

Virginia National Bankshares Corp  
Form 10-Q  
August 14, 2015

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

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
For the quarterly period ended June 30, 2015

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **000-55117**

**VIRGINIA NATIONAL BANKSHARES CORPORATION**

(Exact name of registrant as specified in its charter)

**Virginia**  
(State or other jurisdiction of  
incorporation or organization)

**46-2331578**  
(I.R.S. Employer  
Identification No.)

**404 People Place, Charlottesville, Virginia**  
(Address of principal executive offices)

**22911**  
(Zip Code)

**(434) 817-8621**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Yes

No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of August 12, 2015:

| Class of Stock                 | Shares Outstanding |
|--------------------------------|--------------------|
| Common Stock, Par Value \$2.50 | 2,435,874          |

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## VIRGINIA NATIONAL BANKSHARES CORPORATION

## FORM 10-Q

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**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

**VIRGINIA NATIONAL BANKSHARES CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
(dollars in thousands, except share data)

|  | June 30, 2015<br>(UNAUDITED) | December 31, 2014 * |
|--|------------------------------|---------------------|
| <b>ASSETS</b>  |                              |                     |
| Cash and due from banks  | \$ 12,228                    | \$ 12,834           |
| Federal funds sold   | 4,301                        | 41,273              |
| Securities:  |                              |                     |
| Available for sale, at fair value  | 120,158                      | 141,816             |
| Restricted securities, at cost   | 1,586                        | 1,565               |
| Total securities   | 121,744                      | 143,381             |
| Loans  | 367,085                      | 313,254             |
| Allowance for loan losses  | (3,454)                      | (3,164)             |
| Loans, net   | 363,631                      | 310,090             |
| Premises and equipment, net  | 9,138                        | 9,465               |
| Other real estate owned, net of valuation allowance  | 732                          | 1,177               |
| Bank owned life insurance  | 13,251                       | 13,034              |
| Accrued interest receivable and other assets   | 5,407                        | 5,799               |
| Total assets   | \$ 530,432                   | \$ 537,053          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                              |                     |
| <b>Liabilities:</b>  |                              |                     |
| Demand deposits:   |                              |                     |
| Noninterest-bearing  | \$ 160,577                   | \$ 152,107          |
| Interest-bearing   | 81,004                       | 93,208              |
| Money market deposit accounts  | 97,404                       | 94,310              |
| Certificates of deposit and other time deposits  | 118,812                      | 117,094             |
| Total deposits   | 457,797                      | 456,719             |
| Securities sold under agreements to repurchase   | 16,108                       | 17,995              |
| Accrued interest payable and other liabilities   | 1,337                        | 1,707               |
| Total liabilities  | 475,242                      | 476,421             |
| <b>Shareholders' equity:</b>   |                              |                     |
| Preferred stock, \$2.50 par value, 2,000,000<br>shares authorized, no shares outstanding   | -                            | -                   |
| Common stock, \$2.50 par value, 10,000,000<br>shares authorized; 2,435,874 and 2,688,336<br>issued and outstanding at June 30, 2015 and<br>December 31, 2014, respectively | 6,090                        | 6,721               |
| Capital surplus  | 22,750                       | 27,889              |
| Retained earnings  | 26,716                       | 25,978              |
| Accumulated other comprehensive income (loss)  | (366)                        | 44                  |
| Total shareholders' equity   | 55,190                       | 60,632              |
| Total liabilities and shareholders' equity   | \$ 530,432                   | \$ 537,053          |

\*Derived from audited Consolidated Financial Statements

See Notes to Consolidated Financial Statements

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

|   | For the three months ended |               | For the six months ended |               |
|---|----------------------------|---------------|--------------------------|---------------|
|   | June 30, 2015              | June 30, 2014 | June 30, 2015            | June 30, 2014 |
| <b>Interest and dividend income:</b>  |                            |               |                          |               |
| Loans, including fees   | \$ 3,529                   | \$ 3,107      | \$ 6,791                 | \$ 6,296      |
| Federal funds sold  | 6                          | 22            | 29                       | 41            |
| Investment securities:  |                            |               |                          |               |
| Taxable   | 550                        | 526           | 1,132                    | 1,050         |
| Tax exempt  | 109                        | 121           | 225                      | 240           |
| Dividends   | 20                         | 21            | 41                       | 42            |
| Other   | 6                          | 3             | 13                       | 6             |
| <b>Total interest and dividend income</b>                                     | <b>4,220</b>               | <b>3,800</b>  | <b>8,231</b>             | <b>7,675</b>  |
| <b>Interest expense:</b>  |                            |               |                          |               |
| Demand and savings deposits   | 58                         | 49            | 115                      | 99            |
| Certificates and other time deposits  | 171                        | 171           | 338                      | 338           |
| Federal funds purchased and securities sold<br>under agreements to repurchase | 13                         | 9             | 25                       | 18            |
| <b>Total interest expense</b>   | <b>242</b>                 | <b>229</b>    | <b>478</b>               | <b>455</b>    |
| Net interest income   | 3,978                      | 3,571         | 7,753                    | 7,220         |
| Provision for (recovery of) loan losses                                       | -                          | (118)         | 317                      | (118)         |
| Net interest income after provision for<br>(recovery of) loan losses          | 3,978                      | 3,689         | 7,436                    | 7,338         |
| <b>Noninterest income:</b>  |                            |               |                          |               |
| Trust income  | 445                        | 468           | 894                      | 960           |
| Customer service fees   | 233                        | 224           | 467                      | 439           |
| Debit/credit card and ATM fees  | 219                        | 184           | 399                      | 357           |
| Earnings/increase in value of bank owned<br>life insurance                    | 110                        | 109           | 218                      | 216           |
| Gains on sales of securities  | 24                         | 3             | 46                       | 16            |
| Royalty income  | 36                         | 38            | 81                       | 38            |
| Fees on mortgage sales  | 57                         | 9             | 94                       | 9             |
| Other   | 131                        | 115           | 240                      | 192           |
| <b>Total noninterest income</b>   | <b>1,255</b>               | <b>1,150</b>  | <b>2,439</b>             | <b>2,227</b>  |
| <b>Noninterest expense:</b>   |                            |               |                          |               |
| Salaries and employee benefits  | 2,215                      | 2,356         | 4,531                    | 4,592         |
| Net occupancy   | 483                        | 491           | 979                      | 983           |
| Equipment   | 136                        | 121           | 266                      | 267           |
| Other   | 1,341                      | 1,306         | 2,517                    | 2,597         |
| <b>Total noninterest expense</b>  | <b>4,175</b>               | <b>4,274</b>  | <b>8,293</b>             | <b>8,439</b>  |
| Income before income taxes  | 1,058                      | 565           | 1,582                    | 1,126         |
| Provision for income taxes  | 291                        | 120           | 400                      | 175           |
| Net income  | \$ 767                     | \$ 445        | \$ 1,182                 | \$ 951        |
| Earnings per common share, basic  | \$ 0.30                    | \$ 0.16       | \$ 0.45                  | \$ 0.35       |
| Earnings per common share, diluted  | \$ 0.30                    | \$ 0.16       | \$ 0.45                  | \$ 0.35       |

See Notes to Consolidated Financial Statements

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

|  | For the three months ended |               | For the six months ended |               |
|--|----------------------------|---------------|--------------------------|---------------|
|  | June 30, 2015              | June 30, 2014 | June 30, 2015            | June 30, 2014 |
| Net income   | \$ 767                     | \$ 445        | \$ 1,182                 | \$ 951        |
| Other comprehensive income (loss)  |                            |               |                          |               |
| Unrealized gain (loss) on securities,<br>net of tax of (\$576) and (\$196)<br>for the three and six months<br>ended June 30, 2015; and net<br>of tax of \$281 and \$576<br>for the three and six months<br>ended June 30, 2014 | (1,117)                    | 545           | (379)                    | 1,119         |
| Reclassification adjustment<br>net of tax of (\$8) and (\$15)<br>for the three and six months<br>ended June 30, 2015; and net<br>of tax of (\$1) and (\$5) for the<br>three and six months ended<br>June 30, 2014              | (16)                       | (2)           | (31)                     | (11)          |
| Total other comprehensive income (loss)  | (1,133)                    | 543           | (410)                    | 1,108         |
| Total comprehensive income (loss)  | \$ (366)                   | \$ 988        | \$ 772                   | \$ 2,059      |

See Notes to Consolidated Financial Statements

**VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2015 AND 2014**  
(dollars in thousands, except per share data)  
(unaudited)

|   | Common<br>Stock | Capital<br>Surplus | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total            |
|---|-----------------|--------------------|----------------------|--|------------------|
| <b>Balance, December 31, 2013</b>           | \$ 6,725        | \$ 27,915          | \$ 24,747            | \$ (1,431)   | \$ 57,956        |
| Stock option/grant expense                  | -               | 30                 | -                    | -  | 30               |
| Stock options exercised                     | 15              | 98                 | -                    | -  | 113              |
| Cash dividend (\$0.125 per share)           | -               | -                  | (336)                | -  | (336)            |
| Net income                                  | -               | -                  | 951                  | -  | 951              |
| Other comprehensive income                  | -               | -                  | -                    | 1,108  | 1,108            |
| <b>Balance, June 30, 2014</b>               | <b>\$ 6,740</b> | <b>\$ 28,043</b>   | <b>\$ 25,362</b>     | <b>\$ (323)</b>  | <b>\$ 59,822</b> |
| <b>Balance, December 31, 2014</b>           | <b>\$ 6,721</b> | <b>\$ 27,889</b>   | <b>\$ 25,978</b>     | <b>\$ 44</b>   | <b>\$ 60,632</b> |
| Stock options exercised                     | 3               | 20                 | -                    | -  | 23               |
| Stock purchased under stock repurchase plan | (634)           | (5,174)            | -                    | -  | (5,808)          |
| Stock option expense                        | -               | 15                 | -                    | -  | 15               |
| Cash dividend (\$0.175 per share)           | -               | -                  | (444)                | -  | (444)            |
| Net income                                  | -               | -                  | 1,182                | -  | 1,182            |
| Other comprehensive loss                    | -               | -                  | -                    | (410)  | (410)            |
| <b>Balance, June 30, 2015</b>               | <b>\$ 6,090</b> | <b>\$ 22,750</b>   | <b>\$ 26,716</b>     | <b>\$ (366)</b>  | <b>\$ 55,190</b> |

See Notes to Consolidated Financial Statements

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

|   | For the six months ended |                  |
|---|--------------------------|------------------|
|   | June 30, 2015            | June 30, 2014    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                          |                  |
| Net income  | \$ 1,182                 | \$ 951           |
| Adjustments to reconcile net income to net cash provided by operating activities:       |                          |                  |
| Provision for (recovery of) loan losses   | 317                      | (118)            |
| Net amortization and accretion of securities  | 392                      | 353              |
| Net gains on sales of securities  | (46)                     | (16)             |
| Net gains on sales of assets  | -                        | (11)             |
| Earnings/increase in value of bank owned life insurance                                 | (218)                    | (216)            |
| Depreciation and amortization   | 590                      | 577              |
| Stock option/stock grant expense  | 15                       | 30               |
| Writedown of other real estate owned  | -                        | 64               |
| Losses on sales of other real estate owned  | -                        | 9                |
| Decrease in accrued interest receivable and other assets                                | 604                      | 11,095           |
| Decrease in accrued interest payable and other liabilities                              | (370)                    | (7,167)          |
| Net cash provided by operating activities   | 2,466                    | 5,551            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                          |                  |
| Purchases of available for sale securities  | (26,770)                 | (19,179)         |
| Net (increase) decrease in restricted investments                                       | (21)                     | 144              |
| Proceeds from maturities, calls and principal payments of available for sale securities | 31,074                   | 12,643           |
| Proceeds from sales of available for sale securities                                    | 16,387                   | 6,490            |
| Net (increase) decrease in organic loans  | (31,392)                 | 7,433            |
| Net increase in purchased loans   | (22,466)                 | -                |
| Proceeds from sale of other real estate owned   | 445                      | 295              |
| Proceeds from sale of bank premises and equipment                                       | -                        | 11               |
| Purchase of bank premises and equipment   | (263)                    | (354)            |
| Net cash (used in) provided by investing activities                                     | (33,006)                 | 7,483            |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                          |                  |
| Net (decrease) increase in demand deposits, NOW accounts, and money market accounts     | (640)                    | 6,246            |
| Net increase (decrease) in certificates of deposit and other time deposits              | 1,718                    | (1,577)          |
| Net decrease in securities sold under agreements to repurchase                          | (1,887)                  | (5,533)          |
| Common stock repurchased  | (5,808)                  | -                |
| Proceeds from stock options exercised   | 23                       | 113              |
| Cash dividends  | (444)                    | (336)            |
| Net cash used in financing activities   | (7,038)                  | (1,087)          |
| <b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>                             | <b>\$ (37,578)</b>       | <b>\$ 11,947</b> |
| <b>CASH AND CASH EQUIVALENTS:</b>   |                          |                  |
| Beginning of period   | \$ 54,107                | \$ 40,072        |
| End of period   | \$ 16,529                | \$ 52,019        |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>                                |                          |                  |
| Cash payments for:  |                          |                  |
| Interest  | \$ 479                   | \$ 468           |
| Taxes   | \$ 439                   | \$ 2,438         |
| <b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>              |                          |                  |
| Unrealized gain (loss) on available for sale securities                                 | \$ (575)                 | \$ 1,695         |
| Transfer of loans to other real estate owned  | \$ -                     | \$ 244           |

See Notes to Consolidated Financial Statements



**VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**June 30, 2015**

**Note 1. Significant Accounting Policies Basis of Presentation**

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

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

The preparation of financial statements in conformity with GAAP and the reporting guidelines prescribed by regulatory authorities requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred tax assets and other real estate owned. Operating results for the three-month and six-month periods ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

The statements should be read in conjunction with the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2014. If needed, certain previously reported amounts have been reclassified to conform to current period presentation. No such reclassifications were significant.

