



JOHN MARSHALL BANK

Reston, Virginia

FINANCIAL STATEMENTS

DECEMBER 31, 2015 and 2014



Independent Auditor's Report

To the Audit Committee of the Board of Directors
John Marshall Bank
Reston, Virginia

Report on the Financial Statements

We have audited the accompanying financial statements of John Marshall Bank, which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to the financial statements, (collectively, financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of John Marshall Bank as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 29, 2016

JOHN MARSHALL BANK

Balance Sheets

December 31, 2015 and 2014

(In thousands, except share and per share data)

Assets	2015	2014
Cash and due from banks	\$ 8,217	\$ 10,799
Interest-bearing deposits in banks	46,738	17,786
Securities available-for-sale, at fair value	32,145	13,482
Securities held-to-maturity, fair value of \$46,780 in 2015 and \$50,499 in 2014	46,479	49,934
Restricted securities, at cost	6,210	5,401
Loans, net of allowance for loan losses of \$7,130 in 2015 and \$6,506 in 2014	774,633	676,777
Bank premises and equipment, net	2,690	3,041
Accrued interest receivable	2,318	2,168
Other assets	9,190	7,450
Total assets	<u>\$ 928,620</u>	<u>\$ 786,838</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Non-interest bearing demand deposits	\$ 136,361	\$ 121,219
Interest bearing demand deposits	235,313	198,438
Savings deposits	17,154	6,500
Time deposits	<u>342,025</u>	<u>291,456</u>
Total deposits	730,853	617,613
Repurchase agreements	11,972	12,404
Federal Home Loan Bank advances	71,000	52,000
Accrued interest payable	109	132
Other liabilities	<u>5,384</u>	<u>5,040</u>
Total liabilities	<u>819,318</u>	<u>687,189</u>
Shareholders' Equity		
Preferred stock, par value \$5 per share; authorized 1,000,000 shares; none issued	- -	- -
Common stock, nonvoting, par value \$5 per share; authorized 1,000,000 shares; none issued	- -	- -
Common stock, voting, par value \$5 per share; authorized 20,000,000 shares; issued and outstanding, 10,016,574 shares in 2015 and 8,305,086 in 2014	50,083	41,525
Additional paid-in capital	31,313	39,023
Retained earnings	28,153	19,288
Accumulated other comprehensive loss	<u>(247)</u>	<u>(187)</u>
Total shareholders' equity	<u>109,302</u>	<u>99,649</u>
	<u>\$ 928,620</u>	<u>\$ 786,838</u>

See Notes to Financial Statements.

JOHN MARSHALL BANK
Statements of Income
Years Ended December 31, 2015 and 2014
(In thousands, except per share data)

	<u>2015</u>	<u>2014</u>
Interest and Dividend Income		
Interest and fees on loans	\$ 37,145	\$ 32,873
Interest on investment securities, taxable	1,280	1,061
Interest on investment securities, tax-exempt	104	91
Dividends	296	237
Interest on deposits in banks	<u>65</u>	<u>74</u>
Total interest and dividend income	<u>38,890</u>	<u>34,336</u>
Interest Expense		
Deposits	4,572	3,926
Federal Home Loan Bank advances	580	392
Other short-term borrowings	<u>61</u>	<u>54</u>
Total interest expense	<u>5,213</u>	<u>4,372</u>
Net interest income	33,677	29,964
Provision for loan losses	<u>1,197</u>	<u>1,018</u>
Net interest income after provision for loan losses	<u>32,480</u>	<u>28,946</u>
Noninterest Income		
Service charges on deposit accounts	482	409
Other service charges and fees	68	57
Other operating income	<u>29</u>	<u>--</u>
Total noninterest income	<u>579</u>	<u>466</u>
Noninterest Expenses		
Salaries and employee benefits	11,421	10,154
Occupancy expense of premises	1,781	1,581
Furniture and equipment expenses	1,065	994
Other real estate owned expense	247	--
Other operating expenses	<u>4,767</u>	<u>4,294</u>
Total noninterest expenses	<u>19,281</u>	<u>17,023</u>
Income before income taxes	13,778	12,389
Income tax expense	<u>4,911</u>	<u>4,370</u>
Net income	<u>\$ 8,867</u>	<u>\$ 8,019</u>
Earnings Per Common Share		
Basic	\$ 0.89	\$ 0.81
Diluted	\$ 0.85	\$ 0.77

See Notes to Financial Statements.

JOHN MARSHALL BANK

Statements of Comprehensive Income

Years Ended December 31, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Net income	\$ 8,867	\$ 8,019
Other comprehensive (loss) income:		
Unrealized (loss) gain on available for sale securities, net of tax of \$(57) and \$226	(111)	444
Amortization of unrealized loss on securities transferred to held to maturity, net of tax of \$26 and \$4	<u>51</u>	<u>7</u>
Total other comprehensive (loss) income	<u>(60)</u>	<u>451</u>
Total comprehensive income	<u>\$ 8,807</u>	<u>\$ 8,470</u>

See Notes to Financial Statements.

JOHN MARSHALL BANK

Statements of Changes in Shareholders' Equity

Years Ended December 31, 2015 and 2014

(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2013	\$ 41,432	\$ 38,605	\$ 11,269	\$ (638)	\$ 90,668
Net income	--	--	8,019	--	8,019
Other comprehensive income	--	--	--	451	451
Exercise of stock options	93	60	--	--	153
Share-based compensation	--	358	--	--	358
Balance, December 31, 2014	<u>\$ 41,525</u>	<u>\$ 39,023</u>	<u>\$ 19,288</u>	<u>\$ (187)</u>	<u>\$ 99,649</u>
Net income	--	--	8,867	--	8,867
Other comprehensive loss	--	--	--	(60)	(60)
Exercise of stock options	242	100	--	--	342
6 for 5 stock split in the form of a 20% stock dividend	8,316	(8,316)	--	--	--
Share-based compensation	--	506	--	--	506
Cash paid in lieu of fractional shares	--	--	(2)	--	(2)
Balance, December 31, 2015	<u>\$ 50,083</u>	<u>\$ 31,313</u>	<u>\$ 28,153</u>	<u>\$ (247)</u>	<u>\$ 109,302</u>

See Notes to Financial Statements.

