Where Community and Banking Come Together

Bank of The James

FINANCIAL GROUP, INC.

2020 MESSAGE TO SHAREHOLDERS

Where Community and Banking Come Together

President's Letter

Dear Shareholders, Customers and Communities,

The past year delivered a set of health, social, and economic circumstances unlike any experienced in our lifetimes. Although the events of 2020 interrupted the normal course of life and business, our Bank of the James team exhibited the dedication and commitment to meet the challenges, adapt to changes, and meet the financial needs of our customers and served communities. Our employees' ability to go above and beyond to exceed customers' expectations and drive positive financial results for the Company made 2020 one of the finest years in Bank of the James' history.

First and foremost was protecting the safety and welfare of employees and customers through remote working, appropriate social distancing and safe operation of facilities. We maintained these high standards and continue these positive practices. We called on our extensive technological and digital capabilities to maintain internal operations, and interface with customers to provide the Bank's full range of services and products with less reliance on physical interaction.

More customers relied on our mobile and web-based capabilities for contactless banking, facilitating routine banking activity and more complex transactions. The range of electronic corporate treasury services played an increased role, enabling our business customers to remotely manage their financial activities. Our bankers provided strong customer communication, support, and financial education through phone, email and our website.

Notably, in a year that required operational flexibility and adjustments, the Company's efficiency ratio in 2020 was on par with the prior year. We believe that is a tribute to our team's ability to function effectively and efficiently despite a sometimes challenging and changing environment.

Ensuring continued financial strength and stability was a top priority in 2020. The Company focused on managing credit quality through diligent credit monitoring, promptly working with customers to address credit issues, and providing appropriate relief for customers experiencing challenges. Partnerships with our clients contributed to the Company's continuing strong asset quality ratios.

We increased our allowance for potential loan losses and built the Company's liquidity and cash reserves, taking a prudent and conservative approach reflecting ongoing economic uncertainties, which strengthened our balance sheet. The Company in 2020 strengthened its balance sheet further by completing a private placement of unregistered debt securities and using approximately half the proceeds to retire an earlier private placement carrying a higher rate. Increasing the provision for loan losses in 2020 impacted net interest income after provision for loan losses and net income. However, being well-reserved is appropriate and necessary to support the Company's safety and security in light of the risks and uncertainties of the pandemic.

The Company's financial performance generally reflected slower growth and activity than in past years, particularly in commercial banking, as most customers appropriately focused on conservative operation and cash conservation. Given the circumstances, our 2020 financial performance was positive. Net income for the 12 months ended December 31, 2020 was $4.98 million or $1.15 per diluted share, compared with $5.61 million or $1.28 per diluted share for the 12 months ended December 31, 2019.

Earnings in 2020 reflected strong year-over-year noninterest income, which included higher revenue from corporate treasury services, gains on sales of available-for-sale securities, loan processing and other fees, and record revenue from the gain on sales of originated residential mortgages to the secondary market. In 2020, total noninterest income was up 53% compared with a year earlier.

Our Bank of the James Mortgage team did an exceptional job in serving customers and meeting a strong residential mortgage demand in our markets. By continuing to solidify their reputation for customer support and efficient mortgage application processing, our bankers earned a considerable amount of origination business, which drove increased fee income and gains on the sale of originated mortgage loans.

Net interest income before the provision for loan losses was $25.1 million in 2020, up slightly from a year earlier. Although interest income was slightly lower in 2020 than the year before, reflecting lower than normal commercial loan activity due to the pandemic, the decrease was more than offset by lower interest expense during the same period. Even with a larger deposit base in 2020 than a year earlier, we significantly reduced rates paid on interest-bearing liabilities to achieve lower interest expense.

Commercial lending, which has in recent years been a primary driver of loan growth and interest income, was generally subdued, with the exception of brisk activity in construction lending. We processed and closed approximately $68 million in Payroll Protection Plan (PPP) loans to more than 500 small businesses, supporting over 9000 employees. The contributions and responsiveness of our banking team made the endeavor a success. We continued PPP lending in 2021.

Assets increased year-over-year, primarily reflecting increased loans, including PPP loans, loans held-for-sale related to the Company's mortgage originations, and higher levels of cash and liquid assets consistent with the economic conditions and the potential impact of COVID-19 on customers.

Finally, the Company built measures of shareholder value, with increased total stockholders' equity, higher retained earnings, increased book value per share and cash dividend payments to shareholders in all four quarters of 2020. We greatly appreciate the support of our shareholders, the contributions made by our Board of Directors and Advisory Boards, the dedicated efforts of employees, and the loyalty of our customers.

Sincerely,

Robert R. Chapman III
President and CEO

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, 2020

BANK OF THE JAMES FINANCIAL GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

Commission file number 001-35402

Virginia (State or Other Jurisdiction of Incorporation or Organization)	**20-0500300** (I.R.S. Employer Identification No.)
828 Main Street, Lynchburg, VA (Address of Principal Executive Offices)	**24504** (Zip Code)

(434) 846-2000
(Issuer's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Trading Symbol(s)	Name of Exchange on Which Registered
Common Stock, $2.14 par value	BOTJ	The NASDAQ Capital Markets

Securities registered under Section 12(g) of the Exchange Act: None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section13 or Section 15(d) of the Act. ☐ Yes ☑ No

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

Indicate by check mark whether the registrant has submitted every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
☑ Yes ☐ No

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

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

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☑	Smaller reporting company ☑
	Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

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

The aggregate value of the voting common equity held by nonaffiliates as of June 30, 2020, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $40,994,652 based on the price at which the common stock last traded on such day. This price reflects inter-dealer prices without retail mark up, mark down, or commissions, and may not represent actual transactions.

The number of shares outstanding of Common Stock, $2.14 par value as of March 29, 2021 was approximately 4,324,836.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2021 Proxy Statement to be used in conjunction with the Annual Meeting of Shareholders, scheduled to be held on May 18, 2021, are incorporated by reference into Part III of this Form 10-K

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PART I

Item 1. Business

General

Bank of the James Financial Group, Inc. ("Financial" or the "Company") is a bank holding company with its headquarters in Lynchburg, Virginia. Financial was incorporated at the direction of Bank of the James (the "Bank" or "Bank of the James") on October 3, 2003 to serve as a bank holding company of the Bank. Financial acquired all of the shares of the Bank in a statutory share exchange on a one-for-one basis on January 1, 2004.

The Bank is a Virginia banking corporation headquartered in Lynchburg, Virginia. The Bank was incorporated under the laws of the Commonwealth of Virginia as a state-chartered bank in 1998 and began banking operations in July 1999. The Bank was organized to engage in general retail and commercial banking business.

The Bank's principal office is located at 828 Main Street, Lynchburg, Virginia 24504 and its telephone number is (434) 846-2000. The Bank also maintains a website at www.bankofthejames.bank.

Financial conducts two principal activities: (1) general retail and commercial banking through Bank of the James; and (2) mortgage brokerage services through Bank of the James Mortgage, a division of the Bank (the "Mortgage Division").

In addition, Financial provides securities brokerage and other investment services through BOTJ Investment, a division of the Bank, and acts as an agent for insurance and annuity products through BOTJ Insurance, Inc., a wholly-owned subsidiary of the Bank. The operating results of these business operations have not had a material impact on our financial performance and are not considered principal activities of Financial at this time.

The Bank, BOTJ Insurance, and BOTJ Investment Group, Inc., a non-operating subsidiary, are our only subsidiaries and primary assets.

Products and Services

Retail and Commercial Banking

The Bank currently conducts business within Virginia from 16 full-service offices, two limited service offices, and one residential mortgage loan production office. The location of and services provided by each of our facilities is described in "Item 2. Properties" below. The Bank established a mortgage loan origination division that conducts business under the name "Bank of the James Mortgage, a Division of Bank of the James." The Mortgage Division conducts business primarily from the division's main office located in the Forest branch of the Bank. In addition, the Bank expanded into Charlottesville in 2013 (opening a full-service branch in 2015), Harrisonburg in 2014 (opening a full-service branch in 2015), Appomattox in 2016 (opening a permanent full-service branch in 2017), Roanoke in 2013 (opening a full-service branch in 2017), Blacksburg in 2018 (opening a mortgage origination office), Lexington in 2019 with a full-service branch, and Rustburg in 2019 with a full-service branch.

Deposit Services. Deposits are a major source of our funding. The Bank offers a full range of deposit services that are typically available in most banks and other financial institutions including checking accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to the Bank's market area at rates competitive to those offered in the market area. In addition, the Bank offers its customers Individual Retirement Accounts (IRAs) and Health Care Savings Accounts (HSAs). All deposit accounts are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum amount allowed by law (generally, $250,000 per depositor, subject to aggregation rules). The Bank solicits such accounts from individuals, businesses, associations and organizations, and governmental authorities.

Lending Services. The Bank offers a full range of short- to medium-term commercial and consumer loans. Our primary focus is on making loans to small and medium-sized businesses and consumers in the Region 2000 (Lynchburg, Amherst, Bedford, Campbell) area, Charlottesville, Harrisonburg, Roanoke, Appomattox, and Blacksburg. In addition, we also provide a wide range of real estate finance services. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. Additionally, the Bank originates fixed and floating-rate mortgage loans and real estate construction and acquisition loans. Where appropriate, the Bank attempts to limit interest rate risk through the use of variable interest rates and terms of less than five years.

In general, the Bank offers the following lending services in our market areas:

- *Commercial Business Lending.* We make loans to small- and medium-sized businesses for purposes such as purchases of equipment, facilities upgrades, inventory acquisition and various working capital purposes.
- *Real Estate Construction*. We make commercial and residential construction and development loans.
- *Commercial Real Estate Mortgage*. We make loans to borrowers secured by commercial real estate. In underwriting these types of loans we consider the historic and projected future cash flows of the real estate.
- *Residential Mortgage.* We originate conforming and non-conforming closed-end residential mortgages. These loans are secured by liens on 1 to 4 family properties. We typically sell the conventional mortgage loans to correspondent financial institutions.
- *Consumer*. We offer various types of secured and unsecured consumer loans, including personal loans, lines of credit, overdraft lines of credit, automobile loans, installment loans,

demand loans, and home equity loans. We make consumer loans primarily for personal, family or household purposes.

We sell loan participations in the ordinary course of business when a loan originated by us exceeds our legal lending limit or we otherwise want to share risk with another bank. We also purchase loan participations from time to time from other banks in the ordinary course of business. Our loan participations are without recourse against the originating bank. Purchased loan participations are underwritten in accordance with our loan policy and represent a source of loan growth.

Other Banking Services. Other services offered by the Bank include safe deposit boxes, traveler's checks, direct deposit of payroll and social security checks, automatic drafts for various accounts, treasury management services and credit card merchant services. The Bank also is associated with a shared network of automated teller machines (ATMs) that may be used by Bank customers throughout Virginia, the United States, and internationally.

The Bank intends to introduce new products and services desired by the public and as permitted by the regulatory authorities. The Bank remains committed to meeting the challenges that require technology. The Bank provides its customers with access to the latest technological products, such as telephone banking and internet banking, including online bill pay. This service allows customers to handle routine transactions using a standard touch tone telephone, applications for mobile devices, and via the internet at the Bank's website.

Mortgage Banking. The Bank, through the Mortgage Division originates conforming and non-conforming home mortgages primarily in the Region 2000 area. Beginning in 2013 we began operating the Mortgage Division with hybrid correspondent relationships that allow the Bank to close loans in its name before an investor purchases the loan. By using the Bank's funds to close the loan (as compared to a broker relationship in which loans are funded by the purchaser of the mortgage), the Bank is able to obtain better pricing due to the slight increase in risk. Management believes that there is acceptable risk associated with this arrangement.

Other Activities

We provide brokerage and investment services through the Bank's Investment division ("Investment Division"). The Investment Division provides securities brokerage services to Bank customers and others through an agreement with Infinex Financial Group, LLC ("Infinex"), a registered broker-dealer. Under our agreement, Infinex operates a service center at the main office located at 828 Main St, Lynchburg, Virginia. To date the operating results of the Investment Division have not had a material impact on our financial performance.

We provide insurance and annuity products through BOTJ Insurance as an agent for national insurance companies. As of the date hereof, we offer the following insurance products: life insurance, fixed annuities, and disability insurance. We began providing these services in September 2008. To date the operating results of BOTJ Insurance have not had a material impact on our financial performance.

Employees

As of March 29, 2021, we had approximately 146 employees, 141 of which are full-time and five of which are part-time. None of our employees are represented by any collective bargaining agreements, and relations with employees are considered excellent. We maintain employee benefit programs that include health insurance, a health savings account, a 401(k) plan, and an employee stock purchase plan.

Location and Market Area

The Bank's market area primarily consists of Region 2000, which encompasses the seven jurisdictions of the Town of Altavista, Amherst County, Appomattox County, the Town of Bedford, Bedford County, Campbell County, and the City of Lynchburg. Region 2000 supports a diverse, well-rounded economy. U.S. Routes 29, 60, 221, 460 and 501 and State Routes 24 and 40 all pass through the trade area and provide efficient access to other regions of the state. Regional airport service and rail service provide additional transportation channels.

Total population in the market area equals approximately 267,000. According to publically available information, the current populations of the localities in the Region 2000 market area were approximately as follows: City of Lynchburg – 82,000; Amherst County – 32,000; Appomattox County – 15,000; Bedford County (including the Town of Bedford) – 79,000; Campbell County (including the Town of Altavista) – 55,000. The area is serviced by one daily newspaper and a number of radio and television stations providing diverse media outlets. Median family income in Region 2000 has risen over the past ten years.

Region 2000 has a broad range of services, light industry, and manufacturing plants. Principal service, industrial, research and development employers include: BWX Technologies, Inc. (nuclear fuel); Framatome (nuclear services); Centra Health, Inc. (health care services); Banker Steel Company, LLC (fabricated steel); Pacific Life (life insurance and other financial products); Frito-Lay, Inc. (snack foods); Griffin Pipe Products Co. (ductile iron pipe); as well as six colleges and universities including Randolph College, Sweet Briar College, Liberty University, and the University of Lynchburg.

In recent years we have expanded into Charlottesville, Virginia (north of Region 2000), Roanoke, Virginia (west of Region 2000), Harrisonburg, Virginia (northwest of Region 2000), Appomattox (east of Region 2000), Blacksburg (southwest of Region 2000), Lexington, Virginia (northwest of Region 2000), and Rustburg, Virginia (south of Region 2000).

Even with this expansion outside of Region 2000, the Bank continues to consider its primary market to be Region 2000.

Competition

Retail and Commercial Banking

The banking business is highly competitive. We compete with other commercial banks, savings institutions, credit unions, financial technology companies, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, and other financial institutions operating in the Region 2000 market area and elsewhere. Many of our nonbank competitors are not subject to the same extensive federal regulations that govern federally-insured banks and state regulations governing state-chartered banks. As a result, such nonbank competitors may have advantages over the Bank in providing certain services.

Virginia law permits statewide branching by banks. Consequently, the Bank's market area is a highly competitive, highly branched banking market. Competition in the market area for loans to individuals, small businesses, and professional concerns, the Bank's target market, is keen, and pricing is important. Most of the Bank's competitors have substantially greater resources and lending limits than the Bank and offer certain services, such as extensive and established branch networks and trust services, that the Bank is not currently providing. Deposit competition is strong and comes from institutions in the market, U.S. Government securities, private issuers of debt obligations and suppliers of other investment alternatives for depositors, among other sources. As a result, the Bank has paid, and may in the future pay, above-market rates to attract deposits.

The adoption of legislation permitting nationwide interstate banking and branching and the use of financial holding companies may also increase competition in the Bank's market area. See "Supervision and Regulation of Financial" below.

Mortgage Banking

The Mortgage Division competes with large national and regional banks, credit unions, regional mortgage lenders and local mortgage brokers. Following the 2008 downturn in the economy and subsequent real estate turmoil, the guidelines surrounding agency business (i.e., loans sold to Fannie Mae and Freddie Mac) became much more restrictive and the associated mortgage insurance for loans above 80 percent loan-to-value has continued to tighten. These changes in the conventional market have caused a dramatic increase in government lending and state bond programs. The Mortgage Division competes by attracting the top sales people in our market, providing an operational infrastructure that manages the guideline changes efficiently and effectively, offering a product menu that is both competitive in loan parameters as well as price, and providing consistently high-quality customer service.

Although the Mortgage Division sells loans to various intermediaries, the ability of these aggregators to purchase loans would be limited if certain government-sponsored entities (e.g. Fannie Mae, Freddie Mac, etc.) cease to exist or materially limit their purchases of mortgage loans.

SUPERVISION AND REGULATION OF FINANCIAL

General

Financial, as a bank holding company, and the Bank, as a state-chartered bank, are subject to extensive federal and state laws and regulations. These laws and regulations impose specific requirements or restrictions on and provide for general regulatory oversight of virtually all aspects of our operations. The following briefly summarizes the more significant provisions of applicable federal and state laws, certain regulations and the potential impact of such provisions on Financial and the Bank. These laws and regulations are generally intended to protect depositors, not shareholders. The following summary is qualified by reference to the statutory and regulatory provisions discussed. No assurance can be given that these statutes or regulations will not change.

Changes in applicable laws or regulations may have a material effect on our business and prospects. Our operations may be affected by legislative changes and the policies of various regulatory authorities. We cannot predict the effect that fiscal or monetary policies, economic control, or new federal or state legislation may have on our business and earnings in the future.

Regulation of Financial

General. Financial is subject to the periodic reporting requirements of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), including the filing with the Securities and Exchange Commission (the "SEC") of annual, quarterly and other reports on the financial condition and performance of the organization. Financial is directly affected by the corporate responsibility and accounting reform legislation signed into law on July 30, 2002, known as the Sarbanes-Oxley Act of 2002 (the "SOx Act"), and the related rules and regulations. The SOx Act includes provisions that, among other things, require that periodic reports containing financial statements that are filed with the SEC be accompanied by chief executive officer and chief financial officer certifications as to the accuracy and compliance with law, additional disclosure requirements and corporate governance and other related rules. Although we are not required to receive an opinion from our external auditors regarding our internal controls over financial reporting under section 404 of the SOx Act because of our status as a smaller reporting company, our management's report on internal control over financial reporting is set forth in Item 8 and incorporated into Item 9A herein. Financial has expended considerable time and money in complying with the SOx Act and expects to continue to incur additional expenses in the future.

Bank Holding Company Act. As a bank holding company registered under the Bank Holding Company Act of 1956 (the "BHCA"), Financial is subject to regulation and examination by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). Financial is required to file with the Federal Reserve Board an annual report and such other additional information as the Federal Reserve Board may require pursuant to the BHCA.

The Federal Reserve Board requires a bank holding company to act as a source of financial and managerial strength and to take measures to preserve and protect its bank subsidiaries. Financial would be compelled by the Federal Reserve Board to invest additional capital in the event the Bank experiences either significant loan losses or rapid growth of loans or deposits.

The Federal Reserve Board has jurisdiction under the BHCA to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. The BHCA, and other applicable laws and regulations, generally limit the activities of a bank holding company and its subsidiaries to that of banking, managing or controlling banks, or any other activity that is so closely related to banking or to managing or controlling banks as to be a proper incident thereto.

Pursuant to the BHCA, the FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or ownership constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

The FRB also has the authority to examine the Company and its subsidiaries, as well as any arrangements between the Company and its subsidiaries, with the cost of any such examinations to be borne by the Company. Banking subsidiaries of bank holding companies are also subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates.

Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Act (the "GLB Act") which was effective March 11, 2000, permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. A bank holding company may become a financial holding company by filing a declaration that the bank holding company wishes to become a financial holding company if each of its subsidiary banks (i) is well-capitalized under regulatory prompt corrective action provisions, (ii) is well managed, and (iii) has at least a satisfactory rating under the Community Reinvestment Act ("CRA"). No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

The GLB Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Board has determined to be closely related to banking. Subsidiary banks of a financial holding company must continue to be well-capitalized and well-managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has a CRA rating of satisfactory or better.

As discussed in more detail below under "*Confidentiality and Required Disclosure of Consumer Information*," the GLB Act also imposes customer privacy requirements on financial institutions.

The cumulative effect of the GLB Act and other recent bank legislation has caused us to strengthen our staff to handle the procedures required by this additional regulation. The increased staff and operational costs have impacted our profitability. Although the above laws may have a significant impact on the banking industry by promoting, among other things, competition, it is not possible for the management of the Bank to determine, with any degree of certainty, the impact of such laws on the Bank.

Limits on the Payment of Dividends. Financial is a legal entity, separate and distinct from the Bank. Financial currently does not have any significant sources of revenue other than cash dividends paid to it by the Bank. Both Financial and the Bank are subject to laws and regulations that limit the payment of cash dividends, including requirements to maintain capital at or above regulatory minimums. As a bank that is a member of the Federal Reserve System ("state member bank"), the Bank must obtain prior written approval for any cash dividend if the total of all dividends declared in any calendar year would exceed the total of its net profits for that year combined with its retained net profits for the preceding two years.

Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, the Federal Deposit Insurance Act (FDIA) prohibits insured depository institutions such as the Bank from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become undercapitalized as defined in the statute. In addition, the Federal Reserve is authorized to determine under certain circumstances relating to the financial condition of a bank that the payment of dividends would be an unsafe and unsound practice and to prohibit payment thereof. The payment of dividends that deplete a bank's capital base could be deemed to constitute such an unsafe and unsound banking practice. The Federal Reserve has indicated that banking organizations generally pay dividends only out of current operating earnings. In addition, under Virginia law, no dividend may be declared or paid out of a Virginia bank's paid-in capital. The Bank may be prohibited under Virginia law from the payment of dividends if the Virginia Bureau of Financial Institutions determines that a limitation of dividends is in the public interest and is necessary to ensure the Bank's financial soundness, and may also permit the payment of dividends not otherwise allowed by Virginia law.

The Dodd-Frank Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Reform Act") was signed into law. The Dodd-Frank Reform Act represents a significant overhaul of many aspects of the regulation of the financial services industry, although many of its provisions (e.g., the interchange and trust preferred capital limitations) apply to companies that are significantly larger than Financial. The Dodd-Frank Reform Act directs applicable regulatory authorities to promulgate regulations implementing its provisions, and its effect on Financial and on the financial services industry as a whole will be clarified as those regulations are issued. Major elements of the Dodd-Frank Reform Act include:

- The Dodd-Frank Reform Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminated the ceiling on the size of the Deposit Insurance Fund (DIF) and increased the floor applicable to the size of the DIF. The Dodd-Frank Act also made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000.

- The Dodd-Frank Reform Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

- The Dodd-Frank Reform Act required new disclosure relating to executive compensation and corporate governance.

- The Dodd-Frank Reform Act implemented amendments to the Truth in Lending Act aimed at improving consumer protections with respect to mortgage originations, including originator compensation, minimum repayment standards, and prepayment considerations.

- The Dodd-Frank Reform Act established the Financial Stability Oversight Council, which will be responsible for identifying and monitoring systemic risks posed by financial firms, activities, and practices.

- The Dodd-Frank Reform Act amended the Electronic Fund Transfer Act (EFTA) to, among other things, require that debit card interchange fees must be reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In June 2011, the Federal Reserve Board adopted regulations setting the maximum permissible interchange fee as the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, with an additional adjustment of up to one cent per transaction if the issuer implements additional fraud-prevention standards. Although issuers that have assets of less than $10 billion are exempt from the Federal Reserve Board's regulations that set maximum interchange fees, these regulations are expected to significantly affect the interchange fees that financial institutions with less than $10 billion in assets are able to collect.

- The Dodd-Frank Reform Act eliminated (over time) the inclusion of trust preferred securities as a permitted element of Tier 1 capital.

- The Dodd-Frank Reform Act created a special regime to allow for the orderly liquidation of systemically important financial companies, including the establishment of an orderly liquidation fund.

- The Dodd-Frank Reform Act requires the development of regulations to address derivatives markets, including clearing and exchange trading requirements and a framework for regulating derivatives-market participants.

- The Dodd-Frank Reform Act enhanced supervision of credit rating agencies through the Office of Credit Ratings within the SEC.

- The Dodd-Frank Reform Act established the Consumer Financial Protection Bureau, within the Federal Reserve, to serve as a dedicated consumer-protection regulatory body. The Consumer Financial Protection Bureau is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, small institutions. As a smaller institution, most consumer protection aspects of the Dodd-Frank Reform Act will continue to be overseen by the Federal Reserve.

- The Dodd-Frank Act allows banks to engage in de novo interstate branching, a practice that was previously significantly limited.

Many aspects of the Dodd-Frank Reform Act are subject to rulemaking and will take effect over several years. As a result, it is difficult to anticipate the overall impact of the act on Financial. Financial continues to evaluate the potential impact of the Dodd-Frank Reform Act.