**Recent Accounting Pronouncements**

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

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

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

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

In May 2015, the FASB issued ASU No. 2015-08, Business Combinations (Topic 805): Pushdown Accounting Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115. The amendments in ASU 2015-08 amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115, Topic 5: Miscellaneous Accounting, regarding various pushdown accounting issues, and did not have a material impact on the Company's consolidated financial statements.

## Note 2. Securities

The amortized cost and fair values of securities available for sale as of June 30, 2015 and December 31, 2014 were as follows (dollars in thousands):

| June 30, 2015                   | Amortized  | Gross Unrealized | Gross Unrealized | Fair       |
|---------------------------------|------------|------------------|------------------|------------|
|                                 | Cost       | Gains            | Losses           | Value      |
| U.S. Government agencies        | \$ 20,703  | \$ 191           | \$ (76)          | \$ 20,818  |
| Corporate bonds                 | 12,258     | -                | (74)             | 12,184     |
| Asset-backed securities         | 2,124      | 4                | (17)             | 2,111      |
| Mortgage-backed securities/CMOs | 62,915     | 197              | (523)            | 62,589     |
| Municipal bonds                 | 22,712     | 94               | (350)            | 22,456     |
|                                 | \$ 120,712 | \$ 486           | \$ (1,040)       | \$ 120,158 |

| December 31, 2014               | Amortized  | Gross Unrealized | Gross Unrealized | Fair       |
|---------------------------------|------------|------------------|------------------|------------|
|                                 | Cost       | Gains            | Losses           | Value      |
| U.S. Government agencies        | \$ 31,189  | \$ 395           | \$ (56)          | \$ 31,528  |
| Corporate bonds                 | 21,373     | 21               | (118)            | 21,276     |
| Asset-backed securities         | 2,133      | -                | (28)             | 2,105      |
| Mortgage-backed securities/CMOs | 63,327     | 297              | (404)            | 63,220     |
| Municipal bonds                 | 23,727     | 157              | (197)            | 23,687     |
|                                 | \$ 141,749 | \$ 870           | \$ (803)         | \$ 141,816 |

Securities having carrying values of \$25.512 million at June 30, 2015 were pledged as collateral to secure public deposits and securities sold under agreements to repurchase. At December 31, 2014, securities having carrying values of \$23.799 million were similarly pledged.

For the six months ended June 30, 2015, proceeds from the sales and calls of securities amounted to \$35.887 million, and net realized gains on these securities were \$46 thousand. For the six months ended June 30, 2014, proceeds from the sales of securities amounted to \$6.490 million, and net realized gains on these securities were \$16 thousand.

Restricted securities are securities with limited marketability and consist of stock in the Federal Reserve Bank of Richmond ( FRB ), the Federal Home Loan Bank of Atlanta ( FHLB ), and CBB Financial Corporation ( CBBFC ), the holding company for Community Bankers Bank, totaling \$1.586 million as of June 30, 2015 and \$1.565 million as of December 31, 2014. These restricted securities are carried at cost.



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The following table summarizes all securities with unrealized losses, segregated by length of time in a continuous unrealized loss position, at June 30, 2015 and December 31, 2014 (dollars in thousands):

**June 30, 2015**

|                          | Less than 12 Months Unrealized |          | 12 Months or more Unrealized |          | Total Unrealized |            |
|--------------------------|--------------------------------|----------|------------------------------|----------|------------------|------------|
|                          | Fair Value                     | Losses   | Fair Value                   | Losses   | Fair Value       | Losses     |
| U.S. Government agencies | \$ 9,933                       | \$ (52)  | \$ 976                       | \$ (24)  | \$ 10,909        | \$ (76)    |
| Corporate bonds          | 12,184                         | (74)     | -                            | -        | 12,184           | (74)       |
| Asset-backed securities  | -                              | -        | 947                          | (17)     | 947              | (17)       |
| Mortgage-backed/CMOs     | 22,776                         | (197)    | 13,287                       | (326)    | 36,063           | (523)      |
| Municipal bonds          | 10,797                         | (256)    | 2,444                        | (94)     | 13,241           | (350)      |
|                          | \$ 55,690                      | \$ (579) | \$ 17,654                    | \$ (461) | \$ 73,344        | \$ (1,040) |

**December 31, 2014**

|                          | Less than 12 Months Unrealized |          | 12 Months or more Unrealized |          | Total Unrealized |          |
|--------------------------|--------------------------------|----------|------------------------------|----------|------------------|----------|
|                          | Fair Value                     | Losses   | Fair Value                   | Losses   | Fair Value       | Losses   |
| U.S. Government agencies | \$ 6,375                       | \$ (21)  | \$ 966                       | \$ (35)  | \$ 7,341         | \$ (56)  |
| Corporate bonds          | 13,213                         | (102)    | 3,032                        | (16)     | 16,245           | (118)    |
| Asset-backed securities  | 98                             | -        | 2,007                        | (28)     | 2,105            | (28)     |
| Mortgage-backed/CMOs     | 6,276                          | (35)     | 25,081                       | (369)    | 31,357           | (404)    |
| Municipal bonds          | 1,769                          | (19)     | 10,330                       | (178)    | 12,099           | (197)    |
|                          | \$ 27,731                      | \$ (177) | \$ 41,416                    | \$ (626) | \$ 69,147        | \$ (803) |

As of June 30, 2015, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of its amortized cost basis. As of June 30, 2015, there were \$73.344 million, or 76 issues of individual securities in a loss position. These securities have an unrealized loss of \$1.040 million and consisted of 30 mortgage-backed/CMOs, 28 municipal bonds, 11 corporate bonds, and 7 other security issues.

The Company's securities portfolio is primarily made up of fixed rate bonds, whose prices move inversely with interest rates. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. At the end of any accounting period, the portfolio may have both unrealized gains and losses. Management does not believe any of the securities in an unrealized loss position are impaired due to credit quality. Accordingly, as of June 30, 2015, management believes the impairments detailed in the table above are temporary, and no impairment loss has been realized in the Company's consolidated income statement.

An other-than-temporary impairment ( OTTI ) is considered to exist if any of the following conditions are met: it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, or the Company does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). In the event that a security would suffer impairment for a reason that was other than temporary, the Company would be expected to write down the security's value to its new fair value, and the amount of the write down would be included in earnings as a realized loss. As of June 30, 2015, management has concluded that none of its investment securities have an OTTI based upon the information available at this time. Additionally, management has the ability to hold any security with an unrealized loss until maturity or until such time as the value of the security has recovered from its unrealized loss position.

**Note 3. Loans**

The composition of the loan portfolio by loan classification at June 30, 2015 and December 31, 2014 appears below (dollars in thousands).

|  | June 30,<br>2015 | December 31,<br>2014 |
|--|------------------|----------------------|
| <b>Commercial</b>                        |                  |                      |
| Commercial and industrial - organic      | \$ 50,336        | \$ 46,125            |
| Commercial and industrial - syndicated   | 26,489           | 14,815               |
| Total commercial and industrial          | 76,825           | 60,940               |
| <b>Real estate construction and land</b> |                  |                      |
| Residential construction                 | 1,032            | 337                  |
| Other construction and land              | 14,994           | 11,575               |
| Total construction and land              | 16,026           | 11,912               |
| <b>Real estate mortgages</b>             |                  |                      |
| 1-4 family residential                   | 61,594           | 60,162               |
| Home equity lines of credit              | 26,564           | 25,498               |
| Multifamily                              | 20,544           | 26,462               |
| Commercial owner occupied                | 55,364           | 60,868               |
| Commercial non-owner occupied            | 85,100           | 54,012               |
| Total real estate mortgage               | 249,166          | 227,002              |
| <b>Consumer</b>                          |                  |                      |
| Consumer revolving credit                | 5,656            | 3,428                |
| Consumer all other credit                | 8,620            | 9,972                |
| Student loans purchased                  | 10,792           | -                    |
| Total consumer                           | 25,068           | 13,400               |
| Total loans                              | 367,085          | 313,254              |
| Less: Allowance for loan losses          | (3,454)          | (3,164)              |
| Net loans                                | \$ 363,631       | \$ 310,090           |

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

Generally, loans are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other non-accrual loans is recognized only to the extent of interest payments received.

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

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Following is a breakdown by class of the loans classified as impaired loans as of June 30, 2015 and December 31, 2014. These loans are reported at their recorded investment, which is the carrying amount of the loan as reflected on the Company's balance sheet, net of charge-offs and other amounts applied to reduce the net book balance. Average recorded investment in impaired loans is computed using an average of month-end balances for these loans for either the six months ended June 30, 2015 or the twelve months ended December 31, 2014. Interest income recognized is for the six months ended June 30, 2015 or the twelve months ended December 31, 2014. (Dollars below reported in thousands.)

**June 30, 2015**

|   | Recorded Investment | Unpaid Principal Balance | Associated Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---------------------|--------------------------|----------------------|-----------------------------|----------------------------|
| Impaired loans without a valuation allowance: |                     |                          |                      |                             |                            |
| Other construction and land                   | \$ 64               | \$ 106                   | \$ -                 | \$ 66                       | \$ -                       |
| 1-4 family residential mortgages              | 691                 | 712                      | -                    | 867                         | 15                         |
| Commercial non-owner occupied real estate     | 1,082               | 1,082                    | -                    | 1,091                       | 23                         |
| Impaired loans with a valuation allowance     | -                   | -                        | -                    | -                           | -                          |
| Total impaired loans                          | \$ 1,837            | \$ 1,900                 | \$ -                 | \$ 2,024                    | \$ 38                      |

**December 31, 2014**

|   | Recorded Investment | Unpaid Principal Balance | Associated Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---------------------|--------------------------|----------------------|-----------------------------|----------------------------|
| Impaired loans without a valuation allowance: |                     |                          |                      |                             |                            |
| Other construction and land                   | \$ 69               | \$ 109                   | \$ -                 | \$ 79                       | \$ 1                       |
| 1-4 family residential mortgages              | 525                 | 545                      | -                    | 437                         | 16                         |
| Home equity lines of credits                  | -                   | -                        | -                    | 50                          | 3                          |
| Commercial owner occupied real estate         | 1,103               | 1,103                    | -                    | 1,124                       | 60                         |
| Commercial non-owner occupied real estate     | -                   | -                        | -                    | 46                          | -                          |
| Impaired loans with a valuation allowance     | -                   | -                        | -                    | -                           | -                          |
| Total impaired loans                          | \$ 1,697            | \$ 1,757                 | \$ -                 | \$ 1,736                    | \$ 80                      |

Non-accrual loans are shown below by class (dollars in thousands):

|                                  | June 30, 2015 | December 31, 2014 |
|----------------------------------|---------------|-------------------|
| Other construction and land      | \$ 64         | \$ 69             |
| 1-4 family residential mortgages | 141           | 149               |
| Total nonaccrual loans           | \$ 205        | \$ 218            |

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

**Troubled debt restructuring (TDRs)**

|   | June 30, 2015 |                     | December 31, 2014 |                     |
|---|---------------|---------------------|-------------------|---------------------|
|   | No. of Loans  | Recorded Investment | No. of Loans      | Recorded Investment |
| Performing TDRs                           |               |                     |                   |                     |
| 1-4 family residential mortgages          | 3             | \$ 550              | 2                 | \$ 376              |
| Commercial non-owner occupied real estate | 1             | 1,082               | 1                 | 1,103               |
| Total performing TDRs                     | 4             | \$ 1,632            | 3                 | \$ 1,479            |
| Nonperforming TDRs                        |               |                     |                   |                     |
| Other construction and land               | 1             | \$ 37               | 1                 | \$ 39               |
| Total TDRs                                | 5             | \$ 1,669            | 4                 | \$ 1,518            |





A summary of loans that were modified under the terms of a TDR during the six months ended June 30, 2015 and 2014 is shown below by class. The Post-Modification Recorded Balance reflects the period end balances, inclusive of all partial principal pay downs and principal charge-offs since the modification date. Loans modified as TDRs that were fully paid down, charged-off, or foreclosed upon by period end are not reported. (Dollars below reported in thousands.)

| Loans modified at below market rates<br>and interest only term | During six months ended<br>June 30, 2015 |                                     |                                     | During six months ended<br>June 30, 2014 |                                     |                                     |
|--|--|-------------------------------------|-------------------------------------|--|-------------------------------------|-------------------------------------|
|  | Number<br>of<br>Loans                    | Pre-                                | Post-                               | Number<br>of<br>Loans                    | Pre-                                | Post-                               |
|  |  | Modification<br>Recorded<br>Balance | Modification<br>Recorded<br>Balance |  | Modification<br>Recorded<br>Balance | Modification<br>Recorded<br>Balance |
| 1-4 family residential mortgage                                | 1  | \$ 179                              | \$ 179                              | -  | \$ -                                | \$ -                                |
| Total loans modified during the period                         | 1  | \$ 179                              | \$ 179                              | -  | \$ -                                | \$ -                                |

There were no loans modified as TDRs that subsequently defaulted during the six months ended June 30, 2015 and 2014 that were modified as TDRs during the twelve months prior to default.