JOHN MARSHALL BANK

Statements of Cash Flows

Years Ended December 31, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities		
Net income	\$ 8,867	\$ 8,019
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	775	710
Provision for loan losses	1,197	1,018
Share-based compensation	506	358
Net amortization of securities	411	321
Loss on impairment and sale of other real estate owned	176	--
Deferred tax (benefit)	(389)	(482)
Loss on disposal of fixed assets	1	3
Changes in assets and liabilities:		
(Increase) in accrued interest receivable	(150)	(274)
(Increase) in other assets	(1,320)	(783)
(Decrease) increase in accrued interest payable	(23)	--
Increase in other liabilities	344	531
Net cash provided by operating activities	<u>\$ 10,395</u>	<u>\$ 9,421</u>
Cash Flows from Investing Activities		
(Increase) decrease in interest bearing deposits in banks	\$ (28,952)	\$ 5,412
Net (increase) in loans	(100,061)	(111,066)
Purchase of available-for-sale securities	(36,374)	(22,069)
Purchase of held-to-maturity securities	(3,114)	(1,106)
Proceeds from maturities, calls and principal repayments of available-for-sale securities	17,500	7,078
Proceeds from maturities, calls and principal repayments of held-to-maturity securities	6,278	4,250
Net (purchase) of restricted securities	(809)	(1,396)
Proceeds from sale of other real estate owned	832	--
Purchases of bank premises and equipment	(425)	(642)
Net cash used in investing activities	<u>\$ (145,125)</u>	<u>\$ (119,539)</u>
Cash Flows from Financing Activities		
Net increase in deposits	\$ 113,240	\$ 102,687
Net proceeds from FHLB advances	19,000	13,000
(Decrease) in repurchase agreements	(432)	(901)
Issuance of common stock	342	153
Cash paid in lieu of fractional shares	(2)	--
Net cash provided by financing activities	<u>\$ 132,148</u>	<u>\$ 114,939</u>

See Notes to Financial Statements.

Statements of Cash Flows (continued)
Years Ended December 31, 2015 and 2014
(In thousands)

	<u>2015</u>	<u>2014</u>
Net (decrease) increase in cash and cash equivalents	\$ (2,582)	\$ 4,821
Cash and cash equivalents at beginning of period	<u>10,799</u>	<u>5,978</u>
Cash and cash equivalents at end of period	<u><u>\$ 8,217</u></u>	<u><u>\$ 10,799</u></u>
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	<u>\$ 5,236</u>	<u>\$ 4,372</u>
Income taxes	<u><u>\$ 4,766</u></u>	<u><u>\$ 4,540</u></u>
Supplemental Disclosures of Noncash Transactions		
Unrealized (loss) gain on securities available for sale	<u>\$ (168)</u>	<u>\$ 670</u>
Securities transferred from available for sale to held to maturity		
to held to maturity	<u>\$ -</u>	<u>\$ 50,875</u>
Amortization of unrealized loss on securities transferred		
to held to maturity	<u>\$ 77</u>	<u>\$ 11</u>
Loans transferred to other real estate owned	<u><u>\$ 1,008</u></u>	<u><u>\$ -</u></u>

See Notes to Financial Statements.

Notes to Financial Statements

JOHN MARSHALL BANK

Notes to Financial Statements

Note 1. Nature of Banking Activities and Significant Accounting Policies

Nature of Banking Activities

John Marshall Bank (the Bank) is a corporation formed on April 5, 2005 under the laws of the Commonwealth of Virginia and was chartered on February 9, 2006, by the State Corporation Commission – Bureau of Financial Institutions. The Bank is a member of the Federal Reserve System and is subject to the rules and regulations of the Virginia State Banking Commission, the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and the Federal Deposit Insurance Corporation (the “FDIC”). The Bank opened for business on April 17, 2006 and provides banking services to its customers primarily in the Washington, D.C. metropolitan area.

The accounting and reporting policies of John Marshall Bank conform to generally accepted accounting principles in the United States of America and reflect practices of the banking industry. The policies are summarized below.

Significant Accounting Policies

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the evaluation for other-than-temporary impairment of securities.

Concentrations of Credit Risk

Most of the Bank’s activities are with customers located in the Washington, D.C. metropolitan area. Real estate loans, including commercial and construction and land development loans, represented 88% of the total portfolio at December 31, 2015 and 2014. The Bank does not have any significant concentrations to any one industry or customer.

Reclassifications

Certain amounts in the prior year’s financial statements have been reclassified to conform to the current year’s presentation. The only significant reclassification was related to a change in loan coding during 2015. Loan balances totaling \$57.1 million reported in the prior year were reclassified from the commercial real estate segment to residential real estate segment of the portfolio. All related tables have been updated to reflect this change.

Notes to Financial Statements

Cash and Cash Equivalents

For the purposes of the statements of cash flows, cash and cash equivalents include cash and balances due from banks, all of which mature within ninety days.

Interest-Bearing Deposits in Banks

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

Securities

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

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (a) the intent is to sell the security or (b) it is more likely than not that it will be necessary to sell the security prior to recovery of its amortized cost basis. If, however, the Bank’s intent is not to sell the security and it is not more than likely that the Bank will be required to sell the security before recovery, the Bank must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

For equity securities carried at cost as restricted securities, impairment is considered to be other-than-temporary based on the Bank's ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in income.

The Bank regularly reviews each security for other-than-temporary impairment based on criteria that include the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, the security’s ratings, the Bank's best estimate of the present value of cash flows expected to be collected from debt securities, the intention with regards to holding the security to maturity and the likelihood that the Bank would be required to sell the security before recovery.

Loans

The Bank grants real estate, commercial and consumer loans to customers (representing the Bank’s loan segments). A substantial portion of the loan portfolio is represented by mortgage loans in the Washington, D.C. metropolitan area. Within the real estate segment, the Bank has also identified the residential, commercial and construction classes. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Notes to Financial Statements

Underwriting and risk characteristics of each loan class are summarized as follows:

- Real estate residential mortgage loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.
- Real estate commercial mortgage loans carry risks associated with the successful operation of a business, the continued creditworthiness of the borrower and any related guarantors and changes in the value of the collateral. In the case of investor-owned commercial real estate, risks are expanded to include the financial strength of the tenants occupying the property and the stability of occupancy and lease rates.
- Real estate construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a customer of the Bank, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.
- Commercial loans carry risks associated with the successful operation of a business and the financial strength of any related guarantors. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.
- Consumer loans carry the risks associated with the continued creditworthiness of the borrower and the value of any collateral. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for 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 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 the process of collection. Other personal loans are typically charged off no later than 180 days past due. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual 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 the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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 earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Real estate loans are generally written down to the net realizable value when the loan is 180 days past due. Commercial and consumer loans are generally charged off when the loan is 180 days past due. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon

Notes to Financial Statements

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For such loans that are 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 nonclassified loans and is based on historical loss experience adjusted for qualitative factors. Qualitative factors used for each segment include an analysis of the levels of and trends in delinquencies, nonaccrual loans, and watch list loans; trends in volume and terms of loans; effects of any changes in lending policies and practices; experience, ability, and depth of management; and national and local economic trends and conditions. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan in each class is considered impaired when, based on current information and events, it is probable that the Bank 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 for commercial, construction, and mortgage loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures.

