Virginia National Bankshares Corp
Form 10-K
March 30, 2016

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## 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, 2015** **Commission File Number: 000-55117**

## VIRGINIA NATIONAL BANKSHARES CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Virginia** | **46-2331578** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| **404 People Place, Charlottesville, Virginia** | **22911** |
| (Address of principal executive offices) | (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** | **OTC Markets Group s OTCQX Marketplace** |
| (Title of class) | (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 | Accelerated filer | Non-accelerated filer | 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 X**

On June 30, 2015, the aggregate market value of the common equity held by non-affiliates of the registrant was $46,984,807.

**The registrant has one class of common stock, of which 2,358,777 shares were outstanding as of close of business March 14, 2016.**

**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 18, 2016.

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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 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, should, or words of similar meaning or other statements conce 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 management's belief regarding future events, many of which, by their nature, are inherently uncertain and outside management's control. Any forward-looking statements made by the Company speak only as of the date on which such statements are made. The Company's 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.**

## 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 or Federal Reserve ). 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.

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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 regulations 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 also has a loan production office in Warrenton, Virginia. 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, treasury and cash management services and merchant card services. In addition, the Bank is affiliated with Visa® which is accepted worldwide and offers debit cards to consumer and business customers.

In the second quarter of 2014, the Company began to originate residential mortgage loans and to sell on the secondary market those loans which the Company does not wish to retain for its own loan portfolio due to the interest rate risks that are inherent with long-term fixed rate loans.

Investment management, wealth advisory and trust and estate services are offered through the Bank’s wholly-owned subsidiary, VNBTrust, National Association which offers services under the trade name VNB Wealth Management ( VNBTrust or VNB Wealth ). The flagship product for managed accounts employs a value-based, catalyst-driven investment strategy. The financial instruments used include common and preferred stock, corporate bonds, bank loans and other debt securities, convertible securities, Exchange Traded Funds ( EFTs ), options, warrants and cash equivalents. More information on VNB Wealth Management is available at www.vnbwealth.com.

Brokerage, investment advisory, annuity and insurance services and products are offered under the name of VNB Investment Services pursuant to networking agreement(s) with a registered broker/dealer and/or registered investment adviser to provide services through representatives who are also employees of the Company.

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. The Fund managed by SRCM represented less than 7 percent of the total assets managed by VNBTrust and SRCM at the Closing Date. A former officer of VNBTrust is the principal owner of SRCM Holdings. Additional details on this transaction are available in Note 1, in the notes to consolidated financial statements, contained in Item 8. Financial Statements and Supplementary Data.

References to the Company s subsidiaries in this document include both the Bank and the Bank s subsidiary, VNBTrust.

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As of March 1, 2016, the Company and its subsidiaries occupied the following seven full-service banking facilities in the cities of Charlottesville and Winchester, as well as the counties of Albemarle and Orange in Virginia:

| Location |
|---|
| 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 |
| 3119 Valley Avenue in Winchester, Virginia |
| 404 People Place, Charlottesville, Virginia |

The multi-story office building at 404 People Place also serves as the Company s corporate headquarters and operations center, as well as the principal offices of VNB Wealth Management. Additionally, the Company has a loan production office in Warrenton, Virginia.

**Market Area**

The population in the market area served by the Company continues to grow. According to the U.S. Census Bureau, the total market area served by the Company grew 20.0% between 2000 and 2010, as compared to 13.0 percent for the Commonwealth of Virginia as a whole. The Virginia State Demographer (the VSD ) estimates that, as of 2015, the population of the Commonwealth had grown by 4.7%, while the population in the Company s current markets had grown by 5.7%. By 2020, the VSD expects Virginia's population will be 10.1% higher than the 2010 Census totals, with the population in the Company's current market area projected to be 15.2% higher than reported by the 2010 Census,

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% between April 1, 2000 and April 1, 2010. The VSD estimates that the two municipalities have grown by an additional 7.6% to a population of 153,261 as of 2015 and projects these municipalities will continue to grow 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, Federal government-based facilities, and a large number of national retail chains.

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%. 2015 VSD estimates show the population to have grown to 34,015 persons.

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 VSD estimates that the combined populations for these two areas have already grown to 110,138 by 2015, a 5.4% increase, and expects these populations to be 125,159 by 2020, an increase of 19.8% over the 2010 census figure. The Winchester area combines growth within its own service and industrial sectors with growth attributable to the western and southern regions of Northern Virginia.

The Company s newest market area of Warrenton and Fauquier County is estimated by VSD to have a population of 67,898 as of 2015 and is projected to grow to 74,118 persons by 2020, a 5.7% increase over the 2010 population. Similar to the Winchester area, Fauquier County benefits from its proximity to Washington, D.C. and Northern Virginia for realizing growth.

**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.

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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.

***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.

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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 Wall Street Reform and Consumer Protection Act ( 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, and asset growth, as well as 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 respective 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.

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***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.* 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.

*2014 Capital Requirements*. Under the risk-based capital requirements of the Federal Reserve and the OCC that were effective through December 31, 2014, the Company and the Bank were 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, were 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 was required to be Tier 1 capital, which consisted 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 ) consisted 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 16.98% and 17.87%, respectively, as of December 31, 2014, thus exceeding the minimum requirements. The Tier 1 and total capital to risk-weighted asset ratios of the Bank were 14.74% and 15.63%, respectively, as of December 31, 2014, also exceeding the minimum requirements.

Each of the federal bank regulatory agencies also established a minimum leverage capital ratio of Tier 1 capital to average adjusted assets ( Tier 1 leverage ratio ) that was effective through December 31, 2014. The guidelines required a minimum Tier 1 leverage ratio of 3.0% for bank holding companies and banking organizations with the highest supervisory rating. All other banking organizations were required to maintain a minimum Tier 1 leverage ratio of 4% unless a different minimum was specified by an appropriate regulatory authority. In addition, for a depository institution to have been considered well capitalized under the regulatory framework for prompt corrective action, its Tier 1 leverage ratio must have been at least 5.0%. As of December 31, 2014, the Tier 1 leverage ratio of the Company and the Bank were 11.38% and 9.86%, respectively, well above the minimum requirements.

*Basel III Capital Requirements Effective January 1, 2015*. In June 2012, the federal bank regulatory agencies issued a series of proposed rules intended to 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 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 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 2.5% 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 2.5% 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.

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The Tier 1 and total capital to risk-weighted asset ratios of the Company were 12.60% and 13.39%, respectively, as of December 31, 2015, thus exceeding the minimum requirements. The Tier 1 and total capital to risk-weighted asset ratios of the Bank were 12.31% and 13.10%, respectively, as of December 31, 2015, also exceeding the minimum requirements. As of December 31, 2015, the Tier 1 leverage ratio of the Company and the Bank were 10.05% and 9.81%, respectively, well above the minimum requirements.

The capital conservation buffer requirement is being phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing by the same amount 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 prior ratio of 6.0%); and (iii) eliminating the provision that provided that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized. These new thresholds were effective for the Bank as of January 1, 2015. The minimum total capital to risk-weighted assets ratio (10.0%) and minimum leverage ratio (5.0%) for well-capitalized status were unchanged by the final rules.

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 non-accrual 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, 2015, the Company and 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.

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 2015 and 2014, the Company expensed only the base assessment rate for well capitalized institutions, which totaled $322,000 and $240,000, respectively, in regular deposit insurance assessments.

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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 2015 and 2014, the Company paid a Financing Corporation assessment of $29,000 and $28,000, respectively.

*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, 2015.

As described above in The Bank 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 received a satisfactory CRA rating in its most rece examination.

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*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 were effective April 1, 2014, with full compliance being phased in over a period which will end on July 21, 2016. The Company has evaluated the implications of the final rules on its investments and does not expect any material financial implications.

Under the 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 regulators solicited comments on the interim final rule, and this exemption could change prior to its effective date. The Company currently does not have any impermissible holdings of TruPS CDOs under the interim final rule and, therefore, will not be required to divest of any such investments or change their accounting treatment. The Company is continuously reviewing its investments to ensure compliance as the various provisions of the Volcker Rule regulations become effective.

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*Consumer Financial Protection*. The Bank is subject to a number of federal and state consumer protection laws that extensively govern its relationship with its customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, Secure and Fair Enforcement for Mortgage Licensing Act, laws governing flood insurance, federal and state laws prohibiting unfair and deceptive business practices, foreclosure laws, and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans and providing other services. If the Bank fails to comply with these laws and regulations, it may be subject to various penalties. Failure to comply with consumer protection requirements may also result in failure to obtain any required bank regulatory approval for merger or acquisition transactions the Bank may wish to pursue or being prohibited from engaging in such transactions even if approval is not required.

The Dodd-Frank Act centralized responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the CFPB ), and giving it responsibility for implementing, examining, and enforcing compliance with federal consumer protection laws. The CFPB focuses on (i) risks to consumers and compliance with the federal consumer financial laws, (ii) the markets in which firms operate and risks to consumers posed by activities in those markets, (iii) depository institutions that offer a wide variety of consumer financial products and services, and (iv) non-depository companies that offer one or more consumer financial products or services.

The CFPB has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks, including, among other things, the authority to prohibit unfair, deceptive or abusive acts and practices. Abusive acts or practices are defined as those that materially interfere with a consumer s ability to understand a term or condition of a consumer financial product or service or take unreasonable advantage of a consumer s (i) lack of financial savvy, (ii) inability to protect himself in the selection or use of consumer financial products or services, or (iii) reasonable reliance on a covered entity to act in the consumer s interests. The CFPB can issue cease-and-desist orders against banks and other entities that violate consumer financial laws. The CFPB may also institute a civil action against an entity in violation of federal consumer financial law in order to impose a civil penalty or injunction.

*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, and the consumer s debt-to-income ( DTI ) must be below the prescribed threshold. 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. Small creditors, as described below, may originate qualified mortgages that are not restricted by the specific DTI threshold (however, the DTI must still be considered). Small creditors are those financial institutions that meet the following requirements: (i) have assets below $2 billion (adjustable annually by CFPB); (ii) 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) hold the qualified mortgage loan in its portfolio after origination. The Company, as a small creditor, does comply with the qualified mortgage rules and the other applicable Truth in Lending requirements.

*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.

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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, 2015, the Company and the Bank have not been made aware of any instances of non-compliance with the final guidance.

*Cybersecurity*. In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution s management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution s operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution falls victim to this type of cyber-attack. This includes appropriate due diligence of its critical service providers to ensure effective recovery efforts have been implemented. If the Company fails to observe the regulatory guidance, it could be subject to various regulatory sanctions, including financial penalties. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, and the expanding use of technology-based products and services. The Company is, however, taking industry leading measures to combat these types of threats and manage risk to the Company and its customers.

***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; Availability of Information***

The Company is subject to the periodic and other reporting requirements of the Exchange Act, including the filing of annual, quarterly and other reports with the SEC. Prior to the Reorganization, the Bank filed the periodic and annual reports required under the Exchange Act with the OCC. Annual reports 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.vnbcorp.com* and under the Investor Relations section of the Bank s website at *www.vnb.com*. The Company s SEC filings are posted and available as soon as reasonably practicable after the reports are filed electronically with the SEC. The information on the Company’s or Bank’s website is not incorporated into this report or any other filing the Company makes with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at *www.sec.gov*.

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**Employees**

At December 31, 2015, the Company had 94 full time equivalent employees. None of its employees are represented by any collective bargaining unit. The Company considers relations with its employees to be good.

The Company owns Bank Owned Life Insurance ( BOLI ) policies on executives and other 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 insured employee and the Company.

**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, a loan production office was opened in 2014 at 92 Main Street, Suite 202-6, in Warrenton, Virginia.

The five-story building located at 404 People Place, Charlottesville, Virginia, just east of the Charlottesville city limits on Pantops Mountain, 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 Company, is the manager and indirect owner of Pantops Park, LLC. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal. The 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 its operations center, as well as the principal offices of VNB Wealth Management. A portion of the additional space not occupied by the Company and its subsidiaries is leased to tenants.

The property located at 1580 Seminole Trail, Charlottesville, Virginia has been fully owned by the Company since 2012. As of December 31, 2015, all of the other locations were leased from parties other than related parties. The banking facility located at 1900 Arlington Boulevard, Charlottesville, Virginia, was constructed by the Bank on a pad site which is leased by the Company; this facility has additional space not occupied by the banking facility that has been leased to tenants.

See Note 6 Premises and Equipment in the notes to consolidated financial statements in Item 8. Financial Statements and Supplementary Data for information with respect to the amounts at which the Company s premises and equipment are carried and commitments under long-term leases.