There were no loans secured by 1-4 family residential property that were in the process of foreclosure at either June 30, 2015 or December 31, 2014. The one property that had previously been transferred to Other Real Estate Owned consisted of a 1-4 family residential property and was reported net of valuation allowance at \$732 thousand at June 30, 2015 and \$1.177 million at December 31, 2014. A portion of the property was sold during the second quarter of 2015 accounting for the decrease in the amount carried.

**Note 4. Allowance for Loan Losses**

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

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Within these segments, the Company has sub-segmented its portfolio by classes within the segments, based on the associated risks within these classes.

**Loan Classes by Segments**

Commercial loan segment:

- Commercial and industrial - organic
- Commercial and industrial - syndicated

Real estate construction and land loan segment:

- Residential construction
- Other construction and land

Real estate mortgage loan segment:

- 1-4 family residential
- Home equity lines of credit
- Multifamily
- Commercial owner occupied
- Commercial non-owner occupied

Consumer loan segment:

- Consumer revolving credit
- Consumer all other credit

Student loans purchased

Based on the internal risk ratings assigned to each credit, a historical loss factor is assigned to the balances for each class of loans, using a cumulative historical loss rate for the most recent twelve quarters. The Company's internal creditworthiness grading system is based on experiences with similarly graded loans. Higher risk-rated credits are reviewed quarterly by experienced senior lenders based on each borrower's situation. Additionally, internal monitoring and review of credits is conducted on an annual basis and a percentage of the loan portfolio is reviewed by an external loan review group.

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

### **Risk Ratings And Historical Loss Factor Applied**

#### **Excellent**

0% applied, as these loans are secured by cash and represent a minimal risk. The Company has never experienced a loss within this category.

#### **Good**

0% applied, as these loans represent a low risk and are either secured by marketable securities within margin, or in the case of the student loans purchased, are fully guaranteed by a surety bond purchased by the Company. The Company has never experienced a loss within this category.

#### **Pass**

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

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

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

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

**Watch** acceptable risk loans which require more attention than normal servicing

#### **Special Mention**

These potential problem loans are currently protected but are potentially weak. Historical loss factor for loans rated **special mention** is applied to current balances of like-rated loans pooled by class.

#### **Substandard**

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

#### **Doubtful**

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

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The following represents the loan portfolio designated by the internal risk ratings assigned to each credit as of June 30, 2015 and December 31, 2014 (dollars in thousands).

| <b>June 30, 2015</b>                   | Excellent     | Good             | Pass              | Special<br>Mention | Sub-<br>standard | Doubtful    | TOTAL             |
|--|---------------|------------------|-------------------|--------------------|------------------|-------------|-------------------|
| <b>Commercial</b>                      |               |                  |                   |                    |                  |             |                   |
| Commercial and industrial - organic    | \$ 620        | \$ 31,542        | \$ 18,001         | \$ -               | \$ 173           | \$ -        | \$ 50,336         |
| Commercial and industrial - syndicated | -             | -                | 23,511            | -                  | 2,978            | -           | 26,489            |
| <b>Real estate construction</b>        |               |                  |                   |                    |                  |             |                   |
| Residential construction               | -             | -                | 1,032             | -                  | -                | -           | 1,032             |
| Other construction and land            | -             | -                | 14,345            | -                  | 649              | -           | 14,994            |
| <b>Real estate mortgages</b>           |               |                  |                   |                    |                  |             |                   |
| 1-4 family residential                 | -             | 1,897            | 57,923            | 865                | 909              | -           | 61,594            |
| Home equity lines of credit            | -             | -                | 26,482            | -                  | 82               | -           | 26,564            |
| Multifamily                            | -             | -                | 20,544            | -                  | -                | -           | 20,544            |
| Commercial owner occupied              | -             | -                | 54,239            | -                  | 1,125            | -           | 55,364            |
| Commercial non-owner occupied          | -             | -                | 84,018            | 1,082              | -                | -           | 85,100            |
| <b>Consumer</b>                        |               |                  |                   |                    |                  |             |                   |
| Consumer revolving credit              | 66            | 5,103            | 481               | -                  | 6                | -           | 5,656             |
| Consumer all other credit              | 267           | 6,670            | 1,639             | -                  | 44               | -           | 8,620             |
| Student loans purchased                | -             | 10,792           | -                 | -                  | -                | -           | 10,792            |
| <b>Total Loans</b>                     | <b>\$ 953</b> | <b>\$ 56,004</b> | <b>\$ 302,215</b> | <b>\$ 1,947</b>    | <b>\$ 5,966</b>  | <b>\$ -</b> | <b>\$ 367,085</b> |

| <b>December 31, 2014</b>               | Excellent       | Good             | Pass              | Special<br>Mention | Sub-<br>standard | Doubtful    | TOTAL             |
|--|-----------------|------------------|-------------------|--------------------|------------------|-------------|-------------------|
| <b>Commercial</b>                      |                 |                  |                   |                    |                  |             |                   |
| Commercial and industrial - organic    | \$ 3,579        | \$ 23,261        | \$ 18,487         | \$ 64              | \$ 734           | \$ -        | \$ 46,125         |
| Commercial and industrial - syndicated | -               | -                | 14,815            | -                  | -                | -           | 14,815            |
| <b>Real estate construction</b>        |                 |                  |                   |                    |                  |             |                   |
| Residential construction               | -               | -                | 337               | -                  | -                | -           | 337               |
| Other construction and land            | -               | -                | 10,903            | 507                | 165              | -           | 11,575            |
| <b>Real estate mortgages</b>           |                 |                  |                   |                    |                  |             |                   |
| 1-4 family residential                 | -               | 1,910            | 56,968            | 455                | 829              | -           | 60,162            |
| Home equity lines of credit            | -               | -                | 25,411            | -                  | 87               | -           | 25,498            |
| Multifamily                            | -               | -                | 26,462            | -                  | -                | -           | 26,462            |
| Commercial owner occupied              | -               | -                | 58,890            | -                  | 1,978            | -           | 60,868            |
| Commercial non-owner occupied          | -               | -                | 54,012            | -                  | -                | -           | 54,012            |
| <b>Consumer</b>                        |                 |                  |                   |                    |                  |             |                   |
| Consumer revolving credit              | 34              | 3,054            | 332               | -                  | 8                | -           | 3,428             |
| Consumer all other credit              | 200             | 7,856            | 1,867             | -                  | 49               | -           | 9,972             |
| <b>Total Loans</b>                     | <b>\$ 3,813</b> | <b>\$ 36,081</b> | <b>\$ 268,484</b> | <b>\$ 1,026</b>    | <b>\$ 3,850</b>  | <b>\$ -</b> | <b>\$ 313,254</b> |

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

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

8) Changes in the level of policy exceptions

It has been the Company's experience that the first four factors drive losses to a much greater extent than the last four factors; therefore, the first four factors are weighted more heavily. Although the markets served by the Company remain stronger than the national economy as a whole, management continues to pay close attention on a case-by-case basis for any yet unforeseen potential ripple effects of the housing downturn and the related financial market fallout.

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Like the historical factors, qualitative factors are not assessed against loans rated excellent or rated good, since these are fully collateralized by cash or readily marketable securities or, in the case of the student loans purchased, are fully guaranteed by a surety bond purchased by the Company.

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

Impaired loans are individually evaluated and, if deemed appropriate, a specific allocation is made for these loans. In reviewing the seven loans in the amount of \$1.837 million classified as impaired loans at June 30, 2015, there was no specific valuation allowance on any of these loans after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the borrower.

A summary of the transactions in the Allowance for Loan Losses by loan portfolio segment for the six months ended June 30, 2015 and the year ended December 31, 2014 appears below (dollars in thousands):

**As of and for the period ended June 30, 2015**

|   | Commercial<br>Loans | Real Estate<br>Construction and<br>Land | Real Estate<br>Mortgages | Consumer<br>Loans | Total      |
|---|---------------------|---|--------------------------|-------------------|------------|
| <b>Allowance for Loan Losses:</b>       |                     |   |                          |                   |            |
| Balance as of December 31, 2014         | \$ 674              | \$ 102                                  | \$ 2,360                 | \$ 28             | \$ 3,164   |
| Charge-offs                             | (85)                | -                                       | -                        | (3)               | (88)       |
| Recoveries                              | 15                  | -                                       | 46                       | -                 | 61         |
| Provision for (recovery of) loan losses | 234                 | 22                                      | 66                       | (5)               | 317        |
| Ending Balance                          | \$ 838              | \$ 124                                  | \$ 2,472                 | \$ 20             | \$ 3,454   |
| <b>Ending Balance:</b>                  |                     |   |                          |                   |            |
| Individually evaluated for impairment   | \$ -                | \$ -                                    | \$ -                     | \$ -              | \$ -       |
| Collectively evaluated for impairment   | 838                 | 124                                     | 2,472                    | 20                | 3,454      |
| <b>Loans:</b>                           |                     |   |                          |                   |            |
| Individually evaluated for impairment   | \$ -                | \$ 64                                   | \$ 1,773                 | \$ -              | \$ 1,837   |
| Collectively evaluated for impairment   | 76,825              | 15,962                                  | 247,393                  | 25,068            | 365,248    |
| Ending Balance                          | \$ 76,825           | \$ 16,026                               | \$ 249,166               | \$ 25,068         | \$ 367,085 |

**As of and for the year ended December 31, 2014**

|   | Commercial<br>Loans | Real Estate<br>Construction and<br>Land | Real Estate<br>Mortgages | Consumer<br>Loans | Total      |
|---|---------------------|---|--------------------------|-------------------|------------|
| <b>Allowance for Loan Losses:</b>       |                     |   |                          |                   |            |
| Balance as of December 31, 2013         | \$ 340              | \$ 198                                  | \$ 2,788                 | \$ 34             | \$ 3,360   |
| Charge-offs                             | (286)               | -                                       | (262)                    | (3)               | (551)      |
| Recoveries                              | 32                  | -                                       | 10                       | 7                 | 49         |
| Provision for (recovery of) loan losses | 588                 | (96)                                    | (176)                    | (10)              | 306        |
| Ending Balance                          | \$ 674              | \$ 102                                  | \$ 2,360                 | \$ 28             | \$ 3,164   |
| <b>Ending Balance:</b>                  |                     |   |                          |                   |            |
| Individually evaluated for impairment   | \$ -                | \$ -                                    | \$ -                     | \$ -              | \$ -       |
| Collectively evaluated for impairment   | 674                 | 102                                     | 2,360                    | 28                | 3,164      |
| <b>Loans:</b>                           |                     |   |                          |                   |            |
| Individually evaluated for impairment   | \$ -                | \$ 69                                   | \$ 1,628                 | \$ -              | \$ 1,697   |
| Collectively evaluated for impairment   | 60,940              | 11,843                                  | 225,374                  | 13,400            | 311,557    |
| Ending Balance                          | \$ 60,940           | \$ 11,912                               | \$ 227,002               | \$ 13,400         | \$ 313,254 |



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

The following tables show the aging of past due loans as of June 30, 2015 and December 31, 2014. Also included are loans that are 90 or more days past due but still accruing, because they are well secured and in the process of collection. The loans classified as nonaccrual totaling \$205 thousand and \$218 thousand, respectively, as of June 30, 2015 and December 31, 2014 were all current and reported as such in the table below. (Dollars below reported in thousands.)

