Virginia National Bankshares Corp
Form 10-K
March 27, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2013 **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 Number)
404 People Place, Charlottesville, Virginia (Address of principal executive offices)	**22911** (Zip Code)

(434) 817-8621
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, $2.50 par value (Title of class)	**OTC Markets Group s OTCQB Marketplace** (Name of exchange on which registered)

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

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

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** X **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 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** X **No** _

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

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

On June 30, 2013, the aggregate market value of the common equity held by non-affiliates of the registrant was $36,952,024.

The registrant has one class of common stock, of which 2,690,320 shares were outstanding as of close of business March 14, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are hereby incorporated into Part I and Part III of this Form 10-K by reference: the Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2014.

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FORWARD-LOOKING STATEMENTS AND FACTORS THAT COULD AFFECT FUTURE RESULTS

Certain statements contained or incorporated by reference in this annual report on Form 10-K, 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 the Bank, 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. 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 the Company may make 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, and 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.

Part I

Item 1. BUSINESS.

General

Virginia National Bankshares Corporation (the Company) was incorporated under the laws of the Commonwealth of Virginia on February 21, 2013 at the direction of the Board of Directors of Virginia National Bank (the Bank) for the purpose of acquiring all of the outstanding shares of the Bank and becoming the holding company of the Bank. On June 19, 2013, the shareholders of the Bank approved the Reorganization Agreement and Plan of Share Exchange, dated March 6, 2013, whereby the Bank would reorganize into a holding company structure (the Reorganization).

On December 16, 2013, when the Reorganization became effective, the Bank became a wholly-owned subsidiary of the Company, and each share of the Bank s common stock was exchanged for one share of the Company s common stock. The Company is regulated under the Bank Holding Company Act of 1956, as amended (BHC Act), and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). The Company is also under the jurisdiction of the Securities and Exchange Commission (SEC) and is subject to the disclosure and regulatory requirements of the Securities Exchange Act of 1934, as amended, (the Exchange Act) as administered by the SEC. Virginia National Bankshares Corporation is headquartered at 404 People Place, Charlottesville, Virginia.

Virginia National Bank, the principal operating subsidiary of the Company, was organized in 1998 under federal law as a national banking association to engage in a general commercial and retail banking business. The Bank received its charter from the Office of the Comptroller of the Currency (the OCC) and commenced operations on July 29, 1998. The Bank is headquartered in Charlottesville, Virginia. The Bank s deposits are insured up to the maximum amount provided by the Federal Deposit Insurance Act by the Federal Deposit Insurance Corporation (FDIC). The Bank is subject to the supervision, examination and regulation of the OCC.

The Bank serves the Virginia communities in and around the City of Charlottesville, Albemarle County, Orange County and the City of Winchester. The Bank offers a full range of banking and related financial services, including checking accounts, NOW accounts, money market deposit accounts, certificates of deposit, individual retirement accounts and other depository services. The Bank actively solicits such accounts from individuals, businesses, associations and other organizations within its trade area. The Bank also offers short-to-long term commercial, real estate and consumer loans. The Bank is committed to being a reliable and consistent source of credit, with loans that are priced based upon an overall banking relationship, easy access to the Bank s local decision makers who possess strong local market knowledge, local delivery, fast response, and continuity in the banking relationship. Other services offered by the Bank include automated teller machines (ATMs), Internet banking, safe deposit boxes, merchant card services, cash management services and direct deposit of payroll and federal recurring payments. In addition, the Bank is affiliated with Visa® which is accepted worldwide and offers debit cards to consumer and business customers.

Since July 29, 1998, the Bank has conducted business from its full-service main banking office located at 222 East Main Street in Charlottesville, Virginia. On March 15, 1999, a full-service banking office was opened at 1580 Seminole Trail in Charlottesville, Virginia. On December 21, 1999, a full-service banking office was opened at 1900 Arlington Boulevard in Charlottesville, Virginia. On November 8, 2000, a full-service banking office was opened at 102 East Main Street in Orange, Virginia. On January 28, 2002, a full-service banking office was opened at 186 North Loudoun Street, Winchester, Virginia. On December 29, 2003, a full-service banking office was opened at 3119 Valley Avenue, #102, Winchester, Virginia. On April 28, 2008, a full-service banking office was opened at 404 People Place, Charlottesville, Virginia. Additionally, the multi-story office building at 404 People Place serves as the Company s corporate headquarters and the Bank s Operations Center.

In October 2012, the Bank started offering annuity, insurance and brokerage services to the public at its banking offices, under the title of VNB Investment Strategies. The Bank entered into an agreement with LPL Financial LLC, which provides broker/dealer and advisory services through registered representatives. The goal of the program is to offer customers additional opportunities to access additional financial products and services beyond the traditional banking products.

Investment and trust services are offered through the Bank s wholly-owned subsidiary, VNBTrust, National Association (VNBTrust). VNBTrust employs a value-based, event-driven investment strategy. The strategy includes investing in a wide variety of securities and financial instruments in the public markets, utilizing securities exchanges, over-the-counter and privately negotiated transactions. Investment trades include common and preferred stock, corporate bonds, bank loans and other debt securities, convertible securities, Exchange Traded Funds (EFTs), options, warrants and cash equivalents.

Prior to July 18, 2013, VNBTrust was the sole owner of an operating subsidiary, Swift Run Capital Management, LLC (SRCM), formerly known as VNB Investment Management Company, LLC, a Delaware limited liability corporation. SRCM operates as the general partner of Swift Run Capital L.P. (Fund), a hedge fund. On July 18, 2013 (the Closing Date), VNBTrust completed the sale of all of the membership interests of SRCM to SRCM Holdings LLC (SRCM Holdings) pursuant to a purchase and sale agreement dated June 27, 2013 among SRCM Holdings, VNBTrust, SRCM and the Bank (the Sale Agreement). The Fund managed by SRCM represented less than 7 percent of the total assets managed by VNBTrust and SRCM at the date of the sale. Additional details on this transaction are available in Note 1, in the notes to the consolidated financial statements, contained in Item 8.

On January 1, 2014, VNBTrust began doing business under the trade name of VNB Wealth Management. While the trade name is new, clients will continue to receive community-based trust and investment services. VNB Wealth Management employs an integrated approach to financial planning and investment management which is designed to provide clients with a comprehensive wealth management solution. More information on VNB Wealth Management is available at www.vnbwealth.com.

Market Area

The population in the market area served by the Company continues to grow. According to the U.S. Census Bureau, the combined populations of the City of Charlottesville and Albemarle County stood at 142,445 persons as of April 1, 2010, an increase of approximately 14.6 percent between April 1, 2000 and April 1, 2010. The Virginia State Demographer projects the two municipalities to grow 13.2 percent to a population of 161,278 by 2020. Charlottesville and Albemarle County support a diverse, well-rounded economy. Stability in the local economy stems from the significant number of persons employed by a wide variety of employers including the University of Virginia, large medical and research facilities such as Martha Jefferson and UVA Health Services, insurance and technology industries, large number of national retail chains and Federal government-based facilities.