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial condition, the Bank may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring ("TDR"). The Bank strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructured loan as noted above for impaired loans.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation of property and equipment is computed on the straight-line method over the useful lives of the assets,

Notes to Financial Statements

ranging from three to fifteen years, or the expected term of leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured. Maintenance and repairs of property and equipment are charged to operations and major improvements are capitalized.

Other Real Estate Owned

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed. There were no properties held in other real estate owned at December 31, 2015 and 2014. At December 31, 2015, there were no consumer mortgage loans secured by residential real estate for which formal foreclosure proceedings were in place.

Transfers of Financial Assets

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

Income Taxes

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences, operating loss carryforwards, and tax credit carryforwards. Deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are differences between the reported amounts of assets and liabilities and their tax bases. 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. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Bank recorded no liability for unrecognized tax benefits at December 31, 2015 or 2014.

Notes to Financial Statements

Earnings Per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflects 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. Potential common shares relate solely to outstanding stock options and are determined using the treasury stock method. Per share amounts for all periods have been adjusted to reflect a 6 for 5 stock split in the form of a 20% stock dividend declared May 19, 2015 and paid July 1, 2015.

Advertising Costs

The Bank follows the policy of charging the production costs of advertising to expense as incurred. Advertising expense was \$450 thousand and \$432 thousand for the years ended December 31, 2015 and 2014, respectively.

Share-Based Compensation

The Bank recognizes the compensation cost relating to share-based payment transactions based on the grant date fair value of the equity instruments issued. The share compensation accounting guidance requires that compensation cost for all share-based awards be calculated and recognized over the vesting period. A Black-Scholes model is used to estimate the fair value of stock options.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains (losses) on securities available for sale, which is also recognized as a separate component of equity.

Fair Value of Financial Instruments

Fair values of various assets and liabilities are estimated using relevant market information, valuation techniques and other assumptions, as more fully disclosed in Note 14. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Recent Accounting Pronouncements

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation – Stock Compensation (Topic 718)," should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Bank does not expect the adoption of ASU 2014-12 to have a material impact on its financial statements.

Notes to Financial Statements

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

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

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

In August 2015, the FASB issued ASU No. 2015-14, “Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date.” The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. All other

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entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. All other entities may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities also may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which the entity first applies the guidance in ASU 2014-09. The Bank does not expect the adoption of ASU 2015-14 (or ASU 2014-09) to have a material impact on its financial statements.

In August 2015, the FASB issued ASU 2015-15, “Interest – Imputation of Interest (Subtopic 835-30) – Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting).” On April 7, 2015, the FASB issued ASU 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires entities to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability. The guidance in ASU 2015-03 (see paragraph 835-30-45-1A) does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff stated that they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 adds these SEC comments to the “S” section of the Codification. The adoption of ASU 2015-15 did not have a material impact on our financial statements.

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

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition

Notes to Financial Statements

approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Bank is currently assessing the impact that ASU 2016-02 will have on its financial statements.

Note 2. Securities

The amortized cost and fair values of securities available for sale and held to maturity as of December 31, 2015 and 2014 are as follows:

Available for Sale				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
	2015			
(In thousands)				
U.S government and federal agencies	\$ 32,331	\$ - -	\$ (186)	\$ 32,145
	<u>\$ 32,331</u>	<u>\$ - -</u>	<u>\$ (186)</u>	<u>\$ 32,145</u>
	2014			
U.S government and federal agencies	\$ 13,500	\$ 27	\$ (45)	\$ 13,482
	<u>\$ 13,500</u>	<u>\$ 27</u>	<u>\$ (45)</u>	<u>\$ 13,482</u>
Held to Maturity				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
	2015			
U.S government and federal agencies	\$ 7,916	\$ 10	\$ (48)	\$ 7,878
Taxable municipal	8,333	126	(20)	8,439
Tax-exempt municipal	5,926	92	(3)	6,015
Mortgage-backed	24,304	255	(111)	24,448
	<u>\$ 46,479</u>	<u>\$ 483</u>	<u>\$ (182)</u>	<u>\$ 46,780</u>
	2014			
U.S government and federal agencies	\$ 9,366	\$ 28	\$ (81)	\$ 9,313
Taxable municipal	7,321	130	(20)	7,431
Tax-exempt municipal	6,071	96	(18)	6,149
Mortgage-backed	27,176	488	(58)	27,606
	<u>\$ 49,934</u>	<u>\$ 742</u>	<u>\$ (177)</u>	<u>\$ 50,499</u>

Notes to Financial Statements

In 2014, the Bank transferred securities with a fair value of \$50.9 million from the available for sale to the held to maturity classification. The net unrealized holding loss of \$238 thousand at the time of the transfer remained in accumulated other comprehensive loss and is being amortized to income over the remaining lives of the securities.

The amortized cost and fair value of securities available for sale and held to maturity as of December 31, 2015, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because the securities may be called or prepaid without any penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In thousands)				
Due in one year or less	\$ - -	\$ - -	\$ 1,001	\$ 1,003
Due after one year through five years	28,331	28,157	10,055	10,108
Due after five years through ten years	3,000	2,992	10,938	11,049
Due after ten years	1,000	996	24,485	24,620
	<u>\$ 32,331</u>	<u>\$ 32,145</u>	<u>\$ 46,479</u>	<u>\$ 46,780</u>

The following table shows the gross unrealized losses and fair value of the Bank's investments with unrealized losses that are not deemed to be other-than-temporarily impaired aggregated by category and length of time that individual securities have been in a continuous loss position at December 31, 2015 and 2014.

	Less Than 12 Months		12 Months or Longer	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
(In thousands)				
<u>2015</u>				
U.S. government and federal agencies	\$ 212	\$ 34,515	\$ 22	\$ 1,945
Taxable municipal	-	-	20	512
Tax-exempt municipal	1	563	2	219
Mortgage-backed	52	6,567	59	2,873
	<u>\$ 265</u>	<u>\$ 41,645</u>	<u>\$ 103</u>	<u>\$ 5,549</u>
<u>2014</u>				
U.S. government and federal agencies	\$ 29	\$ 5,471	\$ 97	\$ 6,246
Taxable municipal	4	1,586	16	527
Tax-exempt municipal	5	1,688	13	1,292
Mortgage-backed	5	830	53	4,762
	<u>\$ 43</u>	<u>\$ 9,575</u>	<u>\$ 179</u>	<u>\$ 12,827</u>

U.S. Government and Federal Agencies

The unrealized losses in thirty-seven and thirteen investments in direct obligations of U.S. government agencies at December 31, 2015 and 2014, respectively, were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Bank does

Notes to Financial Statements

not consider those investments to be other-than-temporarily impaired at December 31, 2015 or 2014.