**Item 3. LEGAL PROCEEDINGS.**

There are no material pending legal proceedings to which the Company, including its subsidiaries, is a party or of which its property is the subject.

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**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.**

**Common Stock Performance and Dividends**

Virginia National Bankshares Corporation s Common Stock is quoted on the OTC Markets Group s OTCQX tier ( OTCQX ) under the symbol VABK. As of December 31, 2015, the Company had issued and outstanding 2,412,589 shares of Common Stock. These shares were held by approximately 500 shareholders of record, not including beneficial holders of securities held in street name at a brokerage or other firm.

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 Bank.

The data in the table below represents the high bid and low bid quotations that occurred for the periods shown, as reported by the OTCQX, for the years ended December 31, 2015 and December 31, 2014. 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 2015 and 2014.

| | Bid Quotations | | | | Dividends Declared | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | 2015 | 2014 |
| | High | Low | High | Low | | |
| First Quarter | $ 22.70 | $ 21.50 | $ 21.89 | $ 18.05 | $ 0.075 | $ 0.050 |
| Second Quarter | $ 22.45 | $ 21.75 | $ 23.45 | $ 21.57 | $ 0.100 | $ 0.075 |
| Third Quarter | $ 23.00 | $ 21.70 | $ 23.60 | $ 22.65 | $ 0.100 | $ 0.075 |
| Fourth Quarter | $ 25.00 | $ 22.52 | $ 23.50 | $ 22.67 | $ 0.100 | $ 0.075 |
| Total | | | | | $ 0.375 | $ 0.275 |

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

**Stock Repurchase Program**

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 Company announced on September 21, 2015 that its Board of Directors extended the program for another year to September 18, 2016. As of December 31, 2015, a total of 288,497 shares had been purchased since the beginning of this program, with the remaining 111,503 shares available for purchase through September 18, 2016 under the extended program (the Stock Repurchase Program ).

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The table below represents the number of shares repurchased by quarter since the Stock Repurchase Program s inception on September 16, 2014 through December 31, 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 16, 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 |
| July 1, 2015 to September 30, 2015 | - | - | 265,212 | 134,788 |
| 4th quarter 2015 (by month): | | | | |
| October 1-31, 2015 | - | - | 265,212 | 134,788 |
| November 1-30, 2015 | - | - | 265,212 | 134,788 |
| December 1-31, 2015 | 23,285 | 22.90 | 288,497 | 111,503 |
| Total October 1, 2015 to December 31, 2015 | 23,285 | $ 22.90 | 288,497 | 111,503 |
| Total | 288,497 | $ 22.89 | 288,497 | 111,503 |

**Item 6. SELECTED FINANCIAL DATA.**

Not required.

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

The following discussion provides information about the major components of the results of 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 in Item 8. Financial Statements and Supplementary Data.

**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.

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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 are 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 when 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 of the impairment, using either the present value of estimated future cash flows at 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 Losses 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 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)** represents 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 in the notes to consolidated financial statements.

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**Non-GAAP Presentations**

The Company, in referring to its net income, is referring to income computed under GAAP. Management s Discussion and Analysis of Consolidated Financial Condition and Results of Operations also refer 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 noninterest expense divided by the sum of net interest income (on an FTE basis) and noninterest 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**

**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:

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Return on average assets | 0.56% | 0.37% | 1.40% |
| Return on average equity | 5.34% | 3.16% | 12.70% |
| Average equity to average assets | 10.55% | 11.62% | 11.04% |
| Cash dividend payout ratio | 30.49% | 39.09% | 5.86% |

Net income for the year ended December 31, 2015 was $3.1 million, or $1.23 diluted per common share, a 64.4% increase compared to $1.9 million, or $0.70 diluted per common share, for the year ended December 31, 2014. This $1.2 million increase was positively impacted by a $1.8 million increase in interest income and a $1.0 million decrease in noninterest expense. Negatively affecting net income for 2015 compared to 2014 was a decrease of $726,000 in noninterest income, an increase of $741,000 in provision for income taxes, and an increase of $157,000 in provision for loan loss.

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. The Company computes its efficiency ratio by dividing noninterest expense by the sum of net interest income (on an FTE basis) and noninterest income. A lower ratio is an indicator of increased efficiency.

The efficiency ratio for 2015 compared favorably to 2014 as a result of improvements on both sides of the equation with lower noninterest expense and increased net interest income. The efficiency ratio was 76.6% for the year ended December 31, 2015 compared to 85.7% for the same period of 2014. Loan and deposit growth added to the revenue stream, while cost containment strategies lowered expenses.

The efficiency ratio for 2014 compared to 2013 was negatively impacted as a result of a revenue decrease of $12.2 million and despite a decrease in noninterest expense of $4.6 million in 2014 over 2013. The contraction in revenue and expense in 2014 from 2013 were primarily attributable to a decrease in Trust performance fee revenue and the associated incentive compensation expense. This is a result of the restructuring of VNBTrust (now operating under the trade name VNB Wealth Management) and the transactions related to Swift Run Capital Management, LLC discussed earlier under Item 1. Business.

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The efficiency ratios for the years ended December 31, 2015, 2014, and 2013 are shown below.

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Efficiency Ratio | 76.6% | 85.7% | 67.9% |

The Company has two reportable segments, the Bank and VNB Wealth. The Bank s commercial banking activities involve making loans, taking deposits and offering related services to 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. The VNB Wealth segment includes investment management, wealth advisory and trust and estate services offered by VNBTrust. Income from the VNB Wealth segment is primarily derived from two forms of fee income: management fees and performance fees.

The Bank segment earned net income of $3.8 million in 2015, a $2.0 million increase over the $1.8 million netted in 2014. VNB Wealth segment recorded a loss of $699,000 in 2015, compared to net income of $127,000 in 2014.

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

**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 for the Company and accounted for 77.0% of the total revenue in 2015. 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.

The following table details the average balance sheet, including an analysis of net interest income for earning assets and interest bearing liabilities, for the years ended December 31, 2015, 2014, and 2013.

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

| (dollars in thousands) | Year Ended December 31, 2015 Average Balance | Interest Income Expense | Average Yield/ Cost | Year Ended December 31, 2014 Average Balance | Interest Income Expense | Average Yield/ Cost | Year Ended December 31, 2 Average Balance | Interest Income Expense | Av Yie C |
|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | |
| Interest earning assets: | | | | | | | | | |
| Securities | | | | | | | | | |
| Taxable securities | $ 109,337 | $ 2,014 | 1.84% | $ 119,774 | $ 2,248 | 1.88% | $ 106,842 | $ 1,914 | |
| Tax exempt securities [1] | 18,858 | 660 | 3.50% | 19,876 | 723 | 3.64% | 19,315 | 677 | |
| Total securities [1] | 128,195 | 2,674 | 2.09% | 139,650 | 2,971 | 2.13% | 126,157 | 2,591 | |
| Loans: | | | | | | | | | |
| Real estate | 264,369 | 11,219 | 4.24% | 231,310 | 10,253 | 4.43% | 230,320 | 10,651 | |
| Commercial | 73,131 | 2,545 | 3.48% | 51,799 | 1,871 | 3.61% | 50,382 | 1,910 | |
| Consumer | 27,115 | 990 | 3.65% | 12,811 | 424 | 3.31% | 12,769 | 437 | |
| Total Loans | 364,615 | 14,754 | 4.05% | 295,920 | 12,548 | 4.24% | 293,471 | 12,998 | |
| Fed funds sold | 24,347 | 58 | 0.24% | 41,156 | 90 | 0.22% | 33,770 | 74 | |
| Other interest bearing deposits | 1,751 | 21 | 1.20% | 1,767 | 19 | 1.08% | 1,250 | 13 | |
| Total earning assets | 518,908 | 17,507 | 3.37% | 478,493 | 15,628 | 3.27% | 454,648 | 15,676 | |
| Less: Allowance for loan losses | (3,438) | | | (3,240) | | | (3,439) | | |
| Total non-earning assets | 38,278 | | | 41,044 | | | 40,728 | | |
| Total assets | $ 553,748 | | | $ 516,297 | | | $ 491,937 | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | | | | | | |
| Interest bearing liabilities: | | | | | | | | | |
| Interest bearing deposits: | | | | | | | | | |
| Interest checking | $ 82,641 | $ 41 | 0.05% | $ 81,881 | $ 41 | 0.05% | $ 77,954 | $ 39 | |
| Money market deposits | 99,918 | 210 | 0.21% | 89,061 | 164 | 0.18% | 94,369 | 183 | |
| Time deposits | 115,092 | 674 | 0.59% | 122,659 | 686 | 0.56% | 128,816 | 758 | |
| Total interest-bearing deposits | 297,651 | 925 | 0.31% | 293,601 | 891 | 0.30% | 301,139 | 980 | |
| Fed funds purchased & securities sold under agreement to repurchase | 20,171 | 49 | 0.24% | 15,480 | 37 | 0.24% | 7,941 | 17 | |
| Total interest-bearing liabilities | 317,822 | 974 | 0.31% | 309,081 | 928 | 0.30% | 309,080 | 997 | |
| Non-Interest-Bearing Liabilities: | | | | | | | | | |
| Demand deposits | 176,256 | | | 144,964 | | | 127,480 | | |
| Other liabilities | 1,233 | | | 2,277 | | | 1,067 | | |
| Total liabilities | 495,311 | | | 456,322 | | | 437,627 | | |
| Shareholders' equity | 58,437 | | | 59,975 | | | 54,310 | | |
| Total liabilities & shareholders' equity | $ 553,748 | | | $ 516,297 | | | $ 491,937 | | |
| Net interest income (tax equivalent) | | $ 16,533 | | | $ 14,700 | | | $ 14,679 | |
| Interest rate spread [2] | | | 3.06% | | | 2.97% | | | |
| Interest expense as a percentage of average earning assets | | | 0.19% | | | 0.19% | | | |
| Net interest margin [3] | | | 3.19% | | | 3.07% | | | |

[1] Tax-exempt income for investment securities has been adjusted to a tax-equivalent basis (FTE), using a Federal income tax rate of 34%.
[2] Interest Rate 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.

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This next table describes the impact on the net interest income of the Company resulting from changes in average balances and average rates for the periods 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. Interest income is reported on a tax-equivalent basis.

**Volume and Rate Analysis**

**2015 compared to 2014**
**(dollars in thousands)**

| | Change due to: Volume | Change due to: Rate | Increase/ (Decrease) |
|---|---|---|---|
| Assets: | | | |
| Securities | $ (240) | $ (57) | $ (297) |
| Loans: | | | |
| Real estate | 1,417 | (451) | 966 |
| Commercial | 745 | (71) | 674 |
| Consumer | 518 | 48 | 566 |
| Total loans | 2,680 | (474) | 2,206 |
| Federal funds sold | (39) | 7 | (32) |
| Other interest bearing deposits | - | 2 | 2 |
| Total earning assets | $ 2,401 | $ (522) | $ 1,879 |
| | | | |
| Liabilities and Shareholders' equity: | | | |
| Interest-bearing deposits: | | | |
| Interest checking | $ - | $ - | $ - |
| Money market | 21 | 25 | 46 |
| Time deposits | (43) | 31 | (12) |
| Total interest-bearing deposits | (22) | 56 | 34 |
| Fed funds purchased & securities sold under agreements to repurchase | 11 | 1 | 12 |
| Total interest-bearing liabilities | (11) | 57 | 46 |
| Change in net interest income | $ 2,412 | $ (579) | $ 1,833 |

**2014 compared to 2013**
**(dollars in thousands)**

| | Change due to: Volume | Change due to: Rate | Increase/ (Decrease) |
|---|---|---|---|
| Assets: | | | |
| Securities | $ 261 | $ 119 | $ 380 |
| Loans: | | | |
| Real estate | 46 | (444) | (398) |
| Commercial | 53 | (92) | (39) |
| Consumer | 1 | (14) | (13) |
| Total loans | 100 | (550) | (450) |
| Federal funds sold | 16 | - | 16 |
| Other interest bearing deposits | 6 | - | 6 |
| Total earning assets | $ 383 | $ (431) | $ (48) |
| | | | |
| Liabilities and Shareholders' equity: | | | |
| Interest-bearing deposits: | | | |
| Interest checking | $ 2 | $ - | $ 2 |
| Money market | (10) | (9) | (19) |
| Time deposits | (35) | (37) | (72) |
| Total interest-bearing deposits | (43) | (46) | (89) |

| | | | |
|---|---|---|---|
| Fed funds purchased & securities sold under agreements to repurchase | 18 | 2 | 20 |
| Total interest-bearing liabilities | (25) | (44) | (69) |
| Change in net interest income | $ 408 | $ (387) | $ 21 |

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For the twelve months of 2015, net interest income of $16.3 million was recognized, an improvement of $1.8 million or 12.4% over the same period in 2014. Net interest income for 2014 totaled $14.5 million and was fairly level with the 2013 total of $14.4 million. An increase of $40.4 million in average earning assets for 2015 compared to the prior year, along with an improved mix in earning assets, contributed to the significant rise in revenue. The average balance for loans as a percentage of earnings assets for 2015 improved to 70.3% compared to 61.8% and 64.5% in 2014 and 2013, respectively.