The combined populations of the City of Winchester and Frederick County increased approximately 26.2 percent between April 1, 2000 and April 1, 2010, to a population of 104,508 persons in 2010. The combined population is expected to be 125,159 by 2020, an increase of 19.8 percent.

Orange County had a population of approximately 33,481 persons as of 2010. Between April 1, 2000 and April 1, 2010, its population grew 29.4 percent.

The total market area served by the Company grew 20.4 percent between 2000 and 2010, as compared to 13.0 percent for the state as a whole. Over the next decade, Virginia is expected to have only a 10.1 percent growth, where the Company s current market is expected to be 15.6 percent higher by 2020 than reported by the 2010 Census.

Competition

The Company engages in highly competitive activities. Each activity involves competition with other banks, as well as with non-banking enterprises that offer financial products and services that compete directly with the Company s product and service offerings. The Company actively competes with other banks in its efforts to obtain deposits and make loans, in the scope and types of services offered, in interest rates paid on time deposits and charged on loans, and in other aspects of banking.

In addition to competing with other commercial banks within and outside its primary service areas, the Company competes with other financial institutions engaged in the business of making loans or accepting deposits, such as credit unions, insurance companies, small loan companies, finance companies, mortgage companies, certain governmental agencies and other enterprises. Competition for funds from securities brokers and mutual funds for money market accounts is strong. Additional competition for deposits comes from government and private issues of debt obligations and other investment alternatives for depositors such as money market funds.

The market areas served by the Company are highly competitive with respect to banking. Competition for loans to small businesses and professionals is intense, and pricing is important. Many of the Company s competitors have substantially greater resources and lending limits than the Company and offer certain services such as extensive and established branch networks that the Company does not expect to match. Deposit competition is also very strong. Management believes, however, that a market exists for the personal and customized financial services an independent, locally owned bank can offer.

Supervision and Regulation

Bank holding companies and banks are extensively regulated under both federal and state laws. The following description briefly addresses certain historic and current provisions of federal and state laws and certain regulations, proposed regulations and the potential impacts on the Company and the Bank. To the extent statutory or regulatory provisions or proposals are described in this Report, the description is qualified in its entirety by reference to the particular statutory or regulatory provisions or proposals.

Regulatory Reform The Dodd-Frank Act

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act significantly restructures the financial regulatory regime in the United States and has a broad impact on the financial services industry as a result of the significant regulatory and compliance changes required under the act. While significant rulemaking under the Dodd-Frank Act has occurred, certain of the act s provisions require additional rulemaking by the federal bank regulatory agencies, a process which will take years to fully implement. The Company believes that short- and long-term compliance costs for the Company will be greater because of the Dodd-Frank Act. A summary of certain provisions of the Dodd-Frank Act is set forth below:

- Increased Capital Standards. The federal banking agencies are required to establish minimum leverage and risk-based capital requirements for banks and bank holding companies. See The Bank Capital Requirements Basel III Capital Requirements below. Among other things, the Dodd-Frank Act provides for new capital standards that eliminate the treatment of trust preferred securities as Tier 1 capital. Existing trust preferred securities are grandfathered for banking entities with less than $15 billion of assets. The Company has no trust preferred securities.

- Deposit Insurance. The Dodd-Frank Act makes permanent the $250,000 deposit insurance limit for insured deposits. Amendments to the Federal Deposit Insurance Act also revise the assessment base against which an insured depository institution s deposit insurance premiums paid to the Deposit Insurance Fund (the DIF) will be calculated. Under the amendments, the assessment base is no longer the institution s deposit base, but rather its average consolidated total assets less its average tangible equity during the assessment period. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act also provides that, effective one year after the date of enactment, depository institutions may pay interest on demand deposits.

- Enhanced Lending Limits. The Dodd-Frank Act strengthens the existing limits on a depository institution s credit exposure to one borrower. Current banking law limits a depository institution s ability to extend credit to one person (or group of related persons) in an amount exceeding certain thresholds.

- The Consumer Financial Protection Bureau (the CFPB). The Dodd-Frank Act creates the CFPB within the Federal Reserve Bank. The CFPB is charged with establishing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services.

- Compensation Practices. The Dodd-Frank Act provides that the appropriate federal regulators must establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company or bank that provides an insider or other employee with excessive compensation or could lead to a material financial loss to such firm. In June 2010, prior to the Dodd-Frank Act, the federal bank regulatory agencies promulgated the Interagency Guidance on Sound Incentive Compensation Policies, which requires that financial institutions establish metrics for measuring the impact of activities to achieve incentive compensation with the related risk to the financial institution of such behavior.

Although a significant number of the rules and regulations mandated by the Dodd-Frank Act have been finalized, certain of the act s requirements have yet to be implemented. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the federal bank regulatory agencies in the future, the full extent of the impact such requirements will have on the operations of the Company and the Bank is unclear. The changes resulting from the Dodd-Frank Act may affect the profitability of business activities, require changes to certain business practices, impose more stringent regulatory requirements or otherwise adversely affect the business and financial condition of the Company and the Bank. These changes may also require the Company to invest significant management attention and resources to evaluate and make necessary changes to comply with new statutory and regulatory requirements.

The Company

General. As a bank holding company registered under the BHC Act, the Company is subject to supervision, regulation, and examination by the Federal Reserve. The Company is also registered under the bank holding company laws of Virginia and is subject to supervision, regulation, and examination by the Virginia State Corporation Commission (the SCC).

Permitted Activities. A bank holding company is limited to managing or controlling banks, furnishing services to or performing services for its subsidiaries, and engaging in other activities that the Federal Reserve determines by regulation or order to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is permissible, the Federal Reserve must consider whether the performance of such an activity reasonably can be expected to produce benefits to the public that outweigh possible adverse effects. Possible benefits include greater convenience, increased competition, and gains in efficiency. Possible adverse effects include undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices. Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any activity or to terminate ownership or control of any subsidiary when the Federal Reserve has reasonable cause to believe that a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company may result from such an activity.

Banking Acquisitions; Changes in Control. The BHC Act requires, among other things, the prior approval of the Federal Reserve in any case where a bank holding company proposes to (i) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank or bank holding company (unless it already owns a majority of such voting shares), (ii) acquire all or substantially all of the assets of another bank or bank holding company, or (iii) merge or consolidate with any other bank holding company. In determining whether to approve a proposed bank acquisition, the Federal Reserve will consider, among other factors, the effect of the acquisition on competition, the public benefits expected to be received from the acquisition, the projected capital ratios and levels on a post-acquisition basis, and the acquiring institution s performance under the Community Reinvestment Act of 1977 and its compliance with fair housing and other consumer protection laws.

Subject to certain exceptions, the BHC Act and the Change in Bank Control Act, together with the applicable regulations, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company s acquiring control of a bank or bank holding company. A conclusive presumption of control exists if an individual or company acquires the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25% or more of any class of voting securities of any insured depository institution. A rebuttable presumption of control exists if a person or company acquires 10% or more but less than 25% of any class of voting securities of an insured depository institution and either the institution has registered its securities with the SEC under Section 12 of the Exchange Act or no other person will own a greater percentage of that class of voting securities immediately after the acquisition. The Company s common stock is registered under Section 12 of the Exchange Act.