Incentive Compensation

In June 2010, the Federal Reserve, the Office of the Comptroller of the Currency ("OCC") and the FDIC issued comprehensive final guidance on incentive compensation intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization'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 organization's board of directors.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as Financial, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization'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 organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The Dodd-Frank Reform Act requires the SEC and the federal bank regulatory agencies to establish joint regulations or guidelines that require financial institutions with assets of at least $1 billion to disclose the structure of their incentive compensation practices and prohibit such institutions from maintaining compensation arrangements that encourage inappropriate risk-taking by providing excessive compensation or that could lead to material financial loss to the financial institution.

The Regulatory Relief Act

The Regulatory Relief Act was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act. While it maintains the majority of the regulatory structure established by the Dodd-Frank Act, the Regulatory Relief Act amends certain aspects for small depository institutions with less than $10 billion in assets, such as the Bank. Sections in the Regulatory Relief Act address access to mortgage credit; consumer access to credit; protections for veterans, consumers, and homeowners; rules for certain bank or financial holding companies; capital access; and protections for student borrowers. Financial and the Bank will focus on the implementing rules and guidance for the various provisions in each section of the Regulatory Relief Act that impact their operations and activities.

Pursuant to the Regulatory Relief Act, on September 17, 2019, the federal banking agencies adopted a final rule regarding a community bank leverage ratio. Under the final rule, which was effective on January 1, 2020, depository institutions and depository institution holding companies that have less than $10 billion in total consolidated assets and meet other qualifying criteria, including a leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than 9 percent, will be eligible to opt into the community bank leverage ratio framework (qualifying community banking organizations). Qualifying community banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than 9 percent will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act.

The Regulatory Relief Act also expands the universe of holding companies that are permitted to rely on the "Small Bank Holding Company and Savings and Loan Holding Company Policy Statement." The asset size of a qualifying holding company was increased from $1 billion to $3 billion on August 30, 2018, thus excluding holding companies in this category from consolidated capital requirements. However, subsidiary depository institutions continue to be subject to minimum capital requirements.

Further, the Regulatory Relief Act decreased the burden for community banks in regards to call reports, the Volcker Rule (which generally restricts banks from engaging in certain investment activities and limits involvement with hedge funds and private equity firms), mortgage disclosures, and risk weights for some high-risk commercial real estate loans. On December 28, 2018, the federal banking agencies issued a final rule increasing the asset threshold to qualify for an 18-month examination cycle from $1 billion to $3 billion for qualifying institutions that are well capitalized, well managed and meet certain other requirements.

Any number of the provisions of the Regulatory Relief Act may have the effect of increasing our expenses, decreasing our revenues, or changing the activities in which we choose to engage. The environment in which banking organizations operate, including legislative and regulatory changes affecting capital, liquidity, supervision, permissible activities, corporate governance and compensation, changes in fiscal policy and steps to eliminate government support for banking organizations, may have long-term effects on the profitability of banking organizations that cannot now be foreseen.

It is difficult at this time to determine the direct impact of the Regulatory Relief Act on Financial or the Bank. Implementing rules and regulations are required and many have not yet been written or finalized.

Regulation of the Bank

The Bank is a Virginia chartered commercial bank and a state member bank. The Bank's deposit accounts are insured by the Deposit Insurance Fund ("DIF") of the FDIC up to the maximum legal limits of the FDIC and it is subject to regulation, supervision and regular examination by the Virginia Bureau of Financial Institutions and the Federal Reserve. The regulations of these various agencies govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends and location and number of branch offices. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds, and not for the purpose of protecting shareholders.

General. As a state-chartered commercial bank, the Bank and its subsidiaries are subject to regulation, supervision and examination by the Federal Reserve and the Virginia State Corporation Commission's Bureau of Financial Institutions (the "BFI"). As such, the Bank is subject to various statutes and regulations administered by these agencies that govern, among other things, required reserves, investments, loans, lending limits, acquisitions of fixed assets, interest rates payable on deposits, transactions among affiliates and the Bank, the payment of dividends, mergers and consolidations, and establishment of branch offices.

The earnings of the Bank are affected by general economic conditions, management policies and the legislative and governmental actions of the various regulatory authorities, including those referred to above.

FDIC Insurance Premiums. The FDIC's DIF provides insurance coverage for certain deposits, which insurance is funded through assessments on banks, like the Bank. Pursuant to the Dodd-Frank Act, the amount of deposit insurance coverage for deposits increased to $250,000 per depositor, subject to aggregation rules. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection act (the "Dodd-Frank Act"), the FDIC has established 2.0% as the designated reserve ratio (the "DRR"), that is, the ratio of the DIF to insured deposits. The Dodd-Frank Act directs the FDIC to amend its assessment regulations so that future assessments will generally be based upon a depository institution's average total consolidated assets minus the average tangible equity of the insured depository institution during the assessment period, whereas assessments were previously based on the amount of an institution's insured deposits. The minimum DIF rate has increased from 1.15% to 1.35%, and the cost of the increase will be borne by depository institutions with assets of $10 billion or more. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, will increase or decrease assessment rates, following notice-and-comment rule making if required.

In 2020, the Bank expensed $336,000 in FDIC assessments which compared to $226,000 in 2019. Any increases in FDIC insurance premiums could adversely affect the Bank's profitability.

After giving primary regulators an opportunity to first take action, FDIC may initiate an enforcement action against any depository institution it determines is engaging in unsafe or unsound actions or which is in an unsound condition, and the FDIC may terminate that institution's deposit insurance.

Capital Requirements. On June 7, 2012, the Federal Reserve issued a series of proposed rules that would revise and strengthen its risk-based and leverage capital requirements and its method for calculating risk-weighted assets. The rules were proposed to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Reform Act. On July 2, 2013, the Federal Reserve approved certain revisions to the proposals and finalized new capital requirements for banking organizations.

Effective January 1, 2015, the final rules required 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 6.0% of risk-weighted assets (increased from the previous requirement of 4.0%); (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from the previous requirement); and (iv) a leverage ratio of 4.0% of total assets. These were the initial capital requirements, which were phased in over a five-year period. As fully phased in on January 1, 2019, the rules require 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 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

The capital conservation buffer requirement was phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until it was 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 previous 6.0%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized.

The capital requirements also included changes in the risk weights of assets to better reflect credit risk and other risk exposures. These included 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.

As discussed above under "*Supervision and Regulation - The Regulatory Relief Act*," recently enacted legislation directs the federal bank regulatory agencies to develop a "Community Bank Leverage Ratio," calculated by dividing tangible equity capital by average consolidated total assets, of not less than 8% and not more than 10%. On September 17, 2019, pursuant to the Regulatory Relief Act, the federal banking agencies adopted a final rule setting community bank leverage ratio of 9%. If a "qualified community bank," generally a depository institution or depository institution holding company with consolidated assets of less than $10 billion, has a leverage ratio which exceeds the Community Bank Leverage Ratio, then such bank will be considered to have met all generally applicable leverage and risk based capital requirements; the capital ratio requirements for "well capitalized" status under Section 38 of the FDIA, and any other leverage or capital requirements to which it is subject. In response to the COVID-19 pandemic, regulatory authorities have lowered the tier 1 leverage ratio required under the community bank leverage ratio framework to 8% and 8.5% for 2020 and 2021, respectively.

The asset size of a qualifying holding company was increased from $1 billion to $3 billion on August 30, 2018, thus excluding holding companies in this category from consolidated capital requirements.

Because total assets on a consolidated basis are less than $3 billion, Financial is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Although the Company's subsidiary depository institution continues to be subject to minimum capital requirement, it is unlikely that the Company will be required to comply with the consolidated capital rules until well into the future.

Transactions with Affiliates. The Bank is subject to the provisions of Section 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W of the Federal Reserve Bank which place limits on the amount of loans or extensions of credit to affiliates (as defined in the Federal Reserve Act), investments in or certain other transactions with affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The law and regulation limit the aggregate amount of transactions with any individual affiliate to ten percent (10%) of the capital and surplus of the Bank and also limit the aggregate amount of transactions with all affiliates to twenty percent (20%) of capital and surplus. Loans and certain other extensions of credit to affiliates are required to be secured by collateral in an amount and of a type described in the regulation, and the purchase of low-quality assets from affiliates is generally prohibited. The law and Regulation W also, among other things, prohibit an institution from engaging in certain transactions with certain affiliates (as defined in the Federal Reserve Act) unless the transactions are on terms substantially the same, or at least as favorable to such institution and/or its subsidiaries, as those prevailing at the time for comparable transactions with non-affiliated entities. In the absence of comparable transactions, such transactions may only occur under terms and circumstances, including credit standards that in good faith would be offered to or would apply to non-affiliated companies.

Loans to Insiders. The Bank is subject to the restrictions contained in Section 22(h) of the Federal Reserve Act and the Federal Reserve Board's Regulation O thereunder on loans to executive officers, directors and principal stockholders. Under Section 22(h), loans to a director, an executive officer or a greater-than-10% stockholder of a bank as well as certain affiliated interests of any of the foregoing may not exceed, together with all other outstanding loans to such person and affiliated interests, the loans-to-one-borrower limit applicable to national banks (generally 15% of the institution's unimpaired capital and surplus), and all loans to all such persons in the aggregate may not exceed the institution's unimpaired capital and unimpaired surplus. Regulation O also prohibits the making of loans in an amount greater than $25,000 or 5% of capital and surplus but in any event not over $500,000, to directors, executive officers and greater-than-10% stockholders of a bank, and their respective affiliates, unless such loans are approved in advance by a majority of the board of directors of the bank with any "interested" director not participating in the voting. Furthermore, Regulation O requires that loans to directors, executive officers and principal stockholders of a bank be made on terms substantially the same as those that are offered in comparable transactions to unrelated third parties unless the loans are made pursuant to a benefit or compensation program that is widely available to all employees of the bank and does not give preference to insiders over other employees. Regulation O also prohibits a depository institution from paying overdrafts over $1,000 of any of its executive officers or directors unless they are paid pursuant to written pre-authorized extension of credit or transfer of funds plans.

All of the Bank's loans to its and the Company's executive officers, directors and greater-than-10% stockholders, and affiliated interests of such persons, comply with the requirements of Regulation W and Section 22(h) of the Federal Reserve Act and Regulation O.

Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency or the Office of Thrift Supervision shall evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. An institution's CRA activities are considered in, among other things, evaluating mergers, acquisitions and applications to open a branch or facility, as well as determining whether the institution will be permitted to exercise certain of the powers allowed by the GLB Act. The CRA also requires all institutions to make public disclosure of their CRA ratings. The Bank currently has a CRA rating of "satisfactory."

Safety and Soundness. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institutions in question are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," all such terms are defined under uniform regulations defining such capital levels issued by each of the federal banking agencies. An insured depository institution which is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities. As of December 31, 2020, the Bank was considered "well-capitalized."

Regulatory Enforcement Authority. Applicable banking laws include substantial enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions, including the filing of misleading or untimely reports with regulatory authorities, may provide the basis for enforcement action.

Confidentiality and Required Disclosures of Consumer Information. The Bank is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure.

In August, 2018, the CFPB published its final rule to update Regulation P pursuant to the amended GLB Act. Under this rule, certain qualifying financial institutions are not required to provide annual privacy notices to customers. To qualify, a financial institution must not share nonpublic personal information about customers except as described in certain statutory exceptions which do not trigger a customer's statutory opt-out. In addition, the financial institution must not have changed its disclosure policies and practices from those disclosed in its most recent privacy notice. The rule sets forth timing requirements for delivery of annual privacy notices in the event that a financial institution that qualified for the annual notice exemption later changes its policies or practices in such a way that it no longer qualifies for the exemption.

The Bank is also subject to various laws and regulations that attempt to combat money laundering and terrorist financing. The Bank Secrecy Act requires all financial institutions to, among other things, create a system of controls designed to prevent money laundering and the financing of terrorism, and imposes recordkeeping and reporting requirements. The USA Patriot Act facilitates information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering, and requires financial institutions to establish anti-money laundering programs. The Office of Foreign Assets Control ("OFAC"), which is a division of the U.S. Department of the Treasury, is responsible for helping to ensure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name of an "enemy" of the United States on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds into a blocked account, file a suspicious activity report with the Treasury and notify the FBI.

Mortgage Banking Regulation. The Bank's Mortgage Division is subject to the rules and regulations by the Department of Housing and Urban Development ("HUD"), the Federal Housing Administration (the "FHA"), the Department of Veteran Affairs and state regulatory authorities with respect to originating, processing, servicing and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers and, in some cases, restrict certain loan features, and fix maximum interest rates and fees. In addition to other federal laws, mortgage origination activities are subject to the Equal Credit Opportunity Act, Truth-in-Lending Act, Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Home Ownership Equity Protection Act, and the regulations promulgated thereunder. These laws prohibit discrimination, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level.

Effect of Governmental Monetary Policies

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Bank's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board have major effects upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

Future Regulatory Uncertainty

Legislative and regulatory proposals regarding changes in banking, and the regulation of banks, federal savings institutions, and other financial institutions and bank and bank holding company powers are being considered by the executive branch of the federal government, Congress and various state governments. Certain of these proposals, if adopted, could significantly change the regulation or operations of banks and the financial services industry. New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations, and competitive relationships of the nation's financial institutions.

Because federal regulation of financial institutions changes regularly and is the subject of constant legislative debate, we cannot forecast how federal regulation of financial institutions may change in the future and impact our operations. The recent economic environment has required a greater degree of coordination and overlap of the duties and responsibilities of the U.S. Treasury, federal and state banking regulators and the FDIC. We fully expect that the financial institution industry will remain heavily regulated in the near future and that additional laws or regulations may be adopted further regulating specific banking practices. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

Item 1A. Risk Factors

RISK FACTORS

In addition to the other information included in this Annual Report on Form 10-K, the following risk factors should be carefully considered in connection with evaluating our business and any forward-looking statements contained herein. Our business, financial condition, results of operations and cash flows could be harmed by any of the risk factors described below, or other risks that have not been identified or which we believe are immaterial or unlikely. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our business, financial condition, operating results and cash flows could be materially adversely affected.

RISKS RELATED TO OUR BUSINESS

Our profitability depends significantly on local economic conditions.

Our success depends primarily on the general economic conditions of the primary markets in Virginia in which we operate and where our loans are concentrated. Unlike nationwide banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the Lynchburg metropolitan statistical area ("MSA"). Lynchburg's MSA, which is often referred to as Region 2000, consists of approximately 2,122 square miles, and includes the City of Lynchburg and the Counties of Bedford, Campbell, Amherst and Appomattox. To a lesser extent, our lending market includes the Roanoke, Charlottesville and Harrisonburg MSAs. Our branches in localities outside of Region 2000 have a short operating history. As of December 2020, the Lynchburg MSA had an unemployment rate (seasonally adjusted) of 4.8%, as compared to a statewide average unemployment rate of 5.6%.

The local economic conditions in these areas have a significant impact on the Company's commercial and industrial, real estate and construction loans, the ability of its borrowers to repay their loans and the value of the collateral securing these loans. In addition, if the population or income growth in the Company's market areas is slower than projected, income levels, deposits and housing starts could be adversely affected and could result in a reduction of the Company's expansion, growth and profitability. If the Company's market areas experience a downturn or a recession for a prolonged period of time, the Company could experience significant increases in nonperforming loans, which could lead to operating losses, impaired liquidity and eroding capital. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreaks of hostilities or other international or domestic calamities, unemployment, monetary and fiscal policies of the federal government or other factors could impact these local economic conditions and could negatively affect the Company's financial condition, results of operations and cash flows.

The Company's business, financial condition, liquidity and results of operations have been, and will likely continue to be, adversely affected by the COVID-19 pandemic.

The COVID-19 pandemic has negatively impacted the local, state, national, and world economies. The pandemic has created economic and financial disruptions that have adversely affected, and are likely to continue to adversely affect, the Company's business, financial condition, liquidity and results of operations. The extent to which the COVID-19 pandemic will continue to negatively affect our business, financial condition, liquidity and results of operations will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic, the continued effectiveness of the Company's business continuity plan, the direct and indirect impact of the pandemic on the Company's employees, customers, clients, and service providers, as well as other market participants, and actions taken by governmental authorities and other third parties in response to the pandemic.

The COVID-19 pandemic has contributed to or resulted in:

- Increased unemployment and decreased consumer confidence and business generally.
- Temporary closures of many businesses and the institution of social distancing or other measurements.
- Ratings downgrades, credit deterioration and defaults in many industries, including natural resources, hospitality, transportation and commercial real estate.
- A sudden and significant reduction in the valuation of the equity, fixed-income and commodity markets and the significant increase in the volatility of those markets.
- A decrease in the rates and yields on U.S. Treasury securities.
- Increased demands on capital and liquidity.
- Heightened cybersecurity, information security and operational risks as a result of work-from-home arrangements.

As a result:

- The demand for our products and services could be significantly impacted, which could decrease our net interest income and adversely affect our revenue and net income.
- We could have an increase in customer delinquencies and loan defaults, including defaults on unsecured loans, and further increases in our allowance for loan losses and foreclosures.
- Customers may draw on lines of credit, which could impact our liquidity.
- The decline in rates and yields could have a negative effect on our yields on assets which could compress our net interest margin.
- We may take some measures with respect to customer requests, such as a deferral of loan payments and the suspension of foreclosures due to unfavorable market conditions, that may have a negative impact on the Company's business, financial condition, liquidity and results of operations.

Governmental authorities have taken unprecedented measures to provide economic assistance to individual households and businesses, stabilize the markets and support economic growth. The success of these measures is unknown and they may not be sufficient to fully mitigate the negative impact of the COVID-19 pandemic. The Company also faces an increase in governmental and regulatory scrutiny as a result of the effects of COVID-19 on market and economic conditions and actions governmental authorities take in response to those conditions.

The extent to which the COVID-19 pandemic impacts our business, results of operation, and financial condition, as well as our regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and the actions taken by governmental authorities and other third parties in response to the pandemic.

The length of the pandemic and the efficacy of the extraordinary measures being put in place to address it are unknown. Even after the pandemic subsides, the U.S. economy may experience a recession, and the Company anticipates the Company's businesses would be materially and adversely affected by a prolonged recession. To the extent the pandemic adversely affects the Company's business, financial condition, liquidity or results of operations, it may also have the effect of heightening many of the other risks described in the section.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A substantial majority of our loans have real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. Because most of our loans are concentrated in the Region 2000 area in and surrounding the City of Lynchburg, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are more geographically diverse. A weakening of the real estate market in our primary market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Additionally, acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

Our loan portfolio contains a number of real estate loans with relatively large balances.

A significant portion of our total loan portfolio contains real estate loans with balances in excess of $1,000,000. The deterioration of one or a few of these loans could cause a significant increase in nonperforming loans, which could result in a net loss of earnings, an increase in the provision for loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

Commercial real estate loans increase our exposure to credit risk.

A majority of our loan portfolio is secured by commercial real estate. Loans secured by commercial real estate are generally viewed as having more risk of default than loans secured by residential real estate or consumer loans because repayment of the loans often depends on the successful operation of the property, the income stream of the borrowers, the accuracy of the estimate of the property's value at completion of construction and the estimated cost of construction. An adverse development with respect to one lending relationship can expose us to a significantly greater risk of loss as compared with a single-family residential mortgage loan because we typically have more than one loan with such borrowers. Additionally, these loans typically involve larger loan balances to single borrowers or groups of related borrowers compared with single-family residential mortgage loans. Therefore, the deterioration of one or a few of these loans could cause a significant decline in the related asset quality. These loans represent higher risk and could result in a sharp increase in loans charged-off and could require us to significantly increase our allowance for loan losses, which could have a material adverse impact on our business, financial condition, results of operations and cash flows.

A percentage of the loans in our portfolio currently include exceptions to our loan policies and supervisory guidelines.

All of the loans that we make are subject to written loan policies adopted by our board of directors and to supervisory guidelines imposed by our regulators. Our loan policies are designed to reduce the risks associated with the loans that we make by requiring our loan officers to take certain steps that vary depending on the type and amount of the loan, prior to closing a loan. These steps include, among other things, making sure the proper liens are documented and perfected on property securing a loan, and requiring proof of adequate insurance coverage on property securing loans. Loans that do not fully comply with our loan policies are known as "exceptions." We categorize exceptions as policy exceptions, financial statement exceptions and document exceptions. As a result of these exceptions, such loans may have a higher risk of loan loss than the other loans in our portfolio that fully comply with our loan policies. In addition, we may be subject to regulatory action by federal or state banking authorities if they believe the number of exceptions in our loan portfolio represents an unsafe banking practice.

As a community bank, we have different lending risks than larger banks. We provide services to individuals and small to medium-sized businesses in our local markets who may have fewer financial resources to weather a downturn in the economy.

Our ability to diversify our economic risks is limited by our own local markets and economies. We lend primarily to small to medium-sized businesses, professionals and individuals, which may expose us to greater lending risks than those of banks lending to larger, better-capitalized businesses with longer operating histories. For instance, small to medium-sized businesses frequently have smaller market share than their competition, may be more vulnerable to economic downturns, have fewer financial resources in terms of capital or borrowing capacity than larger entities, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair the borrower's ability to repay a loan. In addition, the success of a small to medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact the Company's market areas could cause the Company to incur substantial credit losses that could negatively affect the Company's results of operations and financial condition.

We depend on the accuracy and completeness of information about clients and counterparties, and our financial condition could be adversely affected if we rely on misleading information.

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information, which we do not independently verify as a matter of course. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to customers, we may assume that a customer's audited financial statements conform with U.S. Generally Accepted Accounting Principles ("GAAP") and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements that do not comply with GAAP or are materially misleading.

If we suffer loan losses from a decline in credit quality, our earnings will decrease.

We could sustain losses if borrowers, guarantors or related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for loan losses, that we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations.

These policies and procedures necessarily rely on our making various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover probable incurred losses in our loan portfolio, resulting in additions to our allowance. Any future additions to our allowance could materially decrease our net income.

In addition, the Federal Reserve Bank of Richmond and the Virginia Bureau of Financial Institutions (the "BFI") periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by regulatory authorities might have a material adverse effect on our financial condition and results of operations.

Our allowance may not be adequate to cover actual loan losses.

A significant source of risk arises from the possibility that we could sustain losses due to loan defaults and nonperformance on loans. We maintain an allowance in accordance with GAAP to provide for such defaults and other nonperformance. As of December 31, 2020, our allowance as a percentage of total loans was 1.17% and our allowance as a percentage of nonperforming loans was 346.71%. The determination of the appropriate level of allowance is an inherently difficult process and is based on numerous assumptions. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, many of which are beyond our control. In addition, our underwriting policies, adherence to credit monitoring processes and risk management systems and controls may not prevent unexpected losses. Our allowance may not be adequate to cover actual loan losses. Moreover, any increase in our allowance will adversely affect our earnings by decreasing our net income.

In June 2016, the Financial Accounting Standards Board decided to change how banks estimate losses in the allowance calculation, and it issued ASU 2016-13, Financial Instruments-Credit Losses. Currently, the impairment model is based on incurred losses, and loans are recognized as impaired when there is no longer an assumption that future cash flows will be collected in full under the originally contracted terms. This model will be replaced by the new Current Expected Credit Losses ("CECL") model that will become effective for us, as a smaller reporting company, for the first interim and annual reporting periods beginning after December 15, 2022. Under the new CECL model, we will be required to use historical information, current conditions and reasonable and supportable forecasts to estimate the expected loss over the life of the loan. The transition to the CECL model will bring with it significantly greater data requirements and changes to methodologies to accurately account for expected losses under the new parameters.

Management is currently evaluating the impact of these changes to our financial position and results of operations. The allowance is a material estimate of ours, and given the change from an incurred loss model to a methodology that considers the credit loss over the life of the loan, there is the potential for an increase in the allowance at adoption date. We anticipate a significant change in the processes and procedures to calculate the allowance, including changes in assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. We expect to continue developing and implementing processes and procedures to ensure we are fully compliant with the CECL requirements at its adoption date.

The markets for our deposit and lending products and services are highly competitive, and we face substantial competition.

The banking and financial services industry is highly competitive. We compete as a financial intermediary with other commercial banks, savings banks, credit unions, finance companies, mutual funds, insurance companies and brokerage and investment banking firms soliciting business from residents of and businesses located in the Virginia localities where the Bank has a presence, surrounding areas and elsewhere. Many of these competing institutions have nationwide or regional operations and have greater resources than we have. We also face competition from local community institutions. Many of our competitors enjoy competitive advantages, including greater name recognition, financial resources, a wider geographic presence or more accessible branch office locations, the ability to offer additional services, greater marketing resources, more favorable pricing alternatives for loans and deposits and lower origination and operating costs. We are also subject to lower lending limits than our larger competitors. Our profitability depends upon our continued ability to successfully compete in our market areas. Increased deposit competition could increase our cost of funds and could adversely affect our ability to generate the funds necessary for our lending operations. If we must raise interest rates paid on deposits or lower interest rates charged on our loans, our net interest margin and profitability could be adversely affected. Competition could result in a decrease in loans we originate and could negatively affect our ability to grow and our results of operations.

Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services.

We have increased and plan to continue to increase our levels of commercial and industrial loans. We may not be successful in continuing to penetrate this market segment, which has helped to drive some of our recent earnings.

A significant percentage of our loans are commercial and industrial loans. Our portfolio of commercial and industrial loans has increased during the past year.

While we intend to originate these types of loans in a manner that is consistent with safety and soundness, these non-residential loans generally expose us to greater risk of loss than one- to four-family residential mortgage loans, as repayment of such commercial and industrial loans generally depends, in large part, on the borrower's business to cover operating expenses and debt service. In addition, these types of loans typically involve larger loan balances to single borrowers or groups of related borrowers, as compared to one- to four-family residential mortgage loans. Changes in economic conditions that are beyond our or the borrower's control could adversely affect the value of the security for the loan, including the future cash flow of the affected business. As we increase our portfolio of these loans, we may experience higher levels of non-performing assets or loan losses, or both.

Our plans for future expansion depend, in some instances, on factors beyond our control, and an unsuccessful attempt to achieve growth could have a material adverse effect on our business, financial condition, results of operations and future prospects.

We expect to continue to engage in new branch expansion in the future. We may also seek to acquire other financial institutions, or parts of those institutions, though we have no present plans in that regard. Expansion involves a number of risks, including, without limitation:

- the time and costs of evaluating new markets, hiring experienced local management and opening new offices;
- the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- our entrance into new markets where we lack experience;
- the introduction of new products and services with which we have no prior experience into our business;
- failure to culturally integrate an acquisition target or new branches or failing to identify and select the optimal candidate for integration or expansion; and
- failure to identify and retain experienced key management members with local expertise and relationships in new markets.

We may acquire and hold other real estate owned (OREO) properties, which could lead to increased operating expenses and vulnerability to declines in the market value of real estate in our areas of operations.

From time-to-time, we foreclose upon and take title to the real estate serving as collateral for our loans as part of our business. If our OREO balance increases, management expects that our earnings will be negatively affected by various expenses associated with OREO, including personnel costs, insurance and taxes, completion and repair costs, valuation adjustments and other expenses associated with property ownership. Also, at the time that we foreclose upon a loan and take possession of a property, we estimate the value of that property using third-party appraisals and opinions and internal judgments. OREO property is valued on our books at the estimated market value of the property, less the estimated costs to sell (or "fair value"). Upon foreclosure, a charge-off to the allowance for loan losses is recorded for any excess between the value of the asset on our books over its fair value. Thereafter, we periodically reassess our judgment of fair value based on updated appraisals or other factors, including, at times, at the request of our regulators. Any declines in our estimate of fair value for OREO will result in valuation adjustments, with a corresponding expense in our statements of income that is recorded under the line item for "Other real estate expenses." As a result, our results of operations are vulnerable to declines in the market for residential and commercial real estate in the areas in which we operate. The expenses associated with OREO and property write downs could have a material adverse effect on our results of operations and financial condition. Any increase in non-accrual loans may lead to increases in our OREO balance in the future.

Additional growth and regulatory requirements may require us to raise additional capital in the future, and capital may not be available when it is needed or may have unfavorable terms, which could adversely affect our financial condition and results of operations.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. While the boards of the Company and the Bank intend to take steps to ensure that the capital plan aligns with the Bank's strategic plan, that all material risks to the Bank are identified and measured and that capital limits are appropriate for the institution's risk profile, failure to successfully implement such steps could have a material adverse effect on our financial condition and results of operations. We may at some point need to raise additional capital to support our continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we can make no assurances of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations could be materially impaired.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the teamwork and increased productivity fostered by our culture, which could harm our business.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters teamwork and increased productivity. As our organization grows and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

If we fail to retain our key employees, our growth and profitability could be adversely affected.

Our success is, and is expected to remain, highly dependent on our executive management team. Four of our key executives are Robert R. Chapman III (President of the Company and President and CEO of the Bank), J. Todd Scruggs (Secretary-Treasurer of the Company and Executive Vice President and CFO of the Bank), Harry P. "Chip" Umberger (Executive Vice President and Senior Credit Officer of the Bank), and Michael A. Syrek (Executive Vice President and Senior Loan Officer of the Bank). We are especially dependent on these executives as well as other key personnel because, as a community bank, we depend on our management team's ties to the community to generate business for us, and our executives have key expertise needed to implement our business strategy. Our executive management and other key personnel have not signed non-competition covenants.

Competition for personnel is intense, and we may not be successful in attracting or retaining qualified personnel. Our failure to compete for these personnel, or the loss of the services of several of such key personnel, could adversely affect our growth strategy and seriously harm our business, results of operations and financial condition.

Severe weather, natural disasters, widespread disease or pandemics (including the COVID-19 pandemic), acts of war or terrorism or other adverse external events could significantly impact our business.

Severe weather, natural disasters, widespread disease or pandemics (including the recent coronavirus outbreak), acts of war or terrorism or other adverse external events could have a significant impact on our ability to conduct business. In addition, such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue or cause us to incur additional expenses. The occurrence of any of these events in the future could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

As a community bank, our ability to maintain our reputation is critical to the success of our business, and our failure to do so may materially adversely affect our performance.

As a community bank, our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. Negative publicity can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance, acquisitions and actions taken or threatened by government regulators and community organizations in response to those activities. If our reputation is negatively affected by the actions of our employees or otherwise, there may be an adverse effect on our ability to keep and attract customers, and we might be exposed to litigation and regulatory action. Any of such events could harm our business, and, therefore, our operating results may be materially adversely affected. As a financial services company with a high profile in our market area, we are inherently exposed to this risk. While we take steps to minimize reputation risk in dealing with customers and other constituencies, we will continue to face additional challenges maintaining our reputation with respect to customers of the Bank in our current primary market area in Region 2000 and in establishing our reputation in new market areas.

Our decisions regarding how we manage our credit exposure may materially and adversely affect our business.

We manage our credit exposure through careful monitoring of lending relationships and loan concentrations in particular industries, and through loan approval and review procedures.

We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimate based on experience, judgment and expectations regarding our borrowers and the economies in which we and our borrowers operate, as well as the judgment of our regulators. While our board and senior management are continuing to improve the Bank's risk management framework and align the Bank's risk philosophy with its capital and strategic plans, failure to continue to improve such risk management framework could have a material adverse effect on our financial condition and results of operations. We can make no assurances that our loan loss reserves will be sufficient to absorb future loan losses or prevent a material adverse effect on our business, financial condition or results of operations.

Our profitability is vulnerable to interest rate fluctuations and changes in monetary policies.

Our profitability depends substantially upon our net interest income. Net interest income is the difference between the interest earned on interest-earning assets, such as loans and investment securities, and the interest expense paid on interest-bearing liabilities, such as NOW accounts, savings accounts, time deposits and other borrowings. Market interest rates for loans, investments and deposits are highly sensitive to many factors beyond our control. Interest rate spreads have seen a sustained period of narrowness due to many factors, such as market conditions, policies of various government and regulatory authorities and competitive pricing pressures, and we cannot predict whether these rate spreads will narrow further. This narrowing of interest rate spreads could adversely affect our financial condition and results of operations. In addition, we cannot predict whether interest rates will continue to remain at present levels. Changes in interest rates may cause significant changes, up or down, in our net interest income. Depending on our portfolio of loans and investments, our results of operations may be adversely affected by changes in interest rates.

Our financial condition and results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve Board. Actions by monetary and fiscal authorities, including the Federal Reserve Board, could have an adverse effect on our deposit levels, loan demand or business and earnings.

A failure in or breach of our operational or security systems or infrastructure, or those of our third party vendors and other service providers, including as a result of cyber-attacks, could disrupt our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer-relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur; or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could disrupt our business, increase our costs, result in the disclosure of confidential client information, damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability; any of which could have a material adverse effect on our financial condition and results of operations.

Our computer systems, software and networks have been and will continue to be vulnerable to unauthorized access, loss or destruction of data (including confidential client information), account takeovers, unavailability of service, computer viruses or other malicious code, cyber-attacks and other events. These threats may derive from human error, fraud or malice on the part of employees or third parties, or may result from accidental technological failure. Information security risks for financial institutions such as ours have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and digital technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists and other external parties. Some of our operations rely on the secure processing, transmission and storage of confidential information in our computer systems and networks. Our business relies on our digital technologies, computer and email systems, software and networks to conduct its operations. In addition, to access our products and services, our customers may use personal smartphones, tablets, personal computers and other mobile devices that are beyond our control systems. Although we have information security procedures and controls in place, our technologies, systems, networks and our customers' devices may become the target of cyber-attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our or our customers' confidential, proprietary and other information, or otherwise disrupt our or our customers' or other third parties' business operations.

Although we maintain safeguards to protect against these risks, there can be no assurance that we will not suffer losses in the future that may be material in amount or nature.

Changes in consumers' use of banks and changes in consumers' spending and saving habits could adversely affect our financial results.

Technology and other changes now allow many consumers to complete financial transactions without using banks. For example, consumers can pay bills and transfer funds directly without going through a bank. This disintermediation could result in the loss of fee income, as well as the loss of customer deposits and income generated from those deposits. In addition, changes in consumer spending and saving habits could adversely affect our operations, and we may be unable to timely develop competitive new products and services in response to these changes that are accepted by new and existing customers.

Failure to implement new technologies in our operations may adversely affect our growth or profits.

The market for financial services, including banking services and consumer finance services, is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, Internet-based banking and telebanking. Our ability to compete successfully in our markets may depend on the extent to which we are able to exploit such technological changes. However, we can provide no assurance that we will be able to properly or timely anticipate or implement such technologies or properly train our staff to use such technologies. Any failure to adapt to new technologies could adversely affect our business, financial condition or operating results.

In addition, the financial services industry is undergoing rapid technological changes, with new technology-driven products and services being frequently introduced. The changes could cause our customers to use these new services and products rather than the Bank. For example, financial technology (or "fintech") companies that rely on technology to provide financial services such as peer-to-peer platforms, blockchain and other distributed ledger technologies have the potential to disrupt the financial services industry and change the way banks do business. Fintech companies are subject to limited regulation. We may not be able to effectively implement new technology-driven products and services or be successful in competing against products, which could impair our growth and profitability.

We are subject to operational risks.

The Company may also be subject to disruptions of its systems arising from events that are wholly or partially beyond our control (including, for example, computer viruses or electrical or telecommunications outages), which may give rise to losses in service to customers and to financial loss or liability. The Company is further exposed to the risk that its external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as is the Company) and to the risk that the Company's (or its vendors') business continuity and data security systems prove to be inadequate.

We are subject to liquidity risk.

Liquidity risk is the potential that we will be unable to meet our obligations as they become due, capitalize on growth opportunities as they arise or pay regular cash dividends because of an inability to liquidate assets or obtain adequate funding in a timely basis, at a reasonable cost and within acceptable risk tolerances. A failure to adequately manage our liquidity risk could adversely affect our business, financial condition or operating results, especially in the event of another financial crisis. Further, the Federal Reserve could impose additional requirements on the Company if the agency determines that our enhanced liquidity risk management practices do not adequately manage our liquidity risk.

We may lose lower-cost funding sources.

Checking, savings and money market deposit account balances and other forms of customer deposits can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, the Bank could lose a relatively low-cost source of funds, thereby increasing its funding costs and reducing the Bank's net interest income and net income.

If we fail to maintain an effective system of internal and disclosure controls, we may not be able to accurately report our financial results or prevent or detect fraud.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent or detect fraud and to operate successfully as a public company.

The Company faces the risk that the design of its controls and procedures, including those to mitigate the risk of fraud by employees or outsiders, may prove to be inadequate or are circumvented, thereby causing delays in detection of errors or inaccuracies in data and information. We regularly review and update the Company's internal controls, disclosure controls and procedures and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

Any failure to maintain effective controls or timely effect any necessary improvement of our internal and disclosure controls could hinder our ability to accurately report our operating results or cause us to fail to meet our reporting obligations, which could affect our ability to remain listed with The NASDAQ Capital Market. Ineffective internal and disclosure controls could also harm our reputation, negatively impact our operating results or cause investors to lose confidence in our reported financial information, which likely would have a negative effect on the trading price of our securities.

Changes in the financial markets could impair the value of our investment portfolio.

Our investment securities portfolio is a significant component of our total earning assets. Turmoil in the financial markets could impair the market value of our investment portfolio, which could adversely affect our net income and possibly our capital.

From time to time, we hold as investments certain securities that have unrealized losses. While we currently maintain substantial liquidity which supports our intent and ability to hold these investments until they mature, or until there is a market price recovery, if we were to cease to have the ability and intent to hold these investments until maturity or if the market prices do not recover, and we were to sell these securities at a loss, it could adversely affect our net income and possibly our capital.

Our deposit insurance premiums could be substantially higher in the future, which could have a material adverse effect on our future earnings.

The FDIC insures deposits at FDIC-insured depository institutions, such as the Bank, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. Bank failures significantly depleted the FDIC's Deposit Insurance Fund and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Reform Act, banks are now assessed deposit insurance premiums based on the bank's average consolidated total assets, and the FDIC has modified certain risk-based adjustments, which increase or decrease a bank's overall assessment rate. This has resulted in increases to the deposit insurance assessment rates, and thus raised deposit premiums for many insured depository institutions. If these increases are insufficient for the Deposit Insurance Fund to meet its funding requirements, further special assessments or increases in deposit insurance premiums may be required. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums could reduce our profitability, may limit our ability to pursue certain business opportunities or otherwise negatively impact our operations.

REGULATORY AND LEGAL RISKS

We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business, which limitations or restrictions could adversely affect our profitability.

As a bank holding company, we are primarily regulated by the Federal Reserve. The Bank is primarily regulated by the BFI and the Federal Reserve. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a financial institution, the classification of assets by a financial institution and the adequacy of a financial institution's allowance for loan losses. The Company periodically reviews its policies, procedures and limits, and undertakes reporting, to ensure all guidance is appropriate for the Bank's current and planned operations and aligns with regulatory expectations. In this regard, regulatory authorities may impose particular requirements on the Bank, which could have a material adverse effect on our results of operations. Any change in such regulation and regulatory oversight, whether in the form of regulatory policy, regulations or legislation, could have a material impact on us and our operations. Further, our compliance with Federal Reserve and the BFI regulations is costly. Because our business is highly regulated, the applicable laws, rules and regulations are subject to regular modification and change. Laws, rules and regulations may be adopted in the future that could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects. For instance, such changes may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capital requirements by our regulators.

The laws and regulations, including the Dodd-Frank Reform Act, applicable to the banking industry could change at any time, and these changes may adversely affect our business and profitability.

We are subject to extensive federal and state regulation. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably. The increased scope, complexity, and cost of corporate governance, reporting, and disclosure practices are proportionately higher for a company of our size and will affect our profitability more than that of some of our larger competitors. We expect to experience increasing compliance costs related to this supervision and regulation.

Also, the 2020 national election results and new administration have introduced additional uncertainty into future implementation and enforcement of the Dodd-Frank Reform Act and other financial sector regulatory requirements. Such additional regulation and supervision may increase our costs and limit our ability to pursue business opportunities. The effects of any such recently enacted, or proposed, legislation and regulatory programs on us cannot reliably be determined at this time.

The Consumer Financial Protection Bureau's (the "CFPB") "ability-to-repay" and "qualified mortgage" rules may have a negative impact on our loan origination process and foreclosure proceedings, which could adversely affect our business, operating results and financial condition.

On January 10, 2013, the CFPB issued a final rule to implement the "qualified mortgage" provisions of the Dodd-Frank Reform Act requiring mortgage lenders to consider consumers' ability to repay home loans before extending them credit. The CFPB's "qualified mortgage" rule, which became effective on January 10, 2014, describes certain minimum requirements for lenders making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. Lenders will be presumed to have complied with the ability-to-repay rule if they issue "qualified mortgages," which are generally defined as mortgage loans prohibiting or limiting certain risky features. Loans that do not meet the ability-to-repay standard can be challenged in court by borrowers who default, and the absence of ability-to-repay status can be used against a lender in foreclosure proceedings. Any loans that we make outside of the "qualified mortgage" criteria could expose us to an increased risk of liability and reduce or delay our ability to foreclose upon the underlying property. Any decreases in loan origination volume or increases in compliance and foreclosure costs caused by the rule could negatively affect our business, operating results and financial condition. The CFPB also has adopted a number of additional requirements and issued additional guidance, including with respect to appraisals, escrow accounts and servicing, each of which entails increased compliance costs. In addition, the CFPB likely will continue to make rules relating to consumer protection, and it is difficult to predict which of our products and services will be subject to these rules or how these rules will be implemented.

Compliance with the Dodd-Frank Reform Act will increase our regulatory compliance burdens, and may increase our operating costs and may adversely impact our earnings or capital ratios, or both.

Signed into law on July 21, 2010, the Dodd-Frank Reform Act has represented a significant overhaul of many aspects of the regulation of the financial services industry. Among other things, the Dodd-Frank Reform Act created the CFPB, tightened capital standards, imposed clearing and margining requirements on many derivatives activities and generally increased oversight and regulation of financial institutions and financial activities.

In addition to the self-implementing provisions of the statute, the Dodd-Frank Reform Act calls for over 200 administrative rulemakings by numerous federal agencies to implement various parts of the legislation. While many rules have been finalized or issued in proposed form, additional rules have yet to be proposed. It is not possible at this time to predict when all such additional rules will be issued or finalized, and what the content of such rules will be. We will have to apply resources to ensure that we are in compliance with all applicable provisions of the Dodd-Frank Reform Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings or capital, or both.

The Dodd-Frank Reform Act and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment and our ability to conduct business.

The short-term and long-term impact of regulatory capital requirements and capital rules is uncertain.

Under the capital standards, in order to be well-capitalized, the Bank is required to have a common equity to Tier 1 capital ratio of 6.5% and a Tier 1 capital ratio of 8.0%. The application of more stringent capital requirements for the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models or increase our holdings of liquid assets, or all or any combination of the foregoing. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, or both, could result in management modifying its business strategy, and could limit our ability to make distributions, including paying out dividends or buying back shares.

Pursuant to the Regulatory Relief Act, on September 17, 2019, the federal banking agencies adopted a final rule regarding a community bank leverage ratio. Under the final rule, which was effective on January 1, 2020, depository institutions and depository institution holding companies that have less than $10 billion in total consolidated assets and meet other qualifying criteria, including a leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than 9 percent, will be eligible to opt into the community bank leverage ratio framework (qualifying community banking organizations). Qualifying community banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than 9 percent will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. At this point the Bank has chosen not to opt in to the community bank leverage ratio framework.

RISKS RELATED TO OUR STOCK

Our ability to pay cash dividends is limited, and we may be unable to pay future dividends even if we desire to do so.

The Company is a legal entity, separate and distinct from the Bank. The Company currently does not have any significant sources of revenue other than cash dividends paid to it by the Bank. Both the Company and the Bank are subject to laws and regulations that limit the payment of cash dividends, including requirements to maintain capital at or above regulatory minimums. As a bank that is a member of the Federal Reserve System, the Bank must obtain prior written approval for any cash dividend if the total of all dividends declared in any calendar year would exceed the total of its net profits for that year combined with its retained net profits for the preceding two years.

Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, the FDIA prohibits insured depository institutions such as the Bank from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become undercapitalized as defined in the statute. Moreover, the Federal Reserve is authorized to determine under certain circumstances relating to the financial condition of a bank that the payment of dividends would be an unsafe and unsound practice and to prohibit payment thereof. The payment of dividends that deplete a bank's capital base could be deemed to constitute such an unsafe and unsound banking practice. The Federal Reserve has indicated that banking organizations generally pay dividends only out of current operating earnings. The Bank may be prohibited under Virginia law from the payment of dividends, including in the event the BFI determines that a limitation of dividends is in the public interest and is necessary to ensure the Bank's financial soundness.

In addition, the Bank's ability to pay dividends will be limited if the Bank does not have the capital conservation buffer required by the capital rules, which may limit the Company's ability to pay dividends to stockholders.

If the Bank is not permitted to pay cash dividends to the Company, it is unlikely that the Company would be able to pay cash dividends on our common stock. Moreover, holders of our common stock are entitled to receive dividends only when and if declared by our board of directors. Although we currently pay cash dividends on our common stock, we are not required to do so and our board of directors could reduce or eliminate the amount of our common stock dividends in the future.

A limited market exists for our common stock.

Our common stock commenced trading on The NASDAQ Capital Market on January 25, 2012, and trading volumes since that time have been relatively low as compared to other larger financial services companies. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market. Accordingly, holders of our common stock may have difficulty selling our common stock at prices which holders find acceptable or which accurately reflect the value of the Company.

Future offerings of debt or other securities may adversely affect the market price of our stock.

In the future, we may attempt to increase our capital resources or, if our or the Bank's capital ratios fall below the required minimums, we or the Bank could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of any debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock.

Our stockholders may experience dilution due to our issuance(s) of additional securities in the future.

We may in the future issue additional shares of our common stock to raise cash for operations or to fund acquisitions, to provide equity-based incentives to our management and employees, to permit our stockholders to invest cash dividends and optional cash payments in shares of our common stock or as consideration in acquisition transactions. Additional equity offerings and issuance(s) of additional shares of our common stock may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. No assurances can be given that the Company will not issue additional securities that will have the effect of diluting the equity interest of our stockholders. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

Virginia law and the provisions of our articles of incorporation and bylaws could deter or prevent takeover attempts by a potential purchaser of our common stock that would be willing to pay holders a premium for their shares of our common stock.

Our articles of incorporation and bylaws contain provisions that may be deemed to have the effect of discouraging or delaying uninvited attempts by third parties to gain control of us. These provisions include the division of our board of directors into classes with staggered terms, the ability of our board of directors to set the price, terms and rights of, and to issue, one or more series of our preferred stock and the ability of our board of directors, in evaluating a proposed business combination or other fundamental change transaction, to consider the effect of the business combination on us and our stockholders, employees, customers and the communities which we serve. Similarly, the Virginia Stock Corporation Act contains provisions designed to protect Virginia corporations and employees from the adverse effects of hostile corporate takeovers. These provisions reduce the possibility that a third party could effect a change in control without the support of our incumbent directors. These provisions may also strengthen the position of current management by restricting the ability of stockholders to change the composition of the board of directors, to affect its policies generally and to benefit from actions which are opposed by the current board of directors.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Current Locations and Property

Depending on such factors as cost, availability, and location, we may either lease or purchase our operating facilities. The existing facilities that we have purchased typically have been former branches of other financial institutions. As of March 29, 2021, the Bank conducts its operations from 19 locations, of which we own 11 and lease 8. The following table describes the location and general character of our operating facilities:

Address	Type of Facility	Year Opened	Owned/Leased
5204 Fort Avenue Lynchburg, Virginia	Full-service branch with drive thru and ATM	2000	Owned
4698 South Amherst Highway Madison Heights, Virginia	Full-service branch with drive thru and ATM	2002	Owned
17000 Forest Road Forest, Virginia	Full-service branch with drive thru and ATM Headquarters for Mortgage Division	2005	Owned
164 South Main Street Amherst, Virginia	Full-service branch with drive thru and ATM	2007	Owned
1405 Ole Dominion Blvd Bedford, Virginia	Full-service branch with drive thru and ATM	2008	Owned
1110 Main Street Altavista, Virginia	Full-service branch with drive thru and ATM	2009	Owned
828 Main Street Lynchburg, Virginia	Corporate Headquarters; Full-service branch with drive thru and ATM	2004	Leased (1)
4935 Boonsboro Road, Suites C and D Lynchburg, Virginia	Full-service branch with drive thru and ATM	2006	Leased (2)
501 VES Road Lynchburg, Virginia	Limited service branch	2010	Leased (3)

250 Pantops Mountain Road Charlottesville, Virginia	Limited service branch	2015	Leased (4)
1391 South High Street Harrisonburg, Virginia	Full-service branch with drive thru and ATM	2015	Owned
1745 Confederate Blvd Appomattox, Virginia	Full-service branch with drive thru and ATM	2017	Owned
225 Merchant Walk Avenue Charlottesville, Virginia	Full-service branch with drive thru and ATM	2016	Leased (5)
3562 Electric Road Roanoke, Virginia	Full-service branch with ATM	2017	Leased (6)
2001 South Main Street #107 Blacksburg, Virginia	Mortgage origination office	2018	Leased (7)
550 East Water Street Suite 100 Charlottesville, Virginia	Full-service branch with ATM	2019	Owned
2101 Electric Road Roanoke, Virginia	Full-service branch with drive thru and ATM	2019	Leased (8)
45 South Main Street Lexington, Virginia	Full-service branch with ATM	2019	Owned
13 Village Highway Rustburg, VA 24588	Full-service branch with drive thru and ATM	2019	Owned

(1) Upon closure of the 615 Church Street Branch in 2019, the Bank elected to consolidate the Church Street operations at 828 Main Street. In order to secure more square footage for the consolidation, effective June 1, 2019, the Bank entered into an amended and restated lease for the 828 Main Street location. The current term of the amended and restated lease expires in five years and the Bank has three five-year renewal options (subject to the terms and conditions outlined in the lease). The Bank leases this property from Jamesview Investment, LLC, which is wholly-owned by William C. Bryant III, a member of the Board of Directors of both Financial and the Bank.