| Past Due Aging as of                   | 30-59<br>Days<br>Past | 60-89<br>Days<br>Past | 90<br>Days<br>or<br>More<br>Past | Total<br>Past | Current           | Total<br>Loans    | 90   |
|--|-----------------------|-----------------------|----------------------------------|---------------|-------------------|-------------------|--|
|  |                       |                       |                                  |               |                   |                   | Days<br>Past Due<br>and<br>Still<br>Accruing |
| <b>June 30, 2015</b>                   |                       |                       |                                  |               |                   |                   |  |
| Commercial loans                       |                       |                       |                                  |               |                   |                   |  |
| Commercial and industrial - organic    | \$ -                  | \$ 72                 | \$ -                             | \$ 72         | \$ 50,264         | \$ 50,336         | \$ -   |
| Commercial and industrial - syndicated | -                     | -                     | -                                | -             | 26,489            | 26,489            | -  |
| Real estate construction and land      |                       |                       |                                  |               |                   |                   |  |
| Residential construction               | -                     | -                     | -                                | -             | 1,032             | 1,032             | -  |
| Other construction and land            | -                     | -                     | -                                | -             | 14,994            | 14,994            | -  |
| Real estate mortgages                  |                       |                       |                                  |               |                   |                   |  |
| 1-4 family residential                 | 83                    | 23                    | -                                | 106           | 61,488            | 61,594            | -  |
| Home equity lines of credit            | 13                    | -                     | -                                | 13            | 26,551            | 26,564            | -  |
| Multifamily                            | -                     | -                     | -                                | -             | 20,544            | 20,544            | -  |
| Commercial owner occupied              | -                     | -                     | -                                | -             | 55,364            | 55,364            | -  |
| Commercial non-owner occupied          | -                     | -                     | -                                | -             | 85,100            | 85,100            | -  |
| Consumer loans                         |                       |                       |                                  |               |                   |                   |  |
| Consumer revolving credit              | -                     | -                     | -                                | -             | 5,656             | 5,656             | -  |
| Consumer all other credit              | 3                     | -                     | -                                | 3             | 8,617             | 8,620             | -  |
| Student loans purchased                | -                     | -                     | -                                | -             | 10,792            | 10,792            | -  |
| <b>Total Loans</b>                     | <b>\$ 99</b>          | <b>\$ 95</b>          | <b>\$ -</b>                      | <b>\$ 194</b> | <b>\$ 366,891</b> | <b>\$ 367,085</b> | <b>\$ -</b>                                  |

| Past Due Aging as of                   | 30-59<br>Days<br>Past | 60-89<br>Days<br>Past | 90<br>Days<br>or<br>More<br>Past | Total<br>Past | Current           | Total<br>Loans    | 90   |
|--|-----------------------|-----------------------|----------------------------------|---------------|-------------------|-------------------|--|
|  |                       |                       |                                  |               |                   |                   | Days<br>Past Due<br>and<br>Still<br>Accruing |
| <b>December 31, 2014</b>               |                       |                       |                                  |               |                   |                   |  |
| Commercial loans                       |                       |                       |                                  |               |                   |                   |  |
| Commercial and industrial - organic    | \$ 6                  | \$ -                  | \$ -                             | \$ 6          | \$ 46,119         | \$ 46,125         | \$ -   |
| Commercial and industrial - syndicated | -                     | -                     | -                                | -             | 14,815            | 14,815            | -  |
| Real estate construction and land      |                       |                       |                                  |               |                   |                   |  |
| Residential construction               | -                     | -                     | -                                | -             | 337               | 337               | -  |
| Other construction and land            | -                     | -                     | -                                | -             | 11,575            | 11,575            | -  |
| Real estate mortgages                  |                       |                       |                                  |               |                   |                   |  |
| 1-4 family residential                 | -                     | 24                    | -                                | 24            | 60,138            | 60,162            | -  |
| Home equity lines of credit            | -                     | -                     | -                                | -             | 25,498            | 25,498            | -  |
| Multifamily                            | -                     | -                     | -                                | -             | 26,462            | 26,462            | -  |
| Commercial owner occupied              | -                     | -                     | -                                | -             | 60,868            | 60,868            | -  |
| Commercial non-owner occupied          | -                     | -                     | -                                | -             | 54,012            | 54,012            | -  |
| Consumer loans                         |                       |                       |                                  |               |                   |                   |  |
| Consumer revolving credit              | 1                     | -                     | -                                | 1             | 3,427             | 3,428             | -  |
| Consumer all other credit              | 12                    | 30                    | -                                | 42            | 9,930             | 9,972             | -  |
| <b>Total Loans</b>                     | <b>\$ 19</b>          | <b>\$ 54</b>          | <b>\$ -</b>                      | <b>\$ 73</b>  | <b>\$ 313,181</b> | <b>\$ 313,254</b> | <b>\$ -</b>                                  |





**Note 5. Earnings Per Share**

On September 22, 2014, the Company announced the approval by its Board of Directors of a stock repurchase program authorizing repurchase of up to 400,000 shares of the Company's common shares through September 18, 2015. During the second quarter of 2015, the Company purchased 252,907 shares of its common stock at a weighted average price of \$22.90 per share. A total of 265,212 shares at a weighted average price of \$22.89 per share have been repurchased since the beginning of the program.

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock for the three months and six months ended June 30, 2015 and 2014. Potential dilutive common stock has no effect on income available to common shareholders.

| Three Months Ended               | June 30, 2015 |           |         | June 30, 2014 |           |         |
|----------------------------------|---------------|-----------|---------|---------------|-----------|---------|
|                                  | Net           | Weighted  | Per     | Net           | Weighted  | Per     |
| (dollars in thousands, except    | Income        | Average   | Share   | Income        | Average   | Share   |
| share and per share data)        |               | Shares    | Amount  |               | Shares    | Amount  |
| Basic earnings per share         | \$ 767        | 2,577,424 | \$ 0.30 | \$ 445        | 2,695,386 | \$ 0.16 |
| Effect of dilutive stock options | -             | 9,357     | -       | -             | 10,968    | -       |
| Diluted earnings per share       | \$ 767        | 2,586,781 | \$ 0.30 | \$ 445        | 2,706,354 | \$ 0.16 |

| Six Months Ended                 | June 30, 2015 |           |         | June 30, 2014 |           |         |
|----------------------------------|---------------|-----------|---------|---------------|-----------|---------|
|                                  | Net           | Weighted  | Per     | Net           | Weighted  | Per     |
| (dollars in thousands, except    | Income        | Average   | Share   | Income        | Average   | Share   |
| share and per share data)        |               | Shares    | Amount  |               | Shares    | Amount  |
| Basic earnings per share         | \$ 1,182      | 2,632,605 | \$ 0.45 | \$ 951        | 2,692,867 | \$ 0.35 |
| Effect of dilutive stock options | -             | 9,510     | -       | -             | 8,834     | -       |
| Diluted earnings per share       | \$ 1,182      | 2,642,115 | \$ 0.45 | \$ 951        | 2,701,701 | \$ 0.35 |

For the period ended June 30, 2015, 134,654 option shares were considered anti-dilutive, and were excluded from this calculation. For the period ended June 30, 2014, 142,708 option shares were considered anti-dilutive.

**Note 6. Stock Compensation Plans**

At the Annual Shareholders Meeting on May 21, 2014, shareholders approved the Virginia National Bankshares Corporation 2014 Stock Incentive Plan ( 2014 Plan ). The 2014 Plan makes available up to 250,000 shares of the Company's common stock to be issued to plan participants. Similar to the Virginia National Bank 1998 Stock Incentive Plan ( 1998 Plan ), 2003 Stock Incentive Plan ( 2003 Plan ), and 2005 Stock Incentive Plan ( 2005 Plan ), the 2014 Plan provides for granting of both incentive and nonqualified stock options, as well as restricted stock and other stock based awards. The 2005 Plan expired on December 20, 2014. No new grants will be issued under the 1998 Plan, the 2003 Plan, or the 2005 Plan as all three plans have expired.

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

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A summary of the shares issued and available under each of the Plans is shown below as of June 30, 2015:

|  | 1998 Plan | 2003 Plan          | 2005 Plan          | 2014 Plan |
|--|-----------|--------------------|--------------------|-----------|
| Aggregate shares issuable                            | 430,100   | 128,369            | 230,000            | 250,000   |
| Options issued, net of forfeited and expired options | (379,939) | (108,054)          | (144,097)          | -         |
| Cancelled due to Plan expiration                     | (50,161)  | (20,315)           | (85,903)           | -         |
| Remaining available for grant                        | -         | -                  | -                  | 250,000   |
| <b>Grants issued and outstanding:</b>                |           |                    |                    |           |
| Total vested and unvested shares                     | -         | 30,214             | 141,454            | -         |
| Fully vested shares                                  | -         | 30,214             | 135,204            | -         |
| Exercise price range                                 | N/A       | \$15.65 to \$18.26 | \$11.74 to \$36.74 | N/A       |

The Company accounts for all of its stock incentive plans under recognition and measurement accounting principles which require that the compensation cost relating to stock-based payment transactions be recognized in the financial statements. Stock-based compensation arrangements include stock options and restricted stock. All stock-based payments to employees are required to be valued using a fair value method on the date of grant and expensed based on that fair value over the applicable vesting period. For the six months ended June 30, 2015 and 2014, the Company recognized \$15 thousand and \$28 thousand, respectively, in compensation expense for stock options, and for the six months ended June 30, 2014, an additional \$2 thousand was recognized in compensation expense for restricted stock grants. As of June 30, 2015, there was \$50 thousand in unamortized compensation expense remaining to be recognized in future reporting periods through 2017.

### Stock Options

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

|                                      | Number of Options | June 30, 2015                   |                           |
|--------------------------------------|-------------------|---------------------------------|---------------------------|
|                                      |                   | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| Outstanding at January 1, 2015       | 180,796           | \$ 25.86                        | \$ 271                    |
| Forfeited                            | (7,878)           | 24.47                           | -                         |
| Exercised                            | (1,250)           | 18.10                           | -                         |
| Outstanding at June 30, 2015         | 171,668           | \$ 25.98                        | \$ 238                    |
| Options exercisable at June 30, 2015 | 165,418           | \$ 26.32                        | \$ 204                    |

The fair value of any grant is estimated at the grant date using the Black-Scholes pricing model. There were no stock option grants during the first or second quarters of 2015, and there were stock option grants of 5,000 shares during the first quarter of 2014.

Summary information pertaining to options outstanding at June 30, 2015 is as follows:

| Exercise Price    | Options Outstanding |   |                                 | Options Exercisable |                                 |  |
|-------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|--|
|                   | Number of Options   | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number of Options   | Weighted-Average Exercise Price |  |
| \$ 11.74 to 20.00 | 45,764              | 5.0 Years                                   | \$ 17.17                        | 39,514              | \$ 17.22                        |  |
| \$ 20.01 to 30.00 | 59,664              | 2.7 Years                                   | 24.82                           | 59,664              | 24.82                           |  |
| \$ 30.01 to 36.74 | 66,240              | 0.9 Years                                   | 33.10                           | 66,240              | 33.10                           |  |
| Total             | 171,668             | 2.6 Years                                   | \$ 25.98                        | 165,418             | \$ 26.32                        |  |

### Restricted Stock

The restricted stock that had been outstanding as of June 30, 2014 was fully vested in November 2014. No restricted stock grants were awarded during 2014 or the first six months of 2015.

### Note 7. Fair Value Measurements

#### Determination of Fair Value

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

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

#### Fair Value Hierarchy

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

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

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

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

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

### Securities available for sale

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

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The following tables present the balances measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014 (dollars in thousands):

| <b>Fair Value Measurements at June 30, 2015<br/>Using:</b> |                   |   |   |  |
|--|-------------------|---|---|--|
| <b>Description</b>   | Balance           | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br><br>Observable<br>Inputs<br>(Level 2) | Significant<br><br>Unobservable<br>Inputs<br>(Level 3) |
|  |                   | <b>Assets:</b>  |   |  |
| U.S. Government agencies                                   | \$ 20,818         | \$ -  | \$ 20,818   | \$ -   |
| Corporate bonds  | 12,184            | -   | 12,184  | -  |
| Asset-backed securities                                    | 2,111             | -   | 2,111   | -  |
| Mortgage-backed securities/CMOs                            | 62,589            | -   | 62,589  | -  |
| Municipal bonds  | 22,456            | -   | 22,456  | -  |
| <b>Total securities available for sale</b>                 | <b>\$ 120,158</b> | <b>\$ -</b>   | <b>\$ 120,158</b>   | <b>\$ -</b>  |

| <b>Fair Value Measurements at December 31,<br/>2014 Using:</b> |                   |   |   |  |
|--|-------------------|---|---|--|
| <b>Description</b>   | Balance           | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br><br>Observable<br>Inputs<br>(Level 2) | Significant<br><br>Unobservable<br>Inputs<br>(Level 3) |
|  |                   | <b>Assets:</b>  |   |  |
| U.S. Government agencies                                       | \$ 31,528         | \$ -  | \$ 31,528   | \$ -   |
| Corporate bonds  | 21,276            | -   | 21,276  | -  |
| Asset-backed securities  | 2,105             | -   | 2,105   | -  |
| Mortgage-backed securities/CMOs                                | 63,220            | -   | 63,220  | -  |
| Municipal bonds  | 23,687            | -   | 23,687  | -  |
| <b>Total securities available for sale</b>                     | <b>\$ 141,816</b> | <b>\$ -</b>   | <b>\$ 141,816</b>   | <b>\$ -</b>  |

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

Impaired Loans

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



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

Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. The Company had \$1.837 million and \$1.697 million in impaired loans as of June 30, 2015 and December 31, 2014, respectively. None of these impaired loans required a valuation allowance after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

Other Real Estate Owned

Other real estate owned ( OREO ) is measured at fair value less cost to sell, based on an appraisal conducted by an independent, licensed appraiser outside of the Company. If the collateral value is significantly adjusted due to differences in the comparable properties, or is discounted by the Company because of marketability, then the fair value is considered Level 3. OREO is measured at fair value on a nonrecurring basis. Any initial fair value adjustment is charged against the Allowance for Loan Losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest expense on the Consolidated Statements of Income.