In addition, Virginia law requires the prior approval of the SCC for (i) any Virginia bank or Virginia bank holding company to acquire more than 5% of the voting shares of a Virginia bank or any holding company that controls a Virginia bank, or (ii) the acquisition by a Virginia bank holding company of a bank or its holding company domiciled outside Virginia.

Source of Strength. Federal Reserve policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to depositors and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Safety and Soundness. There are a number of obligations and restrictions imposed on bank holding companies and their subsidiary banks by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance fund in the event of a depository institution default. For example, under the Federal Deposit Insurance Company Improvement Act of 1991, to avoid receivership of an insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any subsidiary bank that may become undercapitalized with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal bank regulatory agency up to the lesser of (i) an amount equal to 5% of the institution s total assets at the time the institution became undercapitalized, or (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan.

Under the Federal Deposit Insurance Act (FDIA), the federal bank regulatory agencies have adopted guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines.

Capital Requirements. The Federal Reserve imposes certain capital requirements on bank holding companies under the BHC Act, including a minimum leverage ratio and a minimum ratio of qualifying capital to risk-weighted assets. These requirements are described below under The Bank Capital Requirements.

Limits on Dividends and Other Payments. The Company is a legal entity, separate and distinct from its subsidiaries. A significant portion of the revenues of the Company result from dividends paid to it by the Bank. There are various legal limitations applicable to the payment of dividends by the Bank to the Company and to the payment of dividends by the Company to its shareholders. The Bank is subject to various restrictions on its ability to pay dividends to the Company. The OCC has advised that a national bank should generally pay dividends only out of current operating earnings. Under current regulations, prior approval from the Federal Reserve is required if cash dividends declared in any given year exceed net income for that year, plus retained net profits of the two preceding years. The payment of dividends by the Bank or the Company may be limited by other factors, such as requirements to maintain capital above regulatory guidelines. Bank regulatory agencies have the authority to prohibit the Bank or the Company from engaging in an unsafe or unsound practice in conducting their business. The payment of dividends, depending on the financial condition of the Bank, or the Company, could be deemed to constitute such an unsafe or unsound practice.

Under the FDIA, insured depository institutions such as the Bank, are prohibited from making capital distributions, including the payment of dividends, if, after making such distributions, the institution would become undercapitalized (as such term is used in the statute). Based on the Bank s current financial condition, the Company does not expect this provision will have any impact on its ability to receive dividends from the Bank.

The Bank

General. The Bank is supervised and regularly examined by the OCC. The various laws and regulations administered by the bank regulatory agencies affect corporate practices, such as the payment of dividends, incurrence of debt and acquisition of financial institutions and other companies; they also affect business practices, such as the payment of interest on deposits, the charging of interest on loans, types of business conducted and location of offices. Certain of these law and regulations are referenced above under The Company.

Capital Requirements:

Current Capital Requirements. The OCC and the other federal banking agencies have issued risk-based and leverage capital guidelines applicable to U.S. banking organizations. In addition, those regulatory agencies may from time to time require that a banking organization maintain capital above the minimum levels because of its financial condition or actual or anticipated growth. Under the current risk-based capital requirements of the Federal Reserve and the OCC, the Company and the Bank are required to maintain a minimum ratio of total capital (which is defined as core capital and supplementary capital less certain specified deductions from total capital such as reciprocal holdings of depository institution capital instruments and equity investments) to risk-weighted assets of at least 8.0%. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet activities, recourse obligations, residual interests and direct credit substitutes, are multiplied by a risk-weight factor assigned by the capital regulation based on the risks believed inherent in the type of asset. At least half of the total capital is required to be Tier 1 capital, which consists principally of common and certain qualifying preferred shareholders equity (including grandfathered trust preferred securities), less certain intangibles and other adjustments. The remainder (Tier 2 capital) consists of cumulative preferred stock, long-term perpetual preferred stock, a limited amount of subordinated and other qualifying debt (including certain hybrid capital instruments), and a limited amount of the general loan loss allowance. The Tier 1 and total capital to risk-weighted asset ratios of the Company were 17.03% and 18.00%, respectively, as of December 31, 2013, thus exceeding the minimum requirements. The Tier 1 and total capital to risk-weighted asset ratios of the Bank were 14.65% and 15.62%, respectively, as of December 31, 2013, also exceeding the minimum requirements.

Each of the federal bank regulatory agencies also has established a minimum leverage capital ratio of Tier 1 capital to average adjusted assets (Tier 1 leverage ratio). The guidelines provide for a minimum Tier 1 leverage ratio of 3.0% for bank holding companies and banking organizations that have the highest supervisory rating. All other banking organizations are required to maintain a minimum Tier 1 leverage ratio of 4% unless a different minimum is specified by an appropriate regulatory authority. In addition, for a depository institution to be considered well capitalized under the regulatory framework for prompt corrective action, its Tier 1 leverage ratio must be at least 5.0%. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. The Federal Reserve and the OCC have not advised the Company or the Bank of any specific minimum leverage ratio applicable to either entity. As of December 31, 2013, the Tier 1 leverage ratio of the Company and the Bank were 11.86% and 10.20%, respectively, well above the minimum requirements.

Basel III Capital Requirements. In June 2012, the federal bank regulatory agencies issued a series of proposed rules that would revise and strengthen its risk-based and leverage capital requirements and its method for calculating risk-weighted assets. The rules were proposed to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. In July 2013, the federal bank regulatory agencies approved certain revisions to the proposals and finalized new capital requirements for banking organizations.

Effective January 1, 2015, the final rules require the Company and the Bank 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 current requirement of 4%); (iii) a total capital ratio of 8% of risk-weighted assets (unchanged from current requirement); and (iv) a leverage ratio of 4% of total assets. These are the initial capital requirements, which will be phased in over a four-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% capital conservation buffer (which is added to the 4.5% common equity Tier 1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7% upon full implementation); (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets.

The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

With respect to the Bank, the rules also revised the prompt corrective action regulations pursuant to Section 38 of the FDIA by (i) introducing a common equity Tier 1 capital ratio requirement at each level (other than critically undercapitalized), with the required ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum ratio for well-capitalized status being 8.0% (as compared to the current 6.0%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized.

The new capital requirements also include changes in the risk weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and nonresidential mortgage loans that are 90 days past due or otherwise on nonaccrual status, a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital, and increased risk-weights (from 0% to up to 600%) for equity exposures.

Based on management s understanding and interpretation of the new capital rules, it believes that, as of December 31, 2013, the Company and the Bank would meet all capital adequacy requirements under such rules on a fully phased-in basis as if such requirements were in effect as of such date.

Deposit Insurance. The deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC and are subject to deposit insurance assessments to maintain the DIF. On April 1, 2011, the deposit insurance assessment base changed from total deposits to average total assets minus average tangible equity, pursuant to a rule issued by the FDIC as required by the Dodd-Frank Act.