The 2015 net interest margin of 3.19% improved 12 basis points from 3.07% for the year ended December 31, 2014. The yield on average earning assets for 2015 of 3.37% was 10 basis points higher than the 2014 yield of 3.27%, resulting in the margin improvement. Although loan yields dropped by 19 basis points year-over-year, the $68.7 million increase in average loans and the resultant shift in the earning asset mix contributed to the overall yield increase on earning assets. Loan yields contracted due to lower rates on new production in the protracted low interest rate environment combined with pay-offs and repricing of higher interest loans. The Company expects some downward pressure on loan yields to continue into early 2016.

Interest expense as a percentage of average earning assets remained fairly consistent and low compared to peers at 19 basis points for 2015 and 2014, down from the 22 basis points in 2013. 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 (dollars in thousands).

**Non-interest and low-cost deposit account analysis**

| (dollars in thousands) | 2015 | | 2014 | | 2013 | |
|---|---|---|---|---|---|---|
| | Average Balance | % of Total Deposits | Average Balance | % of Total Deposits | Average Balance | % of Total Deposits |
| Non-interest demand deposits | $ 176,256 | 37.2% | $ 144,964 | 33.0% | $ 127,480 | 29.7% |
| Interest checking accounts | 82,641 | 17.4% | 81,881 | 18.7% | 77,954 | 18.2% |
| Money market deposit accounts | 99,918 | 21.1% | 89,061 | 20.3% | 94,369 | 22.0% |
| Total non-interest and low-cost deposit accounts | $ 358,815 | 75.7% | $ 315,906 | 72.0% | $ 299,803 | 69.9% |
| Total deposit account balances | $ 473,907 | | $ 438,565 | | $ 428,619 | |

**Provision for Loan Losses**

The level of the allowance reflects changes in the size of the portfolio or in any of its components as well as management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, and current loan portfolio quality, as well as economic, political and regulatory conditions. Additional information concerning management s methodology in determining the adequacy of the allowance for loan losses is contained later in this section under Allowance for Loan Loss, in addition to Note 1 and Note 4 of the notes to consolidated financial statements, found in Item 8. Financial Statements and Supplementary Data, later in this report.

Based on management s continuing evaluation of the loan portfolio in 2015, the Company recorded a provision for loan losses of $463,000, compared to a provision of $306,000 in 2014. The major factor driving the $157,000 increase in the provision for loan loss between 2015 and 2014 was the net increase in loan balances of $110.4 million from year-end 2014 to year-end 2015. Allowance for loans loss for the year 2015 compared to 2014 increased 12.7%, even though total loan balances increased 35.2% over that same period. Net loan charge-offs of $60,000 in 2015 and $67,000 in 2013 were significantly lower than the net charge-offs of $502,000 in 2014. The relatively higher charge-offs experienced in 2014 required the Company to replenish the Allowance for Loan Loss balance and was a major factor in accounting for the provision expense of $306,000 in 2014, compared to the 2013 provision of $160,000.

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The following is a summary of the changes in the allowance for loan losses for the years ended December 31, 2015, 2014, and 2013:

| (dollars in thousands) | 2015 | 2014 | 2013 |
|---|---|---|---|
| Allowance for loan losses, January 1 | $ 3,164 | $ 3,360 | $ 3,267 |
| Charge-offs | (141) | (551) | (161) |
| Recoveries | 81 | 49 | 94 |
| Provision for loan losses | 463 | 306 | 160 |
| Allowance for loan losses, December 31 | $ 3,567 | $ 3,164 | $ 3,360 |
| Allowance for loan losses as a percentage of period-end total loans | 0.84% | 1.01% | 1.12% |

**Noninterest Income**

The major components of noninterest income are detailed below. Year-to-year variances are shown for each noninterest income category.

| | For the year ended | | Variance | |
|---|---|---|---|---|
| (dollars in thousands) | December 31, 2015 | December 31, 2014 | $ | % |
| Noninterest income: | | | | |
| Trust income | $ 1,710 | $ 2,367 | $ (657) | -27.8% |
| Customer service fees | 956 | 894 | 62 | 6.9% |
| Debit/credit card and ATM fees | 825 | 742 | 83 | 11.2% |
| Earnings on bank owned life insurance | 442 | 439 | 3 | 0.7% |
| Gains on sales of assets | - | 44 | (44) | -100.0% |
| Gains on sales of securities | 104 | 24 | 80 | 333.3% |
| Royalty income | 140 | 593 | (453) | -76.4% |
| Fees on mortgage sales | 217 | 76 | 141 | 185.5% |
| Other | 477 | 418 | 59 | 14.1% |
| Total noninterest income | $ 4,871 | $ 5,597 | $ (726) | -13.0% |

Year-over-year total noninterest income declined $726,000. This decrease is primarily driven by lower trust and royalty income. Trust performance fees, if any, are generally realized in the fourth quarter each year as they are contingent and variable based upon the performance of the accounts that we actively manage on a year-over-year basis. Performance fees of $16,000 were recognized during 2015 from accounts managed by VNB Wealth Management. This compared to performance fees of $523,000 recognized during 2014 and was the major factor in the $657,000 decline in trust income. Additionally, performance fee royalty income associated with the sale of a former fund management business is also recognized in the same manner and timeframe as performance related trust fees. No performance fee royalty income was recognized in 2015, compared to $426,000 in 2014, which drove the majority of the $453,000 decrease in total royalty income for 2015.

Higher revenue, largely associated with fee restructure initiatives which began in late 2014, partially offset these decreases in performance fees. 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 competitive and providing customers the same high level of service. Increases were recognized in customer service fees, debit/credit card and ATM fees, and miscellaneous service charges, and in total increased $263,000 in 2015 compared to 2014. While the new fee schedules started positively impacting revenue in late 2014, the full effect was not realized until 2015.

In addition, in mid-2014, the Company initiated a new source of revenue by hiring a secondary market mortgage loan originator. Since the Company did not begin to recognize income from this new business line until late in 2014, the Company had not yet fully realized the impact that these fees on mortgage sales would have on a full-year basis until 2015, which explains the $141,000 increase on a sequential year basis.

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**Noninterest Expense**

In a year-over-year comparison, noninterest expense of $16.4 million reported for the twelve months of 2015 was down $1.0 million or 5.7% from the $17.4 million for the same period of 2014. The major components of noninterest expense are detailed below. Year-to-year variances are shown for each noninterest expense category.

| (dollars in thousands) | For the year ended December 31, 2015 | For the year ended December 31, 2014 | Variance $ | Variance % |
|---|---|---|---|---|
| Noninterest expense: | | | | |
| Salaries and employee benefits | $ 8,869 | $ 9,305 | $ (436) | -4.7% |
| Net occupancy | 1,940 | 1,954 | (14) | -0.7% |
| Equipment | 550 | 531 | 19 | 3.6% |
| ATM, debit and credit card | 301 | 349 | (48) | -13.8% |
| Bank franchise tax | 381 | 328 | 53 | 16.2% |
| Computer software | 332 | 330 | 2 | 0.6% |
| Data processing | 1,049 | 1,025 | 24 | 2.3% |
| FDIC deposit insurance assessment | 351 | 268 | 83 | 31.0% |
| Marketing, advertising and promotion | 505 | 774 | (269) | -34.8% |
| Net OREO write downs and expenses | 231 | 345 | (114) | -33.0% |
| Professional fees | 544 | 696 | (152) | -21.8% |
| Other | 1,345 | 1,486 | (141) | -9.5% |
| Total noninterest expense | $ 16,398 | $ 17,391 | $ (993) | -5.7% |

Salaries and employee benefits accounted for $436,000 of the $1.0 million savings. At December 31, 2015, the Company had 94 full time equivalent employees compared to 101 at year-end 2014. A concerted effort to utilize technology more efficiently, to reassess the headcounts needed in retail offices, and to discontinue unprofitable services led to the headcount decrease and resulted in lower expenses for salaries and employee benefits.

Decreased marketing and promotion expenses of $269,000, professional and consulting fees of $152,000, and OREO write downs and expenses of $114,000, together with more modest decreases in other noninterest expense categories, were other drivers in the year-over-year decline. Management continues to evaluate expense categories for potential reductions that would have a positive impact on net income on an ongoing basis.

**Provision for Income Taxes**

In 2015, the Company provided $1.2 million for Federal income taxes, resulting in an effective income tax rate of 27.7%. For 2014, the Company provided $456,000 for Federal income taxes, resulting in an effective income tax rate of 19.4%. The effective income tax rates differed from the U.S. statutory rate of 34% during the comparable periods primarily due to the effect of tax-exempt income from municipal bonds and life insurance policies. The tax benefits from the tax-exempt income in 2015 and 2014 of $298,000 and $318,000, respectively, remained fairly constant over the two periods. However, the higher effective tax rate for 2015 compared to the prior year was a result of significantly higher net income before taxes that was taxable at the full statutory rate.

More information on income taxes, including net deferred taxes can be found in Note 8 of the notes to consolidated financial statements which is found in Item 8. Financial Statements and Supplementary Data, later in this report.

**BALANCE SHEET ANALYSIS**

**Securities**

The investment securities portfolio has a primary role in the management of the Company s liquidity requirements, interest rate sensitivity and in generating substantial interest income. Investment securities play a key role in diversifying the Company s balance sheet. In addition, a portion of the investment securities portfolio is pledged as collateral for public fund deposits and for commercial customers utilizing the Bank s overnight repurchase program. Changes in deposit and other funding balances and in loan production will impact the overall level of the investment portfolio.

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As of December 31, 2015, the Company s investment portfolio totaled $76.5 million, of which obligations of U.S. government corporations and government-sponsored enterprises amounted to $49.7 million which is approximately 65.0% of the total. The investment portfolio as of December 31, 2014 totaled $143.4 million. The year-over-year decline of 46.7% was a result of management s focus on maximizing the earning capacity of the Company by moving funds from investment securities into higher yielding loans. The average yield, on a tax-equivalent basis, on the investment securities in 2015 was 2.09%, or almost 2% lower than the average yield on loans of 4.05% for the same period. A discussion on the growth in the loan portfolio follows.

For the year ended December 31, 2015, proceeds from the sales and calls of securities amounted to $72.3 million, and gross realized gains on these securities were $104,000. For the year ended December 31, 2014, proceeds from the sales and calls of securities amounted to $10.3 million, and gross realized gains on these securities were $24,000.

In accordance with ASC 320, Investments - Debt and Equity Securities, the Company has categorized its unrestricted securities portfolio as Available for Sale ( AFS ). Securities classified as AFS may be sold in the future, prior to maturity. Any decision to sell a security classified as AFS 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. AFS securities are carried at fair value. Net aggregate unrealized gains or losses on these securities are included, net of taxes, as a component of shareholders equity. All of the Company s securities were investment grade or better as of December 31, 2015. Given the generally high credit quality of the portfolio, management expects to realize all of its investment upon market recovery or the maturity of such instruments and thus believes that any impairment in value is interest-rate-related and therefore temporary. AFS securities included gross unrealized gains of $447,000 and gross unrealized losses of $625,000 as of December 31, 2015.

