undistributed income of subsidiaries	5,075	7,093	7,898
Income tax benefit	(588 )	(467 )	(469 )
Income before undistributed income of subsidiaries	5,663	7,560	8,367
Undistributed income of subsidiaries	10,741	7,859	5,558
Net income	\$16,404	\$15,419	\$13,925

**ACCESS NATIONAL CORPORATION****(Parent Corporation Only)****Statements of Comprehensive Income**

(In Thousands)

Year Ended December 31,  
2016 2015 2014

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Net income	\$16,404	\$15,419	\$13,925
Other comprehensive income:			
Unrealized gains (losses) on securities			
Unrealized holding gains (losses) arising during period	(816 )	(528 )	2,205
Less: reclassification adjustment for gains included in net income	(52 )	(188 )	(18 )
Tax effect	304	255	(765 )
Net of tax amount	(564 )	(461 )	1,422
Comprehensive income	\$15,840	\$14,958	\$15,347

## Notes to Consolidated Financial Statements

## Note 18. Parent Corporation Only Statements (continued)

## ACCESS NATIONAL CORPORATION

## (Parent Corporation Only)

## Statements of Cash Flows

	Year Ended December 31, 2016 (In Thousands)	2015	2014
Cash Flows from Operating Activities			
Net income	\$ 16,404	\$ 15,419	\$ 13,925
Adjustments to reconcile net income to net cash provided by operating activities:			
Undistributed income of subsidiaries	(10,741 )	(7,859 )	(5,558 )
(Increase) decrease in other assets	3	12	(6 )
Increase (decrease) in other liabilities	51	(75 )	89
Stock-based compensation	335	332	236
Net cash provided by operating activities	6,052	7,829	8,686
Cash Flows from Investing Activities			
Payments for investments in and advances to subsidiaries	(127 )	(592 )	(433 )

Sale or repayment of investments in and advances to subsidiaries	728	968	30
Net cash provided by (used in) investing activities	601	376	(403 )
Cash Flows from Financing Activities			
Net proceeds from issuance of common stock	1,567	1,145	1,066
Dividends paid	(6,350 )	(9,866 )	(5,214 )
Net cash used in financing activities	(4,783 )	(8,721 )	(4,148 )
Increase (decrease) in cash and cash equivalents	1,870	(516 )	4,135
Cash and Cash Equivalents			
Beginning	9,469	9,985	5,850
Ending	\$ 11,339	\$ 9,469	\$ 9,985

#### Note 19. Bank-Owned Life Insurance

The Corporation had \$26.4 million and \$15.8 million in bank-owned life insurance (“BOLI”) at December 31, 2016 and 2015, respectively. The Corporation recognized interest income, which is included in other noninterest income, of \$558 thousand, \$460 thousand, and \$332 thousand in 2016, 2015, and 2014, respectively.

## Notes to Consolidated Financial Statements

### Note 20. Merger with Middleburg Financial Corporation

On October 24, 2016, the Corporation announced the signing of a definitive agreement and plan of reorganization, dated October 21, 2016 (the “Middleburg Merger Agreement”), to acquire Middleburg Financial Corporation (“Middleburg”), and its wholly-owned subsidiaries, Middleburg Bank and Middleburg Investment Group, Inc. Middleburg Bank is a Virginia-based bank with twelve financial service centers and one limited service facility primarily servicing Northern Virginia. The Middleburg Merger Agreement and the transactions pursuant thereto have been unanimously approved by the Boards of Directors of the Corporation and Middleburg and the merger is expected to close in the second quarter of 2017, subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of each company’s shareholders. At December 31, 2016, Middleburg had total assets of \$1.27 billion, gross loans of \$860.1 million, and total deposits of \$1.05 billion. Under the terms of the Middleburg Merger Agreement, Middleburg shareholders will receive 1.3314 shares of the Corporation’s common stock for each share of Middleburg common stock held immediately prior to the effective date of the merger. As a result of the merger, each option to purchase shares of Middleburg common stock granted under a Middleburg equity-based compensation plan that is outstanding immediately prior to the effective date of the merger will be cancelled for a cash payment equal to the product of (i) the difference between the closing sale price of Middleburg common stock on the trading day immediately preceding the effective date of the merger and the per share exercise price of the stock option, and (ii) the number of shares of Middleburg common stock subject to such stock option. Each restricted share of Middleburg common stock granted under a Middleburg equity compensation plan that is outstanding immediately prior to the effective date of the merger will, pursuant to the terms of each such grant, vest in full immediately prior to the effective date of the merger and be converted into unrestricted shares of the Corporation’s common stock based on the exchange ratio.

**ITEM 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A – CONTROLS AND PROCEDURES**

The Corporation's management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Corporation'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 Chief Executive Officer and Chief Financial Officer concluded that the Corporation'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 Corporation 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 the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation to disclose material information required to be set forth in the Corporation's periodic and current reports.