The following table presents the Company's assets that were measured at fair value on a nonrecurring basis as of June 30, 2015 and December 31, 2014 (dollars in thousands):

| Description             | Balance | Fair Value Measurements at June 30, 2015 Using:                |   |   |
|-------------------------|---------|--|---|---|
|                         |         | Quoted Prices in Active Markets for Identical Assets (Level 1) | Other Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets:                 |         |  |   |   |
| Other Real Estate Owned | \$ 732  | \$ -   | \$ -  | \$ 732                                    |

| Description             | Balance  | Fair Value Measurements at December 31, 2014 Using:            |   |   |
|-------------------------|----------|--|---|---|
|                         |          | Quoted Prices in Active Markets for Identical Assets (Level 1) | Other Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets:                 |          |  |   |   |
| Other Real Estate Owned | \$ 1,177 | \$ -   | \$ -  | \$ 1,177                                  |

For the assets measured at fair value on a nonrecurring basis as of June 30, 2015, the following table displays quantitative information about Level 3 Fair Value Measurements (dollars in thousands):

| Description | Valuation Technique | Unobservable Inputs | Weighted Average |
|-------------|---------------------|---------------------|------------------|
|-------------|---------------------|---------------------|------------------|



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Fair  
Value

Assets:

---

|                         |    |     |                    |  |      |
|-------------------------|----|-----|--------------------|--|------|
| Other Real Estate Owned | \$ | 732 | Market comparables | Discount applied to market comparables * | 6.0% |
|-------------------------|----|-----|--------------------|--|------|

\*A discount percentage is applied based on age of independent appraisals, current market conditions, and cost to sell. ASC 825, Financial Instruments, requires disclosures about fair value of financial instruments for interim periods and excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

**Cash and cash equivalents**

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

**Securities**

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

**Loans**

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

**Bank owned life insurance**

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

**Accrued interest**

The carrying amounts of accrued interest approximate fair value.

**Deposit liabilities**

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

**Securities sold under agreements to repurchase**

The carrying amounts of securities sold under agreements to repurchase approximate fair value.

**Off-balance sheet financial instruments**

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

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The carrying values and estimated fair values of the Company's financial instruments as of June 30, 2015 and December 31, 2014 are as follows (dollars in thousands):

Fair Value Measurement at June 30, 2015 using:

|  | Carrying value | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | Fair Value |
|--|----------------|--|-------------------------------------|---------------------------------|------------|
|  |                | Level 1  | Level 2                             | Level 3                         |            |
| <b>Assets</b>  |                |  |                                     |                                 |            |
| Cash and cash equivalent   | \$ 16,529      | \$ 16,529  | \$ -                                | \$ -                            | \$ 16,529  |
| Available for sale securities  | 120,158        | -  | 120,158                             | -                               | 120,158    |
| Loans, net   | 363,631        | -  | -                                   | 364,139                         | 364,139    |
| Bank owned life insurance  | 13,251         | -  | 13,251                              | -                               | 13,251     |
| Accrued interest receivable  | 1,307          | -  | 531                                 | 776                             | 1,307      |
| <b>Liabilities</b>   |                |  |                                     |                                 |            |
| Demand deposits and interest-bearing transaction and money market accounts | \$ 338,985     | \$ -   | \$ 338,985                          | \$ -                            | \$ 338,985 |
| Certificates of deposit  | 118,812        | -  | 118,835                             | -                               | 118,835    |
| Securities sold under agreements to repurchase                             | 16,108         | -  | 16,108                              | -                               | 16,108     |
| Accrued interest payable   | 116            | -  | 116                                 | -                               | 116        |

Fair Value Measurement at December 31, 2014 using:

|  | Carrying value | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | Fair Value |
|--|----------------|--|-------------------------------------|---------------------------------|------------|
|  |                | Level 1  | Level 2                             | Level 3                         |            |
| <b>Assets</b>  |                |  |                                     |                                 |            |
| Cash and cash equivalent   | \$ 54,107      | \$ 54,107  | \$ -                                | \$ -                            | \$ 54,107  |
| Available for sale securities  | 141,816        | -  | 141,816                             | -                               | 141,816    |
| Loans, net   | 310,090        | -  | -                                   | 310,806                         | 310,806    |
| Bank owned life insurance  | 13,034         | -  | 13,034                              | -                               | 13,034     |
| Accrued interest receivable  | 1,296          | -  | 566                                 | 730                             | 1,296      |
| <b>Liabilities</b>   |                |  |                                     |                                 |            |
| Demand deposits and interest-bearing transaction and money market accounts | \$ 339,625     | \$ -   | \$ 339,625                          | \$ -                            | \$ 339,625 |
| Certificates of deposit  | 117,094        | -  | 117,189                             | -                               | 117,189    |
| Securities sold under agreements to repurchase                             | 17,995         | -  | 17,995                              | -                               | 17,995     |
| Accrued interest payable   | 117            | -  | 117                                 | -                               | 117        |

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk; however, borrowers with fixed rate obligations are less likely to prepay in a

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rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

**Note 8. Other Comprehensive Income**

A component of the Company's other comprehensive income, in addition to net income from operations, is the recognition of the unrealized gains and losses on available for sale securities, net of income taxes. Reclassifications of realized gains and losses on available for sale securities are reported in the income statement as Gains on sales of securities with the corresponding income tax effect reflected as a component of income tax expense. Amounts reclassified out of accumulated other comprehensive income are presented below for the three and six months ended June 30, 2015 and 2014 (dollars in thousands):

|                                       | Three Months Ended |               | Six Months Ended |               |
|---------------------------------------|--------------------|---------------|------------------|---------------|
|                                       | June 30, 2015      | June 30, 2014 | June 30, 2015    | June 30, 2014 |
| Available for sale securities         |                    |               |                  |               |
| Realized gains on sales of securities | \$ 24              | \$ 3          | \$ 46            | \$ 16         |
| Tax effect                            | (8)                | (1)           | (15)             | (5)           |
| Realized gains, net of tax            | \$ 16              | \$ 2          | \$ 31            | \$ 11         |

**Note 9. Segment Reporting**

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

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

VNB Wealth services include investment management, trust and estate administration, custody services, and financial planning. Fees for these services are charged on a fixed basis and a performance basis. A management fee for administrative and technology support services provided by the Bank is charged to VNB Wealth. For the six months ended June 30, 2015 and June 30, 2014, management fees of \$68 thousand and \$125 thousand, respectively, were charged to VNB Wealth and eliminated in consolidated totals. The VNB Wealth total assets as shown in the following tables represent the assets of VNB Wealth and should not be confused with client assets under management.

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

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Segment information for the three and six months ended June 30, 2015 and 2014 is shown in the following tables (dollars in thousands):

| <b>Three months ended June 30, 2015</b> | Bank       | VNB Wealth | Consolidated |
|---|------------|------------|--------------|
| Net interest income                     | \$ 3,971   | \$ 7       | \$ 3,978     |
| Provision for loan losses               | -          | -          | -            |
| Noninterest income                      | 774        | 481        | 1,255        |
| Noninterest expense                     | 3,413      | 762        | 4,175        |
| Income (loss) before income taxes       | 1,332      | (274)      | 1,058        |
| Provision for (benefit of) income taxes | 383        | (92)       | 291          |
| Net income (loss)                       | \$ 949     | \$ (182)   | \$ 767       |
| Total assets                            | \$ 520,442 | \$ 9,990   | \$ 530,432   |

| <b>Three months ended June 30, 2014</b> | Bank       | VNB Wealth | Consolidated |
|---|------------|------------|--------------|
| Net interest income                     | \$ 3,563   | \$ 8       | \$ 3,571     |
| Provision for (recovery of) loan losses | (118)      | -          | (118)        |
| Noninterest income                      | 622        | 528        | 1,150        |
| Noninterest expense                     | 3,542      | 732        | 4,274        |
| Income (loss) before income taxes       | 761        | (196)      | 565          |
| Provision for (benefit of) income taxes | 185        | (65)       | 120          |
| Net income (loss)                       | \$ 576     | \$ (131)   | \$ 445       |
| Total assets                            | \$ 496,954 | \$ 9,938   | \$ 506,892   |

| <b>Six months ended June 30, 2015</b>   | Bank     | VNB Wealth | Consolidated |
|---|----------|------------|--------------|
| Net interest income                     | \$ 7,740 | \$ 13      | \$ 7,753     |
| Provision for loan losses               | 317      | -          | 317          |
| Noninterest income                      | 1,464    | 975        | 2,439        |
| Noninterest expense                     | 6,795    | 1,498      | 8,293        |
| Income (loss) before income taxes       | 2,092    | (510)      | 1,582        |
| Provision for (benefit of) income taxes | 571      | (171)      | 400          |
| Net income (loss)                       | \$ 1,521 | \$ (339)   | \$ 1,182     |

| <b>Six months ended June 30, 2014</b>   | Bank     | VNB Wealth | Consolidated |
|---|----------|------------|--------------|
| Net interest income                     | \$ 7,201 | \$ 19      | \$ 7,220     |
| Provision for (recovery of) loan losses | (118)    | -          | (118)        |
| Noninterest income                      | 1,207    | 1,020      | 2,227        |
| Noninterest expense                     | 7,095    | 1,344      | 8,439        |
| Income (loss) before income taxes       | 1,431    | (305)      | 1,126        |
| Provision for (benefit of) income taxes | 277      | (102)      | 175          |
| Net income (loss)                       | \$ 1,154 | \$ (203)   | \$ 951       |

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

The following discussion should be read in conjunction with Virginia National Bankshares Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2014, included in the Company's 2014 Form 10-K. Operating results for the three and six months ended June 30, 2015 are not necessarily indicative of the results for the year ending December 31, 2015 or any future period.

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

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

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

### **APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

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

For additional information regarding critical accounting policies, refer to the Application of Critical Accounting Policies and Critical Accounting Estimates section under Item 7 in the 2014 Form 10-K. There have been no significant changes in the Company's application of critical accounting policies related to the allowance for loan losses since December 31, 2014.

### **FINANCIAL CONDITION**

Total assets

The total assets of the Company as of June 30, 2015 were \$530.4 million. This is a \$6.7 million decrease from the \$537.1 million total assets reported at December 31, 2014 and a \$23.5 million increase from the \$506.9 million reported at June 30, 2014. The balance sheet decrease reported in the first six months of 2015 is primarily attributable to the Company's success with its stock repurchase program approved during the third quarter of 2014, which authorized the purchase of up to 400,000 shares of the Company's common stock. During the first and second quarters of 2015, shares totaling 805 and 252,907, respectively, were repurchased for a total of approximately \$5.8 million. A total of 265,212 shares have been purchased since the beginning of this program. Future purchases may be made as part of an overall capital strategy when they are deemed advantageous compared to other available alternatives.



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### Federal funds sold

The Company had overnight federal funds sold of \$4.3 million at June 30, 2015, compared to \$41.3 million at December 31, 2014. At June 30, 2014, the Company had overnight federal funds sold of \$37.4 million. The decrease in federal funds sold is attributable to both the cash paid for the repurchase of common stock as discussed above and the deployment of the excess funds into higher yielding loans as discussed below.

The Company continues to participate in the Federal Reserve Bank of Richmond's Excess Balance Account (EBA). The EBA is a limited-purpose account at the Federal Reserve Bank for the maintenance of excess cash balances held by financial institutions. The Federal Reserve Bank requires the Company to have its participation in the EBA program managed by a pass-through correspondent bank. The Company's pass-through correspondent is Community Bankers Bank of Midlothian, Virginia. The EBA eliminates the potential of concentration risk that comes with depositing excess balances with one or multiple correspondent banks. Balances on deposit in the EBA are considered to be on deposit with the Federal Reserve Bank, with the correspondent bank acting as agent. Balances in the EBA cannot be used to satisfy reserve balance requirements or contractual clearing agreements with the Federal Reserve Bank.

### Securities

The Company's investment securities portfolio as of June 30, 2015 totaled \$121.7 million, a decrease of \$21.7 million from the \$143.4 million reported at December 31, 2014 and a decrease of \$14.2 million from the \$135.9 million reported at June 30, 2014. Management is focused on maximizing the earning capacity of the Company's excess liquidity. As loan funding needs have increased over the past three quarters, lower earning securities have been called or sold during the first half of 2015 and deployed to these higher earning assets. At June 30, 2015, the investment securities holdings represented 22.9% of the Company's total assets, a decrease from the 26.7% and 26.8% of total assets at December 31, 2014 and June 30, 2014, respectively.