(2) The current term expired on December 31, 2020. The Bank intends to continue operating at this location and is currently leasing this property on a month-to-month basis.

(3) Base lease expires May 31, 2025. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.

(4) Base lease expires April 30, 2025. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.

(5) Base lease expires October 31, 2026. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.

(6) Base lease expires January 31, 2022. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.

(7) Base lease expired February 28, 2021. The Bank intends to continue operating at this location and anticipates continuing on a month-to-month basis.

(8) Base lease expires February 28, 2024. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.

We believe that each of these operating facilities is maintained in good operating condition and is suitable for our operational needs.

Interest in Additional Properties

As discussed in "Management's Discussion and Analysis—Expansion Plans" in addition to the facilities set forth above, the Bank owns the following properties which are being held for possible expansion:

- real property located in the Timberlake Road area of Campbell County (Lynchburg), Virginia. The existing structure located on the property is not suitable for its intended use as a branch bank. Management anticipates that it will be necessary to raze the current structures and replace them with appropriate new construction.

- real property located at 4501 Boonsboro Road, Lynchburg, Virginia. The Bank purchased this property in 2020. This property was previously used by another institution as a branch bank. While the Bank does not anticipate opening a branch at this location until 2022, the Bank believes the investment needed to upfit this property will be minimal and primarily related to aesthetics due to the fact this location was a former bank branch.

Management of the Bank continues to look for and evaluate additional locations for future branch growth and will consider opening an additional branch in the next 18 months if a suitable location is available on acceptable terms. The opening of all additional branches is contingent upon the receipt of regulatory approval.

We will use the internet, consistent with applicable regulatory guidelines, to augment our growth plans. We currently offer online account access, bill payment, and account management functions through our website. The Bank recently released an application that enables customers to transact banking business on smartphones and other mobile devices.

Item 3. Legal Proceedings

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

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

Market Prices and Dividends

As of January 25, 2012, the Common Stock of Financial is traded on the NASDAQ Capital Market LLC (NASDAQ) under the symbol "BOTJ." Prior to this time, the Common Stock of Financial was quoted on the Over the Counter Bulletin Board (OTCBB) under the symbol "BOJF ("BOJF.OB" on some systems) and transactions generally involved a small number of shares.

As of March 29, 2021, there were approximately 4,324,836 shares of Common Stock outstanding, which shares are held by approximately 1,500 active shareholders of record.

Dividend Policy

The Company's future dividend policy is subject to the discretion of its Board of Directors and will depend upon a number of factors, including future earnings, financial condition, liquidity and capital requirements of both the Company and the Bank, applicable governmental regulations and policies and other factors deemed relevant by its Board of Directors.

The Company is organized under the Virginia Stock Corporation Act, which prohibits the payment of a dividend if, after giving it effect, the corporation would not be able to pay its debts as they become due in the usual course of business or if the corporation's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the corporation were to be dissolved, to satisfy the preferential rights upon dissolution of any preferred shareholders.

The Company is a legal entity separate and distinct from its subsidiaries. Its ability to distribute cash dividends will depend primarily on the ability of the Bank to pay dividends to it, and the Bank is subject to laws and regulations that limit the amount of dividends that it can pay. As a state member bank, the Bank is subject to certain restrictions imposed by the reserve and capital requirements of federal and Virginia banking statutes and regulations. For a discussion of these restrictions, see "*Supervision and Regulation of Financial – Limits on the Payment of Dividends.*"

On January 19, 2021 Financial declared a cash dividend for the fourth quarter of 2020 of $0.07 per common share. The dividend was paid on March 19, 2021 to shareholders of record at the close of business on March 5, 2021. Financial will evaluate the factors set forth above when making a determination of whether to continue to pay a cash dividend in 2021.

Share Repurchases

On December 19, 2018, Financial's board of directors authorized the Company to repurchase up to an aggregate of 100,000 shares of its common stock. Although this authorization expired on December 18, 2019, on January 21, 2020 Financial's board of directors adopted a new stock repurchase plan that authorized the Company to repurchase up to an aggregate of 65,000 shares of its common stock. Repurchases may be made in the open market, through block trades, or otherwise, and in privately negotiated transactions.

During the quarter ended December 31, 2020, Financial repurchased no shares of common stock. The plan expired on January 20, 2021, with the Company having purchased a total of 18,000 out of 65,000 shares authorized for repurchase.

Beginning Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 through October 31, 2020	-	N/A	18,000	47,000
November 1 through November 30, 2020	-	N/A	18,000	47,000
December 1 through December 31, 2020	-	N/A	18,000	47,000
Total	-	N/A	18,000	47,000

Item 6. Selected Financial Data -- Not applicable

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to assist readers in understanding and evaluating our financial condition and results of operations. You should read this discussion in conjunction with our financial statements and accompanying notes included elsewhere in this report. Because Bank of the James Financial Group, Inc. ("Financial") has no material operations and conducts no business other than the ownership of its operating subsidiary, Bank of the James (and its divisions and subsidiary), the discussion primarily concerns the business of the Bank. However, for ease of reading and because our financial statements are presented on a consolidated basis, references to "we," "us," or "our" refer to Financial, Bank of the James, and their divisions and subsidiaries as appropriate.

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements that constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Statements made in this document and in any documents that are incorporated by reference which are not purely historical are forward-looking statements, including any statements regarding descriptions of management's plans, objectives, or goals for future operations, products or services, and forecasts of its revenues, earnings, or other measures of performance. Forward-looking statements are based on current management expectations and, by their nature, are subject to risks and uncertainties. These statements generally may be identified by the use of words such as "believe," "expect," "anticipate," "plan," "estimate," "should," "will," "intend," or similar expressions. Shareholders should note that many factors, some of which are discussed elsewhere in this document, could affect the future financial results of Financial and could cause those results to differ materially from those expressed in forward-looking statements contained in this document. These factors, many of which are beyond Financial's control, include, but are not necessarily limited to the following:

- the effects of the COVID-19 pandemic on the business, customers, employees and third-party service providers of Financial or any of its acquisition targets;
- operating, legal and regulatory risks, including the effects of legislative or regulatory developments affecting the financial industry generally or Financial specifically;
- government legislation and policies (including the impact of the Dodd-Frank Wall Street Reform and the Consumer Protection Act and its related regulations), including changes to address the impact of COVID-19;
- economic, market, political and competitive forces affecting Financial's banking and other businesses;
- competition for our customers from other providers of financial services; government legislation and regulation relating to the banking industry (which changes from time to time and over which we have no control) including but not limited to the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- changes in interest rates, monetary policy and general economic conditions, which may impact Financial's net interest income;
- changes in the value of real estate securing loans made by the Bank;
- diversion of management time on pandemic-related issues;
- adoption of new accounting standards or changes in existing standards;
- changes to statutes, regulations, or regulatory policies or practices resulting from the COVID-19 pandemic;
- compliance or operational risks related to new products, services, ventures, or lines of business, if any, that Financial may pursue or implement; and
- the risk that Financial's analysis of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

Other risks, uncertainties and factors could cause our actual results to differ materially from those projected in any forward-looking statements we make.

These factors should be considered in evaluating the forward-looking statements, and you should not place undue reliance on such statements. Financial specifically disclaims any obligation to update factors or to publicly announce the results of revisions to any of the forward-looking statements or comments included herein to reflect future events or developments.

IMPACT OF COVID-19

The progression of the COVID-19 pandemic in the United States has had an adverse impact on our financial condition and results of operations as of and for the year ended December 31, 2020. Management anticipates that the pandemic will have a significant adverse impact on the economy, the banking industry and our Company in future periods.

Effects on Market Areas

The broad suspension of business activities in the Commonwealth is likely to lead to a prolonged increase in the Commonwealth's and our market areas' unemployment rate. Because these developments commenced late in the first quarter, and because the public health effects of COVID-19 are generally expected to peak later this year in the communities in which we operate, we believe the economic consequences of the pandemic are difficult to quantify and are expected to continue to worsen.

Policy and Regulatory Developments

Federal, state and local governments and regulatory authorities have enacted and issued a range of policy responses to the COVID-19 pandemic, including the following:

- The Federal Reserve decreased the range for the Federal Funds Target Rate by 0.50% on March 3, 2020, and by another 1.0% on March 16, 2020, reaching a current range of 0.0 - 0.25%.

- On March 27, 2020, President Trump signed the Coronavirus Aid, Relief and Economic Security Act, or CARES Act, which established a $2.0 trillion economic stimulus package, including cash payments to individuals, supplemental unemployment insurance benefits and a $349 billion loan program administered through the U.S. Small Business Administration (SBA), referred to as the Paycheck Protection Program, or PPP Program, which was subsequently increased by $320 billion on April 24, 2020. Under the PPP program, small businesses, sole proprietorships, independent contractors and self-employed individuals may apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Bank participated as a lender in the PPP program. Effective August 8, 2020, banks ceased taking applications under the PPP program. In addition, the CARES Act provides financial institutions the option to temporarily suspend certain requirements under GAAP related to loan modifications and classification as troubled debt restructurings ("TDRs") for a limited period of time to account for the effects of COVID-19.

- On April 7, 2020, federal banking regulators issued a revised Interagency Statement on Loan Modifications and Reporting for Financial Institutions, which, among other things, encouraged financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19, and stated that institutions generally do not need to categorize COVID-19-related modifications as TDRs, and that the agencies will not direct supervised institutions to automatically categorize all COVID-19 related loan modifications as TDRs. In addition, upon expiration of the initial loan modification period, the Bank, pursuant to the "Joint Statement on Additional Loan Accommodations Related to COVID-19" published August 3, 2020, is encouraged to continue to work with effected borrowers on additional loan modifications. Loan modifications made through December 31, 2020 are disclosed within Note 5 – Loans and Allowance for Loan Losses.

- On December 27, 2020, President Trump signed the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (the "Economic Aid Act") into law to provide continued assistance to individuals and businesses that have been financially impacted by the ongoing coronavirus pandemic. Section 311 of the Economic Aid Act added a new temporary provision that authorizes the SBA to guarantee Paycheck Protection Program Second Draw Loans (the "PPP Second Draw Program"), under generally the same terms and conditions available under the PPP Under section 311, SBA may guarantee loans under the PPP Second Draw Program through March 31, 2021 (''Second Draw PPP Loans'') to borrowers that previously received an initial PPP loan and have used or will use the full amount of the initial PPP loan for authorized purposes on or before the expected date of disbursement of the Second

Draw PPP Loan. In addition, the Economic Aid Act permits individuals and business that did not receive an initial PPP loan to apply under the PPP Program.

- In accordance with the relief provisions of the CARES Act and the March 22, 2020 (revised April 2020) Joint Interagency Regulatory Guidance, the above modifications were not considered to be troubled debt restructurings and were excluded from the TDR discussion above. The TDR relief provisions provided for by the CARES Act were extended in December 2020 by the Consolidated Appropriations Act through the earlier of January 1, 2022 or 60 days after the national COVID-19 emergency terminates.

Effects on Our Business

The COVID-19 pandemic and the specific developments referred to above are expected to have a significant impact on our business. As a result, we anticipate that our financial condition, capital levels and results of operations could be significantly adversely affected, as described in further detail below.

COVID-19 Crisis Management

As an essential service provider, Bank of the James has continued to provide uninterrupted service to its clients throughout the COVID-19 crisis. On March 2, 2020 the Company's Management Committee initiated plans in response to the emerging risk related to the pandemic.

From the beginning, our management of the crisis has focused on protecting the health and well-being of our employees and clients while continuing to provide our clients with full access to banking services. As the operational risk related to the COVID-19 crisis evolved, the Company took proactive measures to manage operational risk, including the following:

- The Company has implemented its Business Continuity Plan.
- All branches remain open, with routine banking services offered through online banking, drive-thru, ATMs, and limited lobby access.
- Implemented a number of actions to support a healthy workforce, including:
  - Flexible work practices such as work-from-home options, working in shifts and placing greater distances between employees;
  - Discontinuation of non-essential business travel and meetings; and
  - Use of online meeting platforms, including successfully conducting the 2020 Annual Meeting of Shareholders in a virtual format.

Overview

Financial is a bank holding company headquartered in Lynchburg, Virginia. Our primary business is retail banking which we conduct through our wholly-owned subsidiary, Bank of the James (which we refer to as the “Bank”). We conduct three other business activities: mortgage banking through the Bank’s Mortgage Division (which we refer to as “Mortgage”), investment services through the Bank’s Investment division (which we refer to as “Investment Division”), and insurance activities through BOTJ Insurance, Inc., a subsidiary of the Bank, (which we refer to as “Insurance”).

Although we intend to increase other sources of revenue, our operating results depend primarily upon the Bank’s net interest income, which is determined by the difference between (i) interest and dividend income on earning assets, which consist primarily of loans, investment securities and other investments, and (ii) interest expense on interest-bearing liabilities, which consist principally of deposits and other borrowings. The Bank's net income also is affected by its provision for loan losses, as well as the level of its noninterest income, including deposit fees and service charges, gains on sales of mortgage loans, and its noninterest expenses, including salaries and employee benefits, occupancy expense, data processing expenses, miscellaneous other expenses, franchise taxes, and income taxes.

As discussed in more detail below,

- For the year ended December 31, 2020, Financial had net income of $4,980,000, a decrease of $625,000 from net income of $5,605,000, for the year ended December 31, 2019;

- For the year ended December 31, 2020, earnings per basic and diluted common share was $1.15, as compared to earnings of $1.28 per basic and diluted common share for the year ended December 31, 2019;

- Net interest income increased to $25,146,000 for the current year from $24,552,000 for the year ended December 31, 2019;

- Noninterest income (exclusive of net gains on sales and calls of securities) increased to $10,331,000 for the year ended December 31, 2020 from $6,794,000 for the year ended December 31, 2019;

- Total assets as of December 31, 2020 were $851,386,000 compared to $725,394,000 at the end of 2019, an increase of $125,992,000 or 17.37%;

- Net loans (excluding loans held for sale), net of unearned income and the allowance for loan losses, increased to $601,934,000 as of December 31, 2020 from $573,274,000 as of the end of December 31, 2019, an increase of 5.00%; and

- The net interest margin decreased 45 basis points to 3.32% for 2020, compared to 3.77% for 2019.

The following table sets forth selected financial ratios:

	For the Year Ended December 31,		
	2020	2019	2018
Return on average equity	8.01%	9.52%	9.74%
Return on average assets	0.62%	0.80%	0.81%
Dividend yield %	1.99%	1.87%	1.73%
Average equity to total average assets	7.72%	8.43%	8.29%

Effect of Economic Trends

A variety and wide scope of economic factors affect Financial's success and earnings. Although interest rate trends are one of the most important of these factors, Financial believes that interest rates cannot be predicted with a reasonable level of confidence and therefore does not attempt to do so with complicated economic models. Management believes that the best defense against wide swings in interest rate levels is to minimize vulnerability at all potential interest rate levels. Rather than concentrate on any one interest rate scenario, Financial prepares for the opposite as well, in order to safeguard margins against the unexpected.

Between January 2018 and December 2018, the FOMC raised rates by 25 basis points four times, at which point the target rate for federal funds ("fed funds") peaked at 2.25% to 2.50%. Beginning in July 2019, the FOMC began to decrease rates. Between July 2019 and October 2019, the FOMC decreased the target rate three times by 25 basis points.

In its December 11, 2019 statement, the FOMC stated it continues to seek to foster maximum employment and price stability. The FOMC judged that the current stance of monetary policy was appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the FOMC's two percent objective. However, on March 3, 2020, the FOMC lowered the target range of the fed funds rate by 50 basis points in response to concerns related to risks the coronavirus poses to economic activity. Further, in response to concerns that the coronavirus could push the U.S. economy towards a recession, on March 15, 2020, the FOMC, at an emergency meeting lowered the target range of the federal funds rate by an additional 100 basis points. At that meeting, the Federal Reserve also announced that it would buy $700 billion in Treasury and mortgage-backed securities.

Thus, as of March 20, 2020, the FOMC has set a current target rate range of 0% to 0.25%. The target rate remained unchanged for the remainder of 2020. Long term interest rates decreased in 2019 and remained relatively flat in 2020. However, as a result of COVID-19 stimulus, long term rates began to trend slightly upward in the first quarter of 2021.

Critical Accounting Policies

Financial's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within our statements is, to a significant extent, based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. The Bank uses historical loss factors as one factor in determining the inherent loss that may be present in the loan portfolio. Actual losses could differ significantly from the historical factors that the Bank uses in estimating risk. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of Financial's transactions would be the same, the timing of events that would impact the transactions could change.

The allowance for loan losses is management's estimate of the probable losses inherent in our loan portfolio. Management considers impaired loans, historical loss experience, and various qualitative factors (both internal and external) in the Company's determination of the allowances. Historical and industry trends, as well as peer comparisons are also considered in the Company's ongoing evaluation of the allowance for loan losses. The allowance is based on two basic principles of accounting: (i) ASC 450, Contingencies, which requires that losses be accrued when they are probable of occurring and are reasonably estimable and (ii) ASC 310, Receivables, which requires that losses on impaired loans be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance. Guidelines for determining allowances for loan losses are also provided in the SEC Staff Accounting Bulletin No. 102 – "Selected Loan Loss Allowance Methodology and Documentation Issues" and the Federal Financial Institutions Examination Council's interagency guidance, "Interagency Policy Statement on the Allowance for Loan and Lease Losses" (the "FFIEC Policy Statement"). See "*Management Discussion and Analysis Results of Operations – Asset Quality*" below and Note 1 of the Notes to Consolidated Financial Statements for further discussion of the allowance for loan losses.

Other real estate owned ("OREO") consists of properties acquired through foreclosure or deed in lieu of foreclosure. These properties are carried at fair value less estimated costs to sell at the date of foreclosure establishing a new cost basis. These properties are subsequently accounted for at the lower of cost or fair value less estimated costs to sell. Losses from the acquisition of property in full or partial satisfaction of loans are charged against the allowance for loan losses. Subsequent write-downs, if any, are charged against expense. Gains and losses on the sales of foreclosed properties are included in determining net income in the year of the sale. Operating costs after acquisition are expensed. The Bank had OREO totaling $1,105,000 and $2,339,000 as of December 31, 2020 and 2019, respectively.

RESULTS OF OPERATIONS

Year Ended December 31, 2020 compared to year ended December 31, 2019

Net Income

The net income for Financial for the year ended December 31, 2020 was $4,980,000 or $1.15 per basic and diluted share compared with net income of $5,605,000 or $1.28 per basic and diluted share for the year ended December 31, 2019. Note 13 of the consolidated financial statements provides additional information with respect to the calculation of Financial's earnings per share.

The decrease of $625,000 in 2020 net income compared to 2019 was due in large part to an increase in noninterest expense of $3,111,000 or 12.81% and an increase in the provision for loan losses of $2,025,000, or 387.19%. These increases were partially offset by.an increase in net interest income in the amount of $594,000 or 2.42% and an increase in noninterest income of $3,787,000, or 52.69%. As discussed in more detail below, we also adjusted OREO valuations downward by $437,000 during the year ended December 31, 2020. The amount of the provision for loan losses was $2,548,000 in the year ended December 31, 2020 as compared to $523,000 in 2019.

These operating results represent a return on average stockholders' equity of 8.01% for the year ended December 31, 2020 compared to 9.52% for the year ended December 31, 2019. Our return on average stockholder's equity decreased because of an increase in the average equity resulting largely from an increase in the market value of the available-for-sale securities portfolio which is recorded in accumulated other comprehensive income net of the related tax effect and a decrease the decrease in net income in 2020 as compared to 2019. The return on average assets for the year ended December 31, 2020 was 0.62% compared to 0.80% in 2019 primarily due to the increase in our total assets.

Net Interest Income

The fundamental source of Financial's earnings, net interest income, is defined as the difference between income on earning assets and the cost of funds supporting those assets. The significant categories of earning assets are loans, federal funds sold, interest-bearing balances at other banks, and investment securities, while deposits, fed funds purchased, and other borrowings represent interest-bearing liabilities. The level of net interest income is impacted primarily by variations in the volume and mix of these assets and liabilities, as well as changes in interest rates when compared to previous periods of operation.

Interest income decreased to $29,686,000 for the year ended December 31, 2020 from $29,816,000 for the year ended December 31, 2019. This decrease was due to a decrease in the yields on average earning assets which primarily consist of loans and investment securities, as discussed below.

Net interest income for 2020 increased $594,000, or 2.42%, to $25,146,000 from $24,552,000 in 2019. The growth in net interest income was due primarily to the a decrease in interest expense. Our interest expense decreased by $724,000 to $4,540,000 in 2020 from $5,264,000 in 2019. Our interest expense decreased primarily because of a decrease in the rates paid on interest bearing liabilities but was partially offset by an increase in the balance of interest-bearing liabilities. The average balance of interest bearing liabilities increased 13.23% from $544,038,000 for the year ended December 31, 2019 to $615,989,000 for the year ended December 31, 2020. The average interest rate paid on interest bearing liabilities decreased by 23 basis points from 0.97% in 2019 to 0.74% in 2020.

The net interest margin decreased to 3.32% in 2020 from 3.77% in 2019. The average rate on earning assets decreased 66 basis points from 4.57% in 2019 to 3.91% in 2020 and the average rate on interest-bearing deposits decreased from 0.93% in 2019 to 0.69% in 2020. The decreases were primarily caused by the impact of lower-yielding PPP loans. As a result of the spread of COVID-19, economic uncertainties have arisen that are likely to negatively impact net interest margin. Other financial impacts could occur, though such potential impacts are unknown at this time.

The following table shows the average balances of total interest earning assets and total interest bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, stockholders' equity and related revenue, expense and corresponding weighted average yields and rates. The average balances used in this table and other statistical data were calculated using average daily balances.

Net Interest Margin Analysis
Average Balance Sheets
For the Years Ended December 31, 2020, 2019 and 2018
(*dollars in thousands*)

	2020			2019			2018		
	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned /Paid	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/ Paid
ASSETS									
Loans, including fees (1)(2)	$608,831	$27,812	4.57%	$551,362	$27,413	4.97%	$519,850	$24,707	4.75%
Loans AFS	6,876	209	3.04%	3,559	146	4.10%	3,138	129	4.11%
Federal funds sold	57,249	102	0.18%	21,864	454	2.08%	20,832	393	1.89%
Interest-bearing bank balances	18,492	89	0.48%	14,907	326	2.19%	12,594	227	1.80%
Securities (3)	65,458	1,399	2.14%	58,584	1,384	2.36%	60,880	1,443	2.37%
Federal agency equities	1,417	78	5.50%	1,378	92	6.74%	1,402	74	5.28%
CBB equity	116	-	0.00%	116	1	0.86%	116	-	0.00%
Total earning assets	758,439	29,689	3.91%	651,770	29,816	4.57%	618,812	26,973	4.36%
Allowance for loan losses	(5,913)			(4,722)			(4,650)		
Non-earning assets	59,903			51,607			42,776		
Total assets	$812,429			$698,655			$656,938		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Deposits									
Demand interest bearing	$329,396	$652	0.20%	$253,642	$1,316	0.52%	$206,342	$767	0.37%
Savings	92,859	152	0.16%	92,598	221	0.24%	102,383	194	0.19%
Time deposits	181,932	3,348	1.84%	190,512	3,456	1.81%	184,924	2,617	1.42%
Total interest bearing deposits	604,187	4,152	0.69%	536,752	4,993	0.93%	493,649	3,578	0.72%
Other borrowed funds									
Other borrowings	-	-	0.00%	-	-	0.00%	850	17	2.00%
Financing leases	4,292	115	2.68%	2,286	71	3.11%	-	-	0.00%
Capital Notes	7,510	273	3.64%	5,000	200	4.00%	5,000	200	4.00%
Total interest-bearing liabilities	615,989	4,540	0.74%	544,038	5,264	0.97%	499,499	3,795	0.76%
Noninterest bearing deposits	129,000			91,928			101,785		
Other liabilities	5,247			3,818			1,193		
Total liabilities	750,236			639,784			602,477		
Stockholders' equity	62,193			58,871			54,461		
Total liabilities and Stockholders' equity	$812,429			$698,655			$656,938		

Net interest earnings	$25,149		$24,552		$23,178	
Net interest margin		3.32%		3.77%		3.75%
Interest spread		3.17%		3.61%		3.60%

(1) Net deferred loan fees and costs are included in interest income.