The Federal Deposit Insurance Act (the FDIA), as amended by the Federal Deposit Insurance Reform Act and the Dodd-Frank Act, requires the FDIC to set a ratio of deposit insurance reserves to estimated insured deposits of at least 1.35%. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank s capital level and supervisory rating. On February 27, 2009, the FDIC introduced three possible adjustments to an institution s initial base assessment rate: (i) a decrease of up to five basis points for long-term unsecured debt, including senior unsecured debt (other than debt guaranteed under the Temporary Liquidity Guarantee Program) and subordinated debt and, for small institutions, a portion of Tier 1 capital; (ii) an increase not to exceed 50% of an institution s assessment rate before the increase for secured liabilities in excess of 25% of domestic deposits; and (iii) for non-Risk Category I institutions, an increase not to exceed 10 basis points for brokered deposits in excess of 10% of domestic deposits. In 2013 and 2012, the Company expensed only the base assessment rate for well capitalized institutions, which totaled $220 thousand and $297 thousand, respectively, in regular deposit insurance assessments.

On May 22, 2009, the FDIC issued a final rule that levied a special assessment applicable to all insured depository institutions totaling 5 basis points of each institution s total assets less Tier 1 capital as of June 30, 2009, not to exceed 10 basis points of domestic deposits. The special assessment was part of the FDIC s efforts to rebuild the DIF. Deposit insurance expense during 2009 for the Company included an additional $184 thousand related to the special assessment.

On November 12, 2009, the FDIC issued a rule that required all insured depository institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. In the fourth quarter of 2009, the Company paid $1.939 million in prepaid risk-based assessments, most of which has been expensed in the appropriate periods through December 31, 2012. The balance of the prepayment was approximately $629 thousand on December 31, 2012 and was included in other assets in the accompanying consolidated balance sheet. On June 28, 2013, $582 thousand was refunded to the Company from the FDIC. Beginning September 30, 2013, payments are being assessed and charged to financial institutions on a quarterly basis, rather than being applied against the prepaid balance.

In addition, all FDIC insured institutions are required to pay assessments to the FDIC at an annual rate of approximately one basis point of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019. In both 2013 and 2012, the Company paid a FICO assessment of $28 thousand.

Transactions with Affiliates. Pursuant to Sections 23A and 23B of the Federal Reserve Act and Regulation W, the authority of the Bank to engage in transactions with related parties or affiliates or to make loans to insiders is limited. Loan transactions with an affiliate generally must be collateralized and certain transactions between the Bank and its affiliates, including the sale of assets, the payment of money or the provision of services, must be on terms and conditions that are substantially the same, or at least as favorable to the Bank, as those prevailing for comparable nonaffiliated transactions. In addition, the Bank generally may not purchase securities issued or underwritten by affiliates.

Loans to executive officers, directors or to any person who directly or indirectly, or acting through or in concert with one or more persons, owns, controls or has the power to vote more than 10% of any class of voting securities of a bank (a 10% Shareholder), are subject to Sections 22(g) and 22(h) of the Federal Reserve Act and their corresponding regulations (Regulation O) and Section 13(k) of the Exchange Act relating to the prohibition on personal loans to executives (which exempts financial institutions in compliance with the insider lending restrictions of Section 22(h) of the Federal Reserve Act). Among other things, these loans must be made on terms substantially the same as those prevailing on transactions made to unaffiliated individuals and certain extensions of credit to those persons must first be approved in advance by a disinterested majority of the entire board of directors. Section 22(h) of the Federal Reserve Act prohibits loans to any of those individuals where the aggregate amount exceeds an amount equal to 15% of an institution s unimpaired capital and surplus plus an additional 10% of unimpaired capital and surplus in the case of loans that are fully secured by readily marketable collateral, or when the aggregate amount on all of the extensions of credit outstanding to all of these persons would exceed the Bank s unimpaired capital and unimpaired surplus. Section 22(g) of the Federal Reserve Act identifies limited circumstances in which the Bank is permitted to extend credit to executive officers.

Prompt Corrective Action. Federal banking regulators are authorized and, under certain circumstances, required to take certain actions against banks that fail to meet their capital requirements. The federal bank regulatory agencies have additional enforcement authority with respect to undercapitalized depository institutions. Well capitalized institutions may generally operate without supervisory restriction. With respect to adequately capitalized institutions, such banks cannot normally pay dividends or make any capital contributions that would leave it undercapitalized; they cannot pay a management fee to a controlling person if, after paying the fee, it would be undercapitalized; and they cannot accept, renew or roll over any brokered deposit unless the bank has applied for and been granted a waiver by the FDIC.

Immediately upon becoming undercapitalized, a depository institution becomes subject to the provisions of Section 38 of the FDIA, which: (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution s assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the DIF, subject in certain cases to specified procedures. These discretionary supervisory actions include: (i) requiring the institution to raise additional capital; (ii) restricting transactions with affiliates; (iii) requiring divestiture of the institution or the sale of the institution to a willing purchaser; and (iv) any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions. The Bank meets the definition of being well capitalized as of December 31, 2013.

As described above in The Bank Capital Requirements Basel III Capital Requirements, the new capital requirement rules issued by the OCC incorporate new requirements into the prompt corrective action framework.

Community Reinvestment Act. The Bank is subject to the requirements of the Community Reinvestment Act of 1977 (the CRA). The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of the local communities they serve, including low and moderate income neighborhoods. The CRA requires the appropriate federal banking agency, in connection with its examination of a bank, to assess the bank s record in meeting such credit needs. Furthermore, such assessment is also required of banks that have applied, among other things, to merge or consolidate with or acquire the assets or assume the liabilities of an insured depository institution, or to open or relocate a branch. In the case of a bank holding company applying for approval to acquire a bank or another bank holding company, the record of each subsidiary bank of the applicant bank holding company is subject to assessment in considering the application. Under the CRA, institutions are assigned a rating of outstanding, satisfactory, needs to improve, or substantial non-compliance. The Bank currently has a satisfactory CRA rating.

Privacy Legislation. Several recent laws, including the Right to Financial Privacy Act, and related regulations issued by the federal bank regulatory agencies, provide new protections against the transfer and use of customer information by financial institutions. A financial institution must provide to its customers information regarding its policies and procedures with respect to the handling of customers personal information. Each institution must conduct an internal risk assessment of its ability to protect customer information. These privacy provisions generally prohibit a financial institution from providing a customer s personal financial information to unaffiliated parties without prior notice and approval from the customer.

USA Patriot Act of 2001. In October 2001, the USA Patriot Act of 2001 (Patriot Act) was enacted in response to the September 11, 2001 terrorist attacks in New York, Pennsylvania, and Northern Virginia. The Patriot Act is intended to strengthen U.S. law enforcement and the intelligence communities abilities to work cohesively to combat terrorism. The continuing impact on financial institutions of the Patriot Act and related regulations and policies is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws, and imposes various regulations, including standards for verifying customer identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities to identify persons who may be involved in terrorism or money laundering.