The Company's investment securities portfolio included restricted securities totaling \$1.6 million as of June 30, 2015 and December 31, 2014. These securities represent stock in the Federal Reserve Bank of Richmond (FRB-R), the Federal Home Loan Bank of Atlanta (FHLB-A), and CBB Financial Corporation (CBBFC), the holding company for Community Bankers Bank. The level of FRB-R and FHLB-A stock that the Company is required to hold is determined in accordance with membership guidelines provided by the Federal Reserve Bank Board of Governors or the Federal Home Loan Bank of Atlanta. Stock ownership in the bank holding company for Community Bankers Bank provides the Bank with several benefits that are not available to non-shareholder correspondent banks. None of these restricted securities are traded on the open market and can only be redeemed by the respective issuer.

At June 30, 2015, the unrestricted securities portfolio totaled \$120.2 million. The following table summarizes the Company's available for sale securities by type as of June 30, 2015 and December 31, 2014 (dollars in thousands):

|                                     | June 30,<br>2015 | Percent<br>of Total | December<br>31, 2014 | Percent<br>of Total |
|-------------------------------------|------------------|---------------------|----------------------|---------------------|
|                                     | Balance          |                     | Balance              |                     |
| U.S. Government agencies            | \$ 20,818        | 17.32%              | \$ 31,528            | 22.23%              |
| Corporate bonds                     | 12,184           | 10.14%              | 21,276               | 15.00%              |
| Asset-backed securities             | 2,111            | 1.76%               | 2,105                | 1.49%               |
| Mortgage-backed securities          | 62,589           | 52.09%              | 63,220               | 44.58%              |
| Municipal bonds                     | 22,456           | 18.69%              | 23,687               | 16.70%              |
| Total available for sale securities | \$ 120,158       | 100.00%             | \$ 141,816           | 100.00%             |

The Company has no direct exposure to subprime mortgages. The Company does not hold private mortgage-backed securities, credit default swaps, or FNMA or FHLMC preferred stock investments in its investment portfolio.

### Loan portfolio

A management objective is to grow loan balances while maintaining the asset quality of the loan portfolio. The Company seeks to achieve this objective by maintaining rigorous underwriting standards coupled with regular evaluation of the creditworthiness of and the designation of lending limits for each borrower. The portfolio strategies include seeking industry and loan size diversification in order to minimize credit exposure and originating loans in markets with which the Company is familiar. The predominant market

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area for loans is Charlottesville, Albemarle County, Orange County, Winchester, Frederick County, Fauquier County and adjacent counties.

As of June 30, 2015, total loans were \$367.1 million, an increase of \$53.8 million or 17.2% from the balance of \$313.3 million as of December 31, 2014 and an increase of \$74.8 million or 25.6% from the \$292.3 million at June 30, 2014. Loans as a percentage of total assets at June 30, 2015 were 69.2%, an improvement over the 57.7% ratio as of June 30, 2014. Loans as a percentage of deposits at June 30, 2015 were 80.2%, a 19.3% improvement over the 67.2% ratio as of the year prior.

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The Company has experienced three sequential quarters of significant expansion in total loans due to purchases of \$27.0 million in syndicated loans and \$10.8 million in student loans, along with approximately \$37.0 million in net organic loan growth since June 30, 2014. The purchase of loans is considered a secondary strategy, which allows the Company to supplement organic loan growth and enhance earnings. Syndicated loans represent shared national credits in leveraged lending transactions and are included in the commercial and industrial portfolio. The Company has developed policies to limit overall credit exposure to the syndicated market as a whole and to each borrower. The package of student loans totaling \$10.8 million was purchased on the last day of the second quarter of 2015; therefore, the resulting interest income from this purchase will begin to be realized in the third quarter of 2015. Along with the purchase of these student loans, the Company purchased a surety bond that fully guarantees this portion of the Company's consumer portfolio.

The following table summarizes the Company's loan portfolio by type of loan as of June 30, 2015, December 31, 2014, and June 30, 2014 (dollars in thousands):

|                                    | June 30,<br>2015 | Percent<br>of Total | December<br>31, 2014 | Percent<br>of Total | June 30,<br>2014 | Percent<br>of Total |
|------------------------------------|------------------|---------------------|----------------------|---------------------|------------------|---------------------|
|                                    | Balance          |                     | Balance              |                     | Balance          |                     |
| Commercial and industrial          | \$ 76,825        | 20.9%               | \$ 60,940            | 19.5%               | \$ 51,371        | 17.6%               |
| Real estate - commercial           | 161,008          | 43.9%               | 141,342              | 45.1%               | 134,067          | 45.9%               |
| Real estate - residential mortgage | 88,158           | 24.0%               | 85,660               | 27.3%               | 80,974           | 27.7%               |
| Real estate - construction         | 16,026           | 4.4%                | 11,912               | 3.8%                | 14,025           | 4.8%                |
| Consumer installment and other     | 25,068           | 6.8%                | 13,400               | 4.3%                | 11,835           | 4.0%                |
| Total loans                        | \$ 367,085       | 100.0%              | \$ 313,254           | 100.0%              | \$ 292,272       | 100.0%              |

### Loan quality

Nonaccrual loans remained low and totaled \$205 thousand at June 30, 2015, fairly level with the \$218 thousand reported at December 31, 2014 and down \$290 thousand or 58.6% compared to \$495 thousand at June 30, 2014.

At June 30, 2015, the Company had seven loans in the amount of \$1.8 million classified as impaired loans. Of this total, \$1.6 million were Troubled Debt Restructurings (TDRs) which are still accruing interest. The Company had no loans past due ninety or more days and still accruing interest in its portfolio as of June 30, 2015.

At December 31, 2014, the Company had loans in the amount of \$1.7 million classified as impaired loans. Of this total, \$1.5 million were TDRs which are still accruing interest. The Company had no loans past due ninety or more days and still accruing interest in its portfolio as of the end of 2014.

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

### Allowance for loan losses

The allowance for loan losses as a percentage of total loans at June 30, 2015 was 0.94% compared to 1.01% at December 31, 2014 and 1.08% at June 30, 2014.

The following is a summary of the changes in the allowance for loan losses for the six months ended June 30, 2015 and June 30, 2014 (dollars in thousands):

|   | 2015     | 2014     |
|---|----------|----------|
| Allowance for loan losses, January 1    | \$ 3,164 | \$ 3,360 |
| Chargeoffs                              | (88)     | (110)    |
| Recoveries                              | 61       | 25       |
| Provision for (recovery of) loan losses | 317      | (118)    |
| Allowance for loan losses, June 30      | \$ 3,454 | \$ 3,157 |

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Net loan charge-offs for the first six months of 2015 totaled \$27 thousand, compared to net charge-offs totaling \$85 thousand during the first six months of 2014. A provision for loan losses amounting to \$317 thousand was recorded during the first quarter of 2015, with no provision recorded during the second quarter of 2015. During the first six months of 2014, a recovery of provision for loan losses amounting to \$118 thousand was recorded.

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The relationship of the allowance for loan losses to total loans at June 30, 2015, December 31, 2014, and June 30, 2014 appears below (dollars in thousands):

|  | June 30,<br>2015 | December<br>31,<br>2014 | June 30,<br>2014 |
|--|------------------|-------------------------|------------------|
| Loans held for investment at period-end    | \$ 367,085       | \$ 313,254              | \$ 292,272       |
| Allowance for loan losses                  | \$ 3,454         | \$ 3,164                | \$ 3,157         |
| Allowance as a percent of period-end loans | 0.94%            | 1.01%                   | 1.08%            |

As discussed above, a package of student loans totaling \$10.8 million was purchased on June 30, 2015. Along with the purchase of these loans, the Company purchased a surety bond that fully guarantees this portfolio; therefore, no allowance was reserved for this portion of total loans. Additionally, the decreased balance in the allowance relative to total loans compared to the prior periods is reflective of the continued improvement in the underlying credit quality factors used in measuring inherent risk within the loan portfolio.

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

- National and local economic trends;
- Underlying collateral values;
- Loan delinquency status and trends;
- Loan risk classifications;
- Industry concentrations;
- Lending policies;
- Experience, ability and depth of lending staff; and
- Levels of policy exceptions

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

Management reviews the adequacy of the Allowance for Loan Losses on a quarterly basis to ensure it is adequate based upon the calculated potential losses inherent in the portfolio. Management believes the allowance for loan losses was adequately provided for as of June 30, 2015.

### Premises and equipment

The Company's premises and equipment, net of depreciation, as of June 30, 2015 totaled \$9.1 million compared to the December 31, 2014 amount of \$9.5 million. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method based on the estimated useful lives of assets. Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, assets and related accumulated depreciation are removed from the books, and any resulting gain or

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loss is charged to income.

As of June 30, 2015, the Company and its subsidiaries occupied seven full-service banking facilities in the cities of Charlottesville and Winchester, as well as the counties of Albemarle and Orange in Virginia. The Bank also had a loan production office in Warrenton, Virginia.

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

The Arlington Boulevard and People Place facilities also contain office space that is currently under lease to tenants.

Deposits and securities sold under agreement to repurchase

Depository accounts represent the Company's primary source of funds and are comprised of demand deposits, interest-bearing checking accounts, money market deposit accounts and time deposits. These deposits have been provided predominantly by individuals, professionals and small businesses in the Charlottesville/Albemarle area, the Orange County area, and the Winchester area. Total deposits as of June 30, 2015 were \$457.8 million, relatively level with the balances of \$456.7 million at December 31, 2014. In comparing total deposits as of a year ago, balances as of June 30, 2015 are \$22.7 million higher than the \$435.1 million total as of June 30, 2014.

Securities sold under agreement to repurchase are available to non-individual accountholders on an overnight term through the Company's investment sweep product. Total balances in securities sold under agreement to repurchase as of June 30, 2015 were \$16.1 million, compared to \$18.0 million at December 31, 2014 and \$10.8 million as of June 30, 2014.

Noninterest-bearing demand deposits on June 30, 2015 were \$160.6 million, representing 35.1% of total deposits. Interest-bearing transaction and money market accounts totaled \$178.4 million, and represented 38.9% of total deposits at June 30, 2015. Collectively, noninterest-bearing and interest-bearing transaction and money market accounts represented 74.0% and 74.4% of total deposit accounts at June 30, 2015 and December 31, 2014, respectively. These account types are an excellent source of low-cost funding for the Company.

Certificates of deposit and other time deposit accounts totaled \$118.8 million at June 30, 2015 and \$117.1 million at December 31, 2014. Included in this deposit total are Certificate of Deposit Account Registry Service CDs, known as CDARS™, whereby depositors can obtain FDIC deposit insurance on account balances of up to \$50 million. CDARS deposits totaled \$16.0 million as of June 30, 2015, compared to \$18.7 million at December 31, 2014.

Deposit accounts

| (dollars in thousands)                                | June 30, 2015     |                     | December 31, 2014 |                     | June 30, 2014     |                     |
|---|-------------------|---------------------|-------------------|---------------------|-------------------|---------------------|
|   | Balance           | % of Total Deposits | Balance           | % of Total Deposits | Balance           | % of Total Deposits |
| <b>No cost and low cost deposits</b>                  |                   |                     |                   |                     |                   |                     |
| Noninterest demand deposits                           | \$ 160,577        | 35.1%               | \$ 152,107        | 33.3%               | \$ 141,061        | 32.4%               |
| Interest checking accounts                            | 81,004            | 17.7%               | 93,208            | 20.4%               | 82,272            | 18.9%               |
| Money market deposit accounts                         | 97,404            | 21.2%               | 94,310            | 20.7%               | 89,211            | 20.5%               |
| Total noninterest and low cost deposit accounts       | \$ 338,985        | 74.0%               | \$ 339,625        | 74.4%               | \$ 312,544        | 71.8%               |
| <b>Time deposit accounts</b>                          |                   |                     |                   |                     |                   |                     |
| Certificates of deposit                               | \$ 102,792        | 22.5%               | \$ 98,401         | 21.5%               | \$ 96,964         | 22.3%               |
| CDARS deposits  | 16,020            | 3.5%                | 18,693            | 4.1%                | 25,621            | 5.9%                |
| Total certificates of deposit and other time deposits | \$ 118,812        | 26.0%               | \$ 117,094        | 25.6%               | \$ 122,585        | 28.2%               |
| <b>Total deposit account balances</b>                 | <b>\$ 457,797</b> | <b>100.0%</b>       | <b>\$ 456,719</b> | <b>100.0%</b>       | <b>\$ 435,129</b> | <b>100.0%</b>       |

Securities sold under agreements to repurchase

| (dollars in thousands)                         | June 30, 2015<br>Balance | December 31,<br>2014<br>Balance | June 30,<br>2014<br>Balance |
|--|--------------------------|---------------------------------|-----------------------------|
| Securities sold under agreements to repurchase | \$ 16,108                | \$ 17,995                       | \$ 10,764                   |

Shareholders' equity and regulatory capital ratios

The following table displays the changes in shareholders' equity for the Company from December 31, 2014 to June 30, 2015 (dollars in thousands):

|   |           |
|---|-----------|
| Equity, December 31, 2014                               | \$ 60,632 |
| Net income  | 1,182     |
| Change in accumulated other comprehensive income (loss) | (410)     |
| Cash dividends paid                                     | (444)     |
| Stock purchased under stock repurchase plan             | (5,808)   |
| Stock options exercised                                 | 23        |
| Equity increase due to expensing of stock options       | 15        |
| Equity, June 30, 2015                                   | \$55,190  |

Effective January 1, 2015, the final rules adopted by the federal bank regulatory agencies to implement the Basel III regulatory capital rules require the Company and its subsidiaries to comply with the following new minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6% of risk-weighted assets (increased from the prior requirement of 4%); (iii) a total capital ratio of 8% of risk-weighted assets (unchanged from the prior requirement); and (iv) a leverage ratio of 4% of total assets (unchanged from the prior requirement). These are the initial capital requirements, which are currently in effect. Beginning January 1, 2016 a capital conservation buffer requirement will be phased in over a four-year period, beginning at 0.625% of risk-weighted assets and increasing to 2.5% at January 1, 2019. For additional information regarding the new capital requirements, refer to the Supervision and Regulation section, under Item 1. Business, found in the Company's Form 10-K Report for December 31, 2014.