(2) Nonperforming loans are included in the average balances. However, interest income and yields calculated do not reflect any accrued interest associated with non-accrual loans.

(3) The interest income and yields calculated on securities have been tax affected to reflect any tax-exempt interest on municipal securities using the Company's applicable federal tax rate of 21% for each year.

Interest income and expenses are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table shows the direct causes of the year-to-year changes in components of net interest income on a taxable equivalent basis.

Volume and Rate
(dollars in thousands)
Years Ending December 31,

	2020			2019			2018		
	Volume Effect	Rate Effect	Change in Income/ Expense	Volume Effect	Rate Effect	Change in Income/ Expense	Volume Effect	Rate Effect	Change in Income/ Expense
Loans	$ 1,742	$ (1,280)	$ 462	$ 1,548	$ 1,175	$ 2,723	$ 1,646	$ 1,109	$ 2,755
Federal funds sold	(808)	456	(352)	20	41	61	136	124	260
Interest-bearing deposits	105	(342)	(237)	45	54	99	75	70	145
Securities	73	(58)	15	(53)	(6)	(59)	143	(11)	132
Restricted stock	4	(19)	(15)	(1)	21	20	3	(2)	1
Total earning assets	1,116	(1,243)	(127)	1,560	1,284	2,844	2,003	1,290	3,293
Liabilities:									
Demand interest bearing	626	(1,290)	(664)	198	351	549	39	234	273
Savings	1	(70)	(69)	(15)	42	27	(7)	(27)	(34)
Time deposits	309	(417)	(108)	83	756	839	133	414	546
Capital notes	89	(16)	73	-	-	-	13	-	13
Financing leases	52	(8)	44	-	-	-	-	-	-
Repurchase agreements and other borrowings	-	-	-	-	-	-	10	(7)	3
Total interest-bearing liabilities	$ 1,077	$ (1,801)	$ (724)	$ 266	$ 1,149	$ 1,415	$ 188	$ 614	$ 802
Change in net interest income	$ 39	$ 558	$ 597	$ 1,294	$ 135	$ 1,429	$ 1,815	$ 676	$ 2,491

Noninterest Income of Financial

Noninterest income has been and will continue to be an important factor for increasing our profitability. Our management continues to review and consider areas where noninterest income can be increased. Noninterest income (excluding securities gains and losses) consists of income from mortgage originations and sales, service fees, income from life insurance, income from credit and debit card transactions, and fees generated by the investment services of Investment. Service fees consist primarily of monthly service and minimum account balance fees and charges on transactional deposit accounts, treasury management fees, overdraft charges, and ATM service fees.

The Bank, through the Mortgage Division originates both conforming, non-conforming consumer residential mortgage, and reverse mortgage loans primarily in the Region 2000 area as well as in Charlottesville, Harrisonburg, Roanoke, Lexington, and Blacksburg. As part of the Bank's overall risk management strategy, all of the loans originated and closed by the Mortgage Division are presold to mortgage banking or other financial institutions. The Mortgage Division assumes no credit or interest rate risk on these mortgages.

The Mortgage Division originated 1,304 mortgage loans, totaling approximately $298,154,000 during the year ended December 31, 2020 as compared with 768 mortgage loans, totaling $163,394,000 in 2019. Income improved with the increased origination volume, which is attributable in part to an improving residential real estate market throughout our footprint as well as falling long-term interest rates. Beginning in 2013 we began operating the Mortgage Division with hybrid correspondent relationships that allow the Bank to close loans in its name before an investor purchases the loan. By using the Bank's funds to close the loan (as compared to a broker relationship in which loans are funded by the purchaser of the mortgage), the Bank is able to obtain better pricing due to the slight increase in risk. In 2019 and 2020, the Mortgage Division continued to operate in an environment in which real estate values continued to improve some of which may be attributed to a decrease in overall home inventory for sale. Loans for new home purchases comprised 65% of the total volume in 2019 as compared to 54% in 2020. The Mortgage Division's revenue is derived from gains on sales of loans held-for-sale to the secondary market. For the year ended December 31, 2020, the Mortgage Division accounted for 19.44% of Financial's total revenue as compared with 11.50% of Financial's total revenue for the year ended December 31, 2019. Mortgage contributed $2,693,000 and $1,125,000 to Financial's pre-tax net income in 2020 and 2019, respectively. Because of the uncertainty surrounding current and near-term economic conditions arising from the COVID-19 pandemic, management cannot predict future mortgage rates. Management also anticipates that even if rates trend higher, the majority of the loan mix will continue to lean towards new home purchases and away from refinancing.

The Mortgage Division continues to increase its market share in its service areas. We opened a new mortgage origination office in Roanoke in October, 2013 and began originating mortgages in Charlottesville in March, 2014. In addition, in the first quarter of 2016, we hired a new mortgage loan origination officer for the Harrisonburg Market and in 2018 we opened a mortgage origination office in Blacksburg, Virginia with one producer. In 2018, we added one additional mortgage producer in Roanoke and in 2019, a second producer was also added in Blacksburg. In early 2020, a mortgage producer was added at the Bank's branch location in Lexington. Management expects that continued historically low rates coupled with the Mortgage Division's reputation in its markets and our recently-added offices and producers present an opportunity for us to continue to grow the Mortgage Division's revenue.

Service charges and fees and commissions increased to $2,033,000 for the year ended December 31, 2020 from $1,785,000 for the year ended December 31, 2019 primarily due to increases related to commissions on the sales of securities and debit card fees. These decreases were partially offset by an increase in treasury management fees.

Investment provides brokerage services through an agreement with a third-party broker-dealer. Pursuant to this arrangement, the third party broker-dealer operates a service center adjacent to one of the branches of the Bank. The center is staffed by dual employees of the Bank and the broker-dealer. Investment receives commissions on transactions generated and in some cases ongoing management fees such as mutual fund 12b-1 fees. Investment's financial impact on our consolidated revenue has been minimal. Although management cannot predict the financial impact of Investment with certainty, management anticipates it will continue to be a relatively small component of revenue in 2021.

In the third quarter of 2008, we began providing insurance and annuity products to Bank customers and others, through the Bank's Insurance subsidiary. The Bank has one full-time and one part-time employee that are dedicated to selling insurance products through Insurance. Insurance generates minimal revenue and its financial impact on our consolidated revenue has been immaterial. Management anticipates that Insurance's impact on noninterest income will remain immaterial in 2021.

Noninterest income, exclusive of gains and losses on the sale and call of securities, increased to $10,331,000 in 2020 from $6,794,000 in 2019. Inclusive of gains and losses on the sale and call of securities, noninterest income increased to $10,975,000 in 2020 from $7,188,000 in 2019. The following table summarizes our noninterest income for the periods indicated.

	Noninterest Income (*dollars in thousands*) December 31,	
	2020	2019
Gains on sale of loans held for sale	$ 7,812	$ 4,254
Service charges, fees and commissions	2,033	1,785
Life insurance income	436	679
Other	50	76
Gain on sales and calls of securities, net	644	394
Total noninterest income	$ 10,975	$ 7,188

The increase in noninterest income for 2020 as compared to 2019 was primarily due to an increase in income from gains on sale of loans held for sale and an increase in gains on sales of securities. Life insurance income in 2020 decreased due to a death benefit received in 2019.

Noninterest Expense of Financial

Noninterest expenses increased from $24,283,000 for the year ended December 31, 2019 to $27,394,000 for the year ended December 31, 2020. The following table summarizes our noninterest expense for the periods indicated.

	Noninterest Expense (*dollars in thousands*) December 31,	
	2020	**2019**
Salaries and employee benefits	$15,430	$13,092
Occupancy	1,638	1,655
Equipment	2,350	2,107
Supplies	479	597
Professional, data processing and other outside expenses	3,691	3,432
Marketing	667	866
Credit expense	1,112	653
Other real estate expenses	443	366
FDIC insurance expense	336	226
Other	1,248	1,289
Total noninterest expense	$ 27,394	$ 24,283

The increase in noninterest expense was due in large part to an increase in compensation and benefits and credit expense, both of which are have a variable component related to mortgage origination. In addition, compensation expense increased as a result of the Bank's early retirement plan, pursuant to which the Bank incurred approximately $700,000 in salary and benefit expense. To a lesser degree professional, data processing, and other outside expenses, equipment expense, FDIC Insurance, and other real estate expense also contributed to the overall increase. Professional, data processing, and other outside expense increased primarily due increased charges by our core service provider relating to the additional deposit business generated in 2020. The increase in equipment expense was related to the replacement of certain computer equipment and software in order to continue to make progress toward cloud-based computing and a fully electronic signature system. The decrease in our supplies and marketing expenses were primarily the result of the COVID-19 pandemic. During the COVID-19 pandemic more than half of our employees were able to work from home, which resulted in a decrease in the use of supplies. Marketing decreased in part because of a decrease in sponsorships related to events canceled because of COVID-19.

The efficiency ratio, that is the cost of producing each dollar of revenue, is determined by dividing noninterest expense by the sum of net interest income plus noninterest income. Financial's efficiency ratio decreased from 76.51% in 2019 to 75.84% in 2020. Our efficiency ratio decreased because the increases in net interest income and noninterest income was greater than the increase in noninterest expense.

Income Tax Expense

For the year ended December 31, 2019, Financial had federal income tax expense of $1,329,000, as compared to a federal income tax expense of $1,199,000 in 2020, which equates to effective tax rates of 19.17% and 19.40%, respectively. Our effective tax rate was lower than the statutory corporate tax rate in 2019 and 2020 because of federal income tax benefits resulting from the tax treatment of earnings on bank owned life insurance, and certain tax-free municipal securities. Note 12 of the consolidated financial statements provides additional information with respect to our 2019 and 2020 federal income tax expense and deferred tax accounts.

ANALYSIS OF FINANCIAL CONDITION

As of December 31, 2020 and December 31, 2019

General

Our total assets were $851,386,000 at December 31, 2020, an increase of $125,992,000 or 17.37% from $725,394,000 at December 31, 2019, primarily due to an increase in loans and securities available-for-sale, both of which were primarily funded by an increase in deposits. As explained in more detail below, deposits increased from $649,459,000 on December 31, 2019 to $764,967,000 on December 31, 2020. Loans, net of unearned income and the allowance, increased to $601,934,000 on December 31, 2020 from $573,274,000 on December 31, 2019.

Loans

Our loan portfolio is the largest and most profitable component of our earning assets. The Bank has comprehensive policies and procedures which cover both commercial and consumer loan origination and management of credit risk. Loans are underwritten in a manner that focuses on the borrower's ability to repay. Management's goal is not to avoid risk, but to manage it and to include credit risk as part of the pricing decision for each product.

The Bank's loan portfolio consists of commercial short-term lines of credit, term loans, mortgage financing and construction loans that are used by the borrower to build or develop real estate properties, and consumer loans. The consumer portfolio includes residential real estate mortgages, home equity lines and installment loans.

Loans, net of unearned income and the allowance, increased to $601,934,000 on December 31, 2020 from $573,274,000 on December 31, 2019. Total loans, including loans held for sale increased to $616,192,000 on December 31, 2020 from $582,324,000 on December 31, 2019. The increase in total loans was in large part due to the origination of PPP loans. The increase is also attributed to increased calling and sales efforts by our lenders. Despite these factors, competition for qualified borrowers remains strong.

As of December 31, 2020, the Bank had $2,063,000, or 0.34% of its total loans, in non-accrual status compared with $1,301,000, or 0.23% of its total loans, at December 31, 2019. Management is continuing its efforts to reduce non-performing assets through enhanced collection efforts and the liquidation of underlying collateral. The Bank attempts to work with borrowers on a case-by-case basis to attempt to protect the Bank's interests. However, despite our commitment, a reduction of non-accrual loans can be dependent on a number of factors, including improvements in employment, housing, and overall economic conditions at the local, regional and national levels. See "*Asset Quality*" below.

The following table summarizes the composition of the Bank's loan portfolio for the periods indicated by dollar amount:

Loan Portfolio
(*dollars in thousands*)
December 31,

	2020	2019	2018	2017	2016
Commercial	$ 145,145	$ 114,257	$ 92,877	$ 96,127	$ 88,085
Commercial real estate	309,563	303,900	289,171	251,807	237,638
Consumer	92,344	89,945	86,191	83,746	85,099
Residential	62,038	70,001	66,358	64,094	59,247
Total loans	609,090	578,103	534,597	495,774	470,069
Less allowance for loan losses	7,156	4,829	4,581	4,752	5,716
Net loans	$601,934	$573,274	$530,016	$491,022	$464,353

The following table sets forth the maturities of the loan portfolio at December 31, 2020:

	Remaining Maturities of Selected Loans (*dollars in thousands*) At December 31, 2020			
	Less than One Year	**One to Five Years**	**Greater than Five Years**	**Total**
Commercial	$ 20,649	$ 69,202	$ 55,294	$ 145,145
Commercial real estate	26,925	36,009	246,629	309,563
Consumer	6,166	25,343	60,835	92,344
Residential	17,798	1,502	42,738	62,038
Total	$ 71,538	$ 132,056	$ 405,496	$ 609,090
For maturities over one year:				
Fixed Rates	$ 146,958	27.34%		
Variable Rates	390,594	72.66%		
Total	$ 537,552			

Deposits

We experienced an increase in deposits from $649,459,000 at December 31, 2019 to $764,967,000 at December 31, 2020, for an increase of 17.79%. Noninterest-bearing deposits increased $49,409,000 or 52.60% from $93,936,000 at December 31, 2019 to $143,345,000 at December 31, 2020. The increase in noninterest-bearing deposits was due to customers maintaining higher balances due to COVID-19 uncertainty, along with government stimulus, and to a lesser extent, the recent expansion into in Charlottesville, Harrisonburg, Roanoke, and most recently, Appomattox and Rustburg, as well as increased and continued efforts to procure the primary checking accounts of our commercial loan customers through offering treasury services. Interest-bearing deposits increased $66,099,000, or 11.90%, from $555,523,000 at December 31, 2019 to $621,622,000 at December 31, 2020. A total of $0 and $10,020,000 in brokered certificates of deposit was included in total time deposits at December 31, 2020 and 2019, respectively.

The following table sets forth the average deposit balances and the rates paid on deposits for the years indicated:

Average Deposits and Rates Paid

(*dollars in thousands*)

	Year Ended December 31,					
	2020		2019		2018	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest-bearing deposits	$129,000	-	$91,928	-	$101,785	-
Interest-bearing deposits						
Interest checking	$263,381	0.17%	$193,306	0.52%	$138,347	0.34%
Money market	66,015	0.30%	60,336	0.53%	67,995	0.42%
Savings	92,859	0.16%	92,598	0.24%	102,383	0.18%
Time deposits						
Less than $100,000	82,471	1.75%	83,980	1.71%	80,628	1.32%
$100,000 but < $250,000	65,075	1.89%	63,986	1.88%	60,268	1.40%
Greater than $250,000	34,386	1.97%	42,546	1.92%	44,028	1.59%
Total interest-bearing deposits	$604,187	0.69%	$536,752	0.93%	$493,649	0.72%
Total deposits	$733,187		$628,680		$595,434	

The following table includes a summary of maturities of CDs greater than $100,000:

Maturities of CD's Greater than $ 100,000

(dollars in thousands)

	Less than Three Months	Three to Six Months	Six to Twelve Months	Greater than One Year	Total
At December 31, 2020	$ 28,837	$ 10,073	$ 16,282	$ 27,220	$ 82,412

Cash and Cash Equivalents

Cash and cash equivalents increased from $39,111,000 on December 31, 2019 to $100,886,000 on December 31, 2020. Federal funds sold amounted to $69,203,000 on December 31, 2020 compared to $8,317,000 on December 31, 2019. Fluctuations in federal funds sold generally are related to fluctuations in transactional accounts and professional settlement accounts, and the use of cash and cash equivalents to fund loan growth. The large increase in cash and cash equivalents in 2020 can be directly attributed to the growth in deposits as a result of organic growth and PPP loan payoffs received in the fourth quarter of 2020.

Investment Securities

The investment securities portfolio of the Bank is used as a source of income and liquidity.

The following table summarizes the fair value of the Bank's securities portfolio for the periods indicated:

Securities Portfolio
(*dollars in thousands*)
December 31,

	2020	2019	2018
Held-to-maturity			
U.S. agency obligations	$ 4,192	$ 3,861	$ 3,515
Available-for-sale			
U.S. treasuries	$ 2,027	$ 1,964	$ 1,845
U.S. agency obligations	41,320	32,108	23,267
Mortgage - backed securities	15,696	10,264	11,876
Municipals	24,773	11,222	12,009
Corporates	6,369	4,097	3,730
Total available-for-sale	$ 90,185	$ 59,655	$ 52,727

Deposited funds are generally invested in overnight vehicles, including federal funds sold, until approved loans are funded. The decision to purchase investment securities is based on several factors or a combination thereof, including:

a) The fact that yields on acceptably rated investment securities (S&P "A" rated or better) are significantly better than the overnight federal funds rate;

b) Whether demand for loan funding exceeds the rate at which deposits are growing, which leads to higher or lower levels of surplus cash;

c) Management's target of maintaining a minimum of 6% of the Bank's total assets in a combination of federal funds sold and investment securities (aggregate of available-for-sale and held-to-maturity portfolios); and

d) Whether the maturity or call schedule meets management's asset/liability plan.

Available-for-sale securities (as opposed to held-to-maturity securities) may be liquidated at any time as funds are needed to fund loans. Liquidation of securities may result in a net loss or net gain depending on current bond yields available in the primary and secondary markets and the shape of the U.S. Treasury yield curve. Management is cognizant of its credit standards policy and does not feel pressure to maintain loan growth at the same levels as deposit growth and thus sacrifice credit quality in order to avoid security purchases.

Management has made the decision to maintain a significant portion of its available funds in liquid assets so that funds are available to fund future growth of the loan portfolio. Management believes that this strategy will allow us to maximize interest margins while maintaining appropriate levels of liquidity.

Securities held-to-maturity at carrying cost decreased from $3,688,000 as of December 31, 2019 to $3,671,000 as of December 31, 2020. This decrease resulted from the amortization of premiums within the held-to-maturity portfolio. The decision to invest in securities held-to-maturity is based on the same factors as the decision to invest in securities available-for-sale except that management invests surplus funds in securities held-to-maturity only after concluding that such funds will not be necessary for liquidity purposes during the term of such security. However, the held-to-maturity securities may be pledged for such purposes as short term borrowings and as collateral for public deposits.

The portfolio of securities available-for-sale increased to $90,185,000 as of December 31, 2020 from $59,655,000 as of December 31, 2019. The increase is a result of an increase in the fair value of available-for-sale securities along with the fact that we purchased more securities available-for-sale than we sold or were called. Out of an abundance of caution, during the first six months of 2020, the Bank sold available-for-sale securities to increase cash and cash equivalents in light of the uncertainties surrounding the COVID-19 pandemic. Because the need for additional liquidity did not materialize, the Bank reinvested the proceeds. During 2020, the Bank sold $13,313,000 in available-for-sale securities. During 2020, the Bank purchased $51,150,000 of available-for-sale securities. The Bank realized $9,837,000 from paydowns related to the normal amortization of principal related to the Bank's mortgage backed securities, calls, and maturities.

The following table shows the maturities of held-to-maturity and available-for-sale securities at amortized cost and fair value at December 31, 2020 and 2019 and approximate weighted average yields of such securities. Yields on state and political subdivision securities are not shown on a tax equivalent basis. Financial attempts to maintain diversity in its portfolio and maintain credit quality and repricing terms that are consistent with its asset/liability management and investment practices and policies. For further information on Financial's securities, see Note 4 to the consolidated financial statements included in Item 8 of this Form 10-K.

Securities Portfolio Maturity Distribution / Yield Analysis
(*dollars in thousands*)
At December 31, 2020

	Less than One Year	One to Five Years	Five to Ten Years	Greater than Ten Years and Other Securities	Total
Held-to-maturity					
U.S. Agency					
Amortized cost	$ -	$ -	$ 398	$ 3,273	$ 3,671
Fair value	$ -	$ -	$ 452	$ 3,740	$ 4,192
Weighted average yield			2.99%	2.99%	
Available-for-sale securities					
U.S Treasury					
Amortized cost	$ -	$ 2,000	$ -	$ -	$ 2,000
Fair value	$ -	$ 2,027	$ -	$ -	$ 2,027
Weighted average yield		1.38%			
U.S. Agency					
Amortized cost	$ -	$ 4,120	$ 27,244	$ 8,747	$ 40,111
Fair value	$ -	$ 4,215	$ 28,243	$ 8,862	$ 41,320
Weighted average yield		1.00%	1.61%	1.60%	
Mortgage Backed Securities					
Amortized cost	$ -	$ 491	$ 3,072	$ 11,898	$ 15,461
Fair value	$ -	$ 508	$ 3,210	$ 11,978	$ 15,696
Weighted average yield		1.76%	2.25%	1.45%	
Municipals					
Amortized cost	$ 501	$ 2,948	$ 6,126	$ 14,700	$ 24,275
Fair value	$ 501	$ 3,030	$ 6,356	$ 14,886	$ 24,773
Weighted average yield	1.78%	2.27%	2.13%	2.27%	
Corporates					
Amortized cost	$ -	$ 3,075	$ 2,995	$ -	$ 6,070
Fair value	$ -	$ 3,242	$ 3,127	$ -	$ 6,369
Weighted average yield		2.22%	4.40%		
Total portfolio					
Amortized cost	$ 501	$12,634	$ 39,835	$ 38,618	$ 91,588
Fair value	$ 501	$13,022	$ 41,388	$ 39,466	$ 94,377
Weighted average yield	1.78%	1.68%	2.06%	1.93%	

Securities Portfolio Maturity Distribution / Yield Analysis
(*dollars in thousands*)
At December 31, 2019

	Less than One Year	One to Five Years	Five to Ten Years	Greater than Ten Years and Other Securities	Total
Held-to-maturity					
U.S. Agency					
Amortized cost	$ -	$ -	$ -	$ 3,688	$ 3,688
Fair value	$ -	$ -	$ -	$ 3,861	$ 3,861
Weighted average yield				2.98%	
Available-for-sale securities					
U.S Treasury					
Amortized cost	$ -	$ -	$ 1,966	$ -	$ 1,966
Fair value	$ -	$ -	$ 1,964	$ -	$ 1,964
Weighted average yield			1.77%		
U.S. Agency					
Amortized cost	$ -	$ 3,000	$ 17,558	$ 11,605	$ 32,163
Fair value	$ -	$ 2,996	$ 17,705	$ 11,407	$ 32,108
Weighted average yield		1.78%	2.32%	2.21%	
Mortgage Backed Securities					
Amortized cost	$ -	$ 885	$ 3,897	$ 5,576	$ 10,328
Fair value	$ -	$ 877	$ 3,847	$ 5,540	$ 10,264
Weighted average yield		1.71%	2.25%	2.22%	
Municipals					
Amortized cost	$ -	$ 2,984	$ 2,142	$ 5,992	$ 11,118
Fair value	$ -	$ 3,001	$ 2,145	$ 6,076	$ 11,222
Weighted average yield		2.31%	2.66%	2.95%	
Corporates					
Amortized cost	$ -	$ 1,511	$ 2,575	$ -	$ 4,086
Fair value	$ -	$ 1,521	$ 2,576	$ -	$ 4,097
Weighted average yield		2.14%	2.37%		
Total portfolio					
Amortized cost	$ -	$8,380	$ 28,108	$ 26,861	$ 63,349
Fair value	$ -	$8,395	$ 28,237	$ 26,884	$ 63,516
Weighted average yield		2.02%	2.30%	2.48%	

Cash surrender value of bank-owned life insurance

The Company has funded bank-owned life insurance (BOLI) for a small group of its officers. The Company is the owner and sole beneficiary of the BOLI policies. As of December 31, 2020, the BOLI had a cash surrender value of $16,355,000, an increase of $2,669,000 from the cash surrender value of $13,686,000 as of December 31, 2019. The Company purchased an additional $2,280,000 in BOLI during 2020. With the exception of purchases, the value of BOLI increases from the cash surrender values of the pool of insurance. The increase in cash surrender value is recorded as a component of noninterest income; however, the Company does not pay tax on the increase in cash value. This profitability is used to offset a portion of current and future employee benefit costs. BOLI can be liquidated if necessary with associated tax costs. However, the Company intends to hold this pool of insurance, because it provides income that enhances the Company's capital position. Therefore, the Company has not provided for deferred income taxes on the earnings from the increase in cash surrender value.

Liquidity

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities.