**Securities Available for Sale and Restricted Securities**
**(dollars in thousands)**

| **Carrying Value of Securities** | **As of December 31, 2015** | **2014** | **2013** |
|---|---|---|---|
| **Securities Available for Sale** | | | |
| Fair Value: | | | |
| U.S. Government-Sponsored Agencies | $ 11,378 | $ 31,528 | $ 44,005 |
| Corporate Bonds | 5,964 | 21,276 | 9,053 |
| Asset-Backed Securities | - | 2,105 | 2,100 |
| Mortgage-Backed Securities/CMOs | 36,687 | 63,220 | 55,597 |
| Municipal Bonds | 20,772 | 23,687 | 22,272 |
| | $ 74,801 | $ 141,816 | $ 133,027 |
| Cost: | | | |
| Federal Reserve Bank Stock | $ 1,039 | $ 1,039 | $ 1,036 |
| Federal Home Loan Bank Stock | 578 | 462 | 609 |
| CBB Financial Corporation Stock | 64 | 64 | - |
| | $ 1,681 | $ 1,565 | $ 1,645 |

All mortgage-backed securities included in the above tables were issued by U.S. government agencies and corporations. At December 31, 2015, the securities issued by political subdivisions or agencies were highly rated with 79% of the municipal bonds having AA or higher ratings. Approximately 74% of the municipal bonds are general obligation bonds with issuers that are geographically diverse. The Company does not hold any derivative instruments. The Company held no issues that exceeded 10% of Shareholders' Equity at December 31, 2015.

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The Company s holdings of restricted securities totaled $1.7 million at December 31, 2015 and $1.6 million at December 31, 2014 and consisted of stock in Federal Reserve Bank of Richmond, Federal Home Loan Bank of Atlanta, and stock of CBB Financial Corporation, the holding company for Community Bankers Bank. The Bank is required to hold stock in the Federal Reserve Bank of Richmond and the Federal Home Loan Bank of Atlanta as a condition of membership with each of these correspondent banks. The amount of stock required to be held by the Bank is periodically assessed by each bank, and the Bank may be subject to purchase or put back stock held in these banks, as determined by their respective calculations. 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 stock issues are traded on the open market and can only be redeemed by the respective issuer. Restricted stock holdings are recorded at cost.

The table shown below details the amortized cost and fair value of available for sale securities at December 31, 2015 based upon contractual maturities, by major investment categories. Expected maturities may differ from contractual maturities because issuers have the right to call or prepay obligations. The tax-equivalent yield is based upon a federal tax rate of 34%.

**Maturity Distribution and Average Yields**
**(dollars in thousands)**

**Contractual Maturities of Securities at December 31, 2015**

| | Amortized Cost | Fair Value | Tax Equivalent (T/E) Yield | % of AFS Portfolio |
|---|---|---|---|---|
| **U.S. Government-Sponsored Agencies:** | | | | |
| One year or less | $ 5,007 | $ 5,028 | 2.36% | |
| After one year to five years | 3,309 | 3,367 | 2.19% | |
| After five years to ten years | 2,944 | 2,983 | 2.29% | |
| | $ 11,260 | $ 11,378 | 2.29% | 15.1% |
| **Corporate Bonds** | | | | |
| After one year to five years | $ 4,040 | $ 4,012 | 1.76% | |
| After five years to ten years | 1,987 | 1,952 | 2.64% | |
| | $ 6,027 | $ 5,964 | 2.05% | 8.0% |
| **Mortgage-Backed Securities/CMOs** | | | | |
| After one year to five years | $ 555 | $ 548 | 1.05% | |
| After five years to ten years | 9,969 | 9,892 | 1.37% | |
| After ten years | 26,553 | 26,247 | 1.84% | |
| | $ 37,077 | $ 36,687 | 1.70% | 49.4% |
| **Municipal Bonds** | | | | |
| One year or less | $ 105 | $ 105 | 1.82% | |
| After one year to five years | 2,097 | 2,110 | 2.03% | |
| After five years to ten years | 11,286 | 11,427 | 3.19% | |
| After ten years | 7,127 | 7,130 | 3.65% | |
| | $ 20,615 | $ 20,772 | 3.22% | 27.5% |
| **Total Securities Available for Sale** | $ 74,979 | $ 74,801 | | |

As stated, the above table reflects the distribution of the contractual maturities of investment portfolio at December 31, 2015. Management s investment portfolio strategy is to structure the portfolio so that it is a constant source of liquidity for the balance sheet. In order to achieve greater liquidity in the portfolio, securities that have a monthly flow of principal repayments become a key component. To illustrate the difference between contractual maturity and average life, consider the difference for the fixed rate mortgage-backed securities (MBS) component of this portfolio. At December 31, 2015, the weighted average maturity (WAM) of the fixed rate MBS sector was 10.33 years, and the projected average life for this group of securities is 4.0 years.

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Another indication of the investment portfolio s liquidity potential is shown by the projected annual principal cash flow from maturities, callable bonds, and monthly principal repayments. For the next three years, the principal cash flows are estimated to be $12.3 million for 2016, $13.9 million for 2017, and $10.1 million for 2018, based upon rates remaining at current levels. This represents nearly half of the investment portfolio s available for sale balance at December 31, 2015 that will be available to support the future liquidity needs of the Company. Cash flow projections are subject to change based upon changes to market interest rates.

**Loan Portfolio**

The Company s loan portfolio totaled $423.7 million as of December 31, 2015 or 74.7% of total assets. Loan balances increased $110.4 million, or 35.2% from the balance of $313.3 million as of December 31, 2014.

**Loan Portfolio**

**(dollars in thousands)**

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2012** | **2011** |
| Commercial loans | $ 70,868 | $ 60,940 | $ 48,060 | $ 45,370 | $ 42,157 |
| Real estate construction | 18,911 | 11,912 | 18,461 | 14,193 | 17,475 |
| Real estate mortgage: | | | | | |
| Residential | 63,544 | 60,162 | 54,300 | 56,820 | 59,995 |
| Home equity loans | 27,599 | 25,498 | 29,612 | 31,433 | 32,802 |
| Commercial | 178,258 | 141,342 | 135,997 | 125,089 | 128,611 |
| Total real estate mortgage | 269,401 | 227,002 | 219,909 | 213,342 | 221,408 |
| Consumer | 64,484 | 13,400 | 13,604 | 11,955 | 11,492 |
| Total loans | 423,664 | 313,254 | 300,034 | 284,860 | 292,532 |
| Less: Allowance for loan losses | (3,567) | (3,164) | (3,360) | (3,267) | (3,741) |
| Net loans | $ 420,097 | $ 310,090 | $ 296,674 | $ 281,593 | $ 288,791 |

The Company has experienced five sequential quarters of significant expansion in total loans. From the $289.6 million outstanding at September 30, 2014, gross loans have increased $134.1 million, or 46.3%, due to approximately $70.7 million in net organic loan growth, supplemented by purchases of $27.0 million in syndicated loans and $36.4 million in student loans. The purchase of loans is considered a secondary strategy, which allows the Company to supplement organic loan growth. 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 first package of student loans totaling $10.8 million was purchased at the end of the second quarter of 2015, and a second student loan package totaling $25.6 million closed in the fourth quarter of 2015. Along with the purchase of these student loans, the Company purchased a surety bond that fully insures this portion of the Company s consumer portfolio. Management will continue to evaluate loan purchase transactions as needed to supplement organic loan growth, as part of its strategy to strengthen earnings and normalize the loan-to-deposit ratio. The loan-to-deposit ratio at December 31, 2015 stood at 87.1%, an 18.5% improvement over the 68.6% at December 31, 2014.

The Company s objective is to maintain the historically strong credit quality of the loan portfolio by maintaining rigorous underwriting standards. These standards coupled with regular evaluation of the creditworthiness of and the designation of lending limits for each borrower has helped the Company achieve this objective. The primary portfolio strategy includes 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 area for organic loans is Charlottesville, Albemarle County, Orange County, Warrenton, Winchester, Frederick County and adjacent counties.

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Based on underwriting standards, loans and leases may be secured in whole or in part by collateral such as liquid assets, accounts receivable, equipment, inventory and real property. The collateral securing any loan may depend on the type of loan and may vary in value based on market conditions.

The Company s real estate loan portfolio increased by $42.4 million, from the balance of $227.0 million at December 31, 2014, to $269.4 million at December 31, 2015. This category represented 63.6% of all loans, and these loans are secured by mortgages on real property located principally in Virginia. Of this amount, approximately $91.1 million represented loans on residential properties. Commercial real estate loans totaled $178.3 million as of December 31, 2015. Sources of repayment are from the borrower s operating profits, cash flows and liquidation of pledged collateral.

As of December 31, 2015, the Company s commercial and industrial loan portfolio totaled $70.9 million, a $9.9 million increase from the balance at year-end 2014. This category, representing approximately 16.7% of all loans, includes loans made to individuals and small to medium-sized businesses, as well as loans purchased on the syndicated market. The balance on syndicated loans totaled $23.7 million, or 33.4% of the commercial loan total as of the end of 2015.

Consumer loans, comprised of student loans purchased, revolving credit, and other fixed payment loans, totaled $64.5 million as of December 31, 2015 or 15.2% of all loans. Consumer loans experienced the largest expansion of any loan segment and ended 2015 with balances $51.1 million higher than the prior year-end. Although the student loan packages purchased during 2015 totaled $35.7 million at year-end and accounted for most of the increase, organic consumer loans grew significantly by $15.4 million year-over-year.

Loans for construction and land development totaled $18.9 million and made up the remaining 4.5% of loans as of December 31, 2015. These loans grew by $7.0 million compared to December 31, 2014.

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The following table presents the maturity distribution of the Company s loans at December 31, 2015. The table also presents the portion of loans that have fixed interest rates or variable/floating interest rates that fluctuate over the life of the loans in accordance with changes in an interest rate index such as the Wall Street Journal prime rate, LIBOR rates, or U.S. Treasury bond indices.

**Maturities and Sensitivities of Loans to Changes in Interest Rates**

| (dollars in thousands) | As of December 31, 2015 | | | |
|---|---|---|---|---|
| | Due in One Year or Less | After One to Under Five Years | After Five Years | Total |
| Commercial loans | $ 13,820 | $ 34,383 | $ 22,665 | $ 70,868 |
| Real estate construction and land | 5,972 | 3,323 | 9,616 | 18,911 |
| Real estate mortgage: | | | | |
| 1-4 family residential | 6,208 | 2,942 | 54,394 | 63,544 |
| Home equity loans | 637 | 758 | 26,204 | 27,599 |
| Commercial real estate | 1,282 | 12,246 | 164,730 | 178,258 |
| Consumer | 10,589 | 17,342 | 36,553 | 64,484 |
| Total | $ 38,508 | $ 70,994 | $ 314,162 | $ 423,664 |
| | | | | |
| Loans with fixed interest rates | $ 5,577 | $ 34,486 | $ 49,813 | $ 89,876 |
| Loans with floating interest rates | 32,931 | 36,508 | 264,349 | 333,788 |
| Total | $ 38,508 | $ 70,994 | $ 314,162 | $ 423,664 |

**Loan Asset Quality**

Intrinsic to the lending process is the possibility of loss. While management endeavors to minimize this risk, it recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio, which in turn depend on current and future economic conditions, the financial condition of borrowers, the realization of collateral, and the credit management process.

The Company places a loan on non-accrual status when management believes, after considering economic and business conditions and collections efforts, that it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement, or when the loan is past due for 90 days or more, unless the debt is both well-secured and in the process of collection.

Troubled debt restructurings ( 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. TDRs that are considered to be performing continue to accrue interest under the terms of the restructuring agreement. TDRs that have been placed in non-accrual status are considered to be nonperforming.

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At December 31, 2015 and December 31, 2014, the Company had three loans classified as non-accrual with balances of $191,000 and $218,000, respectively. This compares favorably to December 31, 2013, when the Company had five loans with balances of $367,000 classified as non-accrual. TDRs that are still performing have remained fairly constant over the three years shown and ended December 31, 2015 with three loans totaling $1.4 million classified as TDRs. The Company ended the year with no loans over 90 days past due that were still accruing interest. Below is a summary of loans identified with these risk elements:

**(dollars in thousands)**

**Non-Accrual Loans**

| | As of December 31, | | |
|---|---|---|---|
| | **2015** | **2014** | **2013** |
| **Total** | $ 191 | $ 218 | $ 367 |
| **Number of Loans** | 3 | 3 | 5 |

**Loans Past Due 90 Days or More and Still Accruing**

| | As of December 31, | | |
|---|---|---|---|
| | **2015** | **2014** | **2013** |
| **Total** | $ - | $ - | $ 178 |
| **Number of Loans** | 0 | 0 | 2 |

**Troubled Debt Restructurings, Performing**

| | As of December 31, | | |
|---|---|---|---|
| | **2015** | **2014** | **2013** |
| **Total** | $ 1,427 | $ 1,479 | $ 1,369 |
| **Number of Loans** | 3 | 3 | 2 |

See Note 3 Loans and Note 4 Allowance for Loan Losses in the accompanying notes to consolidated financial statements included in Item 8. Financial Statements and Supplementary Data for further details regarding the Company s loan asset quality measurements.