Mortgage-Backed Securities

The unrealized losses on the Bank's investment in eighteen and twelve federal agency mortgage-backed securities at December 31, 2015 and 2014, respectively, were caused by interest rate changes. The contractual cash flows of those investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Bank's investments. Because the decline in market value is attributable to change in interest rates and not credit quality, and because the Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2015 or 2014.

Municipal Securities

The unrealized losses in three and seven investments in municipal securities at December 31, 2015 and 2014, respectively, were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2015 or 2014.

Securities having an amortized cost of \$71.9 million and \$58.6 million at December 31, 2015 and 2014, respectively, were pledged to secure public deposits and for other purposes required by law. These securities had a carrying value of \$71.7 million and \$59.1 million at December 31, 2015 and 2014, respectively.

Note 3. Loans

A summary of the balances of loans follows:

	December 31,	
	2015	2014
	<i>(In thousands)</i>	
Real estate loans:		
Residential	\$ 95,496	\$ 80,609
Commercial	441,309	380,817
Construction and land development	150,786	140,448
Total real estate loans	687,591	601,874
Commercial loans	94,371	81,504
Consumer installment loans	1,203	1,232
Total loans	783,165	684,610
Less: Allowance for loan losses	(7,130)	(6,506)
Net deferred loan fees	(1,402)	(1,327)
Loans, net	<u>\$ 774,633</u>	<u>\$ 676,777</u>

Notes to Financial Statements

Note 4. Allowance for Loan Losses

The following tables present, as of December 31, 2015 and December 31, 2014, the total allowance for loan losses, the allowance by impairment methodology and loans by impairment methodology:

December 31, 2015							
<i>(in thousands)</i>							
	Real Estate						
	Commercial	Construction & Land Development	Residential				
Allowance for loan losses:							
Beginning Balance, December 31, 2014	\$ 3,546	\$ 1,169	\$ 865	\$ 985	\$ 20	\$ (79)	\$ 6,506
Charge-offs	(279)	-	-	(343)	-	-	(622)
Recoveries	-	-	-	49	-	-	49
Provision	583	234	(63)	330	(14)	127	1,197
Ending Balance, December 31, 2015	<u>\$ 3,850</u>	<u>\$ 1,403</u>	<u>\$ 802</u>	<u>\$ 1,021</u>	<u>\$ 6</u>	<u>\$ 48</u>	<u>\$ 7,130</u>
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ 208	\$ -	\$ -	\$ 208
Collectively evaluated for impairment	\$ 3,850	\$ 1,403	\$ 802	\$ 813	\$ 6	\$ 48	\$ 6,922
Loans:							
Ending Balance, December 31, 2015	<u>\$ 441,309</u>	<u>\$ 150,786</u>	<u>\$ 95,496</u>	<u>\$ 94,371</u>	<u>\$ 1,203</u>	<u>\$ -</u>	<u>\$ 783,165</u>
Individually evaluated for impairment	\$ 953	\$ -	\$ 3,059	\$ 419	\$ -	\$ -	\$ 4,431
Collectively evaluated for impairment	\$ 440,356	\$ 150,786	\$ 92,437	\$ 93,952	\$ 1,203	\$ -	\$ 778,734

December 31, 2014							
<i>(in thousands)</i>							
	Real Estate						
	Commercial	Construction & Land Development	Residential				
Allowance for loan losses:							
Beginning Balance, December 31, 2013	\$ 3,133	\$ 1,033	\$ 764	\$ 870	\$ 18	\$ (70)	\$ 5,748
Charge-offs	-	-	-	(262)	-	-	(262)
Recoveries	-	-	-	2	-	-	2
Provision	413	136	101	375	2	(9)	1,018
Ending Balance, December 31, 2014	<u>\$ 3,546</u>	<u>\$ 1,169</u>	<u>\$ 865</u>	<u>\$ 985</u>	<u>\$ 20</u>	<u>\$ (79)</u>	<u>\$ 6,506</u>
Individually evaluated for impairment	\$ 392	\$ -	\$ -	\$ 183	\$ -	\$ -	\$ 575
Collectively evaluated for impairment	\$ 3,154	\$ 1,169	\$ 865	\$ 802	\$ 20	\$ (79)	\$ 5,931
Loans:							
Ending Balance, December 31, 2014	<u>\$ 380,817</u>	<u>\$ 140,448</u>	<u>\$ 80,609</u>	<u>\$ 81,504</u>	<u>\$ 1,232</u>	<u>\$ -</u>	<u>\$ 684,610</u>
Individually evaluated for impairment	\$ 2,264	\$ -	\$ 534	\$ 768	\$ -	\$ -	\$ 3,566
Collectively evaluated for impairment	\$ 378,593	\$ 140,448	\$ 80,075	\$ 80,736	\$ 1,232	\$ -	\$ 681,044

The provision indicated with respect to the each of the segments is due primarily to relative loan growth experienced over the course of the year in the segments. Loss factors for non-classified loans are determined based upon actual and peer group historical loss ratios, adjusted for loan duration and for the effect of certain qualitative factors, which are analyzed and adjusted quarterly.

Notes to Financial Statements

Impaired loans and the related allowance at December 31, 2015 and December 31, 2014, were as follows:

December 31, 2015 <i>(in thousands)</i>							
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real Estate							
Commercial	\$ 953	\$ 953	\$ -	\$ 953	\$ -	\$ 969	\$ 35
Construction and land development	-	-	-	-	-	-	-
Residential	3,059	3,059	-	3,059	-	3,070	95
Commercial	419	211	208	419	208	430	31
Consumer	-	-	-	-	-	-	-
Total impaired loans	<u>\$ 4,431</u>	<u>\$ 4,223</u>	<u>\$ 208</u>	<u>\$ 4,431</u>	<u>\$ 208</u>	<u>\$ 4,469</u>	<u>\$ 161</u>

December 31, 2014 <i>(in thousands)</i>							
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real Estate							
Commercial	\$ 2,264	\$ -	\$ 2,264	\$ 2,264	\$ 392	\$ 2,283	\$ 36
Construction and land development	-	-	-	-	-	-	-
Residential	534	534	-	534	-	539	20
Commercial	768	585	183	768	183	815	22
Consumer	-	-	-	-	-	-	-
Total impaired loans	<u>\$ 3,566</u>	<u>\$ 1,119</u>	<u>\$ 2,447</u>	<u>\$ 3,566</u>	<u>\$ 575</u>	<u>\$ 3,637</u>	<u>\$ 78</u>

As of December 31, 2015, \$1.5 million of impaired loans were classified as TDRs, a decline from \$1.8 million as of December 31, 2014. During 2015, two TDRs totaling \$293 thousand in the commercial and industrial segment were refinanced by the guarantors into a performing loan secured by the guarantor's personal residence and marketable securities, and removed from TDR status. There were no new loans recognized as a TDR in 2015. All TDRs were in compliance with the modified terms as of December 31, 2015. There were no loans modified in a troubled debt restructuring during the year ended December 31, 2015. The following table provides further information regarding troubled debt restructurings recognized during 2014.