Volcker Rule. The Dodd-Frank Act prohibits insured depository institutions and their holding companies from engaging in proprietary trading except in limited circumstances, and prohibits them from owning equity interests in excess of 3% of Tier 1 capital in private equity and hedge funds (known as the Volcker Rule). On December 10, 2013, the federal bank regulatory agencies adopted final rules implementing the Volcker Rule. These final rules prohibit banking entities from (i) engaging in short-term proprietary trading for their own accounts, and (ii) having certain ownership interests in and relationships with hedge funds or private equity funds. The final rules are intended to provide greater clarity with respect to both the extent of those primary prohibitions and of the related exemptions and exclusions. The final rules also require each regulated entity to establish an internal compliance program that is consistent with the extent to which it engages in activities covered by the Volcker Rule, which must include (for the largest entities) making regular reports about those activities to regulators. Although the final rules provide some tiering of compliance and reporting obligations based on size, the fundamental prohibitions of the Volcker Rule apply to banking entities of any size, including the Company and the Bank. The final rules are effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2015. The Company has evaluated the implications of the final rules on its investments and does not expect any material financial implications.

Under the final rules implementing the Volcker Rule, banking entities would have been prohibited from owning certain collateralized debt obligations (CDOs) backed by trust preferred securities (TruPS) as of July 21, 2015, which could have forced banking entities to recognize unrealized market losses based on the inability to hold any such investments to maturity. However, on January 14, 2014, the federal bank regulatory agencies issued an interim rule, effective April 1, 2014, exempting TruPS CDOs from the Volcker Rule if (i) the CDO was established prior to May 19, 2010, (ii) the banking entity reasonably believes that the offering proceeds of the CDO were used to invest primarily in TruPS issued by banks with less than $15 billion in assets, and (iii) the banking entity acquired the CDO on or before December 10, 2013. The Company currently does not have any impermissible holdings of TruPS CDOs under the interim rule, and therefore, will not be required to divest of any such investments or change the accounting treatment. However, regulators are soliciting comments to the Interim Rule, and this exemption could change prior to its effective date.

Ability-to-Repay and Qualified Mortgage Rule. Pursuant to the Dodd-Frank Act, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) the monthly payment on the covered transaction; (iv) the monthly payment on any simultaneous loan; (v) the monthly payment for mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) the monthly debt-to-income ratio or residual income; and (viii) credit history. Alternatively, the mortgage lender can originate qualified mortgages, which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Qualified mortgages that are higher-priced (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not higher-priced (e.g. prime loans) are given a safe harbor of compliance. A small creditor exemption from the qualified mortgage rules applies to financial institutions that meet the following requirements: (i) have assets below $2 billion (adjustable annually by CFPB); (ii) creditor originated no more than 500 first-lien, closed-end residential mortgages subject to the ability-to-repay requirements in the preceding calendar year; and (iii) creditor holds the qualified mortgage loan in its portfolio after origination. As a small creditor, the Company is generally exempt from the qualified mortgage rules. The Company does comply with applicable Truth in Lending requirements.

Consumer Laws and Regulations. The Bank is also subject to certain consumer laws and regulations issued thereunder that are designed to protect consumers in transactions with banks. These laws include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, Real Estate Settlement Procedures Act, Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Fair Housing Act, and the Servicemembers Civil Relief Act, among others. The laws and related regulations mandate certain disclosure requirements and regulate the manner in which financial institutions transact business with customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

Incentive Compensation. In June 2010, the federal bank regulatory agencies issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of financial institutions do not undermine the safety and soundness of such institutions by encouraging excessive risk-taking. The Interagency Guidance on Sound Incentive Compensation Policies, which covers all employees that have the ability to materially affect the risk profile of financial institutions, either individually or as part of a group, is based upon the key principles that a financial institution s incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the institution s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the financial institution s board of directors.

The Federal Reserve and the OCC will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of financial institutions, such as the Company and the Bank, that are not large, complex banking organizations. These reviews will be tailored to each financial institution based on the scope and complexity of the institution s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the institution s supervisory ratings, which can affect the institution s ability to make acquisitions and take other actions. Enforcement actions may be taken against a financial institution if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the institution s safety and soundness and the financial institution is not taking prompt and effective measures to correct the deficiencies. At December 31, 2013, the Company and the Bank have not been made aware of any instances of non-compliance with the final guidance.

Effect of Governmental Monetary Policies

The Company s operations are affected not only by general economic conditions but also by the policies of various regulatory authorities. In particular, the Federal Reserve regulates money and credit conditions and interest rates to influence general economic conditions. These policies have a significant impact on overall growth and distribution of loans, investments and deposits; they affect interest rates charged on loans or paid for time and savings deposits. Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks, including the Company, in the past and are expected to do so in the future.

Reporting Obligations under Securities Laws

The Company is subject to the periodic reporting requirements of the Exchange Act, including the filing of annual, quarterly and other reports with the SEC. As an Exchange Act reporting company, the Company is directly affected by the Sarbanes-Oxley Act of 2002 and regulations promulgated thereunder by the SEC, which are aimed at improving corporate governance and reporting procedures. The Company is complying with the rules and regulations implemented pursuant to the Sarbanes-Oxley Act and intends to comply with any applicable SEC rules and regulations implemented in the future.

Employees

At December 31, 2013, the Company had 102 full time equivalent employees. None of its employees is represented by any collective bargaining unit. The Company considers relations with its employees to be good.

The Company has purchased Bank Owned Life Insurance (BOLI) policies on executives and key personnel of the Company. BOLI is a bank-eligible asset designed to recover costs of providing pre- and post-retirement benefits and/or to finance general employee benefit expenses. Under BOLI policies, the executives and other key personnel are the insured, and the Company is the owner and beneficiary of the policies. The insured has no claim to the insurance policy or to the policy s cash value. Under separate split dollar agreements, a portion of any death benefit may be paid to the beneficiaries of the insured employees, subject to the terms and restrictions of the split dollar endorsement agreement between the officer and the Company.

Availability of Information

Prior to the Reorganization, the Bank filed its periodic and annual reports with the OCC. Beginning with the Reorganization on December 16, 2013, the Company files annual, quarterly, and other reports under the Exchange Act with the SEC. The Company s filings are available through the SEC s website at *www.sec.gov*. In addition, our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, plus any amendments to these reports, are available, free of charge, at www.vnb.com in the Investor Relations section. These reports are available as soon as reasonably practical after they are filed with the SEC. The information on the Bank s Internet website is not incorporated into this Annual Report on Form 10-K or any other filing the Company makes with the SEC.

Item 1A. RISK FACTORS.

Not required

Item 1B. UNRESOLVED STAFF COMMENTS.

None

Item 2. PROPERTIES.

The Company and its subsidiaries currently occupy seven full-service banking facilities in Charlottesville, Winchester, and Albemarle and Orange Counties. The Company s main office and a full-service banking facility are located at 404 People Place, Charlottesville, Virginia. Full-service banking facilities are also located at 222 East Main Street, Charlottesville, Virginia; 1580 Seminole Trail, Charlottesville, Virginia; 1900 Arlington Boulevard, Charlottesville, Virginia; 102 East Main Street, Orange, Virginia; 186 North Loudoun Street, Winchester, Virginia; and 3119 Valley Avenue, #102, Winchester, Virginia. In addition, an administrative office was opened in 2013 at 402 South Main Street, Culpeper, Virginia.