**Allowance for Loan Losses**

The Company is committed to determining, on an ongoing basis, the adequacy of its allowance for loan losses. The purpose of the allowance is to provide for probable 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. 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.

The Company applies historical loss rates to various pools of loans. Thereafter, the adequacy of the allowance is evaluated through reference to 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. 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.

See Note 3 Loans and Note 4 Allowance for Loan Losses in the notes to consolidated financial statements, included in Item 8. Financial Statements and Supplementary Data, later in this report for further details of the risk factors considered by management in estimating the necessary level of the allowance for loan losses.

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Activity for the allowance for loan losses is provided in the following table.

**(dollars in thousands)**

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Balance, beginning of period | $ 3,164 | $ 3,360 | $ 3,267 | $ 3,741 | $ 3,730 |
| Loans charged off | | | | | |
| Real estate | 12 | 262 | 139 | 458 | 549 |
| Commercial | 126 | 286 | 22 | 132 | - |
| Consumer | 3 | 3 | - | 18 | 11 |
| Total | 141 | 551 | 161 | 608 | 560 |
| Recoveries | | | | | |
| Real estate | 46 | 10 | 48 | 176 | 3 |
| Commercial | 35 | 32 | 22 | 7 | 11 |
| Consumer | - | 7 | 24 | 30 | 22 |
| Total | 81 | 49 | 94 | 213 | 36 |
| Provision for (recovery of) loan losses | 463 | 306 | 160 | (79) | 535 |
| Balance, December 31, | $ 3,567 | $ 3,164 | $ 3,360 | $ 3,267 | $ 3,741 |
| Net charge-offs to average loans | 0.02% | 0.17% | 0.02% | 0.13% | 0.18% |
| Allowance for loan losses as a percentage of period-end total loans | 0.84% | 1.01% | 1.12% | 1.15% | 1.28% |

As of December 31, 2015, the allowance for loan losses was $3.6 million, a net increase of $403,000 from $3.2 million at December 31, 2014. Management s estimates for the allowance for loan losses resulted in the Company s allowance to total loans outstanding ratio to be 0.84% at December 31, 2015, compared to the 1.01% at December 31, 2014 and the 1.12% reported at December 31, 2013. The decreased balance in the allowance relative to total loans compared to the prior periods is reflective of the continued improvement in the historical loss rate, as well as a favorable shift in the mix of loans toward categories requiring minimal or no reserve, such as student loans that are insured by a surety bond and loans secured by readily-marketable collateral. Despite an increase in loans risk rated as substandard or special mention ( classified assets ) from $4.9 million as of December 31, 2014 to $8.5 million as of year-end 2015, the allowance required for these additional classified assets had less of an effect than the influence of adding $55.6 million in loans requiring minimal or no reserve in the allowance for loan loss.

There were $141,000 in loan balances charged off during 2015, with a total of $81,000 in recoveries of previously charged-off balances, resulting in net charge-offs of $60,000 during 2015. There were loan balances of $551,000 charged off during 2014, with a total of $49,000 in recoveries of previously charged-off balances. This resulted in net charge-offs of $502,000 during 2014. The ratio of net charge-offs to average loans remained strong at 0.02% for 2015, compared to 0.17% for 2014 and 0.02% for 2013.

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The table below provides an allocation of year-end allowance for loan losses by loan type; however, allocation of a portion of the allowance to one loan category does not preclude its availability to absorb losses in other categories.

**Allocation of the Allowance for Loan Losses**

**(dollars in thousands)**

| | December 31, 2015 | |
|---|---|---|
| | Allowance | Percentage of loans in each category to total loans |
| Commercial loans | $ 797 | 16.73% |
| Real estate construction | 159 | 4.46% |
| Real estate mortgages | 2,592 | 63.59% |
| Consumer | 19 | 15.22% |
| Total | $ 3,567 | 100.00% |

| | December 31, 2014 | |
|---|---|---|
| | Allowance | Percentage of loans in each category to total loans |
| Commercial loans | $ 674 | 19.45% |
| Real estate construction | 102 | 3.80% |
| Real estate mortgages | 2,360 | 72.47% |
| Consumer | 28 | 4.28% |
| Total | $ 3,164 | 100.00% |

| | December 31, 2013 | |
|---|---|---|
| | Allowance | Percentage of loans in each category to total loans |
| Commercial loans | $ 340 | 16.03% |
| Real estate construction | 198 | 6.14% |
| Real estate mortgages | 2,788 | 73.30% |
| Consumer | 34 | 4.53% |
| Total | $ 3,360 | 100.00% |

| | December 31, 2012 | |
|---|---|---|
| | Allowance | Percentage of loans in each category to total loans |
| Commercial loans | $ 303 | 15.93% |
| Real estate construction | 168 | 4.98% |
| Real estate mortgages | 2,750 | 74.89% |
| Consumer | 46 | 4.20% |
| Total | $ 3,267 | 100.00% |

| | December 31, 2011 | |
|---|---|---|
| | Allowance | Percentage of loans in each category to total loans |
| Commercial loans | $ 397 | 14.41% |
| Real estate construction | 319 | 5.97% |
| Real estate mortgages | 2,957 | 75.69% |
| Consumer | 68 | 3.93% |
| Total | $ 3,741 | 100.00% |

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**Deposits**

Depository accounts represent the Company s primary source of funding 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, small businesses and other organizations in the Charlottesville/Albemarle area, the Orange County area, and the Winchester area.

Depository accounts held by the Company as of December 31, 2015, totaled $486.5 million, an increase of $29.8 million or 6.5% compared to the December 31, 2014 total of $456.7 million.

At December 31, 2015, the balances of non-interest bearing demand deposits were $184.6 million or 38.0% of total deposits, an increase from $152.1 million or 33.3% of total deposits at December 31, 2014. Interest-bearing transaction and money market accounts totaled $193.3 million and $187.5 million at December 31, 2015 and December 31, 2014, respectively. The Company s low-cost deposit accounts, which include both non-interest and interest bearing checking accounts as well as money market accounts, represented 77.7% of total deposit account balances at December 31, 2015 and compares favorably to the 74.4% of total deposit account balances at December 31, 2014.

Certificates of deposit and other time deposit balances decreased $8.5 million to $108.6 million at December 31, 2015 from the balance of $117.1 million at December 31, 2014. Included in this deposit total were brokered deposits totaling $17.2 million and $18.7 million at December 31, 2015 and 2014, respectively, which were reciprocal relationships under the Certificate of Deposit Account Registry Service (CDARS ), whereby depositors can obtain FDIC insurance on deposits up to $50 million.

The aggregate amount of total certificates of deposit with a minimum balance of $100,000 was $79.6 million at December 31, 2015. Approximately 97.0% of this total is scheduled to mature within the next twelve months. Included in this total are deposits of $35.3 million with balances of $250,000 or more.

**Deposits**

**(dollars in thousands)**

**Average Balances and Rates Paid**

| | Years Ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | 2013 | |
| | Average Balance | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate |
| Non-interest-bearing demand deposits | $ 176,256 | | $ 144,964 | | $ 127,480 | |
| Interest-bearing deposits: | | | | | | |
| Interest checking | 82,641 | 0.05% | 81,881 | 0.05% | 77,954 | 0.05% |
| Money market deposits | 99,918 | 0.21% | 89,061 | 0.18% | 94,369 | 0.19% |
| Time deposits | 115,092 | 0.59% | 122,659 | 0.56% | 128,816 | 0.59% |
| Total interest-bearing deposits | $ 297,651 | 0.31% | $ 293,601 | 0.30% | $ 301,139 | 0.33% |
| Total deposits | $ 473,907 | | $ 438,565 | | $ 428,619 | |

**Maturities of CD's of $100,000 and Over**

| | December 31, 2015 | |
|---|---|---|
| | Amount | Percentage |
| Three months or less | $ 59,874 | 75.25% |
| Over three months to six months | 11,379 | 14.30% |
| Over six months to one year | 5,922 | 7.44% |
| Over one year | 2,398 | 3.01% |
| Totals | $ 79,573 | 100.00% |

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**Securities Sold Under Agreements to Repurchase**

The Company offers commercial customers the opportunity to invest excess deposit balances into overnight repurchase agreements. Under the agreements to repurchase, invested funds are fully collateralized by Federal government or agency bonds that are pledged on behalf of customers utilizing this product.

| (dollars in thousands) | 2015 | 2014 | 2013 |
|---|---|---|---|
| Period-end balance | $ 23,156 | $ 17,995 | $ 16,297 |
| Maximum amount at any month-end during the year | $ 23,156 | $ 17,995 | $ 16,297 |
| Annual average balance outstanding | $ 20,076 | $ 15,480 | $ 7,941 |
| Annual average interest rate paid | 0.24% | 0.24% | 0.21% |

**ASSET/LIABILITY MANAGEMENT**

The Company s primary earnings source is its net interest income; therefore, the Company devotes significant time and resources to assist in the management of interest rate risk and asset quality. The Company s net interest income is affected by changes in market interest rates and by the level and composition of interest-earning assets and interest-bearing liabilities. The Company s objectives in its asset/liability management are to utilize its capital effectively, to provide adequate liquidity and to enhance net interest income, without taking undue risks or subjecting the Company unduly to interest rate fluctuations. The Company takes a coordinated approach to the management of its liquidity, capital and interest rate risk. This risk management process is governed by policies and limits established by the Bank s Asset/Liability Committee, which are reviewed and approved by the Bank s Board of Directors. This committee, which is comprised of directors and members of management, meets to review, among other things, economic conditions, interest rates, yield curves, cash flow projections, expected customer actions, liquidity levels, capital ratios and repricing characteristics of assets, liabilities and financial instruments.

*Market Risk*

Market risk is the risk of loss in a financial instrument arising from adverse changes in market indices such as interest rates. The Company s principal market risk exposure is interest rate risk. Interest rate risk is the exposure to changes in market interest rates. Interest rate sensitivity is the relationship between market interest rates and net interest income due to the repricing characteristics of assets and liabilities. The Company monitors the interest rate sensitivity of its balance sheet positions by examining its near-term sensitivity and its longer-term gap position. In its management of interest rate risk, the Company utilizes several financial and statistical tools including traditional gap analysis and sophisticated income simulation models.

A traditional gap analysis is prepared based on the maturity and repricing characteristics of interest-earning assets and interest-bearing liabilities for selected time bands. The mismatch between repricings or maturities within a time band is commonly referred to as the gap for that period. A positive gap (asset sensitive) where interest rate sensitive assets exceed interest rate sensitive liabilities generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite result on the net interest margin. The Company s balance sheet structure is primarily short-term in nature with a substantial portion of rate-sensitive assets and rate-sensitive liabilities repricing or maturing within one year, as shown in the Interest Sensitivity Analysis table below.

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**Gap Interest Sensitivity Analysis**

**As of December 31, 2015**

**(dollars in thousands)**

| | Within 90 days | 90 to 365 days | 1 to 4 years | Over 4 years | Nonrate Sensitive | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Loans | $ 159,316 | $ 70,465 | $ 161,699 | $ 31,412 | $ 772 | $ 423,664 |
| Investment securities | 12,300 | 5,564 | 25,382 | 33,414 | (178) | 76,482 |
| Interest bearing deposits | - | 247 | 1,002 | - | - | 1,249 |
| Federal funds sold | 29,327 | - | - | - | - | 29,327 |
| Non-interest-earning assets and allowance for loan losses | - | - | - | - | 36,769 | 36,769 |
| Total assets | $ 200,943 | $ 76,276 | $ 188,083 | $ 64,826 | $ 3 7,363 | $ 567,491 |
| **Liabilities and Shareholders' Equity** | | | | | | |
| Interest checking | $ 3,180 | $ 9,540 | $ 38,160 | $ 39,220 | $ - | $ 90,100 |
| Money market deposits | 8,597 | 25,794 | 68,784 | - | - | 103,175 |
| Time deposits | 78,486 | 24,198 | 5,083 | 851 | - | 108,618 |
| Repurchase agreements | 23,156 | - | - | - | - | 23,156 |
| Non-interest bearing liabilities and shareholders' equity | - | - | - | - | 242,442 | 242,442 |
| Total liabilities and shareholders' equity | $ 113,419 | $ 59,532 | $ 112,027 | $ 40,071 | $ 242,442 | $ 567,491 |
| Period gap | $ 87,524 | $ 16,744 | $ 76,056 | $ 24,755 | N/A | $ 205,079 |
| Cumulative gap | $ 87,524 | $ 104,268 | $ 180,324 | $ 205,079 | N/A | $ 205,079 |
| Ratio of cumulative gap to cumulative earning assets | 43.56% | 37.61% | 38.75% | 38.68% | | |

The Company utilizes the gap analysis to complement its income simulations modeling. However, the traditional gap analysis does not assess the relative sensitivity of assets and liabilities to changes in interest rates and other factors that could have an impact on interest rate sensitivity or net interest income.