The liquidity of Financial depends primarily on Financial's current assets, available credit, and the dividends paid to it by the Bank. Payment of cash dividends by the Bank is limited by regulations of the Federal Reserve Board and is tied to the regulatory capital requirements. Management believes that Financial has sufficient liquidity to meet its current obligations. See "*Capital Resources,*" below.

The objective of liquidity management for the Bank is to ensure the continuous availability of funds to meet the demands of depositors, investors and borrowers. Liquidity management involves monitoring the Bank's sources and uses of funds in order to meet the day-to-day cash flow requirements while maximizing profits. Stable core deposits and a strong capital position are the components of a solid foundation for the Bank's liquidity position. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of securities held-to-maturity is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net non-maturity deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

Funding sources for the Bank primarily include paid-in capital and customer-based deposits but also include borrowed funds and cash flow from operations. The Bank has in place several agreements that will provide alternative sources of funding, including, but not limited to, lines of credit, sale of investment securities, purchase of federal funds, advances through the Federal Home Loan Bank of Atlanta ("FHLBA") and correspondents, and brokered certificate of deposit arrangements. Management believes that the Bank has the ability to meet its liquidity needs.

At December 31, 2020, liquid assets, which include cash, interest-bearing and noninterest-bearing deposits with banks, federal funds sold, and securities available-for-sale totaled $191,071,000 as compared to $98,766,000 at December 31, 2019. Management deems liquidity to be sufficient. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner. However, approximately $22,252,000 (current market value) of these securities are pledged to secure public deposits and $8,950,000 (current market value) are pledged to secure unfunded lines of credit. In the event any secured line of credit is drawn upon, the related debt would need to be repaid before the securities could be sold and converted to cash.

The COVID-19 pandemic could have a material negative impact on Financial's short-term or long-term liquidity. For example, if customers unexpectedly draw down on existing lines of credit, our liquidity could be impacted. While we have not experienced any unusual pressure on our deposit balances or our liquidity position as a result of the COVID-19 pandemic, management is closely monitoring our sources and uses of funds in order to meet our cash flow requirements while maximizing profits. Based in part on recent loan activity including loans made pursuant to the PPP as discussed below under "ASSET QUALITY," the Bank is monitoring liquidity to ensure it is able to fund future loans and withdrawals related to the use of PPP funds.

The following table sets forth non-deposit sources of funding:

Funding Sources
(*dollars in thousands*)

	December 31, 2020		
Source	**Capacity**	**Outstanding**	**Available**
Federal funds purchased lines (unsecured)	$ 33,000	$ -	$ 33,000
Federal funds purchased lines (secured)	8,055	-	8,055
Reverse repurchase agreements	5,000	-	5,000
Borrowings from FHLB Atlanta (1)	212,366	-	212,366
Total	$258,421	$ -	$258,421

(1) Currently the Bank has in place pledged collateral in the amount of approximately $38,500,000 against which $0 was drawn and outstanding on December 31, 2020. Additional collateral would be required to be pledged in order for the full $212,366,000 to be available.

At the end of 2020, approximately 35.32%, or $215,110,000 of the loan portfolio would mature or could reprice within a one-year period. At December 31, 2020, non-deposit sources of available funds totaled $258,421,000, which included $212,366,000 available from the FHLBA.

Capital Resources

Capital adequacy is an important measure of financial stability and performance. Management's objectives are to maintain a level of capitalization that is sufficient to sustain asset growth and promote depositor and investor confidence.

Regulatory agencies measure capital adequacy utilizing a formula that takes into account the individual risk profiles of financial institutions. The guidelines define capital as Tier 1 (primarily common stockholders' equity, defined to include certain debt obligations) and Tier 2 (remaining capital generally consisting of a limited amount of subordinated debt, certain hybrid capital instruments and other debt securities, preferred stock and a limited amount of the general valuation allowance for loan losses).

On June 7, 2012, the Federal Reserve issued a series of proposed rules that would revise and strengthen its risk-based and leverage capital requirements and its method for calculating risk-weighted assets. The rules were proposed to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. On July 2, 2013, the Federal Reserve approved certain revisions to the proposals and finalized new capital requirements for banking organizations.

Effective January 1, 2015, the final rules require the Bank to comply with the following minimum capital ratios: (i) a common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from the previous requirement); and (iv) a leverage ratio of 4.0% of total assets. These initial capital requirements were phased in over a five-year period. The phase was completed, as of January 1, 2019 and the rules require 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, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

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

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

The 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.

Pursuant to the Regulatory Relief Act, on September 17, 2019, the federal banking agencies adopted a final rule regarding a community bank leverage ratio. Under the final rule, which was effective on January 1, 2020, depository institutions and depository institution holding companies that have less than $10 billion in total consolidated assets and meet other qualifying criteria, including a leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than 9 percent, will be eligible to opt into the community bank leverage ratio framework (qualifying community banking organizations). Qualifying community banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than 9 percent will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act.

The Bank's regulatory capital levels exceed those established for well-capitalized institutions.

The following table (along with Note 18 of the consolidated financial statements) shows the minimum capital requirements and the Bank's capital position as of December 31, 2020 and 2019.

Analysis of Capital for Bank of the James (Bank only)
(dollars in thousands)

Analysis of Capital (in 000's)	December 31, 2020	December 31, 2019
Tier 1 capital		
Common Stock	$ 3,742	$ 3,742
Surplus	22,325	22,325
Retained earnings	44,621	40,194
Total Tier 1 capital	$ 70,688	$ 66,261
Common Equity Tier 1 Capital (CET1)	$ 70,688	$ 66,261
Tier 2 capital		
Allowance for loan losses	$ 7,156	$ 4,829
Total Tier 2 capital:	$ 7,156	$ 4,829
Total risk-based capital	$ 77,844	$ 71,090
Risk weighted assets	$ 635,445	$ 616,269
Average total assets	$ 853,558	$ 725,395

	Actual		Regulatory Benchmarks	
	December 31, 2020	December 31, 2019	For Capital Adequacy Purposes (1)	For Well Capitalized Purposes
Capital Ratios:				
Tier 1 capital to average total assets	8.28%	9.13%	4.000%	5.000%
Common Equity Tier 1 capital	11.12%	10.75%	7.000%	6.500%
Tier 1 risk-based capital ratio	11.12%	10.75%	8.500%	8.000%
Total risk-based capital ratio	12.25%	11.54%	10.500%	10.000%

(1) Includes capital conservation buffer of 2.5%, where applicable.

During the first quarter of 2017, Financial closed a private placement of unregistered debt securities (the “2017 Offering”) pursuant to which Financial issued $5,000,000 in principal of notes (the “2017 Notes”). The 2017 Notes were scheduled to mature on January 24, 2022, but were subject to prepayment in whole or in part on or after January 24, 2018 at Financial’s sole discretion on 30 days written notice to the holders. The Company contributed $3,000,000 of the proceeds from the 2017 Offering to the Bank as additional paid in capital. The remainder of the proceeds were retained at the parent level to service the debt and pay dividends.

On April 13, 2020, the Company commenced a private placement of unregistered debt securities (the “2020 Offering”). In the 2020 Offering, the Company sold and closed $10,050,000 in principal of notes (the “2020 Notes”) during the 2nd and 3rd quarters of 2020. The 2020 Offering officially ended on July 8, 2020. The 2020 Notes will bear interest at the rate of 3.25% per year with interest payable quarterly in arrears. The 2020 Notes will mature on September 30, 2025 and are subject to full or partial repayment on or after September 30, 2021. The balance of the 2020 Notes as presented on the December 31, 2020 consolidated balance sheet is net of unamortized issuance costs.

On September 24, 2020 the Bank used $5,000,000 of the proceeds for the payment of principal of the 2017 Notes. The Company intends to use the balance of the proceeds from the 2020 Offering for general corporate purposes in the discretion of Company's management such as payment of interest on the 2020 Notes and as a contribution of additional capital to the Bank.

The capital ratios set forth in the above tables state the capital position and analysis for the Bank only. Because total assets on a consolidated basis are less than $3 billion, Financial is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, Financial does not calculate its financial ratios on a consolidated basis. If calculated, the capital ratios for the Company on a consolidated basis would be slightly lower than the capital ratios of the Bank because the of the Company's decision to contribute $3,000,000 in proceeds from the 2017 Offering to the Bank.

Stockholders' Equity

Stockholders' equity increased by $5,287,000 from $61,445,000 on December 31, 2019 to $66,732,000 on December 31, 2020 because of net income of $4,980,000, less cash dividends paid, plus other comprehensive income for the period.

ASSET QUALITY

We perform monthly reviews of all delinquent loans and loan officers are charged with working with customers to resolve potential payment issues. We generally classify a loan as non-accrual when interest is deemed uncollectible or when the borrower is 90 days or more past due. We generally restore a loan if i) a borrower is no longer 90 days past due on the loan and the borrower has demonstrated the capacity to repay the loan for six consecutive months or ii) the loan committee of the Board of Directors determines that a borrower has the capacity to repay the loan.

Non-accrual loans increased to $2,063,000 on December 31, 2020 from $1,301,000 on December 31, 2019. As set forth in tabular form below, total charge-offs during 2020 were $448,000 compared to $363,000 in 2019.

We also classify other real estate owned (OREO) as a nonperforming asset. OREO is the value of real property acquired by the Bank following default by the borrower. During the twelve months ended December 31, 2020 the Bank acquired one (1) OREO property and disposed of eight (8) OREO properties, wrote down an additional $437,000 and, as of December 31, 2020 is carrying three (3) OREO properties at a value of $1,105,000, as compared to ten (10) properties with a value of $2,339,000 as of December 31, 2019. The OREO properties are available for sale and are being actively marketed on the Bank's website and through other means. The following table represents the changes in OREO balance in 2020 and 2019.

OREO Changes
(*Dollars in Thousands*)

	Year Ended December 31,	
	2020	**2019**
Balance at the beginning of the year (net)	$ 2,339	$ 2,430
Transfers from Loans	18	785
Capitalized costs	-	-
Valuation Adjustment	(437)	(287)
Sales proceeds	(844)	(570)
Gain (loss) on disposition	29	(19)
Balance at the end of the year (net)	$ 1,105	$ 2,339

Non-accrual loans plus OREO decreased to $3,168,000 on December 31, 2020 from $3,640,000 on December 31, 2019, a decrease of 12.94%.

We also classify troubled debt restructurings (TDRs) as both performing and nonperforming assets. We measure impaired loans based on the present value of expected future cash flows discounted at the effective interest rate of the loan or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. TDRs occur when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. TDRs are considered impaired loans. These concessions typically are made for loss mitigation purposes and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Performing TDRs decreased to $392,000 on December 31, 2020 from $410,000 on December 31, 2019.

The following table sets forth the number of outstanding TDR contracts and the total amount of the Bank's TDRs as of December 31, 2020 and 2019.

Troubled Debt Restructurings
(***Dollars in Thousands***)

	December 31, 2020	December 31, 2019
Number of performing TDR contracts	3	3
Number of nonperforming TDR contracts	-	-
Total number of TDR contracts	3	3
Amount of performing TDR contracts	$ 392	$ 410
Amount of nonperforming TDR contracts	-	-
Total amount of TDRs contracts	$ 392	$ 410

The amount allocated during the year to the provision for loan losses represents management's analysis of the existing loan portfolio and credit risks. Management's policy is to maintain the allowance for loan losses at a level sufficient to absorb the estimated losses inherent in the loan portfolio. Both the amount of the provision and the level of the allowance for loan losses are impacted by many factors, including general economic conditions, actual and expected credit losses, loan performance measures, historical trends and specific conditions of the individual borrower.

In performing its loan loss analysis, the Bank assigns a risk rating to each commercial loan in the Bank's portfolio.

The Bank's allowance for loan losses increased 48.19% from $4,829,000 on December 31, 2019 to $7,156,000 on December 31, 2020, primarily due to an increase in the general reserves which was minimally offset by a decrease in the specific reserve, both of which are discussed in the following paragraph. The general reserve component increased significantly as compared to the prior year end. Management intends to continue to be proactive in quantifying and mitigating the ongoing risk associated with all asset classes. Management has provided for the anticipated losses on its non-accrual loans through specific impairment in the allowance for loan losses.

At December 31, 2020, the allowance for loan losses was 1.17% of total loans outstanding, versus 0.84% of total loans outstanding at December 31, 2019. The allowance to total loans, excluding PPP loans, increased to 1.25% at December 31, 2020. Because the PPP loans are guaranteed in full by the U.S. Small Business Administration, management determined that these loans should be excluded from the calculation. At December 31, 2020, management believed the allowance for loan losses was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions continue to deteriorate due to the COVID-19 pandemic, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require increases in the allowance for loan losses. The process of identifying potential credit losses is a subjective process. Therefore, the Company maintains a general reserve to cover credit losses within the portfolio. The methodology management uses to determine the adequacy of the loan loss reserve includes the considerations below.

Despite the relatively small decrease in individual loan impairment, our general reserves (ASC 450) increased in all loan segments. The increase was largely driven by increased qualitative factor adjustments related to the ongoing COVID-19 pandemic, primarily in relation to the economy and loans which received principal and/or interest deferrals during 2020. The relatively small decline in specific reserves was the result of a slight decline in impaired loan balances as well as management's ongoing evaluation of loans for impairment.

No non-accrual loans were excluded from impaired loans at December 31, 2020 and 2019. If interest on these loans had been accrued, such income cumulatively would have approximated $158,000 and $207,000 at December 31, 2020 and December 31, 2019, respectively. Loan payments received on non-accrual loans are applied to principal. When a loan is placed on non-accrual status there are several negative implications. First, all interest accrued but unpaid at the time of the classification is deducted from the interest income totals for the Bank. Second, accruals of interest are discontinued until it becomes certain that both principal and interest can be repaid. Third, there may be actual losses that necessitate additional provisions for credit losses charged against earnings. These loans were included in the nonperforming loan totals listed below. The following table sets forth the detail of loans charged-off, recovered, and the changes in the allowance for loan losses as of the dates indicated:

Allowance for Loan Losses
(dollars in thousands)
At December 31,

	2020	2019	2018	2017	2016
Balance, beginning of period	$ 4,829	$ 4,581	$ 4,752	$ 5,716	$ 4,683
Loans charged-off:					
Commercial	96	106	395	1,652	328
Commercial real estate	224	26	230	91	156
Consumer	75	189	405	246	275
Residential	53	42	34	105	-
Total loans charged off	$ 448	$ 363	$ 1,064	$ 2,094	$ 759
Recoveries:					
Commercial	$ 20	$ 35	$ 113	$ 6	$ 7
Commercial real estate	139	5	4	41	127
Consumer	53	44	60	51	44
Residential	15	4	-	39	2
Total recoveries	$ 227	$ 88	$ 177	$ 137	$ 180
Net charge-offs	$ 221	$ 275	$ 887	$ 1,957	$ 579
Provision for loan losses	2,548	523	716	993	1,612
Balance, end of period	$ 7,156	$ 4,829	$ 4,581	$ 4,752	$ 5,716

The following table shows the balance and percentage of the Bank's allowance for loan losses allocated to each major category of loans:

Allocation of Allowance for Loan Losses
(dollars in thousands)
At December 31,

	2020		**2019**		**2018**		**2017**		**2016**	
	Amount	**Percent of Loans to Total Loans**	**Amount**	**Percent of Loans to Total Loans**	**Amount**	**Percent of Loans to Total Loans**	**Amount**	**Percent of Loans to Total Loans**	**Amount**	**Percent of Loans to Total Loans**
Commercial	$2,001	23.83%	$1,330	19.76%	$1,136	17.38%	$ 1,264	19.39%	$ 2,192	18,74%
Commercial – real estate	3,550	50.82%	1,932	52.57%	1,831	54.09%	1,738	50.79%	2,109	50.55%
Consumer	868	15.16%	865	15.56%	956	16.12%	1,172	16.89%	954	18.10%
Residential	737	10.19%	702	12.11%	658	12.41%	578	12.93%	461	12.61%
	$ 7,156	100.00%	$ 4,829	100.00%	$ 4,581	100.00%	$ 4,752	100.00%	$ 5,716	100.00%

The following table provides information on the Bank's nonperforming assets as of the dates indicated:

Nonperforming Assets
(dollars in thousands)
At December 31,

	2020	**2019**	**2018**	**2017**	**2016**
Non-accrual loans	$ 2,063	$ 1,301	$ 2,939	$ 4,309	$ 2,550
Foreclosed property (OREO)	1,105	2,339	2,430	2,650	2,370
Loans past due 90 days accruing interest	-	-	-	-	-
Total nonperforming assets	$ 3,168	$ 3,640	$ 5,369	$ 6,959	$ 4,920
Restructured loans – performing portion (TDR)	$ 392	$ 410	$ 424	$ 440	$ 455
Allowance for loan losses to period end loans	1.17%	0.84%	0.86%	0.96%	1.22%
Nonperforming assets to period end loans	0.52%	0.63%	1.00%	1.40%	1.05%
Net charge-offs to average loans	0.04%	0.05%	0.17%	0.40%	0.13%
Allowance for loan losses to non-performing loans	346.71%	371.18%	155.87%	110.28%	224.16%

Asset Quality as it Relates to COVID-19

As a result of the COVID-19 pandemic, we anticipate that our commercial, commercial real estate, residential and consumer borrowers will continue to encounter economic difficulties, which could lead to increases in our levels of nonperforming assets, impaired loans and troubled debt restructurings. Any potential financial impacts are unknown at this time.

We have developed relief programs to assist borrowers in financial need due to the effects of the COVID-19 pandemic. Accordingly, we offered short-term modifications made in response to COVID-19 to certain borrowers who were current and otherwise not past due. These include short-term, 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, deferral of principal only (interest only payments), or other delays in payment that are insignificant.

During the year ended December 31, 2020, the Bank modified a total of 191 loans. The principal balances of these loans on December 31, 2020 totaled approximately $95 million. As of December 31, 2020, 4 of the 191 previously modified loans remain in deferment. The principal balance of these 4 loans is approximately $7.06 million, which represents 1.16% of the total loan portfolio. Of the total deferrals, 3 loans, or approximately $6.8 million, are for deferrals of principal only and 1 loan, or approximately $270,000, is for principal and interest deferment.

If a customer requests a second modification, an extensive evaluation of the circumstances surrounding the need for the request is conducted. Procedurally, a commercial borrower will be required to present financial forecasts, proof of business sustainability, and verification of sources of repayment to the primary loan officer, the Chief Lending Officer, and the Chief Credit Officer before a second deferral is granted. Retail borrowers are also required to submit in writing the reason for the need for a second deferral request before an additional deferral is granted. Relationships whose situations do not warrant a second deferral will most likely be downgraded and subsequently evaluated for specific impairment within the allowance for loan loss. We are not currently evaluating any relationships, for second deferrals.

In accordance with the relief provisions of the CARES Act and the March 22, 2020 (revised April 2020) Joint Interagency Regulatory Guidance, the above modifications were not considered to be troubled debt restructurings and were excluded from the TDR discussion above. The TDR relief provisions provided for by the CARES Act were extended in December 2020 by the Consolidated Appropriations Act through the earlier of January 1, 2022 or 60 days after the national COVID-19 emergency terminates.

Management has reviewed loan segments that it believes could be adversely impacted by the COVID-19 pandemic, and identified the following segments: assisted living, education/childcare, entertainment, hospitality, oil & gas (gas stations), religious/charitable, restaurants, retail & services. At December 31, 2020, the loan balances in those segments were as follows:

Industry	**Principal Balance (in thousands)**	**Number of Loans**	**Percent of Total Loan Portfolio**
Assisted Living	$ 6,228	10	1.02%
Education/Childcare	7,518	15	1.23%
Entertainment	6,885	23	1.13%
Hospitality	15,399	8	2.53%
Oil & Gas (Gas Stations)	251	8	0.04%
Religious/Charitable	19,748	40	3.24%
Restaurants	16,599	47	2.73%
Retail & Services	9,098	45	1.49%
Total	$ 81,726	196	13.42%

Management continues to closely monitor loans in these categories.

Interest Rate Sensitivity

The most important element of asset/liability management is the monitoring of Financial's sensitivity to interest rate movements. The income stream of Financial is subject to risk resulting from interest rate fluctuations to the extent there is a difference between the amount of Financial's interest earning assets and the amount of interest-bearing liabilities that prepay, mature or reprice in specified periods. Management's goal is to maximize net interest income with acceptable levels of risk to changes in interest rates. Management seeks to meet this goal by influencing the maturity and re-pricing characteristics of the various lending and deposit taking lines of business and by managing discretionary balance sheet asset and liability portfolios.

Management also is attempting to mitigate interest rate risk by limiting the dollar amount of loans carried on its balance sheet that have fixed rates in excess of five years. To reduce our exposure to interest rate risks inherent with longer term fixed rate loans, we generally do not hold such mortgages on our books. The Bank established the Mortgage Division to serve potential customers that desired fixed rate loans in excess of five years.

Management monitors interest rate levels on a daily basis and meets in the form of an Enterprise Risk Management and Asset/Liability Committee ("ALCO") meeting at least quarterly, or when a special situation arises (e.g., FOMC unscheduled rate change). The following reports and/or tools are used to assess the current interest rate environment and its impact on Financial's earnings and liquidity: monthly and year-to-date net interest margin and spread calculations, monthly and year-to-date balance sheet and income statements versus budget (including quarterly interest rate shock analysis), quarterly economic value of equity analysis, a weekly survey of rates offered by other local competitive institutions, and gap analysis which matches maturities or repricing dates of interest sensitive assets to those of interest sensitive liabilities.

Financial currently subscribes to computer simulated modeling tools made available through its consultant, FinPro, Inc., to aid in asset/liability analysis. In addition to monitoring by ALCO, the board is informed of the current asset/liability position and its potential effect on earnings at least quarterly.

Other Borrowings

Financial uses borrowing in conjunction with deposits to fund lending and investing activities. Borrowings include funding of a short and long-term nature.

Short-term borrowings consist of securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the date sold. short-term borrowings may also include federal funds purchased, which are unsecured overnight borrowings from other financial institutions, which totaled $0 as of December 31, 2020 and December 31, 2019. Unsecured federal funds lines and their respective limits are maintained with the following institutions: Community Bankers' Bank, $13,000,000, PNC Bank $6,000,000, First National Bankers' Bank, $10,000,000, and Zions Bank, $4,000,000. In addition, the Bank maintains a $5,000,000 reverse repurchase agreement with Truist Bank whereby securities may be pledged as collateral in exchange for funds for a minimum of 30 days with a maximum of 90 days. The Bank also maintains a secured federal funds line with Community Bankers' Bank whereby it may pledge securities as collateral with no specified minimum or maximum amount or term. The amount outstanding on the Community Bankers' Bank secured fed funds line was $0 as of December 31, 2020 and 2019.

Long-term borrowings may be obtained through the Federal Home Loan Bank of Atlanta ("FHLBA"). The Bank's remaining available credit through the FHLBA was $212,366,000 as of December 31, 2020, the most recent calculation. Currently the Bank has in place pledged collateral in the amount of approximately $38,500,000 against which $0 was drawn and outstanding on December 31, 2020. Additional collateral would be required to be pledged in order for the full $212,366,000 to be available.

Off-Balance Sheet Arrangements

At December 31, 2020, the Bank had rate lock commitments to originate mortgage loans through its Mortgage Division amounting to approximately $34,952,000 and loans held for sale of $7,102,000. The Bank recorded $425,000 in other assets in relation to its interest rate lock commitments at December 31,

2020. The Bank has entered into corresponding commitments with third party investors to sell each of these loans that close. No other obligation exists.

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. A summary of the Bank's commitments is as follows:

	Contract Amounts (*dollars in thousands*) at December 31,	
	2020	**2019**
Commitments to extend credit	$ 152,834	$ 134,186
Standby letters of credit	3,552	3,469
Total	$ 156,386	$ 137,655

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on its credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral is required in instances which the Bank deems necessary.

Management does not anticipate any material losses as a result of these transactions.

The Bank rents, under non-cancelable leases eight of its banking facilities and one mortgage production office. "Note 23 – Leases" in the Notes to Consolidated Financial Statements provides information on the Company's liability under the Company's leases of significance.

Expansion Plans

Subject to regulatory approval, the Bank anticipates opening additional branches during the next two fiscal years. Although numerous factors could influence the Bank's expansion plans, the following discussion provides a general overview of the real property the Bank is holding for potential branch expansion.

Boonsboro Road, (Lynchburg), Virginia. In 2020 the Bank has purchased a building that formerly operated as a branch bank for another institution located at 4501 Boonsboro Road, Lynchburg, Virginia 24503. While the Bank does not anticipate opening a branch at this location until 2022, the Bank believes the investment needed to upfit this property will be minimal and primarily related to aesthetics due to the fact this location was a former bank branch.