Using the new capital requirements, the Company's capital ratios remain well above the levels designated by bank regulators as "well capitalized" at June 30, 2015. Under the current risk-based capital guidelines of federal regulatory authorities, the Company has a Tier 1 capital ratio of 13.85% of its risk-weighted assets and a total capital ratio of 14.71% of its risk-weighted assets. Both are well in excess of the minimum capital requirements of 6.00% and 8.00%, respectively. Additionally, the Company has a leverage ratio of 10.24% of total assets, which is well in excess of the minimum 5.00% level designated by bank regulators under well capitalized capital guidelines.

Stock repurchase program

On September 22, 2014, the Company issued a press release and filed a Form 8-K with the Securities and Exchange Commission to announce the approval by its Board of Directors of a stock repurchase program authorizing repurchase of up to 400,000 shares of the Company's common shares through the open market or in privately negotiated transactions. The repurchase program is authorized through September 18, 2015. As of June 30, 2015, the Company had repurchased 265,212 shares under this program.

**RESULTS OF OPERATIONS**Net income

Net income for the three months ended June 30, 2015 was \$767 thousand compared to the \$445 thousand reported for the three months ended June 30, 2014. Earnings per share (basic and diluted) were \$0.30 per share for the quarter ended June 30, 2015 compared to \$0.16 per share for the same quarter in the prior year. The \$322 thousand increase in net income for the second quarter of 2015 when compared to the same period of 2014 is attributable to an increase in net interest income of \$407 thousand, an increase in noninterest income of \$105 thousand, and a decrease in noninterest expenses of \$99 thousand, partially offset by an increase of \$118 thousand in the provision for loan losses and an increase of \$171 thousand in the provision for income taxes.

Net income for the first six months of 2015 was \$1.182 million, or 24.3% higher than the reported net income of \$951 thousand during the same period in 2014. Earnings per share (basic and diluted) for the first half of 2015 was \$0.45 per share, or \$0.10 higher than the \$0.35 per share reported in the first half of 2014. The \$231 thousand increase in net income during the first six months of 2015 from the first six months of 2014 is attributable to several positive factors, including an increase of \$533 thousand in net interest income, a \$212 thousand increase in noninterest income, and a decrease of \$146 thousand in noninterest expense. Partially offsetting the net increase was an increase of \$435 thousand in provision for loan losses and an increase of \$225 thousand in provision for income taxes.





Net interest income

Net interest income for the three months ended June 30, 2015 was \$3.978 million, a \$407 thousand increase compared to net interest income of \$3.571 million for the three months ended June 30, 2014. Net interest income is computed as the difference between the interest income on earning assets and the interest expense on deposits and other interest-bearing liabilities. Net interest income represents the principal source of revenue for the Company.

Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates, together with the volume and mix of earning assets and interest-bearing liabilities, impact net interest income and net interest margin. The net interest margin of 3.18% for the three months ended June 30, 2015 was 21 basis points higher than the net interest margin of 2.97% from the quarter ended December 31, 2014 and eight basis points higher than the quarter ended June 30, 2014. On a year to date basis, the net interest margin of 3.09% as of June 30, 2015 was 5 basis points below the 3.14% reported for the first six months of 2014.

Total interest income of \$4.220 million for the quarter ended June 30, 2015 was \$420 thousand higher than the \$3.800 million earned in the same quarter of 2014. Total interest income was positively impacted due to the increase in average earning assets, especially in the loan portfolio growth. For the quarter ended June 30, 2015, average earning assets were \$509.2 million or \$38.8 million higher than the \$470.4 million in average earning assets for the second quarter of 2014. Average loan balances were \$57.0 million higher in the quarter ended June 30, 2015 than the same quarter in 2014, while the average balances in all other earning assets contracted by \$18.2 million. The improvement in the earnings mix resulted in an earning asset yield, adjusted to a tax equivalent basis, for the three months ended June 30, 2015 of 3.37% or 8 basis points above the tax equivalent earning asset yield of 3.29% for the three months ended June 30, 2014.

The loan yield for the second quarter of 2015 was 4.05% or 21 basis points lower than the 4.26% loan yield for the same period in 2014. Loan yields contracted due to lower rates on new production in the protracted low interest rate environment combined with pay-offs of higher interest loans. The decrease in loan rates lowered interest income by \$159 thousand for the three months ended June 30, 2015, compared to the same quarter a year ago. However, the volume increase in loans accounted for an increase of \$581 thousand, resulting in an additional \$422 thousand in interest income on loans for the three months ended June 30, 2015 compared to the same quarter a year ago.

Interest expense of \$242 thousand for the three months ended June 30, 2015 was fairly level with \$229 thousand for the three months ended June 30, 2014. The increase in noninterest-bearing deposit balances resulted in the interest expense as a percentage of average earning assets of 0.19% for the current quarter. The Company's net interest income continues to benefit from having one of the lowest cost of funds among community banks in the country. A table showing the mix of no cost and low cost deposit accounts is shown under Financial Condition - Deposits and securities sold under agreement to repurchase earlier in this report.

For the six months ended June 30, 2015, the Company recorded \$7.753 million in net interest income, or 7.4% more than the \$7.220 million recorded for the same six months a year ago. Total interest income was \$556 thousand higher than the prior year, which was slightly offset by an increase in interest expense of \$23 thousand to account for the \$533 thousand increase in net interest income. The Bank's tax-equivalent net interest margin for the first half of 2015 was 3.09% or 5 basis points lower than the 3.14% reported for the same period in 2014.

The earning asset yield, as computed on a tax-equivalent basis, was 3.28% on average earning asset balances of \$513.4 million for the six months ended June 30, 2015. On average, loan balances and investment securities were 65.5% and 28.8%, respectively, of the earning assets for the first half of 2015. The earning asset yield for the six months ended June 30, 2014 was 3.34% on average earning asset balances of \$470.9 million, or \$42.5 million less than the same period in 2015.

The Company's cost of funds for the six months ended June 30, 2015 and 2014 was 0.19%. On average, total funding increased \$40.0 million to \$486.8 million for the first six months of 2015, as compared to \$446.8 million for the same period in 2014.

The following table details the average balance sheet, including an analysis of net interest income for earning assets and interest bearing liabilities, for the three and six months ended June 30, 2015 and 2014. The table also includes a rate/volume analysis for these same periods (dollars in thousands).

**Consolidated Average Balance Sheet And Analysis of Net Interest Income**

|  | For the three months ended |                         |                     |                 |                         |                     | Change in Interest Income/ Expense |          | Total Increase/Decrease |
|--|----------------------------|-------------------------|---------------------|-----------------|-------------------------|---------------------|------------------------------------|----------|-------------------------|
|  | June 30, 2015              |                         |                     | June 30, 2014   |                         |                     | Change Due to : <sup>4</sup>       | Rate     |                         |
|  | Average Balance            | Interest Income/Expense | Average Yield/ Cost | Average Balance | Interest Income/Expense | Average Yield/ Cost | Volume                             | Rate     |                         |
| <b>ASSETS</b>  |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Interest Earning Assets:                                   |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Securities   |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Taxable Securities   | \$ 126,930                 | \$ 570                  | 1.80%               | \$ 117,105      | \$ 547                  | 1.87%               | \$ 45                              | \$ (22)  | \$                      |
| Tax Exempt Securities <sup>1</sup>                         | 18,825                     | 165                     | 3.51%               | 20,847          | 183                     | 3.51%               | (18)                               | -        | (                       |
| Total Securities <sup>1</sup>                              | 145,755                    | 735                     | 2.02%               | 137,952         | 730                     | 2.12%               | 27                                 | (22)     |                         |
| Total Loans  | 349,612                    | 3,529                   | 4.05%               | 292,642         | 3,107                   | 4.26%               | 581                                | (159)    | 4                       |
| Fed Funds Sold   | 11,893                     | 6                       | 0.20%               | 38,560          | 22                      | 0.23%               | (14)                               | (2)      | (                       |
| Other Interest Bearing Deposits                            | 1,918                      | 6                       | 1.25%               | 1,263           | 3                       | 0.95%               | 2                                  | 1        |                         |
| Total Earning Assets                                       | 509,178                    | 4,276                   | 3.37%               | 470,417         | 3,862                   | 3.29%               | 596                                | (182)    | 4                       |
| Less: Allowance for Loan Losses                            | (3,480)                    |                         |                     | (3,378)         |                         |                     |                                    |          |                         |
| Total Non-Earning Assets                                   | 37,710                     |                         |                     | 41,371          |                         |                     |                                    |          |                         |
| Total Assets   | \$ 543,408                 |                         |                     | \$ 508,410      |                         |                     |                                    |          |                         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Interest Bearing Liabilities:                              |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Interest Bearing Deposits:                                 |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Interest Checking  | \$ 82,315                  | \$ 10                   | 0.05%               | \$ 82,388       | \$ 10                   | 0.05%               | \$ -                               | \$ -     | \$                      |
| Money Market Deposits                                      | 95,018                     | 48                      | 0.20%               | 86,067          | 39                      | 0.18%               | 4                                  | 5        |                         |
| Time Deposits  | 117,107                    | 171                     | 0.59%               | 124,764         | 171                     | 0.55%               | (11)                               | 11       |                         |
| Total Interest-Bearing Deposits                            | 294,440                    | 229                     | 0.31%               | 293,219         | 220                     | 0.30%               | (7)                                | 16       |                         |
| Securities Sold Under Agreement to Repurchase              | 20,355                     | 13                      | 0.26%               | 13,885          | 9                       | 0.26%               | 4                                  | -        |                         |
| Total Interest-Bearing Liabilities                         | 314,795                    | 242                     | 0.31%               | 307,104         | 229                     | 0.30%               | (3)                                | 16       |                         |
| Non-Interest-Bearing Liabilities:                          |                            |                         |                     |                 |                         |                     |                                    |          |                         |
| Demand deposits  | 168,216                    |                         |                     | 140,544         |                         |                     |                                    |          |                         |
| Other liabilities  | 1,041                      |                         |                     | 1,061           |                         |                     |                                    |          |                         |
| Total Liabilities  | 484,052                    |                         |                     | 448,709         |                         |                     |                                    |          |                         |
| Shareholders' Equity                                       | 59,356                     |                         |                     | 59,701          |                         |                     |                                    |          |                         |
| Total Liabilities & Shareholders' Equity                   | \$ 543,408                 |                         |                     | \$ 508,410      |                         |                     |                                    |          |                         |
| Net Interest Income (Tax Equivalent)                       |                            | \$ 4,034                |                     |                 | \$ 3,633                |                     | \$ 599                             | \$ (198) | \$ 4                    |
| Interest Rate Spread <sup>2</sup>                          |                            |                         | 3.06%               |                 |                         | 2.99%               |                                    |          |                         |
| Interest Expense as a Percentage of Average Earning Assets |                            |                         | 0.19%               |                 |                         | 0.20%               |                                    |          |                         |
| Net Interest Margin <sup>3</sup>                           |                            |                         | 3.18%               |                 |                         | 3.10%               |                                    |          |                         |

(1) Tax-exempt income for investment securities has been adjusted to a fully tax-equivalent basis (FTE), using a Federal income tax rate of 34%

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

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

(4) The impact on the net interest income resulting from changes in averages balances and average rates is shown for the period indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