The Asset/Liability Committee routinely monitors simulated net interest income sensitivity over a rolling two-year horizon. It also utilizes additional tools to monitor potential longer-term interest rate risk. The income simulation models measure the Company s net interest income volatility or sensitivity to interest rate changes utilizing statistical techniques that allow the Company to consider various factors which impact net interest income. These factors include actual maturities, estimated cash flows, repricing characteristics, deposit growth/retention and, most importantly, the relative sensitivity of the Company s assets and liabilities to changes in market interest rates. This relative sensitivity is important to consider as the Company s core deposit base has not been subject to the same degree of interest rate sensitivity as its assets. The core deposit costs are internally managed and tend to exhibit less sensitivity to changes in interest rates than the Company s adjustable rate assets whose yields are based on external indices and generally change in concert with market interest rates. The Company s interest rate sensitivity is determined by identifying the probable impact of changes in market interest rates on the yields on the Company s assets and the rates that would be paid on its liabilities. This modeling technique involves a degree of estimation based on certain assumptions that management believes to be reasonable. Utilizing this process, management projects the impact of changes in interest rates on net interest margin. The Company has established certain policy limits for the potential volatility of its net interest margin assuming certain levels of changes in market interest rates with the objective of maintaining a stable net interest margin under various probable rate scenarios. Management generally has maintained a risk position well within the policy limits.

As market conditions vary from those assumed in the income simulation models, actual results will also differ due to: prepayment/refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other variables. Furthermore, this sensitivity analysis does not reflect actions that the Asset/Liability Committee might take in responding to or anticipating changes in interest rates.

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In simulating the effects of upward and downward changes in market rates to net interest income over a rolling two-year horizon, the model utilizes a static balance sheet approach where balance sheet composition or mix as of the measurement date is maintained over the two-year horizon. Similarly, the base case simulation performed assumes interest rates on the measurement date are unchanged for the next 24 months. Then the simulation assumes all rate indices are instantaneously shocked upward and downward by 100 basis points to 400 basis points, in 100 basis point increments. Due to the low level of interest rates, the shock down analysis where the rates fall 200 basis points or more are not considered meaningful and are therefore not shown in the results below as of December 31, 2015.

| (dollars in thousands) | Change in Net Interest Income | |
|---|---|---|
| **Change in Yield Curve** | **Percentage** | **Amount** |
| +400 basis points | 28.68% | $ 10,578 |
| +300 basis points | 24.30% | 8,963 |
| +200 basis points | 18.10% | 6,675 |
| +100 basis points | 10.35% | 3,818 |
| Base case | 0.00% | - |
| -100 basis points | -3.33% | (1,228) |

The shape of the yield curve can cause downward pressure on net interest income. In general, if and to the extent that the yield curve is flatter (i.e., the differences between interest rates for different maturities are relatively smaller) than previously anticipated, then the yield on the Company s interest earning assets and its cash flows will tend to be lower. Management believes that a relatively flat yield curve could continue to affect adversely the Company s results in 2016.

**Liquidity**

Liquidity represents the Company s ability to provide funds to meet customer demand for loan and deposit withdrawals without impairing profitability. Effective management of balance sheet liquidity is necessary to fund growth in earning assets and to pay liability maturities and depository customers withdrawal requirements. The Company maintains a Liquidity Management Policy that is approved by the Board of Directors. The policy sets limits on a number of areas, including limits on the amount of non-core liabilities, and funding long-term assets with non-core liabilities.

The Bank s customer base has provided a stable and steadily increasing source of funds and liquidity. Limits contained within the Bank s Investment Policy also provides for appropriate levels of liquidity through maturities and cash flows within the securities portfolio. Other sources of balance sheet liquidity are obtained from the repayment of loan proceeds and overnight investments. The Bank has numerous secondary sources of liquidity including access to borrowing arrangements from a number of correspondent banks. Available borrowing arrangements maintained by the Bank include formal federal funds lines with three major regional correspondent banks, access to advances from the Federal Home Loan Bank of Atlanta and access to the discount window at the Federal Reserve Bank of Richmond.

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**Borrowing Lines**

**As of December 31, 2015**

**(dollars in thousands)**

| | | |
|---|---|---|
| Correspondent Banks | $ | 31,000 |
| Federal Home Loan Bank of Atlanta | | 40,469 |
| Total Available | $ | 71,469 |

As of December 31, 2015, there were no outstanding balances for any borrowing lines.

Any excess funds are sold on a daily basis in the federal funds market. The Company maintained an average of $24.3 million outstanding in federal funds sold during 2015. On December 31, 2015, the Company sold $29.3 million in the overnight federal funds market. The Company intends to maintain sufficient liquidity at all times to meet its funding commitments.

**Capital**

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. The new Basel III capital regulations are discussed in greater detail under the caption Supervision and Regulation, found earlier in this report under Item 1. Business . In addition, information regarding the Company s risk-based capital at December 31, 2015 and December 31, 2014 is presented in Note 12 Capital Requirements of the notes to consolidated financial statements, contained in Item 8. Financial Statements and Supplementary Data. Using the new capital requirements, the Company s capital ratios remain well above the levels designated by bank regulators as "well capitalized" at December 31, 2015.

**Impact of Inflation and Changing Prices**

The Company s financial statements included herein have been prepared in accordance with GAAP, which require the Company to measure financial position and operating results primarily in terms of historical dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. In management s opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than do changes in the inflation rate.

While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions, and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things, as further discussed under the caption Asset/Liability Management, found earlier in this section.

**Off-Balance Sheet Arrangements**

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. Additional information concerning the Company s off-balance sheet arrangements is contained in Note 10 of the notes to consolidated financial statements, found in Item 8. Financial Statements and Supplementary Data.

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**Contractual Commitments**

In the normal course of business, the Company and its subsidiaries enter into contractual obligations, including obligations on lease arrangements, contractual commitments for capital expenditures, and service contracts. The significant contractual obligations include the leasing of certain of its banking and operations offices under operating lease agreements on terms ranging from 1 to 20 years with renewal options.

Following is a schedule of future minimum rental payments under non-cancelable operating leases that have initial or remaining terms in excess of one year as of December 31, 2015:

| (dollars in thousands) | 1 year or less | 1-3 years | 3-5 years | After 5 years | Total |
|---|---|---|---|---|---|
| Operating lease obligations | $ 804 | $ 1,412 | $ 1,197 | $ 2,668 | $ 6,081 |

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Not required for smaller reporting company.

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**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders
Virginia National Bankshares Corporation
Charlottesville, Virginia

We have audited the accompanying consolidated balance sheets of Virginia National Bankshares Corporation and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Virginia National Bankshares Corporation and subsidiaries as of December 31, 2015 and 2014 and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

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

Winchester, Virginia
March 30, 2016

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

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 14,200 | $ 12,834 |
| Federal funds sold | 29,327 | 41,273 |
| Securities: | | |
| Available for sale, at fair value | 74,801 | 141,816 |
| Restricted securities, at cost | 1,681 | 1,565 |
| Total securities | 76,482 | 143,381 |
| Total loans | 423,664 | 313,254 |
| Allowance for loan losses | (3,567) | (3,164) |
| Total loans, net | 420,097 | 310,090 |
| Premises and equipment, net | 8,668 | 9,465 |
| Other real estate owned, net of valuation allowance | - | 1,177 |
| Bank owned life insurance | 13,476 | 13,034 |
| Accrued interest receivable and other assets | 5,241 | 5,799 |
| Total assets | $ 567,491 | $ 537,053 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities: | | |
| Demand deposits: | | |
| Noninterest-bearing | $ 184,574 | $ 152,107 |
| Interest-bearing | 90,100 | 93,208 |
| Money market deposit accounts | 103,175 | 94,310 |
| Certificates of deposit and other time deposits | 108,618 | 117,094 |
| Total deposits | 486,467 | 456,719 |
| Securities sold under agreements to repurchase | 23,156 | 17,995 |
| Accrued interest payable and other liabilities | 1,571 | 1,707 |
| Total liabilities | 511,194 | 476,421 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, $2.50 par value, 2,000,000 shares authorized, no shares outstanding | - | - |
| Common stock, $2.50 par value, 10,000,000 shares authorized; 2,412,589 and 2,688,336 shares issued and outstanding in 2015 and 2014, respectively | 6,031 | 6,721 |
| Capital surplus | 22,214 | 27,889 |
| Retained earnings | 28,170 | 25,978 |
| Accumulated other comprehensive income (loss) | (118) | 44 |
| Total shareholders' equity | 56,297 | 60,632 |
| Total liabilities and shareholders' equity | $ 567,491 | $ 537,053 |

See Notes to Consolidated Financial Statements

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

| | For the years ended December 31, 2015 | December 31, 2014 |
|---|---|---|
| Interest and dividend income: | | |
| Loans, including fees | $ 14,754 | $ 12,548 |
| Federal funds sold | 58 | 90 |
| Investment securities: | | |
| Taxable | 1,931 | 2,165 |
| Tax exempt | 435 | 477 |
| Dividends | 83 | 83 |
| Other | 21 | 19 |
| Total interest and dividend income | 17,282 | 15,382 |
| Interest expense: | | |
| Demand and savings deposits | 251 | 205 |
| Certificates and other time deposits | 674 | 686 |
| Federal funds purchased and securities sold under agreements to repurchase | 49 | 37 |
| Total interest expense | 974 | 928 |
| Net interest income | 16,308 | 14,454 |
| Provision for loan losses | 463 | 306 |
| Net interest income after provision for loan losses | 15,845 | 14,148 |
| Noninterest income: | | |
| Trust income | 1,710 | 2,367 |
| Customer service fees | 956 | 894 |
| Debit/credit card and ATM fees | 825 | 742 |
| Earnings/increase in value of bank owned life insurance | 442 | 439 |
| Gains on sales of assets | - | 44 |
| Gains on sales of securities | 104 | 24 |
| Royalty income | 140 | 593 |
| Fees on mortgage sales | 217 | 76 |
| Other | 477 | 418 |
| Total noninterest income | 4,871 | 5,597 |
| Noninterest expense: | | |
| Salaries and employee benefits | 8,869 | 9,305 |
| Net occupancy | 1,940 | 1,954 |
| Equipment | 550 | 531 |
| Other | 5,039 | 5,601 |
| Total noninterest expense | 16,398 | 17,391 |
| Income before income taxes | 4,318 | 2,354 |
| Provision for income taxes | 1,197 | 456 |
| Net income | $ 3,121 | $ 1,898 |
| Net income per common share, basic | $ 1.23 | $ 0.70 |
| Net income per common share, diluted | $ 1.23 | $ 0.70 |

See Notes to the Consolidated Financial Statements

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**VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**(dollars in thousands)**

| | For the years ended December 31, 2015 | December 31, 2014 |
|---|---|---|
| Net income | $ 3,121 | $ 1,898 |
| Other comprehensive income (loss) | | |
| Unrealized gains (losses) on securities, net of tax of ($48) and $769 | (93) | 1,491 |
| Reclassification adjustment for realized gains on sales of securities, net of tax of ($35) and ($8) | (69) | (16) |
| Total other comprehensive (loss) income | (162) | 1,475 |
| Total comprehensive income | $ 2,959 | $ 3,373 |

See Notes to Consolidated Financial Statements

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**VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**
**(dollars in thousands, except per share data)**

| | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|
| **Balance, December 31, 2013** | $ 6,725 | $ 27,915 | $ 24,822 | ($ 1,431) | $ 58,031 |
| Stock options exercised or expired | 24 | 156 | - | - | 180 |
| Vested stock grants | 1 | (1) | - | - | - |
| Stock purchased under stock repurchase plan | (29) | (233) | - | - | (262) |
| Stock option/grant expense | - | 52 | - | - | 52 |
| Cash dividend ($0.275 per share) | - | - | (742) | - | (742) |
| Net income | - | - | 1,898 | - | 1,898 |
| Other comprehensive income | - | - | - | 1,475 | 1,475 |
| **Balance, December 31, 2014** | $ 6,721 | $ 27,889 | $ 25,978 | $ 44 | $ 60,632 |
| | | | | | |
| Stock options exercised | 3 | 19 | - | - | 22 |
| Deferred tax adjustment for stock options expired | - | (75) | - | - | (75) |
| Stock purchased under stock repurchase plan | (693) | (5,649) | - | - | (6,342) |
| Stock option/grant expense | - | 30 | - | - | 30 |
| Cash dividend ($0.375 per share) | - | - | (929) | - | (929) |
| Net income | - | - | 3,121 | - | 3,121 |
| Other comprehensive loss | - | - | - | (162) | (162) |
| **Balance, December 31, 2015** | $ 6,031 | $ 22,214 | $ 28,170 | ($ 118) | $ 56,297 |