December 31, 2014 <i>(in thousands)</i>			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Current Recorded Investment
Real Estate			
Commercial	-	\$ -	\$ -
Construction and land development	-	-	-
Residential	-	-	-
Commercial	2	293	293
Consumer	-	-	-
Total	<u>2</u>	<u>\$ 293</u>	<u>\$ 293</u>

Notes to Financial Statements

There were no TDRs that subsequently defaulted within the first twelve months after modification during years ended December 31, 2015 and 2014 with default being defined as past due thirty or more days.

All TDRs have loan loss reserves allocated to them equal to 100% of estimated impairment on the loan. Impairment is determined on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. As of December 31, 2015, none of the Bank's TDRs had a recorded specific reserve.

Following is a summary of past due and non-accrual loans by class as of December 31, 2015 and 2014:

Loans Past Due and Nonaccruals

December 31, 2015 (in thousands)								
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90-Days Past Due and Still Accruing	Nonaccrual Loans
Real Estate								
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 441,309	\$ 441,309	\$ -	\$ -
Construction and land development	-	-	-	-	150,786	150,786	-	-
Residential	-	-	2,538	2,538	92,958	95,496	-	2,538
Commercial	40	-	168	208	94,163	94,371	-	419
Consumer	-	-	-	-	1,203	1,203	-	-
Total	<u>\$ 40</u>	<u>\$ -</u>	<u>\$ 2,706</u>	<u>\$ 2,746</u>	<u>\$ 780,419</u>	<u>\$ 783,165</u>	<u>\$ -</u>	<u>\$ 2,957</u>

December 31, 2014 (in thousands)								
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90-Days Past Due and Still Accruing	Nonaccrual Loans
Real Estate								
Commercial	\$ -	\$ -	\$ 1,287	\$ 1,287	\$ 379,530	\$ 380,817	\$ -	\$ 1,287
Construction and land development	-	-	-	-	140,448	140,448	-	-
Residential	-	-	-	-	80,609	80,609	-	-
Commercial	-	15	403	418	81,086	81,504	-	475
Consumer	-	-	-	-	1,232	1,232	-	-
Total	<u>\$ -</u>	<u>\$ 15</u>	<u>\$ 1,690</u>	<u>\$ 1,705</u>	<u>\$ 682,905</u>	<u>\$ 684,610</u>	<u>\$ -</u>	<u>\$ 1,762</u>

Following is a summary of the Bank's credit quality information for loans by class as of December 31, 2015 and 2014:

December 31, 2015 (in thousands)						
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Real Estate						
Commercial	\$ 439,851	\$ 505	\$ 953	\$ -	\$ -	\$ 441,309
Construction and land development	150,786	-	-	-	-	150,786
Residential	91,494	972	3,030	-	-	95,496
Commercial	93,602	308	253	208	-	94,371
Consumer	1,194	9	-	-	-	1,203
Total	<u>\$ 776,927</u>	<u>\$ 1,794</u>	<u>\$ 4,236</u>	<u>\$ 208</u>	<u>\$ -</u>	<u>\$ 783,165</u>

December 31, 2014 (in thousands)						
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Real Estate						
Commercial	\$ 377,768	\$ 784	\$ 2,265	\$ -	\$ -	\$ 380,817
Construction and land development	140,448	-	-	-	-	140,448
Residential	78,972	1,133	504	-	-	80,609
Commercial	79,635	712	974	183	-	81,504
Consumer	1,220	12	-	-	-	1,232
Total	<u>\$ 678,043</u>	<u>\$ 2,641</u>	<u>\$ 3,743</u>	<u>\$ 183</u>	<u>\$ -</u>	<u>\$ 684,610</u>

Notes to Financial Statements

The Bank assesses credit quality based on internal risk rating of loans. Internal risk rating definitions are:

Pass: These include satisfactory loans which have acceptable levels of risk.

Special Mention: These loans have a potential weakness that requires management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. These credits do not expose the Bank to sufficient risk to warrant further adverse classification.

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. Loans classified as such 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: Loans classified doubtful have all the weaknesses inherent in a substandard asset 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: Loans classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be received in the future.

Note 5. Bank Premises and Equipment

The major classes of bank premises and equipment and the total accumulated depreciation are as follows:

	December 31,	
	2015	2014
(In thousands)		
Leasehold improvements	\$ 2,085	\$ 2,393
Furniture and equipment	3,948	3,602
	\$ 6,033	\$ 5,995
Less accumulated depreciation	(3,343)	(2,954)
Bank premises and equipment, net	<u>\$ 2,690</u>	<u>\$ 3,041</u>

Depreciation expense was \$775 thousand and \$710 thousand for the years ended December 31, 2015 and 2014, respectively.

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Pursuant to the terms of noncancelable lease agreements at December 31, 2015, pertaining to Bank premises and equipment, future minimum rent commitments under various operating leases are as follows:

<i>(In thousands)</i>		
2015	\$	1,301
2016		1,172
2017		1,197
2018		1,108
2019		600
2020 and thereafter		1,935
	\$	<u>7,313</u>

The leases contain options to extend for periods from five to ten years. The cost of such rental is not included above.

Total rent expense amounted to \$1.3 million and \$1.2 million for the years ended December 31, 2015 and 2014, respectively.

Note 6. Income Taxes

The Bank files income tax returns in the U.S. federal jurisdiction, the Commonwealth of Virginia, the District of Columbia and the state of Maryland. With few exceptions, the Bank is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2012.