The property located at 1580 Seminole Trail, Charlottesville, VA was leased in 1998 from Sunny Hill Land Trust (an entity in which Hunter Craig, a director of the Bank, holds a beneficial interest) for a term of five years with six five-year renewal options. In 2008, the Bank exercised the second five-year renewal option. Monthly rent for this space was a fair market rate as verified by an independent third-party appraisal. In the first quarter of 2012, the Bank purchased the property from Sunny Hill Land Trust, thus terminating the lease.

As of December 31, 2013, all of the other full-service banking locations were leased as described further below.

VNBTrust leases space at 310 4th Street, NE, Suite 102, Charlottesville, Virginia. As of January 1, 2014, this property was subleased to SRMC Holdings LLC, as part of the Sale Agreement described in Note 1 of the notes to the consolidated financial statements contained in Item 8. Trust services are now offered in offices at 404 People Place, Charlottesville, Virginia.

Lease terms for the above-mentioned properties are as follows:

404 People Place, Charlottesville, VA:

This property is located just east of the Charlottesville city limits on Pantops Mountain, and fronts on Route 250 East. The building was constructed by the Bank on a pad site leased in 2005 from Pantops Park, LLC for a term of twenty years, with seven five-year renewal options. William D. Dittmar, Jr., a director of the Bank, is the sole managing member of Pantops Park, LLC. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal. A five-story building, consisting of approximately 43,000 square feet, was completed in early 2008, and the Bank opened this full-service office in April, 2008. Additionally, the office building serves as the corporate headquarters for the Company and the Bank s Operations Center.

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222 East Main Street, Charlottesville, VA:

This property was originally leased from Williams Pentagram Corporation in 1998. The Bank entered into a new five-year lease in May, 2013 which provides for four more five-year renewal options.

1900 Arlington Boulevard, Charlottesville, VA:

This property was leased in 1998 from Paul and Jean Holdren for a term of twenty years with seven five-year renewal options. The Arlington Boulevard site has additional space not occupied by the banking facility. This space has been leased to tenants.

102 East Main Street, Orange, VA:

This property was leased in 2000 from The Bryant Foundation for a term of three years with three five-year renewal options. The Bank has exercised the third five-year renewal option. The Bank entered into a new five-year lease in January, 2011 for additional space on the second floor, where the Bank houses its disaster recovery site and some other operational office space. This lease has three two-year renewal options.

186 North Loudoun Street, Winchester, VA:

This property was originally leased in 2001 from Shenandoah University for a term of ten years with two five-year renewal options. In 2011, the Bank and Shenandoah University entered a new lease for this property for a term of five years with one five-year renewal term.

3119 Valley Avenue, #102, Winchester, VA:

This property is located in the Creekside Station Shopping Center. It was leased in 2003 from Joleen, L.C. for a term of ten years expiring January 31, 2014, with two five-year renewal options. In August, 2013, the lease was amended effective February 1, 2014 to extend the lease until January 31, 2019 with reduced payment terms.

310 4th Street, N.E., Suite 102, Charlottesville, VA (VNBTrust, N.A.):

This property was leased by VNBTrust in 2006 from Court Square, L.L.C. for a term of five years, with two five-year renewal options. The lease was amended effective December 20, 2010 to extend the lease until July 31, 2016 and to provide for an additional five-year renewal term with reduced payment terms. As of January 1, 2014, this property was subleased to SRCM Holdings, LLC for the remaining current lease term until July 31, 2016.

Item 3. LEGAL PROCEEDINGS.

In the ordinary course of its operations, the Company s subsidiaries are parties to various legal proceedings. Based on the information presently available, management believes that the ultimate outcome of such proceedings will not have an adverse effect on the business or financial condition of the Company and its subsidiaries.

Item 4. MINE SAFETY DISCLOSURES.

Not applicable

Part II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Virginia National Bankshares Corporation s Common Stock is quoted on the OTC Markets Group s OTCQB tier (OTCQB) under the symbol VABK. As of December 31, 2013, the Company had issued and outstanding 2,690,320 shares of Common Stock. These shares were held by approximately 556 shareholders of record and others who held shares at brokerage firms.

Prior to the second quarter of 2013, the Company had not paid a cash dividend. On June 18, 2013, the Board of Directors declared a quarterly cash dividend of $0.05 per share, payable on July 19, 2013 to shareholders of record as of July 8, 2013. Subsequently, quarterly dividends of $0.05 per share were declared as of September 19, 2013 and December 17, 2013. The payment of dividends is at the discretion of the Company s Board of Directors and is subject to various federal and state regulatory limitations. As a bank holding company, the ability to pay dividends is dependent upon the overall performance and capital requirements of the subsidiary Bank.

For the years ended December 31, 2013 and December 31, 2012, the data in the table below represents the high bid and low bid quotations that occurred for the periods shown as reported by the OTCQB. These over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. Additionally, the table shows the dividends declared per quarter in 2013 and 2012.

	Bid Quotations				Dividends Declared	
	2013		2012		2013	2012
	High	Low	High	Low		
First Quarter	$ 15.85	$ 13.52	$ 15.95	$ 13.87	$ -	$ -
Second Quarter	$ 16.75	$ 15.70	$ 16.00	$ 12.35	$ 0.05	$ -
Third Quarter	$ 17.10	$ 16.50	$ 15.00	$ 12.38	$ 0.05	$ -
Fourth Quarter	$ 18.25	$ 17.00	$ 15.35	$ 12.70	$ 0.05	$ -
Total					$ 0.15	$ -

American Stock Transfer and Trust Company is the Company s stock transfer agent and registrar.

Item 6. SELECTED FINANCIAL DATA.

Not required.

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion provides information about the major components of the results of consolidated operations and financial condition, liquidity and capital resources of Virginia National Bankshares Corporation. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements.

Application of Critical Accounting Policies and Critical Accounting Critical Estimates

The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States (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 financial statements.The Company s accounting policies are fundamental to understanding management s discussion and analysis of financial condition and results of operations.

Following are the accounting policies and estimates that the Company considers as critical:

- **Allowance for loan losses** is a reserve established through a provision for loan losses charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. Accounting policies related to the allowance for loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management. The Company s allowance for loan loss methodology includes allowance allocations calculated in accordance with Accounting Standards Codification (ASC) Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company s control, including the performance of the Company s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications. See the section captioned Allowance for Loan Losses elsewhere in this discussion and Note 3 Loans and Note 4 Allowance for Loan Loss in the notes to consolidated financial statements, included in Item 8. Financial Statements and Supplementary Data, elsewhere in this report for further details of the risk factors considered by management in estimating the necessary level of the allowance for loan losses.
- **Impaired loans** are loans so designated when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. Additional information on impaired loans, which includes both Troubled Debt Restructurings (TDRs) and non-accrual loans, is included in Note 3 Loans and Note 4 Allowance for Loan Loss in the notes to consolidated financial statements.
- **Fair value measurements** are used by the Company to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company s valuation methodologies may produce a fair value calculation that may not be indicative of net realized value or reflective of future fair values. While management believes the Company s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Additional discussion of valuation methodologies is presented in Note 14 Fair Value Measurements of the Company s consolidated financial statements.
- **Securities Available for Sale** are carried at fair value in accordance with ASC 320, Investments Debt and Equity Securities. The Company s unrestricted securities are classified as available for sale, meaning that the Company intends to hold these securities for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company s assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Unrealized gains or losses are reported as a separate component of other comprehensive income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. See the section captioned Securities later in this discussion and Note 1 Summary of Significant Accounting Policies and Note 2 Securities in the notes to consolidated financial statements.