The Corporation's management is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). No changes in the Corporation's internal control over financial reporting occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Report of Management's Assessment of Internal Control over Financial Reporting**

The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act.

With the supervision and participation of its Chief Executive Officer and its Chief Financial Officer, management evaluated the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2016, using the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework (2013)* and based on this assessment has concluded the Corporation's internal control over financial reporting is effective as of that date.

No matter how well designed, internal control over financial reporting may not prevent or detect all misstatements. Projection of the evaluation of effectiveness to future periods is subject to risks, including but not limited to (a) controls may become inadequate due to changes in conditions; (b) a deterioration in the degree of compliance with policies or procedures; and (c) the possibility of control circumvention or override, any of which may lead to misstatements due to undetected error or fraud. Effective internal control over financial reporting can provide only a reasonable assurance with respect to financial statement preparation and reporting.

The Corporation's independent registered public accounting firm, BDO USA, LLP, has audited the Consolidated Financial Statements included in this Annual Report and has issued an attestation report on the Corporation's internal control over financial reporting which is included in "Item 8 – Financial Statements and Supplementary Data" herein.

**ITEM 9B – OTHER INFORMATION**

None.



### **PART III**

#### **Item 10 – Directors, Executive Officers And Corporate governance**

The information contained under the captions “Election of Directors,” “Executive Officers Who Are Not Directors,” “Corporate Governance and the Board of Directors,” “Certain Relationships and Related Transactions” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2017 Proxy Statement that is required to be disclosed in this Item 10 is incorporated herein by reference.

The Corporation has adopted a Code of Ethics (the “Code”) that applies to its directors, executives and employees including the principal executive officer, principal financial officer, principal accounting officer and controller, or persons performing similar functions. This Code is posted on the Corporation’s Internet website at <http://www.accessnationalbank.com> under “Investor Relations – Governance Documents.” The Corporation will provide a copy of the Code to any person without charge upon written request to Access National Corporation, c/o Investor Relations, 1800 Robert Fulton Drive, Suite 300, Reston, Virginia 20191. The Corporation intends to provide any required disclosure of any amendment to or waiver of the Code that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, at <http://www.accessnationalbank.com> under “Investor Relations – Governance Documents” promptly following the amendment or waiver. The Corporation may 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. The information contained on or connected to our Internet website is not incorporated by reference in this report and should not be considered part of this or any other report that the Corporation files with or furnishes to the SEC.

#### **Item 11 – Executive Compensation**

The information contained under the caption “Executive Compensation” in the 2017 Proxy Statement that is required to be disclosed in this Item 11 is incorporated herein by reference.

#### **Item 12 – Security Ownership of Certain Beneficial Owners and Management and related stockholder matters**

The information contained under the captions “Security Ownership of Management”, “Security Ownership of Certain Beneficial Owners” and “Securities Authorized for Issuance Under Equity Compensation Plans” in the 2017 Proxy Statement that is required to be disclosed in this Item 12 is incorporated herein by reference.

**Item 13 – Certain Relationships and Related Transactions, and Director independence**

The information regarding certain relationships between the Corporation and its directors and officers is contained under the captions “Certain Relationships and Related Transactions” and “Corporate Governance and the Board of Directors” in the 2017 Proxy Statement that is required to be disclosed in this Item 13 is incorporated herein by reference.

**ITEM 14 – PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information under the captions “Audit and Non-Audit Fees” and “Audit Committee Pre-Approval Policies” in the 2017 Proxy Statement that is required to be disclosed in this Item 14 is incorporated herein by reference.