Net deferred tax assets consist of the following components as of December 31, 2015 and 2014:

<i>(In thousands)</i>		<u>2015</u>	<u>2014</u>
Deferred tax assets:			
Allowance for loan losses	\$	2,448	\$ 2,200
Start-up costs		62	78
Deferred loan fees		481	456
Share-based compensation expense		343	252
Unrealized losses on securities		128	97
Other		85	104
	\$	<u>3,547</u>	<u>\$ 3,187</u>
Deferred tax liabilities:			
Depreciation	\$	29	\$ 89
	\$	<u>29</u>	<u>\$ 89</u>
Net deferred tax assets	\$	<u>3,518</u>	<u>\$ 3,098</u>

Notes to Financial Statements

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

	<u>2015</u>	<u>2014</u>
(In thousands)		
Current tax expense	\$ 5,300	\$ 4,852
Deferred tax (benefit)	<u>(389)</u>	<u>(482)</u>
	<u>\$ 4,911</u>	<u>\$ 4,370</u>

Income tax expense differs from the amount of tax determined by applying the federal income tax rate to pretax income due to the following:

	<u>2015</u>	<u>2014</u>
(In thousands)		
Computed "expected" tax expense	\$ 4,719	\$ 4,249
Increase (decrease) in income taxes resulting from:		
Tax-exempt interest income	(35)	(31)
Share-based compensation	105	66
State income taxes, net of federal benefit	150	111
Other, net	<u>(28)</u>	<u>(25)</u>
	<u>\$ 4,911</u>	<u>\$ 4,370</u>

Note 7. Fund Restrictions and Reserve Balance

The Bank must maintain a reserve against its deposits in accordance with Regulation D of the Federal Reserve Act. For the final weekly reporting period in the years ended December 31, 2015 and 2014, the aggregate amounts of daily average required balances were approximately \$5.8 million and \$3.8 million.

Note 8. Related Party Transactions

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal shareholders, executive 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 others and did not involve more than the normal risk of collectability or present other unfavorable features. At December 31, 2015 and 2014, these loans totaled \$9.2 million and \$7.0 million, respectively. During 2015, total principal additions were \$2.5 million and total principal payments were \$287 thousand. Deposits of directors and executive officers totaled \$25.1 million and \$21.0 million at December 31, 2015 and 2014, respectively.

Note 9. Deposits

The aggregate amount of certificates of deposit with a minimum denomination of \$250,000 was \$141.1 million and \$103.9 million at December 31, 2015 and 2014, respectively.

Notes to Financial Statements

At December 31, 2015, the scheduled maturities of time deposits (including brokered deposits) are as follows:

(In thousands)	
2016	\$ 268,849
2017	46,261
2018	16,689
2019	8,351
2020	1,873
2021	<u>2</u>
	<u>\$ 342,025</u>

At December 31, 2015 and 2014, overdraft demand deposits reclassified to loans totaled \$555 and \$113, respectively. The Bank obtains certain deposits through the efforts of third-party brokers. At December 31, 2015 and 2014, brokered deposits (not including CDARS) totaled \$22.5 million and \$21.3 million respectively, and were included in time deposits on the Bank's balance sheets. At December 31, 2015 and 2014, CDARS deposits totaled \$62.9 million and \$73.4 million, respectively.

At December 31, 2015, one depositor represented \$47.5 million or 6.5% of the Bank's total deposits.

Note 10. Federal Home Loan Bank Advances and Other Borrowings

The Bank has entered into various note agreements with the Federal Home Loan Bank of Atlanta. At December 31, 2015, the Bank had entered into short-term note agreements for \$36.0 million maturing through December 31, 2016 at a weighted average interest rate of 0.65%. The Bank also has \$35.0 million in fixed-rate term borrowings at a weighted rate of 1.30%. These advances mature \$16.0 million in 2017, \$11.0 million in 2018, \$6.0 million in 2019 and \$2.0 million in 2020. These advances are secured by a blanket floating lien on all real estate mortgage loans secured by 1 to 4 family residential properties, unpledged U.S. Government and agencies and mortgage-backed securities and any other real estate related collateral. Total collateral under the blanket lien amounted to approximately \$129.3 million as of December 31, 2015. Total FHLB available borrowing capacity was \$150.1 million at December 31, 2015.

The Bank also has federal funds lines of credit with correspondent banks available for overnight borrowing of \$15.5 million. No amounts were drawn on these lines at December 31, 2015.

Securities sold under agreements to repurchase amounted to \$12.0 million at December 31, 2015, mature on a daily basis and are secured by U.S. government securities. The weighted average interest rate on these agreements was 0.43% at December 31, 2015.

Notes to Financial Statements

Note 11. Other Operating Expenses

Other operating expenses in the statements of income include the following components:

	Years Ended December 31,	
	2015	2014
(In thousands)		
Advertising expense	\$ 450	\$ 432
Data processing	1,142	1,140
FDIC insurance	425	348
Professional fees	528	485
State franchise tax	727	653
Other operating expense	1,495	1,236
Total other operating expenses	<u>\$ 4,767</u>	<u>\$ 4,294</u>

Note 12. Commitments and Contingencies

In the normal course of business, there are outstanding various commitments and contingent liabilities, which are not reflected in the accompanying financial statements. The Bank does not anticipate any material losses as a result of these transactions. See Note 13 with respect to financial instruments with off-balance-sheet risk.

Note 13. Financial Instruments With Off-Balance-Sheet Risk

The Bank is 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 include commitments to extend credit, standby letters of credit and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate 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 Bank has in particular classes of financial instruments. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments.

The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract or notional amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2015 and 2014 is as follows:

	2015	2014
(In thousands)		
Commitments to extend credit	\$ 179,772	\$ 183,429
Standby letters of credit	12,259	13,456

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a

Notes to Financial Statements

case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, income-producing commercial properties, and other real estate properties.

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. Those lines of credit may not be drawn upon to the total extent to which the Company is committed.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Note 14. Fair Value Measurements

Determination of Fair Value

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

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

Fair Value Hierarchy

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

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

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Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on 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 for substantially the full term of the asset or liability.

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

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.

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

Cash and Cash Equivalents and Interest-Bearing Deposits in Banks

The carrying amounts of cash and short-term instruments approximate fair values based on the short-term nature of the assets.

Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

Securities

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data (level 2). If the inputs used to provide the evaluation for certain securities are unobservable and/or there is little, if any, market activity then the security would fall to the lowest level of the hierarchy (level 3).

The Bank's investment portfolio is primarily valued using fair value measurements that are considered to be level 2. The Bank has contracted with a third party portfolio accounting service vendor for valuation of its securities portfolio. The vendor's primary source for security valuation is J.J. Kenny Drake, which evaluates securities based on market data. J.J. Kenny Drake utilizes evaluated pricing models that vary by asset class and include available trade, bid, and other market information. Generally, the methodology includes broker quotes, proprietary models, vast descriptive terms and conditions databases, as well as extensive quality control programs.