Timberlake Road Area, Campbell County (Lynchburg), Virginia. As previously disclosed, the Bank has purchased certain undeveloped real property located at the intersection of Turnpike and Timberlake Roads, Campbell County, Virginia. The Bank has not determined when it will open a branch at this location. The Bank has determined that the existing structure is not suitable for use as a bank branch.

The Bank estimates that the cost of improvements, furniture, fixtures, and equipment necessary to upfit the property at the undeveloped Timberlake location will be between $900,000 and $1,500,000.

Although the Bank cannot predict with certainty the financial impact of each new branch, management generally anticipates that each new branch will become profitable within 12 to 18 months of opening.

Recent Accounting Pronouncements

For information regarding recent accounting pronouncements and their effect on us, see "Impact of Recent Accounting Pronouncements" in Note 24 to the consolidated financial statements included in Item 8 of this Form 10-K.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Not applicable

Item 8. Financial Statements and Supplementary Data

The following financial statements are filed as a part of this report:

Management's Annual Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Financial Statements

- Balance Sheets, December 31, 2020 and December 31, 2019
- Statements of Income, Years Ended December 31, 2020 and December 31, 2019
- Statements of Comprehensive Income, Years Ended December 31, 2020 and December 31, 2019
- Statements of Changes in Stockholders' Equity, Years Ended December 31, 2020 and December 31, 2019
- Statements of Cash Flows, Years Ended December 31, 2020 and December 31, 2019
- Notes to Consolidated Financial Statements

Bank of The James
FINANCIAL GROUP, INC.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for the preparation and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning effects of events and transactions that are accounted for or disclosed.

Management is also responsible for establishing and maintaining adequate internal control over financial reporting. Financial's internal control over financial reporting includes those policies and procedures that pertain to Financial's ability to record, process, summarize and report reliable financial data. Management recognizes that there are inherent limitations in the effectiveness of any internal control over financial reporting, including the possibility of human error and the circumvention or overriding of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

In order to ensure that Financial's internal control over financial reporting is effective, management regularly assesses such controls and did so most recently for its financial reporting as of December 31, 2020. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations (COSO) in 2013, by the Treadway Commission. Based on this assessment, management has concluded that the internal control over financial reporting was effective as of December 31, 2020.

This annual report does not include an attestation report of Financial's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by Financial's registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit Financial to provide only management's report in the annual report.

The Board of Directors, acting through its Audit Committee, is responsible for the oversight of Financial's accounting policies, financial reporting and internal control. The Audit Committee of the Board of Directors is comprised entirely of outside directors who are independent of management. The Audit Committee is responsible for the appointment and compensation of the independent registered public accounting firm and approves decisions regarding the appointment or removal of Financial's Internal Auditor. It meets periodically with management, the independent registered public accounting firm and the internal auditors to ensure that they are carrying out their responsibilities. The Audit Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting and auditing procedures of Financial in addition to reviewing Financial's financial reports. The independent registered public accounting firm and the internal auditors have full and unlimited access to the Audit Committee, with or without management, to discuss the adequacy of internal control over financial reporting, and any other matter which they believe should be brought to the attention of the Audit Committee.

/s/ Robert R. Chapman III	/s/ J. Todd Scruggs
Chief Executive Officer & President	Secretary-Treasurer (Principal Financial Officer)
March 29, 2021	March 29, 2021

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors
Bank of the James Financial Group, Inc.
Lynchburg, Virginia

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Bank of the James Financial Group, Inc. and its subsidiaries (the Company) as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting 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.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses – General Component – Qualitative Factors

Description of the Matter
As described in Note 2 (Summary of Significant Accounting Policies) and Note 5 (Loans and Allowance for Loan Losses) to the consolidated financial statements, the Company maintains an allowance for loan losses to provide for probable losses inherent in its loan portfolio. At December 31, 2020, the allowance for loan losses totaled $7,156,000, consisting of specific and general components. The general component of the allowance totaled $7,152,000 at December 31, 2020, and is based on historical loss experience adjusted for qualitative factors. The qualitative factors are described in Note 2 and are determined based on management's ongoing evaluation of the factors, which may impact the quality of the Company's loan portfolio.

Management exercised significant judgment when assessing the qualitative factors used in estimating the allowance for loan losses. We identified the assessment of the qualitative factors as a critical audit matter as auditing the qualitative factors involved especially complex and subjective auditor judgment in evaluating management's assessment of the inherently subjective estimates.

How We Addressed the Matter in Our Audit
The primary audit procedures we performed to address this critical audit matter included:

- Substantively testing management's process, including evaluating their judgments and assumptions for developing the qualitative factors, which included:
- Evaluating the completeness and accuracy of data inputs used as a basis for the qualitative factors.
- Evaluating the reasonableness of management's judgments related to the determination of qualitative factors.
- Evaluating the qualitative factors for directional consistency and for reasonableness.
- Testing the mathematical accuracy of the allowance calculation, including the application of the qualitative factors.

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

We have served as the Company's auditor since 2006.

Winchester, Virginia
March 29, 2021

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)

Assets		**December 31, 2020**		**December 31, 2019**
Cash and due from banks	$	31,683	$	30,794
Federal funds sold		69,203		8,317
Total cash and cash equivalents		100,886		39,111
Securities held-to-maturity (fair value of $4,192 in 2020 and $3,861 in 2019)		3,671		3,688
Securities available-for-sale, at fair value		90,185		59,655
Restricted stock, at cost		1,551		1,506
Loans, net of allowance for loan losses of $7,156 in 2020 and $4,829 in 2019		601,934		573,274
Loans held for sale		7,102		4,221
Premises and equipment, net		16,982		16,698
Interest receivable		2,350		1,866
Cash value - bank owned life insurance		16,355		13,686
Other real estate owned		1,105		2,339
Other assets		9,265		9,350
Total assets	$	851,386	$	725,394
Liabilities and Stockholders' Equity				
Deposits				
Noninterest bearing demand	$	143,345	$	93,936
NOW, money market and savings		463,506		362,821
Time		158,116		192,702
Total deposits		764,967		649,459
Capital notes		10,027		5,000
Interest payable		85		173
Other liabilities		9,575		9,317
Total liabilities	$	784,654	$	663,949
Commitments and Contingencies				
Stockholders' equity				
Preferred stock; authorized 1,000,000 shares; none issued and outstanding	$	-	$	-

CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)

	2020	2019
Common stock $2.14 par value; authorized 10,000,000 shares; issued and outstanding 4,339,436 and 4,357,436 as of December 31, 2020 and 2019	9,286	9,325
Additional paid-in-capital	30,989	31,225
Retained earnings	24,665	20,900
Accumulated other comprehensive income (loss)	1,792	(5)
Total stockholders' equity	$ 66,732	$ 61,445
Total liabilities and stockholders' equity	$ 851,386	$ 725,394

See Notes to Consolidated Financial Statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

	For the Year Ended December 31,			
Interest Income	**2020**		**2019**	
Loans	$	28,021	$	27,559
Securities				
US Government and agency obligations		690		755
Mortgage backed securities		217		220
Municipals - taxable		361		312
Municipals - tax-exempt		11		3
Dividends		78		93
Other (Corporates)		117		94
Interest bearing deposits		89		326
Federal Funds sold		102		454
Total interest income		29,686		29,816
Interest Expense				
Deposits				
NOW, money market savings		804		1,537
Time Deposits		3,348		3,456
Finance leases		115		71
Capital notes		273		200
Total interest expense		4,540		5,264
Net interest income		25,146		24,552
Provision for loan losses		2,548		523
Net interest income after provision for loan losses		22,598		24,029
Noninterest income				
Gain on sales of loans held for sale		7,812		4,254
Service charges, fees and commissions		2,033		1,785
Life insurance income		436		679
Other		50		76
Gain on sales and calls of securities, net		644		394
Total noninterest income		10,975		7,188
Noninterest expenses				
Salaries and employee benefits		15,430		13,092
Occupancy		1,638		1,655
Equipment		2,350		2,107
Supplies		479		597

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

Professional, data processing, and other outside expense	3,691	3,432
Marketing	667	866
Credit expense	1,112	653
Other real estate expenses	443	366
FDIC insurance expense	336	226
Other	1,248	1,289
Total noninterest expenses	27,394	24,283
Income before income taxes	6,179	6,934
Income tax expense	1,199	1,329
Net Income	$ 4,980	$ 5,605
Weighted average shares outstanding - basic	4,341,575	4,375,814
Weighted average shares outstanding - diluted	4,341,575	4,381,597
Earnings per common share - basic	$ 1.15	$ 1.28
Earnings per common share - diluted	$ 1.15	$ 1.28

See Notes to Consolidated Financial Statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)

	For the Year Ended December 31, 2020	For the Year Ended December 31, 2019
Net Income	$ 4,980	$ 5,605
Other comprehensive income:		
Unrealized gains on securities available-for-sale	2,918	3,227
Tax effect	(612)	(678)
Reclassification adjustment for gains included in net income (1)	(644)	(394)
Tax effect (2)	135	83
Other comprehensive income, net of tax	1,797	2,238
Comprehensive income	$ 6,777	$ 7,843

(1) Gains are included in “gain on sales and calls of available-for-sale securities, net” on the consolidated statements of income.

(2) The tax effect on these reclassifications is reflected in “income tax expense” on the consolidated statements of income.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands except per share amounts)

	Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2018	4,378,436	$ 9,370	$ 31,495	$ 16,521	$ (2,243)	$ 55,143
Net Income	-	-	-	5,605	-	5,605
Dividends paid on common stock ($0.28 per share)	-	-	-	(1,226)	-	(1,226)
Repurchase of common stock	(21,000)	(45)	(270)	-	-	(315)
Other comprehensive income	-	-	-	-	2,238	2,238
Balance at December 31, 2019	4,357,436	$ 9,325	$ 31,225	$ 20,900	$ (5)	$ 61,445
Net Income	-	-	-	4,980	-	4,980
Dividends paid on common stock ($0.28 per share)	-	-	-	(1,215)	-	(1,215)
Repurchase of common stock	(18,000)	(39)	(236)	-	-	(275)
Other comprehensive income	-	-	-	-	1,797	1,797
Balance at December 31, 2020	4,339,436	$ 9,286	$ 30,989	$ 24,665	$ 1,792	$ 66,732

See Notes to Consolidated Financial Statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	For the Year Ended December 31,	
	2020	2019
Cash flows from operating activities		
Net Income	$ 4,980	$ 5,605
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,029	1,666
Stock based compensation expense	106	106
Net amortization and accretion of premiums and discounts on securities	405	398
Amortization of debt issuance costs	2	-
(Gain) on sales of available-for-sale securities	(644)	(394)
(Gain) on sales of loans held for sale	(7,812)	(4,254)
Proceeds from sales of loans held for sale	303,085	165,097
Origination of loans held for sale	(298,154)	(163,394)
Provision for loan losses	2,548	523
(Gain) loss on sale of other real estate owned	(29)	19
Impairment of other real estate owned	437	287
Benefit for deferred income taxes	(838)	(17)
Bank owned life insurance income	(436)	(679)
(Increase) in interest receivable	(484)	(124)
Decrease (increase) in other assets	(474)	421
(Decrease) increase in interest payable	(88)	46
Increase in other liabilities	566	286
Net cash provided by operating activities	$ 5,199	$ 5,592
Cash flows from investing activities		
Purchases of securities available-for-sale	$ (51,150)	$ (16,991)
Proceeds from maturities, calls and paydowns of securities available-for-sale	9,837	3,171
Proceeds from sale of securities available-for-sale	13,313	9,733
Purchases of bank owned life insurance	(2,280)	-
Life insurance proceeds	405	-
Purchase of Federal Home Loan Bank stock	(45)	(44)
Proceeds from sale of other real estate owned	844	570
Origination of loans, net of principal collected	(31,226)	(44,566)
Purchases of premises and equipment	(1,751)	(4,398)
Net cash (used in) investing activities	$ (62,053)	$ (52,525)

See Notes to Consolidated Financial Statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	2020	2019
Cash flows from financing activities		
Net increase in deposits	$ 115,508	$ 37,416
Principal payments on finance lease obligations	(414)	(156)
Repurchase of common stock	(275)	(315)
Dividends paid to common stockholders	(1,215)	(1,226)
Proceeds from sale of capital notes, net of issuance costs	10,025	-
Retirement of capital notes	(5,000)	-
Net cash provided by financing activities	$ 118,629	$ 35,719
Increase (decrease) in cash and cash equivalents	61,775	(11,214)
Cash and cash equivalents at beginning of period	$ 39,111	$ 50,325
Cash and cash equivalents at end of period	$ 100,886	$ 39,111
Non cash transactions		
Transfer of loans to other real estate owned	$ 18	$ 785
Fair value adjustment for securities available-for-sale	2,274	2,833
Lease liabilities arising from right-of-use assets	-	6,373
Cash transactions		
Cash paid for interest	$ 4,628	$ 5,218
Cash paid for income taxes	1,585	120

Note 1 – Organization

Bank of the James Financial Group, Inc. ("Financial" or the "Company"), a Virginia corporation, was organized in 2003 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Financial is headquartered in Lynchburg, Virginia. Financial conducts its business activities through the branch offices and loan production offices of its wholly owned subsidiary bank, Bank of the James (the "Bank"), the Bank's wholly-owned subsidiary, BOTJ Insurance, Inc. ("BOTJ-Ins."), and through the Bank's two divisions, Bank of the James Mortgage division ("Mortgage Division") and BOTJ Investment Services division ("Investment Division"). The Mortgage Division originates conforming and non-conforming home mortgages in the Region 2000 area, which includes the counties of Amherst, Appomattox, Bedford and Campbell (which includes the Town of Altavista and the county seat in Rustburg), the Town of Bedford and the City of Lynchburg, Virginia, as well as the cities of Charlottesville, Harrisonburg, Lexington, Roanoke, and Blacksburg. Financial exists primarily for the purpose of holding the stock of its subsidiaries, the Bank and such other subsidiaries as it may acquire or establish. Financial also has one wholly-owned non-operating subsidiary.

Bank of the James was incorporated on October 23, 1998, and began banking operations on July 22, 1999. The Bank is a Virginia chartered bank and is engaged in lending and deposit gathering activities in Region 2000 and other markets in Central Virginia and the Shenandoah Valley. It operates under the laws of Virginia and the Rules and Regulations of the Federal Reserve System and the Federal Deposit Insurance Corporation. The Bank's locations consist of four branches (one of which is a limited service branch) in Lynchburg, Virginia, one in Forest, Virginia which includes the Mortgage Division, one in Madison Heights, Virginia, one in the Town of Amherst, Virginia, one in the Town of Bedford, Virginia, one in the Town of Altavista, Virginia, and one in the Town of Appomattox. Outside of Region 2000, the Bank also operates two full-service branches and one limited-service branch in Charlottesville, Virginia, a full-service branch in Harrisonburg, Virginia, two full-service branches in Roanoke, Virginia, a full-service branch in Rustburg, Virginia, a full-service branch in Lexington, Virginia and a mortgage origination office in Blacksburg, Virginia.

Note 2 - Summary of significant accounting policies

Consolidation
The consolidated financial statements include the accounts of Bank of the James Financial Group, Inc. and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

Basis of presentation and use of estimates
The preparation of the consolidated 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 liabilities at the date of the financial statements, as well as the amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and valuation of other real estate owned.

Cash and cash equivalents
Cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within ninety days. Generally, federal funds are purchased and sold for one-day periods.

Note 2 - Summary of significant accounting policies (continued)

Securities
Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held-to-maturity or trading, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss). Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

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

We regularly review each investment security for other-than-temporary impairment based on criteria that include the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, our best estimate of the present value of cash flows expected to be collected from debt securities, our intention with regard to holding the security to maturity, and the likelihood that we would be required to sell the security before recovery.

Restricted investments
As members of the Federal Reserve Bank (FRB) and the Federal Home Loan Bank of Atlanta (FHLBA), the Bank is required to maintain certain minimum investments in the common stock of the FRB and FHLBA. Required levels of investment are based upon the Bank's capital and a percentage of qualifying assets. The Bank also maintains stock ownership in Community Bankers' Bank (CBB). The investment in CBB is minimal and is not mandated but qualifies the Bank for preferred pricing on services offered by CBB. Based on liquidation restrictions, all of these investments are carried at cost.

Note 2 - Summary of significant accounting policies (continued)

Loans
Financial makes real estate, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by real estate loans collateralized by real estate within Region 2000. The ability of Financial's debtors to honor their contracts is dependent upon the real estate and general economic conditions in the area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Past due status
Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual and potentially charged-off at an earlier date if collection of principal or interest is considered doubtful.

Non-accrual status
Financial stops accruing interest on a loan at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. At the time the loan is placed on non-accrual status, all previously accrued but not collected interest is reversed against interest income. While the loan is classified as non-accrual, any payments collected are accounted for using the cost-recovery method which requires the entire amount of the payment to be applied directly to principal, until qualifying for return to performing status. Loans may be, but are not always, returned to performing status when all the principal and interest amounts contractually due are brought current (within 90 days past due), future payments are reasonably assured, and contractually required payments have been made on a timely basis for at least six consecutive months.

Charge-off
At the time a loan is placed on non-accrual status, it is generally reevaluated for expected loss and a specific reserve, if not already assigned, is established against the loan. Consumer term loans are typically charged-off no later than 120 days whereas consumer revolving credit loans are typically charged-off no later than 180 days. Although the goal for commercial and commercial real estate loans is for charge off no later than 180 days, a commercial or commercial real estate loan may not be fully charged off until there is reasonable certainty that no additional workout efforts, troubled debt restructurings or any other types of concession can or will be made by Financial.

Paycheck Protection Program Loans
In 2020, the Company participated in the Paycheck Protection Program (PPP). The PPP commenced subsequent to the passage of the Coronavirus Aid, Relief and Economic Security (CARES) Act in March 2020 and was later expanded by the Paycheck Protection Program and Health Care Enhancement Act of April 2020. The PPP was designed to provide U.S. small businesses with cash-flow assistance during the COVID-19 pandemic through loans that are fully guaranteed by the Small Business Administration (SBA) which may be forgiven upon satisfaction of certain criteria. As of December 31, 2020, the Company had 379 PPP loans with outstanding balances totaling $42.46 million. As compensation for originating the loans, the Company received lender processing fees from the SBA, which were deferred, along with the related loan origination costs. These net fees are being accreted to interest income over the remaining contractual lives of the loans. Upon forgiveness of a PPP loan and repayment by the SBA, which may be prior to the loan's maturity, the remainder of any unrecognized

Note 2 - Summary of significant accounting policies (continued)

net fees are recognized in interest income. The Company has continued to participate in the newest round of the PPP during the first quarter of 2021.

Loans Held for Sale
Loans originated and intended for sale in the secondary market are sold, servicing released, and carried at the lower of cost or fair value, which is determined in the aggregate based on sales commitments to permanent investors or on current market rates for loans of similar quality and type. In addition, the Company requires a firm purchase commitment from a permanent investor before a loan can be closed, thus limiting interest rate risk.

Allowance for loan losses
The allowance for loan losses is management's estimate of probable losses inherent in the loan portfolio and is recorded through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

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

A loan is considered impaired when, based on current information and events, it is probable that Financial will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by evaluating the discounted cash flows or fair value of the underlying collateral, if the loan is collateral dependent.

Note 2 - Summary of significant accounting policies (continued)

Management considers the following when calculating its loan loss reserve requirement:

- In accordance with current accounting rules (ASC 310) and the Bank's impairment methodology, the Bank performs an individual impairment analysis on all loans having a principal balance greater than $100,000 (unless related to another classified relationship or a TDR) with a risk rating of substandard, doubtful, and loss (our internal risk ratings of 7 through 9).

- In accordance with current accounting rules (ASC 450), the Bank examines historical charge-off data by segment in order to determine historical loss rates which are applied to specific pools of loans which carry similar risk characteristics. The Bank updates its historical charge-off data quarterly and adjusts the reserve accordingly.

- The Bank assesses various qualitative factors to adjust the historical loss rates described above to management's estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Such factors include levels and trends of delinquent and non-accrual loans, economic conditions, trends in charge-offs, loan concentrations, lending policies and procedures, lending management, changes in the value of underlying collateral, the effect of external factors such as legal and regulatory requirements, and other factors, as deemed appropriate.

At December 31,2020, commercial loans included $42.46 million of PPP loans. The Company does not maintain an allowance on these balances as they are 100% guaranteed by the SBA.

Troubled debt restructurings
In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring ("TDR"). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loans reach non-accrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. In cases where borrowers are granted new terms that generally (although not required to be considered a TDR) provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans. The Bank had $392 and $410 classified as TDRs as of December 31, 2020 and 2019, respectively.

Premises, equipment and depreciation
Premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is provided over the estimated useful lives of the respective assets on the straight-line basis, which range from 3 to 7 years for equipment and 10 to 39.5 years for buildings and improvements. Leasehold improvements are amortized over a term which is the shorter of their useful life or the remaining lease term. Land is carried at cost and is not depreciable. Expenditures for major renewals and betterments are capitalized and those for maintenance and repairs are charged to operating expenses as incurred.

Bank owned life insurance
Financial has purchased life insurance policies on certain key employees. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value.

Note 2 - Summary of significant accounting policies (continued)

Other real estate owned

Other real estate owned consists of properties acquired through foreclosure or deed in lieu of foreclosure. These properties are carried at fair value less estimated costs to sell at the date of foreclosure establishing a new cost basis. These properties are subsequently accounted for at the lower of cost or fair value less estimated costs to sell. Losses from the acquisition of property in full or partial satisfaction of loans are charged against the allowance for loan losses. Subsequent write-downs, if any, are charged against expense. Gains and losses on the sales of foreclosed properties are included in determining net income in the year of the sale. Operating costs after acquisition are expensed.

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 theBank – 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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absences of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Business Segments

We operate two business segments, community banking and mortgage banking. The community banking segment includes both commercial and consumer lending and provides customers such products as commercial loans, real estate loans, and other business financing and consumer loans. In addition, this segment provides customers with several choices of deposit products, including demand deposit accounts, savings accounts and certificates of deposit. The mortgage banking segment engages primarily in the origination of residential mortgages for sale into the secondary market. For addition information, refer to Note 9 “Business Segments.”

Retirement Plans

Employee 401(k) and profit sharing expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Income taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Note 2 - Summary of significant accounting policies (continued)

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying 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 consolidated statements of income. At December 31, 2020 and 2019, there were no liabilities recorded for unrecognized tax benefits.

Stock-based compensation plans
Compensation cost is recognized for stock-based awards issued to employees based on the fair value of the awards. The Black-Scholes valuation model is utilized to estimate the fair value of stock options and the market value of the Company's common stock on the date of grant is used for restricted stock awards. Restricted stock units, which may be settled in stock or in cash, are a liability classified with the fair value initially measured at the market value of the Company's common stock on the date of grant. These awards are subsequently remeasured to the fair value of the Company's common stock in each reporting period. Compensation cost is recognized over the vesting period of the awards and the Company's policy is to recognize forfeitures as they occur.

Awards under the 2018 Bank of the James Financial Group, Inc. Equity Incentive Plan are detailed in Note 15, "Stock-based Compensation Plans". The Company's ability to grant awards under the Equity Incentive Plan is ongoing.

Earnings per common share
Basic earnings per common share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to stock options and restricted stock units outstanding during the periods, and are determined using the treasury stock method.

Reclassifications
Management has made certain immaterial reclassifications to the prior year financial statements to conform to the 2020 presentation. Reclassifications had no effect on prior year net income or stockholders' equity.

Comprehensive income
Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains (losses) on available-for-sale securities.

Note 2 - Summary of significant accounting policies (continued)

Marketing
The Company expenses advertising costs as incurred. Advertising expenses were $667 and $866 for 2020 and 2019, respectively.

Note 3 - Restrictions on cash

To comply with Federal Reserve regulations, the Bank is required to maintain certain average cash reserve balances. The daily average cash reserve requirements were approximately $0 and $15,716 for the weeks including December 31, 2020 and 2019, respectively. The Federal Reserve announced they were reducing the reserve requirement ratio to zero percent across all deposit tiers as of March 26, 2020. This comes as the COVID-19 pandemic continues to impact much of the way financial institutions both operate and serve their customers.