See Notes to Consolidated Financial Statements

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

| | For the years ended December 31, 2015 | December 31, 2014 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 3,121 | $ 1,898 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 463 | 306 |
| Net amortization and accretion of securities | 723 | 739 |
| Gains on sales of securities | (104) | (24) |
| Earnings/increase in value of bank owned life insurance | (442) | (439) |
| Depreciation and amortization | 1,164 | 1,151 |
| Net gain on sale of assets | - | (44) |
| Deferred tax expense (benefit) | 373 | (61) |
| Stock option/stock grant expense | 30 | 52 |
| Writedown of other real estate owned | 192 | 277 |
| Losses on sale of other real estate owned | - | 27 |
| Decrease in accrued interest receivable and other assets | 194 | 10,330 |
| Decrease in accrued interest payable and other liabilities | (174) | (6,567) |
| Net cash provided by operating activities | 5,540 | 7,645 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of available for sale securities | (26,770) | (44,278) |
| Net (increase) decrease in restricted investments | (116) | 80 |
| Proceeds from maturities, calls and principal payments of available for sale securities | 46,461 | 29,512 |
| Proceeds from sale of available for sale securities | 46,459 | 7,498 |
| Net (increase) decrease in organic loans | (65,977) | 849 |
| Net increase in purchased loans | (44,493) | (14,815) |
| Proceeds from sale of other real estate owned | 985 | 1,135 |
| Proceeds from sale of bank premises and equipment | - | 11 |
| Purchase of bank premises and equipment | (367) | (803) |
| Net cash used in investing activities | (43,818) | (20,811) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in demand deposits, NOW accounts, and money market accounts | 38,224 | 33,327 |
| Net decrease in certificates of deposit and other time deposits | (8,476) | (7,068) |
| Net increase in securities sold under agreements to repurchase | 5,161 | 1,698 |
| Common stock repurchased | (6,342) | (262) |
| Proceeds from stock options exercised | 22 | 180 |
| Cash dividends | (891) | (674) |
| Net cash provided by financing activities | 27,698 | 27,201 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | $ (10,580) | $ 14,035 |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of period | $ 54,107 | $ 40,072 |
| End of period | $ 43,527 | $ 54,107 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Cash payments for: | | |
| Interest | $ 985 | $ 936 |
| Taxes | $ 904 | $ 2,488 |

| | | | | |
|---|---|---|---|---|
| SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES | | | | |
| Unrealized gain (loss) on available for sale securities | $ | (246) | $ | 2,236 |
| Transfer of loans to other real estate owned | $ | - | $ | 244 |

See Notes to Consolidated Financial Statements

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollar amounts in thousands, except share and per share data)**

**Note 1 Summary of Significant Accounting Policies:**

**Organization**

Virginia National Bankshares Corporation (the Company ) is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Company is authorized to issue 10,000,000 shares of common stock with a par value of $2.50 per share. Additionally, the Company is authorized to issue 2,000,000 shares of preferred stock at a par value $2.50 per share. There is currently no preferred stock outstanding. There are no plans currently nor does the Board of Directors of the Company anticipate any need in the foreseeable future to issue shares of preferred stock. The holding 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 Federal Reserve Board.

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 Company announced on September 21, 2015 that its Board of Directors extended the program for another year. The extended repurchase program is authorized through September 18, 2016.

Virginia National Bank (the Bank ) is a wholly-owned subsidiary of the bank holding company and was organized in 1998 under federal law as a national banking association to engage in a general commercial and retail banking business. The Bank is headquartered in Charlottesville, Virginia and primarily serves the Virginia communities in and around the City of Charlottesville, Albemarle County, Orange County, Fauquier County, the City of Winchester and Frederick County. As a national bank, the Bank is subject to the supervision, examination and regulation of the Office of the Comptroller of the Currency ( OCC ).

On May 1, 2007, the OCC granted conditional approval to the Bank s application to establish a new national trust bank with the title VNBTrust, National Association which now trades under the name VNB Wealth Management ( VNBTrust , VNB Wealth or VNB Wealth Management ). VNBTrust operates as a wholly-owned subsidiary of the Bank.

**Sale Agreement with SRCM Holdings LLC and Acquisition Royalty Payments Due to VNBTrust**

In 2007 when VNBTrust was established, the OCC also approved the Bank s application for VNBTrust to create a wholly owned operating subsidiary, VNB Investment Management Company, LLC, a Delaware limited liability corporation. In January, 2010, VNB Investment Management Company changed its name to Swift Run Capital Management, LLC ( SRCM ). SRCM served as the general partner of Swift Run Capital, L.P. (the Fund), a private investment 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 (the SRCM Sale Agreement ). A former officer of VNBTrust is the principal owner of SRCM Holdings. Under the terms of the SRCM Sale Agreement, SRCM Holdings agreed to pay VNBTrust, quarterly during the ten-year period beginning January 1, 2014 and ending December 31, 2023 (the Term ), (a) ongoing acquisition royalty payments equal to (i) 20% of the management and performance fee revenue received by SRCM from limited partners of the Fund as of the Closing Date and (ii) 20% of the management and performance fee revenue received by SRCM from VNBTrust clients that opened accounts with SRCM within 30 days of the Closing Date, and (b) ongoing referral payments equal to 20% of the management and performance fee revenue received by SRCM from clients referred by the Company and its affiliates to SRCM during the Term. The Company recognized $302,000 as gain from the sale of SRCM in 2013, which amount included an estimate of the present value of the portion of the acquisition royalty payments to be received from management fees during the Term. Each quarter, as the Company receives royalty payments from SRCM, a portion of the payment is applied to write down the contingent asset established for this estimated value. The remaining amount of the payment is applied to noninterest income as royalty income.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollar amounts in thousands, except share and per share data)**

**Subsequent Event**

On February 1, 2016 (the Effective Date ), VNB Wealth purchased a book of business, including interest in the client relationships, ( Purchased Relationships ), from a current officer (the Seller ) of VNB Wealth pursuant to an employment and asset purchase agreement (the Purchase Agreement ). Prior to becoming an employee of VNB Wealth and until the Effective Date of the sale, the Seller provided services to these Purchased Relationships as a sole proprietor. As of January 15, 2016, the fair market value of the Purchased Relationships totaled $31.5 million. Under the terms of the Purchase Agreement, the Company will receive all future revenue for brokerage, investment management, advisory, insurance, consulting, trust and related services performed for the Purchased Relationships.

The purchase price of $1.2 million will be paid over a five year period. As required under ASC Topic 805, Business Combinations, using the acquisition method of accounting, an independent third party is in the process of determining the net asset values based on the fair value measurements and the purchase price. The intangible assets identified will be amortized using a straight line method over the estimated useful life, and the amortized cost will be shown as noninterest expense. In accordance with ASC 350, Intangibles-Goodwill and Other, the Company will review the carrying value of indefinite lived goodwill at least annually or more frequently if certain impairment indicators exist.

**Basis of Presentation**

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to the reporting guidelines prescribed by regulatory authorities. The following is a description of the more significant of those policies and practices.

**Principles of consolidation** The consolidated financial statements include the accounts of the Company, its subsidiary the Bank, and the Bank s subsidiary VNBTrust (together, subsidiaries). All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions 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, valuation of other real estate owned, and fair value measurements.

**Cash flow reporting** For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents consist of cash on hand, funds due from banks, and federal funds sold.

**Securities sold under agreements to repurchase** The Company sells certain securities under agreements to repurchase. The agreements are treated as collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying consolidated balance sheets. The dollar amount of the securities underlying the agreements remains in the asset accounts.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollar amounts in thousands, except share and per share data)**

**Securities** Unrestricted investments are to be classified in two categories as described below.

**Securities held to maturity** Securities classified as held to maturity are those debt and equity securities the Company has both the positive intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. Currently the Company has no securities classified as held to maturity because of Management s desire to have more flexibility in managing the investment portfolio.

**Securities available for sale** Securities classified as available for sale are those debt and equity securities that the Company intends to hold 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. Securities available for sale are carried at fair value. 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.
Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities or to call dates, whichever occurs first. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the Company intends to sell the security or (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. If, however, the Company does not intend to sell the security and it is not more-than-likely that the Company will be required to sell the security before recovery, the Company must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

**Restricted securities** As members of the Federal Reserve Bank of Richmond ( FRB ) and the Federal Home Loan Bank of Atlanta ( FHLB ), the Company is required to maintain certain minimum investments in the common stock of the FRB and FHLB. Required levels of investments are based upon the Bank s capital and a percentage of qualifying assets. Additionally, the Company has purchased common stock in CBB Financial Corp. ( CBBFC ), the holding company for Community Bankers Bank. Shares of common stock from the FRB, FHLB and CBBFC are classified as restricted securities which are carried at cost

**Loans** Loans are reported at the principal balance outstanding net of unearned discounts and of the allowance for loan losses. Interest income on loans is reported on the level-yield method and includes amortization of deferred loan fees and costs over the loan term. Purchased loans are accounted for in the same manner as the rest of the loan portfolio. Further information regarding the Company s accounting policies related to past due loans, non-accrual loans, impaired loans and troubled-debt restructurings is presented in Note 3 - Loans.

**Allowance for loan losses** The 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 inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with Financial Accounting Standards Board ( FASB ) ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Further information regarding the Company s policies and methodology used to estimate the allowance for loan losses is presented in Note 4 Allowance for Loan Losses.

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

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollar amounts in thousands, except share and per share data)**

**Premises and equipment** Land is carried at cost. 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, which range from 3 to 20 years. 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, the asset and related accumulated depreciation are removed from the books and any resulting gain or loss is charged to income. More information regarding premises and equipment is presented in Note 6 Premises and Equipment.

**Other real estate owned** Assets acquired through, or in lieu of, loan foreclosures are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in noninterest expense as net OREO write down and expenses. More information regarding other real estate owned is presented in Note 5 Other Real Estate Owned.

**Bank owned life insurance** The Company has purchased life insurance on certain key employees. These policies are recorded at their cash surrender value on the Consolidated Balance Sheets. Income generated from polices is recorded as noninterest income.

**Fair value measurements** ASC Topic 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair values of financial instruments are based upon internally developed models that primarily use, as inputs, observable market-based parameters. Any such valuation adjustments are applied consistently over time. Additional information on fair value measurements is presented in Note 14 Fair Value Measurements.

**Stock-based compensation** The Company accounts for all 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. Stock-based compensation is estimated at the date of grant, using the Black-Scholes option valuation model for determining fair value. The model employs the following assumptions:

**Dividend yield** - calculated as the ratio of historical cash dividends paid per share of common stock to the stock price on the date of grant;

**Expected life (term of the option)** - based on the average of the contractual life and vesting schedule for the respective option;

**Expected volatility** - based on the monthly historical volatility of the Company s stock price over the expected life of the options;

**Risk-free interest rate** - based upon the U.S. Treasury bill yield curve, for periods within the contractual life of the option, in effect at the time of grant.

The Company is required to estimate forfeitures when recognizing compensation expense, and this estimate of forfeitures must be adjusted over the requisite service period or vesting schedule based on the extent to which actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment, which is recognized in the period of change, and also will impact the amount of estimated unamortized compensation expense to be recognized in future periods. Further information on stock-based compensation is presented in Note 17 Stock Incentive Plans.

**Earnings per common share** Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. Additional information on earnings per share is presented in Note 18 Earnings per Share.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollar amounts in thousands, except share and per share data)**

**Comprehensive income** Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. Further information on the Company s other comprehensive income is presented in Note 19 Other Comprehensive Income.

**Advertising costs** The Company follows the policy of charging the costs of advertising to expense as they are incurred.

**Income taxes** Deferred taxes are provided on the asset and liability method whereby deferred tax assets are recognized for deductible temporary differences, operating loss carry forwards, and tax credit carry forwards. Deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

When tax returns are filed, it is highly probable that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statements of income. Further information on the Company s accounting policies for income taxes is presented in Note 8 Income Taxes.