The vendor utilizes proprietary valuation matrices for valuing all municipals securities. The initial curves for determining the price, movement, and yield relationships within the municipal matrices are derived from industry benchmark curves or sourced from a municipal trading desk. The securities are further broken down according to issuer, credit support, state of issuance and rating to incorporate additional spreads to the industry benchmark curves.

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Loans

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans, commercial real estate and investment property mortgage loans, and commercial and industrial loans are estimated using discounted cash flow analyses, using market interest rates for comparable loans. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit Liabilities

The fair values disclosed for demand deposits (for example, interest and noninterest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings

The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on current market rates and similar types of borrowing arrangements. Current market rates for debt with similar terms, and remaining maturities are used to estimate fair value of long-term debt. Fair value of long-term debt is based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market. If a quoted market price is not available, an expected present value technique is used to estimate fair value.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Off-Balance Sheet Credit-Related Instruments

Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking in to account the remaining terms of the agreements and the counterparties' credit standing. Those items were deemed immaterial.

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Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below:

<i>(In thousands)</i> Description	Balance	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
Assets:				
U.S. government and federal agencies	\$ 32,145	\$ --	\$ 32,145	\$ --
December 31, 2014				
Assets:				
U.S. government and federal agencies	\$ 13,482	\$ --	\$ 13,482	\$ --

Assets Measured at Fair Value on a Nonrecurring Basis

Under certain circumstances, the Bank makes adjustment to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The following describes the valuation techniques used by the Bank to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Bank's collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Statements of Income.

Other Real Estate Owned: Fair values of other real estate owned ("OREO") are carried at the lower of carrying value or fair value less selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value using observable market data, the Bank records the property as level 2. When an appraised value using observable market data is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable

Notes to Financial Statements

market price, the Bank records the property as level 3 valuation. Any fair value adjustments are recorded in the period incurred and expensed against current earnings. The Bank had no other real estate owned as of December 31, 2015 and 2014.

The following table summarizes the Bank's assets that were measured at fair value on a nonrecurring basis during the period.

		Fair Value Measurements Using			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(In thousands)					
Description	Balance				
December 31, 2015					
Assets:					
Impaired loans, net of valuation allowance	\$ --	\$ --	\$ --	\$ --	\$ --
December 31, 2014					
Assets:					
Impaired loans, net of valuation allowance	\$ 1,872	\$ --	\$ --	\$ --	\$ 1,872

Fair Value Measurements at December 31, 2014				
Fair Value	Valuation Techniques		Unobservable Inputs	Range
(In thousands)				
Commercial Real Estate	\$ 1,872	Present value of future cash flows Value of mortgage insurance coverage	Discount rate at loan interest rate Mortgage guarantee percentage	3.75% 35.00%
	<u>\$ 1,872</u>			

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

Fair Value Measurements at December 31, 2015										
		Quoted Prices in Active Markets for Identical Assets		Significant Other Observable Inputs	Significant Unobservable Inputs	Total Fair Value				
Carrying Value		Level 1		Level 2	Level 3	Balance				
(In Thousands)										
Financial assets:										
Cash and short-term investments	\$	54,955	\$	54,955	\$	--	\$	54,955		
Securities available for sale		32,145		--		32,145		--	32,145	
Securities held to maturity		46,479		--		46,780		--	46,780	
Loans, net		774,633		--		--		777,808	777,808	
Accrued interest receivable		2,318		--		2,318		--	2,318	
Financial liabilities:										
Deposits	\$	730,853	\$	--	\$	732,398	\$	--	\$	732,398
FHLB advances and other debt		82,972		--		83,008		--		83,008
Accrued interest payable		109		--		109		--		109

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Fair Value Measurements at December 31, 2014					
	Carrying Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value Balance
<i>(In Thousands)</i>					
Financial assets:					
Cash and short-term investments	\$ 28,585	\$ 28,585	\$ - -	\$ - -	\$ 28,585
Securities available for sale	13,482	- -	13,482	- -	13,482
Securities held to maturity	49,934	- -	50,499	- -	50,499
Loans, net	676,777	- -	- -	684,293	684,293
Accrued interest receivable	2,168	- -	2,168	- -	2,168
Financial liabilities:					
Deposits	\$ 617,613	\$ - -	\$ 619,501	\$ - -	\$ 619,501
FHLB advances and other debt	64,404	- -	64,513	- -	64,513
Accrued interest payable	132	- -	132	- -	132

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

Note 15. Concentration Risk

The Bank maintains its cash accounts in several correspondent banks. As of December 31, 2015, deposits in excess of amounts insured by the FDIC were insignificant.

Note 16. Share Compensation Plan

The Bank's share based compensation plan, approved by stockholders and effective April 28, 2015 (the "2015 Plan"), provides for the grant of share-based awards in the form of incentive stock options, nonincentive stock options, restricted stock and restricted stock units to directors and employees. The Bank has reserved 460,969 shares of common stock, as adjusted for the 6 for 5 stock split in the form of a 20% dividend paid July 1, 2015, for issuance under the 2015 Plan, which will remain in effect until April 28, 2025. The Bank's Personnel and Compensation Committee administers the 2015 Plan and has the authority to determine the terms and conditions of each award thereunder. To date, options granted under the 2015 Plan vest over five years and expire ten years from the grant date. Under the 2015 Plan, shares may be granted at not less than 100 percent of the fair market value at the grant date. As of December 31, 2015, 94,629 shares are available to grant in future periods under the 2015 Plan. The maximum term for an option award is ten years from the date of grant.

The Bank's previous share based compensation plan, the 2006 Stock Option Plan (the "2006 Plan"), provided for the grant of share-based awards in the form of incentive stock options and nonincentive stock options to directors and employees.. As amended, the 2006 Plan provided for

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awards of up to 1,490,700 shares, as adjusted for the 6 for 5 stock split in the form of a 20% dividend paid July 1, 2015. In April 2015, the Plan was terminated and replaced with the 2015 Plan. Options outstanding prior to April 28, 2015 were granted under the 2006 Plan and shall be subject to the provisions of the 2006 Plan.