**PART IV**

**Item 15 – Exhibits, FINANCIAL STATEMENT SCHEDULES**

**(a) Exhibit Index:**

Exhibit No. Description

2.1	Agreement and Plan of Reorganization, dated October 21, 2016, between Access National Corporation and Middleburg Financial Corporation (incorporated by reference to Exhibit 2.1 to Form 8-K filed October 25, 2016 (filed number 000-49929))
3.1	Amended and Restated Articles of Incorporation of Access National Corporation (incorporated by reference to Exhibit 3.1 to Form 8-K filed July 18, 2006 (file number 000-49929))
3.1.1	Articles of Amendment to Amended and Restated Articles of Incorporation of Access National Corporation (incorporated by reference to Exhibit 3.1.1 to Form 10-Q filed August 15, 2011 (file number 000-49929))
3.2	Amended and Restated Bylaws of Access National Corporation (incorporated by reference to Exhibit 3.2 to Form 8-K filed October 24, 2007 (file number 000-49929))
4	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.0 to Form 10-KSB filed March 31, 2003)
	Certain instruments relating to long-term debt as to which the total amount of securities authorized thereunder does not exceed 10% of Access National Corporation's total assets have been omitted in accordance with Item 601(b)(4)(iii) of Regulation S-K. The registrant will furnish a copy of any such instrument to the Securities and Exchange Commission upon its request.
10.5*+	Annual Compensation of Non-Employee Directors
10.6*+	Base Salaries for Named Executive Officers
10.10+	Access National Corporation 2009 Stock Option Plan, effective May 19, 2009 (incorporated by reference to Appendix A to the definitive proxy statement filed April 15, 2009)
10.10.1+	Form of Stock Option Agreement for Employee under 2009 Stock Option Plan (incorporated by reference to Exhibit 10.10.1 to Form 8-K filed July 6, 2009)
10.10.2+	Form of Stock Option Agreement for Non-employee Directors under 2009 Stock Option Plan (incorporated by reference to Exhibit 10.10.2 to Form 10-K filed March 14, 2014).
10.13+	Employment Agreement between Access National Bank and Michael W. Clarke 2013 (incorporated by reference to Exhibit 10.13 to Form 10-K filed March 18, 2013 (file number 000-49929))
10.13.1+	Amendment to Employment Agreement between Access National Bank and Michael W. Clarke, dated as of November 19, 2013 (incorporated by reference to Exhibit 10.13.1 to Form 8-K filed November 25, 2013)
10.14+	Employment Agreement between Access National Bank and Robert C. Shoemaker 2013 (incorporated by reference to Exhibit 10.14 to Form 10-K filed March 18, 2013 (file number 000-49929))
10.14.1+	Amendment to Employment Agreement between Access National Bank and Robert C. Shoemaker, dated as of November 19, 2013 (incorporated by reference to Exhibit 10.14.1 to Form 8-K filed November 25, 2013)

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- 10.15+ Employment Agreement between Access National Bank and Dean Hackemer 2013 (incorporated by reference to Exhibit 10.15 to Form 10-K filed March 18, 2013 (file number 000-49929))
- 10.15.1+ Amendment to Employment Agreement between Access National Bank and Dean Hackemer, dated as of November 19, 2013 (incorporated by reference to Exhibit 10.15.1 to Form 8-K filed November 25, 2013)

- 10.16+ Employment Agreement between Access National Bank and Margaret M. Taylor (incorporated by reference to Exhibit 10.16 to Form 10-Q filed May 10, 2013 (file number 000-49929))
- 10.16.1+ Amendment to Employment Agreement between Access National Bank and Margaret M. Taylor, dated as of November 19, 2013 (incorporated by reference to Exhibit 10.16.1 to Form 8-K filed November 25, 2013)
- 21\* Subsidiaries of Access National Corporation
- 23\* Consent of BDO USA, LLP
- 24\* Power of Attorney (included on the signature page of this report)
- 31.1\* CEO Certification Pursuant to Rule 13a-14(a)
- 31.2\* CFO Certification Pursuant to Rule 13a-14(a)
- 32\* CEO/CFO Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350)
- The following materials from Access National Corporation's Annual Report on Form 10-K for the year ended December 31, 2016, formatted in XBRL (Extensible Business Reporting Language), filed herewith:
- 101\* (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements.
- 101.INS\* XBRL Instance Document
- 101.SCH\* XBRL Taxonomy Extension Schema
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase

\* filed herewith

+ indicates a management contract or compensatory plan or arrangement

**ITEM 15 - FORM 10-K SUMMARY**

Not applicable.

## 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.

**Access National Corporation  
(Registrant)**

Date: March 16, 2017

By: /s/ Michael W. Clarke  
Michael W. Clarke  
President and Chief Executive Officer

Date: March 16, 2017

By: /s/ Margaret M. Taylor  
Margaret M. Taylor  
Executive Vice President and Chief Financial Officer

## SIGNATURES

## POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Michael W. Clarke his true and lawful attorney-in-fact and agent with full power of substitution and re-substitution for him and in his name, place and stead, in any and all capacities, to sign any or all amendments to this Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agents full power and authority to do fully and to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, and his substitutes, may lawfully do or cause to be done by virtue hereof.

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.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ Michael W. Clarke Michael W. Clarke	President, Chief Executive Officer & Director (Principal Executive Officer)	March 16, 2017
/s/ John W. Edgemond IV John W. Edgemond IV	Director	March 16, 2017
/s/ Martin S. Friedman Martin S. Friedman	Director	March 16, 2017
/s/ Michael G. Anzilotti Michael G. Anzilotti	Chairman & Director	March 16, 2017
/s/ Thomas M. Kody Thomas M. Kody	Director	March 16, 2017
/s/ Robert C. Shoemaker Robert C. Shoemaker	Director	March 16, 2017
/s/ J. Randolph Babbitt J. Randolph Babbitt	Director	March 16, 2017

/s/ Margaret M. Taylor

Executive Vice President and Chief Financial  
Officer

Margaret M. Taylor

(Principal Financial Officer and Principal  
Accounting Officer)

March 16, 2017