## Consolidated Average Balance Sheet And Analysis of Net Interest Income

|   | For the six months ended |                                |                           |                    |                                |                           | Change in Interest Income/<br>Change Due to: <sup>4</sup> |          | Total<br>Incr<br>(D) |
|---|--------------------------|--------------------------------|---------------------------|--------------------|--------------------------------|---------------------------|---|----------|----------------------|
|   | June 30, 2015            |                                |                           | June 30, 2014      |                                |                           |   |          |                      |
|   | Average<br>Balance       | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Cost | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Cost | Volume  | Rate     |                      |
| <b>ASSETS</b>   |                          |                                |                           |                    |                                |                           |   |          |                      |
| Interest Earning Assets:                                      |                          |                                |                           |                    |                                |                           |   |          |                      |
| Securities  |                          |                                |                           |                    |                                |                           |   |          |                      |
| Taxable Securities  | \$ 128,529               | \$ 1,173                       | 1.83%                     | \$ 115,900         | \$ 1,092                       | 1.88%                     | \$ 116  | \$ (35)  | \$                   |
| Tax Exempt Securities <sup>(1)</sup>                          | 19,361                   | 341                            | 3.52%                     | 20,710             | 364                            | 3.52%                     | (24)  | 1        |                      |
| Total Securities <sup>(1)</sup>                               | 147,890                  | 1,514                          | 2.05%                     | 136,610            | 1,456                          | 2.13%                     | 92  | (34)     |                      |
| Total Loans   | 336,290                  | 6,791                          | 4.07%                     | 295,725            | 6,296                          | 4.29%                     | 831   | (336)    |                      |
| Fed Funds Sold  | 26,992                   | 29                             | 0.22%                     | 37,350             | 41                             | 0.22%                     | (11)  | (1)      |                      |
| Other Interest Bearing Deposits                               | 2,206                    | 13                             | 1.19%                     | 1,257              | 6                              | 0.96%                     | 5   | 2        |                      |
| Total Earning Assets  | 513,378                  | 8,347                          | 3.28%                     | 470,942            | 7,799                          | 3.34%                     | 917   | (369)    |                      |
| Less: Allowance for Loan Losses                               | (3,352)                  |                                |                           | (3,378)            |                                |                           |   |          |                      |
| Total Non-Earning Assets                                      | 38,357                   |                                |                           | 42,073             |                                |                           |   |          |                      |
| Total Assets  | \$ 548,383               |                                |                           | \$ 509,637         |                                |                           |   |          |                      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                   |                          |                                |                           |                    |                                |                           |   |          |                      |
| Interest Bearing Liabilities:                                 |                          |                                |                           |                    |                                |                           |   |          |                      |
| Interest Bearing Deposits:                                    |                          |                                |                           |                    |                                |                           |   |          |                      |
| Interest Checking   | \$ 82,317                | \$ 21                          | 0.05%                     | \$ 81,943          | \$ 20                          | 0.05%                     | \$ -  | \$ 1     | \$                   |
| Money Market Deposits   | 95,408                   | 94                             | 0.20%                     | 86,739             | 79                             | 0.18%                     | 8   | 7        |                      |
| Time Deposits   | 116,491                  | 338                            | 0.59%                     | 124,025            | 338                            | 0.55%                     | (21)  | 21       |                      |
| Total Interest-Bearing Deposits                               | 294,216                  | 453                            | 0.31%                     | 292,707            | 437                            | 0.30%                     | (13)  | 29       |                      |
| Securities Sold Under Agreement<br>to Repurchase              | 20,109                   | 25                             | 0.25%                     | 14,811             | 18                             | 0.25%                     | 7   | -        |                      |
| Total Interest-Bearing Liabilities                            | 314,325                  | 478                            | 0.31%                     | 307,518            | 455                            | 0.30%                     | (6)   | 29       |                      |
| Non-Interest-Bearing Liabilities:                             |                          |                                |                           |                    |                                |                           |   |          |                      |
| Demand deposits   | 172,513                  |                                |                           | 139,304            |                                |                           |   |          |                      |
| Other liabilities   | 1,180                    |                                |                           | 3,500              |                                |                           |   |          |                      |
| Total Liabilities   | 488,018                  |                                |                           | 450,322            |                                |                           |   |          |                      |
| Shareholders' Equity  | 60,365                   |                                |                           | 59,315             |                                |                           |   |          |                      |
| Total Liabilities & Shareholders' Equity                      | \$ 548,383               |                                |                           | \$ 509,637         |                                |                           |   |          |                      |
| Net Interest Income (Tax Equivalent)                          |                          | \$ 7,869                       |                           |                    | \$ 7,344                       |                           | \$ 923  | \$ (398) | \$                   |
| Interest Rate Spread <sup>(2)</sup>                           |                          |                                | 2.97%                     |                    |                                | 3.04%                     |   |          |                      |
| Interest Expense as a Percentage<br>of Average Earning Assets |                          |                                | 0.19 %                    |                    |                                | 0.19 %                    |   |          |                      |
| Net Interest Margin <sup>(3)</sup>                            |                          |                                | 3.09%                     |                    |                                | 3.14%                     |   |          |                      |

(1) Tax-exempt income for investment securities has been adjusted to a fully tax-equivalent basis (FTE), using a Federal income tax rate of 34%

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

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

(4) The impact on the net interest income resulting from changes in averages balances and average rates is shown for the period indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Provision for loan losses

Through the first two quarters of 2015, a total of \$317 thousand in provision for loan losses was recorded, compared to a recovery of provision for loan loss of \$118 thousand being recorded for the first six months of 2014. The 2015 loan loss provision was driven by the \$53.8 million in loan growth. In management's opinion, the allowance was adequately provided for at June 30, 2015. Further discussion of management's assessment of the allowance for loan losses is provided earlier in the report and in Note 4 Allowance for Loan Losses, found in the Notes to the Consolidated Financial Statements.

Noninterest income

Late in the third quarter of 2014, a new fee structure for the Bank was implemented as part of management's revenue enhancement strategy. Many of the Bank's fees had not been increased in several years, and the reassessment of the fees allowed the Bank to increase revenue while remaining at the same level or lower than its competition and to maintain excellent customer service. The full impact of the fee increases are expected to be realized on a full year basis in 2015.

Noninterest income for the quarter ended June 30, 2015 was \$1.255 million, an increase of \$105 thousand from the \$1.150 million reported for the quarter ended June 30, 2014. On a year to date basis, noninterest income for 2015 was \$2.439 million, up \$212 thousand compared to \$2.227 million through the first six months of 2014. This increase was primarily driven by the mortgage banking revenue from a new line of business commenced during the second quarter of 2014 and from the new fee structure implemented late in the third quarter of 2014.

The components of noninterest income for the three and six months are shown below (dollars in thousands):

|   | For the three months ended |                 | For the six months ended |                 |
|---|----------------------------|-----------------|--------------------------|-----------------|
|   | June 30, 2015              | June 30, 2014   | June 30, 2015            | June 30, 2014   |
| <b>Noninterest income:</b>                              |                            |                 |                          |                 |
| Trust income  | \$ 445                     | \$ 468          | \$ 894                   | \$ 960          |
| Customer service fees                                   | 233                        | 224             | 467                      | 439             |
| Debit/credit card and ATM fees                          | 219                        | 184             | 399                      | 357             |
| Earnings/increase in value of bank owned life insurance | 110                        | 109             | 218                      | 216             |
| Gains on sales of securities                            | 24                         | 3               | 46                       | 16              |
| Royalty income  | 36                         | 38              | 81                       | 38              |
| Fees on mortgage sales                                  | 57                         | 9               | 94                       | 9               |
| Other   | 131                        | 115             | 240                      | 192             |
| <b>Total noninterest income</b>                         | <b>\$ 1,255</b>            | <b>\$ 1,150</b> | <b>\$ 2,439</b>          | <b>\$ 2,227</b> |

Noninterest expense

Noninterest expense for the second quarter of 2015 was \$4.175 million, a decrease of \$99 thousand from the \$4.274 million reported in the quarter ended June 30, 2014. For the first six months of 2015, noninterest expense totaled \$8.293 million, a reduction of \$146 thousand from the total of \$8.439 million recorded for the same period in 2014. A decline in other expenses of \$80 thousand and in salaries and employee benefits of \$61 thousand contributed to the year-over-year decrease. Management continues to evaluate expense categories for potential reductions that would have a positive impact on net income on an ongoing basis.

The components of noninterest expense for the three and six months are shown below (dollars in thousands):

|                                | For the three months ended |               | For the six months ended |               |
|--------------------------------|----------------------------|---------------|--------------------------|---------------|
|                                | June 30, 2015              | June 30, 2014 | June 30, 2015            | June 30, 2014 |
| <b>Noninterest expense:</b>    |                            |               |                          |               |
| Salaries and employee benefits | \$ 2,215                   | \$ 2,356      | \$ 4,531                 | \$ 4,592      |
| Net occupancy                  | 483                        | 491           | 979                      | 983           |
| Equipment                      | 136                        | 121           | 266                      | 267           |

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|                           |  |          |  |          |  |          |  |          |
|---------------------------|--|----------|--|----------|--|----------|--|----------|
| Other                     |  | 1,341    |  | 1,306    |  | 2,517    |  | 2,597    |
| Total noninterest expense |  | \$ 4,175 |  | \$ 4,274 |  | \$ 8,293 |  | \$ 8,439 |

The efficiency ratio improved to 78.9% for the second quarter of 2015 compared to 89.8% for the second quarter of 2014. The efficiency ratio of 80.5% for the first half of 2015 compared favorably to the 88.6% for the same period of 2014. The loan growth and mortgage origination initiatives, along with fee increases, should add to the revenue stream. In concert, cost containment strategies should lower expenses. Together, these initiatives and strategies should have the impact of improving efficiency over time.

**OTHER SIGNIFICANT EVENTS**

None

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

Not required

**ITEM 4. CONTROLS AND PROCEDURES**

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

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

Based on their evaluation as of the end of the period covered by this quarterly report on Form 10-Q, the Company's Chief Executive Officer and Controller (Acting Principal Financial Officer) have concluded that the disclosure controls and procedures were effective at the reasonable assurance level. There was no change in the internal control over financial reporting that occurred during the quarter ended June 30, 2015 that has materially affected, or is reasonably likely to materially affect, the internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

None

**ITEM 1A. RISK FACTORS.**

Not required

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

On September 22, 2014, the Company announced the approval by its Board of Directors of a stock repurchase program authorizing repurchase of up to 400,000 shares of the Company's common shares through the open market or in privately negotiated transactions. The repurchase program is authorized through September 18, 2015.

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The table below represents the number of shares repurchased by quarter since the Plan's inception on September 22, 2014 through June 30, 2015.

| Period                                   | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced Plan | Maximum number of shares that may yet be purchased under the Plan |
|--|----------------------------------|------------------------------|---|---|
| September 22, 2014 to September 30, 2014 | -                                | \$ -                         | -   | 400,000   |
| October 1, 2014 to December 31, 2014     | 11,500                           | \$ 22.75                     | 11,500  | 388,500   |
| January 1, 2015 to March 31, 2015        | 805                              | \$ 22.50                     | 12,305  | 387,695   |
| April 1, 2015 to June 30, 2015           | 252,907                          | \$ 22.90                     | 265,212   | 134,788   |
| <b>Total</b>                             | <b>265,212</b>                   | <b>\$ 22.89</b>              | <b>265,212</b>  | <b>134,788</b>  |

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable

ITEM 5. OTHER INFORMATION.

(a) Required 8-K disclosures.

None

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

None



ITEM 6. EXHIBITS.

| Exhibit Number | Description of Exhibit   |
|----------------|--|
| 2.0            | Reorganization Agreement and Plan of Share Exchange, dated as of March 6, 2013, between Virginia National Bank and Virginia National Bankshares Corporation <sup>a</sup>   |
| 3.1            | Articles of Incorporation of Virginia National Bankshares Corporation, as amended and restated <sup>b</sup>  |
| 3.2            | Bylaws of Virginia National Bankshares Corporation <sup>c</sup>  |
| 10.1           | Virginia National Bank 1998 Stock Incentive Plan <sup>d</sup>  |
| 10.2           | Virginia National Bank 2003 Stock Incentive Plan <sup>e</sup>  |
| 10.3           | Virginia National Bank Amended and Restated 2005 Stock Incentive Plan <sup>f</sup>   |
| 10.4           | Virginia National Bankshares Corporation 2014 Stock Incentive Plan <sup>g</sup>  |
| 31.1           | 302 Certification of Principal Executive Officer   |
| 31.2           | 302 Certification of Acting Principal Financial Officer  |
| 32.1           | 906 Certification  |
| 101.0          | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014, (ii) the Consolidated Statements of Income for the three and six months ended June 30, 2015 and June 30, 2014, (iii) the Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2015 and June 30, 2014, (iv) the Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2015 and June 30, 2014, (v) the Consolidated Statements of Cash Flows for the six months ended June 30 and June 30, 2014 and (vi) the Notes to the Consolidated Financial Statements (furnished herewith). |

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

<sup>d</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on or around April 16, 1999.

<sup>e</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 24, 2003.

<sup>f</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on March 30, 2006.

<sup>g</sup> Incorporated herein by reference to Virginia National Bankshares Corporation's Definitive Proxy Statement, filed with the Securities and Exchange Commission on April 10, 2014.

SIGNATURES

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

VIRGINIA NATIONAL BANKSHARES CORPORATION  
(Registrant)

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

Date: August 14, 2015

By: /s/ Vicki T. Miller  
Vicki T. Miller  
Senior Vice President and Controller

Date: August 14, 2015