A summary of the status of awards under the Bank's share based compensation plans is presented below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at beginning of year ⁽¹⁾	992,679	\$ 7.26	
Granted	375,790	14.72	
Exercised	(50,584)	6.75	
Forfeited	(8,475)	10.24	
Outstanding at end of year	<u>1,309,410</u>	<u>\$ 9.40</u>	<u>\$ 9,624,164</u>
Exercisable at end of year	<u>818,236</u>	<u>\$ 6.99</u>	<u>\$ 7,994,166</u>

Weighted average fair value of options

granted during the year \$ 3.75

⁽¹⁾ Share amounts adjusted for the 6 for 5 stock split in the form of a 20% dividend paid July 1, 2015

The aggregate intrinsic value of stock options in the table above represents the total amount by which the current market value of the underlying stock exceeds the exercise price of the option that would have been received by the Bank had all option holders exercised their options on December 31, 2015. The intrinsic value of options exercised was \$506 thousand in 2015 and \$179 thousand in 2014. This amount changes based on changes in the market value of the Bank's stock. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

Information pertaining to options outstanding at December 31, 2015 is as follows:

Exercise Prices	Options Outstanding		Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Remaining Contractual Life
\$0.00 - \$8.00	878,795	4.80	800,866	4.65
\$8.01 - \$9.00	11,925	7.04	5,430	7.04
\$9.01 - \$10.00	2,250	7.39	900	7.39
\$10.01 - \$11.00	12,000	7.64	4,800	7.64
\$11.01 - \$14.00	--	--	--	--
\$14.01 - 15.00	386,940	9.29	3,540	8.34
\$15.01 - 15.60	17,500	8.73	2,700	8.48
	<u>1,309,410</u>	<u>6.23 years</u>	<u>818,236</u>	<u>4.71 years</u>

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For the years ended December 31, 2015 and 2014, share-based compensation expense applicable to the Bank's share based compensation plans was \$506 thousand and \$358 thousand, respectively.

As of December 31, 2015, unrecognized share-based compensation expense related to nonvested options amounted to \$1.4 million. This amount is expected to be recognized over a weighted-average period of 2.1 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Following are the weighted average assumptions used to value options granted in 2015:

	<u>2015</u>
Dividend yield	0.00%
Expected life	6.20 years
Expected volatility	21.50%
Risk-free interest rate	1.76%

The expected volatility is based on historical volatility of the Bank's stock. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on the average of the contractual life and vesting schedule. The dividend yield assumption is based on the Bank's history and expectation of dividend payouts.

Note 17. Earnings Per Common Share

Earnings per common share was computed based on the following for the years ended December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Weighted average common shares outstanding - basic	9,993,231	9,957,130
Effect of dilutive options	<u>490,200</u>	<u>479,299</u>
Weighted average common shares outstanding used to compute diluted earnings per share	<u><u>10,483,431</u></u>	<u><u>10,436,429</u></u>

Weighted average shares and per share amounts for all periods have been adjusted to reflect a 6 for 5 stock split in the form of a 20% stock dividend declared May 19, 2015 and paid July 1, 2015.

Potential common shares did not impact net income. Options with respect to 309,433 and 31,500 shares, as adjusted to reflect a 6 for 5 stock split in the form of a 20% stock dividend declared May 19, 2015 and paid July 1, 2015, were excluded from the calculation of diluted earnings per share for the years ended December 31, 2015 and 2014, respectively, because their impact would have been anti-dilutive.

Note 18. Minimum Regulatory Capital Requirements

The Bank is 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

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effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Capital amounts and ratios for December 31, 2014 were calculated using Basel I rules, which were effective until January 1, 2015. The Basel III Capital Rules became effective January 1, 2015, subject to phase-in period by January 1, 2019.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), common equity tier 1 ("CET 1") to total risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2015 and 2014, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2015, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the institution must maintain minimum total risk-based, Common Equity Tier 1, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios are also presented in the table.

	Actual		Capital Requirement		Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
As of December 31, 2015:						
Total Capital (to Risk Weighted Assets)	\$ 116,852	13.6%	\$ 68,991	8.0%	\$ 86,239	10.0%
Tier 1 Capital (to Risk Weighted Assets)	\$ 109,549	12.7%	\$ 51,743	6.0%	\$ 68,991	8.0%
CET 1 Capital (to Risk Weighted Assets)	\$ 109,549	12.7%	\$ 38,807	4.5%	\$ 56,055	6.5%
Tier 1 Capital (to Average Assets)	\$ 109,549	12.1%	\$ 36,175	4.0%	\$ 45,219	5.0%
As of December 31, 2014:						
Total Capital (to Risk Weighted Assets)	\$ 106,518	14.0%	\$ 60,759	8.0%	\$ 75,948	10.0%
Tier 1 Capital (to Risk Weighted Assets)	\$ 99,836	13.2%	\$ 30,379	4.0%	\$ 45,569	6.0%
Tier 1 Capital (to Average Assets)	\$ 99,836	13.1%	\$ 30,548	4.0%	\$ 38,185	5.0%

Note 19. Restrictions on Dividends

The Bank is subject to certain restrictions on the amount of dividends that it may pay without prior regulatory approval.

Note 20. 401(k) Plan

Effective August 1, 2006, the Bank adopted a contributory 401(k) savings plan (the "401(k) Plan") covering substantially all employees. Eligible employees may elect to defer a portion of their compensation to the 401(k) Plan. The Board of Directors may elect to match a portion of each

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employee's contribution. Contributions of \$301 thousand were made by the Bank for the years ended December 31, 2015 and no contributions were made by the Bank in 2014.

Note 21. Subsequent Events

The Bank evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Based on the evaluation conducted during the period from the balance sheet date through March 29, 2016, the Bank identified no recognized subsequent events that would have required adjustment to the financial statements. As part of the evaluation the Bank determined there was one nonrecognized subsequent event requiring disclosure in the financial statements. This event was related to information obtained by the Bank on March 6, 2016 in regard to a commercial loan relationship. Based on the Bank's assessment as of March 29, 2016, the Bank determined it was probable that a loss would be sustained in the commercial loan portfolio. The Bank has estimated the range of potential loss to be sustained to be between \$1.9 million and \$2.6 million based on the information available at that time. This event was determined to be an unrecognized subsequent event on the basis that the event did not provide evidence about conditions that existed as of the balance sheet date.

Note 22. Low Income Housing Tax Credit Investments

The Bank has invested in five separate housing equity funds as of December 31, 2015 and four separate housing equity funds as of December 31, 2014. The general purpose of these funds is to encourage and assist participate in investing low-income residential rental properties located in the Commonwealth of Virginia, develop and implement strategies to maintain project as low-income housing, deliver Federal Low Income Housing Credits to investors, allocate tax losses and other possible tax benefits to investors, and to preserve and protect project assets. The investments in these funds were recorded as other assets on the Bank's balance sheets and were \$4.5 million and \$3.7 million at December 31, 2015 and 2014, respectively. The expected terms of these investments and the related tax benefits run through 2033. Tax credits and other tax benefits recognized during the twelve months ended December 31, 2015 and 2014, were \$48 thousand and \$55 thousand, respectively, related to these investments. Additional capital calls expected for the funds totaled \$3.6 and \$3.5 at December 31, 2015 and 2014, respectively, and are included in other liabilities on the Bank's balance sheets.