- **Other-than-temporary impairment of securities** accounting policies require a periodic review by management to determine if the decline in the fair value of any security appears to be other-than-temporary. Factors considered in determining whether the decline is other-than-temporary include, but are not limited to: the length of time and the extent to which fair value has been below cost; the financial condition and near-term prospects of the issuer; and the Company s intent to sell. See Note 1 Summary of Significant Accounting Policies and Note 2 Securities, in the notes to consolidated financial statements, for further details on the accounting policies for other-than-temporary impairment of securities and the methodology used by management to make this evaluation.
- **Other real estate owned (OREO)** are assets acquired through, or in lieu of, loan foreclosures and are held for sale. Initially the OREO is recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less cost to sell. More information regarding the valuation methods used as well as the accounting for OREO is presented in Note 5 Other Real Estate Owned and Note 14 Fair Value Measurements of the Company s consolidated financial statements.
- **Income tax** accounting policies have the objective to recognize the amount of taxes payable or refundable for the current year and deferred tax assets and liabilities for future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company s consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact the Company s consolidated financial condition or results of operations. Additional discussion on the accounting for income taxes is presented in Note 1 Summary of Significant Accounting Policies and in Note 8 Income Taxes of the Company s consolidated financial statements.

Non-GAAP Presentations

The Company, in referring to its net income, is referring to income computed under GAAP. Management s Discussion and Analysis of Financial Condition and Results of Operations also refers to various calculations that are non-GAAP presentations. They include:

- **Fully taxable-equivalent (FTE) adjustments** are the result of increasing income from tax-free investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 34% Federal income tax rate, thus making tax-exempt yields comparable to taxable asset yields.
- **Efficiency ratio** is computed as a percentage of non-interest expense divided by the sum of net interest income (on an FTE basis) and non-interest income. This is a financial measure which may provide important information concerning the Company s operational efficiency. Comparison of the Company s efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently.

Results of Operations

The Company reported net income totaled $6.896 million, or $2.56 diluted per common share, in 2013 compared to $5.481 million, or $2.04 diluted per common share in 2012. Net income increased $1.415 million for 2013 compared to 2012. The increase was primarily the result of a $5.814 million increase in non-interest income that was offset by an increase of $2.385 million in non-interest expense, a decrease of $1.174 million in net interest income, and an increase in provision for loan losses and provision for income taxes of $239 thousand and $601 thousand, respectively.

Virginia National Bankshares Corporation has two reportable segments, the commercial bank and VNBTrust. 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 automatic teller machine fees and safe deposit box fees generate additional income for the commercial bank. VNBTrust services include investment management, trust account administration, and estate planning. VNBTrust receives fees on both a fixed basis and a performance basis for providing of these services.

The commercial bank earned net income of $2.049 million in 2013, $111 thousand more than the $1.938 million earned in 2012. VNBTrust earned net income of $4.847 million in 2013, compared to net income of $3.543 million in 2012, an increase of $1.304 million.

Details of the changes in the various components of net income are further discussed below.

Consolidated Return on Equity and Assets

The annualized ratio of net income to average total assets and average shareholders' equity and certain other ratios for the periods indicated are as follows:

	2013	2012	2011
Return on average assets	1.40%	1.11%	0.51%
Return on average equity	12.70%	10.90%	4.95%
Average equity to average assets	11.04%	10.21%	10.21%
Cash dividend payout ratio	5.86%	0.00%	0.00%

One of the ratios the Company examines in its evaluation of net income is the efficiency ratio, which measures the cost to produce one dollar of revenue. A lower ratio, computed by dividing non-interest expense by the sum of net interest income (on an FTE basis) and non-interest income, is an indicator of increased efficiency. The efficiency ratio for 2013 was positively impacted as a result of a revenue increase of $4.732 million as compared to 2012 and despite an increase in non-interest expense of $2.385 million in 2013 over 2012. The increases in revenue and expense in 2013 from 2012 was primarily attributable to VNBTrust's performance fee revenue and VNBTrust's incentive compensation expense. Similarly, the efficiency ratio for 2012 improved from 2011 as a result of an increase in revenue of $6.542 million that came namely from VNBTrust's performance fee revenue. Non-interest expense for 2012 was $2.277 million greater than 2011 due in part to OREO valuation write downs and an increase in VNBTrust s incentive compensation that was associated with the higher performance fee revenue.

The efficiency ratio for the years ended December 31, 2013, 2012, and 2011 is shown below.

	2013	2012	2011
Efficiency Ratio	67.9%	70.9%	82.0%

Net Interest Income

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. Net interest income represented 45.0% of total revenue in 2013. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

During 2013, net interest income, on a tax equivalent basis, was $14.601 million compared to $15.683 million in 2012. The $1.082 million decline in tax-equivalent net interest income year to year was mainly attributed to interest margin compression during this period of historically low interest rates. The net interest margin, which is net interest income expressed as a percentage of average earning assets, declined 21 basis points to 3.21% for the year ended December 31, 2013 from 3.42% reported for 2012. Further, the decrease in the net interest margin for 2012 was 31 basis points from the 3.73% net interest margin reported for the year ended December 31, 2011.

Total interest income, on a tax equivalent basis, aggregated $15.598 million for 2013, down $1.366 million from 2012, primarily as a result of a decline in loan interest income of $1.722 million. The decline in total interest income from loan income was partially offset by an increase of $389 thousand in tax equivalent interest income from the investment portfolio when comparing 2013 to 2012. In comparing 2012 to 2011, total interest income, on a tax equivalent basis, declined $884 thousand to $16.964 million in 2012 from $17.848 million in 2011. The tax-equivalent yield on interest-earning assets was 3.43% for 2013, compared to 3.70% for 2012 and 4.14% for 2011.

The $1.722 million decrease in interest income earned on the loan portfolio for 2013, from $14.720 million in 2012, was mainly attributable to rate adjustments and lower rates on new loans. The yield on the loan portfolio decreased to 4.43% for 2013 from 4.99% for 2012, resulting in a decrease of $1.567 million in loan income. The remaining $155 thousand decline in interest earned on loans for 2013 was due to a slight decrease in average loan balances to $293.5 million in 2013, fairly level with the average balance of $294.8 million for 2012.