**VNBTrust** Securities and other property held by VNBTrust in a fiduciary or agency capacity are not assets of the Company and are not included in the accompanying consolidated financial statements.

**Reclassifications** Certain reclassifications have been made to prior periods to conform to current year presentation. The results of the reclassifications are not considered material.

**Adoption of New Accounting Standards**

**Recent Accounting Pronouncements**

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

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

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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.

In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date. The amendments in ASU 2015-14 defer the effective date of ASU 2014-09, Revenue from Contracts with Customers (Topic 606), for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. All other entities may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities also may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which the entity first applies the guidance in ASU 2014-09. The Company does not expect the adoption of ASU 2015-14 (or ASU 2014-09) to have a material impact on its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in ASU 2015-16 require that an acquirer recognize adjustments to estimated amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments require that the acquirer record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. The amendments also require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the estimated amounts had been recognized as of the acquisition date. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The Company does not expect the adoption of ASU 2015-16 to have a material impact on its consolidated financial statements.

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

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements.

**Note 2 Securities**

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

| **December 31, 2015** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized (Losses)** | **Fair Value** |
|---|---|---|---|---|
| U.S. Government agencies | $ 11,260 | $ 137 | $ (19) | $ 11,378 |
| Corporate bonds | 6,027 | - | (63) | 5,964 |
| Mortgage-backed securities/CMOs | 37,077 | 60 | (450) | 36,687 |
| Municipal bonds | 20,615 | 250 | (93) | 20,772 |
| | $ 74,979 | $ 447 | $ (625) | $ 74,801 |

| **December 31, 2014** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized (Losses)** | **Fair 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 |

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All mortgage-backed securities included in the above tables were issued by U.S. government agencies and corporations. At December 31, 2015, the securities issued by political subdivisions or agencies were highly rated with 79% of the municipal bonds having AA or higher ratings. Approximately 74% of the municipal bonds are general obligation bonds with issuers that are geographically diverse.

There were no securities classified as held to maturity as of December 31, 2015 or December 31, 2014.

Restricted securities are securities with limited marketability and consist of stock in the FRB, FHLB and CBBFC totaling $1.7 million as of December 31, 2015 and $1.6 million as of December 31, 2014. These restricted securities are carried at cost as they are not permitted to be traded.

For the year ended December 31, 2015, proceeds from the sales of securities amounted to $46.5 million, and gross realized gains on these securities were $44,000. An additional $25.9 million in calls of securities accounted for the additional gross realized gains of $60,000. For the year ended December 31, 2014, proceeds from the sales and calls of securities amounted to $7.5 million and gross realized gains on these securities were $24,000.

Securities pledged to secure deposits, and for other purposes required by law, had carrying values of $42.2 million at December 31, 2015 and $23.8 million at December 31, 2014. The increase in the amount of pledged securities during 2015 resulted from increased balances in the overnight repurchase agreement program and in public funds deposit accounts.

Year-end securities with unrealized losses, segregated by length of time in a continuous unrealized loss position, were as follows:

**December 31, 2015**

| | Less than 12 Months | | 12 Months or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government agencies | $ - | $ - | $ 980 | $ (19) | $ 980 | $ (19) |
| Corporate bonds | 5,964 | (63) | - | - | 5,964 | (63) |
| Mortgage-backed/CMOs | 21,003 | (212) | 9,504 | (238) | 30,507 | (450) |
| Municipal bonds | 2,788 | (31) | 1,908 | (62) | 4,696 | (93) |
| | $ 29,755 | $ (306) | $ 12,392 | $ (319) | $ 42,147 | $ (625) |

**December 31, 2014**

| | Less than 12 Months | | 12 Months or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized (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 December 31, 2015, there were $42.1 million, or forty-two issues, of individual securities in a loss position. These securities have an unrealized loss of $625,000 and consisted of twenty-seven mortgage-backed/CMOs, nine municipal bonds, five corporate bonds, and one Agency note.

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 December 31, 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.

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The amortized cost and fair value of available for sale securities at December 31, 2015 are presented below based upon contractual maturities, by major investment categories. Expected maturities may differ from contractual maturities because issuers have the right to call or prepay obligations.

| | Amortized Cost | Fair Value |
|---|---|---|
| U.S. Government agencies | | |
| One year or less | $ 5,007 | $ 5,028 |
| After one year to five years | 3,309 | 3,367 |
| After five years to ten years | 2,944 | 2,983 |
| | $ 11,260 | $ 11,378 |
| Corporate bonds | | |
| After one year to five years | $ 4,040 | $ 4,012 |
| After five years to ten years | 1,987 | 1,952 |
| | $ 6,027 | $ 5,964 |
| Mortgage-backed securities/CMOs | | |
| After one year to five years | $ 555 | $ 548 |
| After five years to ten years | 9,969 | 9,892 |
| Ten years or more | 26,553 | 26,247 |
| | $ 37,077 | $ 36,687 |
| Municipal bonds | | |
| One year or less | $ 105 | $ 105 |
| After one year to five years | 2,097 | 2,110 |
| After five years to ten years | 11,286 | 11,427 |
| Ten years or more | 7,127 | 7,130 |
| | $ 20,615 | $ 20,772 |
| Total Securities Available for Sale | $ 74,979 | $ 74,801 |

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**Note 3 Loans**

The composition of the loan portfolio by loan classification appears below.

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Commercial | | |
| Commercial and industrial - organic | $ 47,215 | $ 46,125 |
| Commercial and industrial - syndicated | 23,653 | 14,815 |
| Total commercial and industrial | 70,868 | 60,940 |
| Real estate construction and land | | |
| Residential construction | 2,178 | 337 |
| Other construction and land | 16,733 | 11,575 |
| Total construction and land | 18,911 | 11,912 |
| Real estate mortgages | | |
| 1-4 family residential | 63,544 | 60,162 |
| Home equity lines of credit | 27,599 | 25,498 |
| Multifamily | 20,209 | 26,462 |
| Commercial owner occupied | 66,244 | 60,868 |
| Commercial non-owner occupied | 91,805 | 54,012 |
| Total real estate mortgage | 269,401 | 227,002 |
| Consumer | | |
| Consumer revolving credit | 17,174 | 3,428 |
| Consumer all other credit | 11,655 | 9,972 |
| Student loans purchased | 35,655 | - |
| Total consumer | 64,484 | 13,400 |
| Total loans | 423,664 | 313,254 |
| Less: Allowance for loan losses | (3,567) | (3,164) |
| Net loans | $ 420,097 | $ 310,090 |

**Loan origination/risk management.** The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and the Board of Directors approve lending policies on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, and nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. Underwriting standards are designed to promote relationship banking rather than transactional banking.

**Commercial and industrial loans** are underwritten after evaluating and understanding the borrower s ability to operate profitably and prudently expand its business. Management examines current and projected cash flows to determine the ability of borrowers to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable, inventory or marketable securities and may incorporate personal guaranties; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

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The Company identifies commercial and industrial loans by classifying them into two classes. Organic loans are originated by the Bank s commercial lenders. Syndicated loans, also referred to as Shared National Credits, are purchased from national lending correspondents. Both organic and syndicated loans are underwritten according to the Bank s loan policies. The Company has developed policies to limit overall credit exposure to the syndicated market as a whole and to each borrower.

**Real estate construction and land loans** consist primarily of loans for the purchase or refinance of unimproved lots or raw land. Additionally, the Company finances the construction of real estate projects typically where the permanent mortgage will remain with the Company. Specific underwriting guidelines are delineated in the loan policy.

**Commercial real estate loans** are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those specific to real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on cash flows, collateral, geography and risk grade criteria. As a general rule, the Company avoids financing projects where the source of repayment is dependent upon the sale or operation of the collateral, unless other underwriting factors are present to help mitigate risk.

**Residential mortgages** include consumer purpose 1-to-4 family residential properties and home equity loans as well as investor-owned residential real estate. Consumer purpose loans have underwriting standards that are heavily influenced by statutory requirements, which include, but are not limited to, documentation requirements, limits on maximum loan-to-value percentages, and collection remedies. Loans to finance 1-4 family investment properties are primarily dependent upon rental income generated from the property and secondarily supported by the borrower's personal income. The Company typically originates residential mortgages with the intention of retaining in its portfolio adjustable-rate mortgages and shorter-term, fixed-rate loans. The Company also originates longer-term, fixed rates loans, which are sold to secondary mortgage market correspondents.

**Consumer loans** are generally small loans spread across many borrowers and are underwritten after determining the ability of the consumer borrower to repay their obligations as agreed. The underwriting standards are heavily influenced by statutory requirements, which include, but are not limited to, documentation requirements and collection remedies. Consumer loans may be secured or unsecured and are comprised of revolving lines, installment loans and other consumer loans. Included in consumer loans are two packages of student loans that were purchased in the second and fourth quarters of 2015. Along with the purchase of these student loans, the Company purchased a surety bond that fully insures this portion of the Company s consumer portfolio. Deposit account overdrafts are included in the consumer loan balances and totaled $38,000 and $53,000 at December 31, 2015 and 2014, respectively.

**Independent loan review** is performed by an independent loan review firm that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management and the Audit and Compliance Committee of the Board. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company s policies and procedures.

**Concentrations of credit.** Most of the Company s lending activity occurs within the Commonwealth of Virginia, primarily in the Company s primary markets and surrounding areas. The majority of the Company s loan portfolio consists of commercial and industrial and commercial real estate loans. As of December 31, 2015, there were no concentrations of loans related to any single industry in excess of 20% of total loans.

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**Related party loans.** In the ordinary course of business, the Company has granted loans to certain directors, principal officers and their affiliates (collectively referred to as related party loans ). Activity in related party loans during 2015 and 2014 is presented in the following table.

| | 2015 | 2014 |
|---|---|---|
| Balance outstanding at beginning of year | $ 10,841 | $ 6,526 |
| Principal additions | 10,445 | 8,043 |
| Principal reductions | (9,730) | (3,728) |
| Balance outstanding at end of year | $ 11,556 | $ 10,841 |

**Past due, non-accrual and charged-off loans**. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Student loans purchased are not placed in non-accrual as they are fully insured by surety bonds, and the Company expects to recover all principal and interest once a claim is processed. Smaller, unsecured consumer loans are typically charged-off when management judges such loans to be uncollectible or the borrowers file for bankruptcy and are generally not placed in non-accrual status prior to charge-off. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Company considers the borrower s debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Company s collateral position.

Regulatory provisions would typically require a loan to be charged-off or placed on non-accrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on non-accrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

Non-accrual loans are shown below by class:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Other construction and land | $ 59 | $ 69 |
| 1-4 family residential mortgages | 132 | 149 |
| Total nonaccrual loans | $ 191 | $ 218 |

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The following tables show the aging of past due loans as of December 31, 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. As of December 31, 2015 and 2014, the Company had no loans that were 90 days or more past due and still accruing.

| Past Due Aging as of December 31, 2015 | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans | 90 Days Past Due and Still Accruing |
|---|---|---|---|---|---|---|---|
| Commercial loans | | | | | | | |
| Commercial and industrial - organic | $ 211 | $ 40 | $ - | $ 251 | $ 46,964 | $ 47,215 | $ - |
| Commercial and industrial - syndicated | - | - | - | - | 23,653 | 23,653 | - |
| Real estate construction and land | | | | | | | |
| Residential construction | - | - | - | - | 2,178 | 2,178 | - |
| Other construction and land | 7 | - | - | 7 | 16,726 | 16,733 | - |
| Real estate mortgages | | | | | | | |
| 1-4 family residential | 156 | 36 | - | 192 | 63,352 | 63,544 | - |
| Home equity lines of credit | - | - | - | - | 27,599 | 27,599 | - |
| Multifamily | - | - | - | - | 20,209 | 20,209 | - |
| Commercial owner occupied | - | - | - | - | 66,244 | 66,244 | - |
| Commercial non-owner occupied | - | - | - | - | 91,805 | 91,805 | - |
| Consumer loans | | | | | | | |
| Consumer revolving credit | - | - | - | - | 17,174 | 17,174 | - |
| Consumer all other credit | 58 | 1 | - | 59 | 11,596 | 11,655 | - |
| Student loans purchased | 813 | 1 | - | 814 | 34,841 | 35,655 | - |
| Total Loans | $ 1,245 | $ 78 | $ - | $ 1,323 | $ 422,341 | $ 423,664 | $ - |

| Past Due Aging as of December 31, 2014 | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans | 90 Days Past Due and Still Accruing |
|---|---|---|---|---|---|---|---|
| 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 | - | - | | | | | |