The decline in interest income earned on the loan portfolio during 2013 was a continuation of the rate compression experienced over the past few years during this period of historically low rates and intense competition for loans. Loan interest income had decreased $1.061 million for 2012 from $15.781 million in 2011. The yield on the loan portfolio decreased 44 basis points in 2012 from 5.43% for 2011.

Although earning assets averaged $4.153 million less in 2013 than in 2012, the change in the mix of earning assets contributed positively to the change in net interest income. The major volume changes occurred with the average balances in low yielding federal funds sold declining $24.650 million year over year, offset by the Company s securities portfolio averaging $21.357 million more in 2013 versus 2012. The increase in the securities portfolio balances was the result of management s efforts to deploy excess funds in overnight federal funds sold, which earned on average 0.22% during 2013, by investing in securities which earned on average 1.99%.

Interest earned on the securities portfolio, on a tax-equivalent basis, increased to $2.513 million for 2013 from $2.124 million in 2012 and $2.019 million in 2011. Average securities balances increased to $126.157 million (27.7% of average earning assets) for 2013 from $104.800 million (22.8% of average earning assets) and $89.227 million (20.7% of average earning assets) in 2012 and 2011, respectively. The average yield on investment securities declined only 4 basis points from 2.03% in the corresponding 2012 period. In 2011, the average yield on the investment portfolio was 2.26%, or 23 basis points higher than in 2012. The continuing low rate environment continues to impact the overall portfolio yield.

Management s asset/liability strategy for the investment portfolio, starting in 2012, was to diversify the investment portfolio by adding mortgage-backed securities and bank-qualified municipal bonds. The average duration of the investment portfolio continues to be relatively short. Adding mortgage-backed securities has resulted in providing a consistent stream of cash flow that can be diverted to loan growth or re-invested in higher yielding securities when interest rates rise.

Total interest expense decreased by $284 thousand for 2013 to $997 thousand from $1.281 million for 2012, mainly due to a decline in the rates paid for interest-bearing liabilities from 0.43% for 2012 to 0.32% for 2013. The decrease in interest expense was partially a result of lower time deposit rates and a change in the mix of deposit balances. Time deposit rates averaged 0.59% in 2013, or 18 basis points lower than the 0.77% paid in 2012. In total, the average balance of interest-bearing liabilities increased $7.687 million. Average time deposit balances decreased $8.016 million in 2013, while average balances on interest checking accounts, daily overnight repurchase agreements, and money market accounts increased $10.056 million, $4.968 million, and $679 thousand, respectively.

Total interest expense decreased by $492 thousand for 2012 from $1.773 million for 2011. Further, rates paid for interest-bearing liabilities declined from 0.59% for 2011 to 0.43% for 2012. Over these same periods, time deposit rates averaged 30 basis points lower than the 1.07% paid in 2011. Average time deposit balances decreased $9.498 million in 2012 compared to 2011, while average interest checking and money market account balances increased $5.260 million and $2.710 million, respectively, for a net decline in the average balance of interest-bearing deposit accounts of $1.528 million.

A continuing primary driver of the Company s low cost of funds compared to peers is the Company s level of non-interest bearing demand deposits and low-cost deposit accounts. Below is a table illustrating the average balances of these accounts as a percentage of total deposit account balances.

Non-interest and low-cost deposit account analysis

(dollars in thousands)	2013		2012		2011	
	Average Balance	% of Total Deposits	Average Balance	% of Total Deposits	Average Balance	% of Total Deposits
Non-interest demand deposits	$ 127,480	29.7%	$ 139,741	31.9%	$ 111,649	27.1%
Interest checking accounts	77,954	18.2%	67,898	15.5%	62,638	15.2%
Money market deposit accounts	94,369	22.0%	93,690	21.4%	90,980	22.1%
Total non-interest and low-cost deposit accounts	$ 299,803	69.9%	$ 301,329	68.8%	$ 265,267	64.4%
Total deposit account balances	$ 428,619		$ 438,161		$ 411,597	

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Consolidated Average Balance Sheet And Analysis of Net Interest Income

(dollars in thousands)	Year Ended December 31, 2013 Average Balance	Interest Income Expense	Average Yield/ Cost	Year Ended December 31, 2012 Average Balance	Interest Income Expense	Average Yield/ Cost	Year Ended December 31, 2011 Average Balance	Interest Income Expense	Average Yield/ Cost
ASSETS									
Interest Earning Assets:									
Securities									
Taxable Securities	$ 106,842	$ 1,914	1.79%	$ 96,776	$ 1,890	1.95%	$ 87,247	$ 1,986	2.28%
Tax Exempt Securities [1]	19,315	599	3.10%	8,024	234	2.92%	1,980	33	1.67%
Total Securities [1]	126,157	2,513	1.99%	104,800	2,124	2.03%	89,227	2,019	2.26%
Loans:									
Real estate	230,320	10,651	4.62%	238,958	12,481	5.22%	240,429	13,573	5.65%
Commercial	50,382	1,910	3.79%	42,876	1,765	4.12%	38,128	1,717	4.50%
Consumer	12,769	437	3.42%	12,996	474	3.65%	11,909	491	4.12%
Total Loans	293,471	12,998	4.43%	294,830	14,720	4.99%	290,466	15,781	5.43%
Fed Funds Sold	33,770	74	0.22%	58,420	112	0.19%	51,444	48	0.09%
Other Interest Bearing Deposits	1,250	13	1.04%	751	8	0.00%	-	-	0.00%
Total Earning Assets	454,648	15,598	3.43%	458,801	16,964	3.70%	431,137	17,848	4.14%
Less: Allowance for Loan Losses	(3,439)			(3,704)			(3,732)		
Total Non-Earning Assets	40,728			37,031			35,532		
Total Assets	$ 491,937			$ 492,128			$ 462,937		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest Bearing Liabilities:									
Interest Bearing Deposits:									
Interest Checking	$ 77,954	$ 39	0.05%	$ 67,898	$ 34	0.05%	$ 62,638	$ 31	0.05%
Money Market Deposits	94,369	183	0.19%	93,690	194	0.21%	90,980	168	0.18%
Time Deposits	128,816	758	0.59%	136,832	1,049	0.77%	146,330	1,568	1.07%
Total Interest-Bearing Deposits	301,139	980	0.33%	298,420	1,277	0.43%	299,948	1,767	0.59%
Securities Sold Under Agreement to Repurchase	7,941	17	0.21%	2,973	4	0.13%	2,672	6	0.22%
Total Interest-Bearing Liabilities	309,080	997	0.32%	301,393	1,281	0.43%	302,620	1,773	0.59%
Non-Interest-Bearing Liabilities:									
Demand deposits	127,480			139,741			111,649		
Other liabilities	1,067			730			1,389		
Total Liabilities	437,627			441,864			415,658		
Shareholders' Equity	54,310			50,264			47,279		
Total Liabilities & Shareholders' Equity	$ 491,937			$ 492,128			$ 462,937		
Net Interest Income (Tax Equivalent)		$ 14,601			$ 15,683			$ 16,075	
Interest Rate Spread [2]			3.11%			3.27%			3.55%

Interest Expense as a Percentage of Average Earning Assets	0.22%	0.28%	0.41%