(dollars in thousands, except per share data)

Note 4 - Securities

A summary of the amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

	December 31, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
U.S. agency obligations	$ 3,671	$ 521	$ -	$ 4,192
Available-for-sale				
U.S. Treasuries	$ 2,000	$ 27	$ -	$ 2,027
U.S. agency obligations	40,111	1,544	(335)	41,320
Mortgage-backed securities	15,461	241	(6)	15,696
Municipals	24,275	594	(96)	24,773
Corporates	6,070	299	-	6,369
	$ 87,917	$ 2,705	$ (437)	$ 90,185

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
U.S. agency obligations	$ 3,688	$ 173	$ -	$ 3,861
Available-for-sale				
U.S. Treasuries	$ 1,966	$ -	$ (2)	$ 1,964
U.S. agency obligations	32,163	278	(333)	32,108
Mortgage-backed securities	10,328	42	(106)	10,264
Municipals	11,118	117	(13)	11,222
Corporates	4,086	32	(21)	4,097
	$ 59,661	$ 469	$ (475)	$ 59,655

Temporarily Impaired Securities

The following tables show the gross unrealized losses and fair value of the Bank's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length

(dollars in thousands, except per share data)

Note 4 –Securities (continued)

of time that individual securities have been in a continuous unrealized loss position, at December 31, 2020 and 2019:

December 31, 2020	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Held-to-maturity						
U.S. agency obligations	$ -	$ -	$ -	$ -	$ -	$ -
Available-for-sale						
U.S. Treasuries	-	-	-	-	-	-
U.S. agency obligations	15,808	335	-	-	15,808	335
Mortgage-backed securities	8,201	6	-	-	8,201	6
Municipals	8,202	96	-	-	8,202	96
Corporates	-	-	-	-	-	-
Total temporarily impaired securities	$ 32,211	$ 437	$ -	$ -	$ 32,211	$ 437

December 31, 2019	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Held-to-maturity						
U.S. agency obligations	$ -	$ -	$ -	$ -	$ -	$ -
Available-for-sale						
U.S. Treasuries	-	-	1,964	2	1,964	2
U.S. agency obligations	12,395	218	12,048	115	24,443	333
Mortgage-backed securities	-	-	6,609	106	6,609	106
Municipals	-	-	2,736	13	2,736	13
Corporates	-	-	1,042	21	1,042	21
Total temporarily impaired securities	$ 12,395	$ 218	$ 24,399	$ 257	$ 36,794	$ 475

(dollars in thousands, except per share data)

Note 4 –Securities (continued)

U.S. agency obligations. The unrealized losses on the seven investments in U.S. agency obligations at December 31, 2020 were caused by an increase in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2020. Each of these seven investments carries an S&P investment grade rating of AA or better.

Mortgage-backed securities. The unrealized loss on the two investments in U.S. government agency mortgage-backed securities at December 31, 2020 was caused by an increase in interest rates. The contractual terms of those investments does not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of the amortized cost basis, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2020. Each of these two investments carries an S&P investment grade rating of AAA.

Municipals. The unrealized losses on the nine investments in municipal obligations at December 31, 2020 were caused by an increase in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2020. Each of these nine investments carries an S&P investment grade rating of A or above.

The amortized costs and fair values of securities at December 31, 2020, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Values	Amortized Cost	Fair Values
Due in one year or less	$ -	$ -	$ 501	$ 501
Due after one year through five years	-	-	12,634	13,022
Due after five years through ten years	398	452	39,437	40,936
Due after ten years	3,273	3,740	35,345	35,726
	$ 3,671	$ 4,192	$ 87,917	$ 90,185

The Bank received $13,313 and $9,733 in proceeds from sales of securities available-for-sale in 2020 and 2019, respectively. Gross realized gains amounted to $644 and $394 in 2020 and 2019, respectively. Gross realized losses amounted to $0 in both years.

Note 4 –Securities (continued)

At December 31, 2020 and 2019, securities with a carrying value of $31,202 and $22,307, respectively, were pledged as collateral for public deposits and for other purposes as required or permitted by law.

Note 5 - Loans and allowance for loan losses

The allowance represents an amount that, in management’s judgment, will be adequate to absorb probable losses inherent in the loan portfolio. Management’s judgment in determining the level of the allowance is based on evaluations of the collectability of loans while taking into consideration such factors as trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower’s ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

Management has an established methodology used to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented certain loans in the portfolio by product type. Within these segments, the Bank has sub-segmented its portfolio by classes within the segments, based on the associated risks within these classes. The classifications set forth below do not correspond directly to the classifications set forth in the call report (Form FFIEC 041). Management has determined that the classifications set forth below are more appropriate for use in identifying and managing risk in the loan portfolio.

Loan Segments:	Loan Classes:
Commercial	Commercial and industrial loans
Commercial real estate	Commercial mortgages – owner occupied Commercial mortgages – non-owner occupied Commercial construction
Consumer	Consumer unsecured Consumer secured
Residential	Residential mortgages Residential consumer construction

Note 5 - Loans and allowance for loan losses (continued)

The evaluation also considers the following risk characteristics of each loan segment:

- Commercial loans carry risks associated with the successful operation of a business because the repayment of these loans may be dependent upon the profitability and cash flows of the business or project. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.

- Commercial real estate loans carry risks associated with a real estate project and other risks associated with the ownership of real estate. In addition, for real estate construction loans there is a risk that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.

- Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy. Unsecured consumer loans carry additional risks associated with the continued credit-worthiness of borrowers who may be unable to meet payment obligations.

- Residential mortgage and construction loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral. Equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

The Bank's internal risk rating system is in place to grade commercial and commercial real estate loans. Category ratings are reviewed periodically by lenders and the credit review area of the Bank based on the borrower's individual situation. Additionally, internal and external monitoring and review of credits are conducted on an annual basis.

Below is a summary and definition of the Bank's risk rating categories:

RATING 1	Excellent
RATING 2	Above Average
RATING 3	Satisfactory
RATING 4	Acceptable / Low Satisfactory
RATING 5	Monitor
RATING 6	Special Mention
RATING 7	Substandard
RATING 8	Doubtful
RATING 9	Loss

Based on the above criteria, we segregate loans into the above categories for special mention, substandard, doubtful and loss from non-classified, or pass rated, loans. We review the characteristics of each rating at least annually, generally during the first quarter. The characteristics of these ratings are as follows:

Note 5 - Loans and allowance for loan losses (continued)

- "Pass." These are loans having risk ratings of 1 through 4. Pass loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.

- "Monitor." These are loans having a risk rating of 5. Monitor loans have currently acceptable risk but may have the potential for a specific defined weakness in the borrower's operations and the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history may currently or in the future be characterized by late payments. The Bank's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.

- "Special Mention." These are loans having a risk rating of 6. Special Mention loans have weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. These loans do warrant more than routine monitoring due to a weakness caused by adverse events.

- "Substandard." These are loans having a risk rating of 7. Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Bank's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Bank. There is a distinct possibility that the Bank will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet our definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Bank will be unable to collect all amounts due.

- "Doubtful." These are loans having a risk rating of 8. Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high.

- "Loss." These are loans having a risk rating of 9. Loss rated loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

(dollars in thousands, except per share data)

Note 5 - Loans and allowance for loan losses (continued)

The Bank grants primarily commercial, real estate, and installment loans to customers throughout its market area. The real estate portfolio can be affected by the condition of the local real estate markets. The commercial and installment loan portfolio can be affected by the local economic conditions.

A summary of loans, net is as follows:

	December 31, 2020	December 31, 2019
Commercial	$ 145,145	$ 114,257
Commercial real estate	309,563	303,900
Consumer	92,344	89,945
Residential	62,038	70,001
Total loans (1)	609,090	578,103
Less allowance for loan losses	7,156	4,829
Net loans	$ 601,934	$ 573,274

(1) Includes net deferred (fees) and costs/premiums of ($18) and $572 as of December 31, 2020 and 2019, respectively.

The amounts of overdraft reclassified as loans were $43 and $86 as of December 31, 2020 and 2019, respectively.

The Company's officers, directors and their related interests have various types of loan relationships with the Bank. The total outstanding balances of these related party loans at December 31, 2020 and 2019 were $12,075 and $12,682 respectively. During 2020, new loans and advances amounted to $3,326 and repayments amounted to $4,221.

(dollars in thousands, except per share data)

Note 5 - Loans and allowance for loan losses (continued)

The following tables set forth information regarding impaired and non-accrual loans as of December 31, 2020 and 2019:

Loans on Non-Accrual Status

	As of December 31,	
	2020	**2019**
Commercial	$ 121	$ 262
Commercial Real Estate:		
Commercial Mortgages-Owner Occupied	940	262
Commercial Mortgages-Non-Owner Occupied	552	450
Commercial Construction	-	-
Consumer		
Consumer Unsecured	-	-
Consumer Secured	240	47
Residential:		
Residential Mortgages	210	280
Residential Consumer Construction	-	-
Totals	$2,063	$1,301

Note 5 - Loans and allowance for loan losses (continued)

	Impaired Loans *(dollars in thousands)* As of and For the Year Ended December 31, 2020				
2020	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With No Related Allowance Recorded:					
Commercial	$ 341	$ 341	$ -	$ 405	$ 30
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	2,143	2,496	-	2,305	135
Commercial Mortgage Non-Owner Occupied	639	677	-	601	43
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	343	346	-	225	16
Residential					
Residential Mortgages	1,347	1,415	-	1,319	62
Residential Consumer Construction	-	-	-	-	-
With an Allowance Recorded:					
Commercial	$ 4	$ 4	$ 4	$ 6	$ -
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	-	-	-	6	-
Commercial Mortgage Non-Owner Occupied	-	-	-	7	-
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	-	-	-	-	-
Residential					
Residential Mortgages	-	-	-	70	-
Residential Consumer Construction	-	-	-	-	-
Totals:					
Commercial	$ 345	$ 345	$ 4	$ 411	$ 30
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	2,143	2,496	-	2,311	135
Commercial Mortgage Non-Owner Occupied	639	677	-	608	43
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	343	346	-	225	16
Residential					
Residential Mortgages	1,347	1,415	-	1,389	62
Residential Consumer Construction	-	-	-	-	-
	$ 4,817	$ 5,279	$ 4	$ 4,944	$ 286

Note 5 - Loans and allowance for loan losses (continued)

	Impaired Loans *(dollars in thousands)* As of and For the Year Ended December 31, 2019				
2019	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With No Related Allowance Recorded:					
Commercial	$ 468	$ 1,036	$ -	$ 949	$ 26
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	2,467	2,643	-	2,441	183
Commercial Mortgage Non-Owner Occupied	563	585	-	347	32
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	107	107	-	98	7
Residential					
Residential Mortgages	1,290	1,290	-	1,583	68
Residential Consumer Construction	-	-	-	-	-
With an Allowance Recorded:					
Commercial	$ 7	$ 7	$ 7	$ 19	$ 1
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	12	12	12	26	1
Commercial Mortgage Non-Owner Occupied	14	14	3	52	1
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	1	-
Consumer Secured	-	-	-	53	-
Residential					
Residential Mortgages	139	158	33	257	4
Residential Consumer Construction	-	-	-	-	-
Totals:					
Commercial	$ 475	$ 1,043	$ 7	$ 968	$ 27
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	2,479	2,655	12	2,467	184
Commercial Mortgage Non-Owner Occupied	577	599	3	399	33
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	1	-
Consumer Secured	107	107	-	151	7
Residential					
Residential Mortgages	1,429	1,448	33	1,840	72
Residential Consumer Construction	-	-	-	-	-
	$ 5,067	$ 5,852	$ 55	$ 5,826	$ 323

Note 5 - Loans and allowance for loan losses (continued)

The following tables set forth the allowance for loan losses activity for the years ended December 31, 2020 and 2019:

	Allowance for Loan Losses and Recorded Investment in Loans *(dollars in thousands)* As of and For the Year Ended December 31, 2020				
2020	**Commercial**	**Commercial Real Estate**	**Consumer**	**Residential**	**Total**
Allowance for Credit Losses:					
Beginning Balance	$ 1,330	$ 1,932	$ 865	$ 702	$ 4,829
Charge-Offs	(96)	(224)	(75)	(53)	(448)
Recoveries	20	139	53	15	227
Provision	747	1,703	25	73	2,548
Ending Balance	2,001	3,550	868	737	7,156
Ending Balance: Individually evaluated for impairment	4	-	-	-	4
Ending Balance: Collectively evaluated for impairment	1,997	3,550	868	737	7,152
Totals:	$ 2,001	$ 3,550	$ 868	$ 737	$ 7,156
Financing Receivables:					
Ending Balance: Individually evaluated for impairment	345	2,782	343	1,347	4,817
Ending Balance: Collectively evaluated for impairment	144,800	306,781	92,001	60,691	604,273
Totals:	$ 145,145	$ 309,563	$ 92,344	$ 62,038	$ 609,090

Note 5 - Loans and allowance for loan losses (continued)

Allowance for Loan Losses and Recorded Investment in Loans
(dollars in thousands)
As of and For the Year Ended December 31, 2019

2019	**Commercial**	**Commercial Real Estate**	**Consumer**	**Residential**	**Total**
Allowance for Credit Losses:					
Beginning Balance	$ 1,136	$ 1,831	$ 956	$ 658	$ 4,581
Charge-Offs	(106)	(26)	(189)	(42)	(363)
Recoveries	35	5	44	4	88
Provision	265	122	54	82	523
Ending Balance	1,330	1,932	865	702	4,829
Ending Balance: Individually evaluated for impairment	7	15	-	33	55
Ending Balance: Collectively evaluated for impairment	1,323	1,917	865	669	4,774
Totals:	$ 1,330	$ 1,932	$ 865	$ 702	$ 4,829
Financing Receivables:					
Ending Balance: Individually evaluated for impairment	475	3,056	107	1,429	5,067
Ending Balance: Collectively evaluated for impairment	113,782	300,844	89,838	68,572	573,036
Totals:	$ 114,257	$ 303,900	$ 89,945	$ 70,001	$ 578,103

(dollars in thousands, except per share data)

Note 5 - Loans and allowance for loan losses (continued)

Age Analysis of Past Due Loans as of December 31, 2020

2020	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days & Accruing
Commercial	$ 157	$ -	$ -	$ 157	$ 144,988	$ 145,145	$ -
Commercial Real Estate:							
Commercial Mortgages-Owner Occupied	38	-	842	880	107,342	108,222	-
Commercial Mortgages-Non-Owner Occupied	252	116	394	762	170,307	171,069	-
Commercial Construction	-	-	-	-	30,272	30,272	-
Consumer:							
Consumer Unsecured	7	-	-	7	3,764	3,771	-
Consumer Secured	309	27	229	565	88,008	88,573	-
Residential:							
Residential Mortgages	575	243	210	1,028	45,868	46,896	-
Residential Consumer Construction	-	-	-	-	15,142	15,142	-
Total	$ 1,338	$ 386	$ 1,675	$ 3,399	$ 605,691	$ 609,090	$ -

Age Analysis of Past Due Loans as of December 31, 2019

2019	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days & Accruing
Commercial	$ 146	$ 1,084	$ 116	$ 1,346	$ 112,911	$ 114,257	$ -
Commercial Real Estate:							
Commercial Mortgages-Owner Occupied	234	192	143	569	104,223	104,792	-
Commercial Mortgages-Non-Owner Occupied	58	9	450	517	181,730	182,247	-
Commercial Construction	-	-	-	-	16,861	16,861	-
Consumer:							
Consumer Unsecured	52	3	-	55	6,812	6,867	-
Consumer Secured	316	130	21	467	82,611	83,078	-
Residential:							
Residential Mortgages	595	576	280	1,451	53,833	55,284	-
Residential Consumer Construction	492	-	-	492	14,225	14,717	-
Total	$ 1,893	$ 1,994	$ 1,010	$ 4,897	$ 573,206	$ 578,103	$ -

(dollars in thousands, except per share data)

Note 5 - Loans and allowance for loan losses (continued)

Credit Quality Information - by Class
December 31, 2020

2020	Pass	Monitor	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 133,075	$ 4,332	$ 7,386	$ 352	$ -	$ 145,145
Commercial Real Estate:						
Commercial Mortgages-Owner Occupied	98,623	3,028	4,428	2,143	-	108,222
Commercial Mortgages-Non-Owner Occupied	161,300	7,277	1,682	810	-	171,069
Commercial Construction	30,272	-	-	-	-	30,272
Consumer						
Consumer Unsecured	3,740	-	30	1	-	3,771
Consumer Secured	88,044	-	-	529	-	88,573
Residential:						
Residential Mortgages	45,441	-	-	1,455	-	46,896
Residential Consumer Construction	15,142	-	-	-	-	15,142
Totals	$ 575,637	$ 14,637	$ 13,526	$ 5,290	$ -	$ 609,090

Credit Quality Information - by Class
December 31, 2019

2019	Pass	Monitor	Special Mention	Substandard	Doubtful	Totals
Commercial	$ 108,907	$ 313	$ 4,518	$ 519	$ -	$ 114,257
Commercial Real Estate:						
Commercial Mortgages-Owner Occupied	93,553	446	8,316	2,477	-	104,792
Commercial Mortgages-Non-Owner Occupied	175,471	5,118	994	664	-	182,247
Commercial Construction	16,572	289	-	-	-	16,861
Consumer						
Consumer Unsecured	6,867	-	-	-	-	6,867
Consumer Secured	82,860	-	-	218	-	83,078
Residential:						
Residential Mortgages	53,714	-	-	1,570	-	55,284
Residential Consumer Construction	14,416	301	-	-	-	14,717
Totals	$ 552,360	$ 6,467	$ 13,828	$ 5,448	$ -	$ 578,103

Note 5 - Loans and allowance for loan losses (continued)

Troubled Debt Restructurings (TDRs)

There were no loan modifications that would have been classified as Troubled Debt Restructurings (TDR) during the twelve months ended December 31, 2020 or 2019.

Loans that were previously classified as TDRs in prior periods and currently outstanding are factored into the determination of the allowance for loan losses and are included in the Bank's impaired loan analysis and individually evaluated for impairment.

At December 31, 2020 and December 31, 2019, the Bank had no outstanding commitments to disburse additional funds on loans classified as TDRs.

There were no loan modifications classified as TDRs within the last twelve months that defaulted (90 days past due) during the twelve months ended December 31, 2020 and 2019.

We have developed relief programs to assist borrowers in financial need due to the effects of the COVID-19 pandemic. Accordingly, we offered short-term modifications made in response to COVID-19 to certain borrowers who were current and otherwise not past due. These include short-term, 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, deferral of principal only (interest only payments), or other delays in payment that are insignificant.

During the year ended December 31, 2020, the Bank modified a total of 191 loans with principal balances totaling approximately $95 million. As of December 31, 2020, 4 of the 191 previously modified loans remain in deferment. The principal balance of these 4 loans is approximately $7.06 million, which represents 1.16% of the total loan portfolio. Of the total deferrals, 3 loans, or approximately $6.8 million, are for deferrals of principal only and 1 loan, or approximately $270,000, is for principal and interest deferment.

If a customer requests a second modification, an extensive evaluation of the circumstances surrounding the need for the request is conducted. Procedurally, a commercial borrower will be required to present financial forecasts, proof of business sustainability, and verification of sources of repayment to the primary loan officer, the Chief Lending Officer, and the Chief Credit Officer before a second deferral is granted. Retail borrowers are also required to submit in writing the reason for the need for a second deferral request before an additional deferral is granted. Relationships whose situations do not warrant a second deferral will most likely be downgraded and subsequently evaluated for specific impairment within the allowance for loan loss. We are not currently evaluating any relationships, for additional deferrals.

In accordance with provisions of Section 4013 of the CARES Act (March 2020) and the Joint Interagency Regulatory Guidance (March 2020, revised April 2020), the above modifications were not considered to be TDRs. The CARES Act addressed COVID-19 related modifications and specified that COVID-19 related modifications on loans that were current as of December 31, 2020 are not TDRs. The Interagency Guidance encouraged financial institutions to work prudently with borrowers that may be unable to meet their contractual obligations because of the effects of COVID-19 and explained that in consultation with the Financial Accounting Standards Board (FASB) staff, the federal banking agencies concluded that short-term modifications (e.g. six months or less) made on a good faith basis to borrowers who were current as of the implementation date of a relief program and not TDRs. In December 2020, the Consolidated Appropriations Act extended the period established by Section 4013 pf the CARES Act for providing temporary relief from TDR classification to the

(dollars in thousands, except per share data)

Note 5 - Loans and allowance for loan losses (continued)

earlier of January 1, 2022 or 60 days after the date when the national emergency concerning COVID-19 terminates.

Note 6 - Other real estate owned

At December 31, 2020 and 2019, OREO was $1,105 and $2,339 respectively. OREO is primarily comprised of residential properties and non-residential properties associated with commercial relationships. As of December 31, 2020 and 2019 respectively, there were no consumer mortgage loans secured by residential real estate that were in the process of foreclosure. The following table represents the changes in OREO balance in 2020 and 2019.

OREO Changes

	Year Ended December 31,	
	2020	**2019**
Balance at the beginning of the year	$ 2,339	$ 2,430
Transfers from Loans	18	785
Capitalized costs	-	-
Valuation adjustments	(437)	(287)
Sales	(844)	(570)
Gain (loss) on sales	29	(19)
Balance at the end of the year	$ 1,105	$ 2,339

There were no residential properties being carried in OREO as of December 31, 2020. There were four residential properties being carried in OREO at a value of $325 as of December 31, 2019.

(dollars in thousands, except per share data)

Note 7 – Premises and equipment

Premises and equipment at December 31, 2020 and 2019 are summarized as follows:

	December 31,	
	2020	2019
Land	$ 3,302	$ 3,302
Building and improvements	9,956	9,983
Property for future expansion	2,102	1,077
Furniture and equipment	7,652	9,298
Leasehold improvements	3,003	3,462
Software	1,964	2,849
	27,979	29,971
Less accumulated depreciation	10,997	13,273
Net premises and equipment	$ 16,982	$ 16,698

Total depreciation and amortization expense related to premises and equipment for the years ended December 31, 2020 and 2019 was $1,467 and $1,126, respectively.

Note 8 - Deposits

A summary of deposit accounts is as follows:

	December 31,	
	2020	2019
Demand		
Noninterest bearing	$ 143,345	$ 93,936
Interest bearing	362,780	274,602
Savings	100,726	88,219
Time, $250,000 or more (1)	25,499	40,751
Other time	132,617	151,951
	$ 764,967	$ 649,459

(1) Includes brokered certificates of deposit of $10,020 as of December 31, 2019. There were no brokered certificates of deposit outstanding at December 31, 2020.

(dollars in thousands, except per share data)

Note 8 – Deposits (continued)

At December 31, 2020, maturities of time deposits are scheduled as follows:

Year Ending December 31,	Amount
2021	$ 100,220
2022	40,998
2023	6,564
2024	2,028
2025 and thereafter	8,306
	$ 158,116

The Bank held deposits from the Company's officers, directors and their related interests of $11,534 and $16,694 at December 31, 2020 and 2019, respectively.

Note 9 – Business Segments

The Company has two reportable business segments: (i) a traditional full-service community banking segment and, (ii) a mortgage loan origination business. The community banking business segment includes Bank of the James which provides loans, deposits, investments and insurance to retail and commercial customers throughout the Bank's market areas. The mortgage segment provides a variety of mortgage loan products principally within the Bank's market areas. Mortgage loans are originated and sold in the secondary market through purchase commitments from investors. Because of the pre-arranged purchase commitments, there is minimal risk to the Company.

Both of the Company's reportable segments are service based. The mortgage business is a fee-based business while the Bank's primary source of revenue is net interest income. The Bank also provides a referral network for the mortgage origination business. The mortgage business may also be in a position to refer its customers to the Bank for banking services when appropriate.

(dollars in thousands, except per share data)

Note 9 – Business Segments (continued)

Information about reportable business segments and reconciliation of such information to the consolidated financial statements for years ended December 31, 2020 and 2019 was as follows:

Business Segments

	Community Banking	Mortgage	Total
For the year ended December 31, 2020			
Net interest income	$ 25,146	$ -	$ 25,146
Provision for loan losses	2,548	-	2,548
Net interest income after provision for loan losses	22,598	-	22,598
Noninterest income	3,163	7,812	10,975
Noninterest expenses	22,275	5,119	27,394
Income before income taxes	3,486	2,693	6,179
Income tax expense	633	566	1,199
Net income	$ 2,853	$ 2,127	$ 4,980
Total assets	$ 843,323	$ 8,063	$ 851,386
For the year ended December 31, 2019			
Net interest income	$ 24,552	$ -	$ 24,552
Provision for loan losses	523	-	523
Net interest income after provision for loan losses	24,029	-	24,029
Noninterest income	2,934	4,254	7,188
Noninterest expenses	21,154	3,129	24,283
Income before income taxes	5,809	1,125	6,934
Income tax expense	1,093	236	1,329
Net income	$ 4,716	$ 889	$ 5,605
Total assets	$ 720,965	$ 4,429	$ 725,394

Note 10 – Capital notes

On April 13, 2020, the Company commenced a private placement of unregistered debt securities (the "2020 Offering"). In the 2020 Offering, the Company sold and closed $10,050,000 in principal of notes (the "2020 Notes") during the 2nd and 3rd quarters of 2020. The 2020 Offering officially ended on July 8, 2020. The 2020 Notes bear interest at the rate of 3.25% per year with interest payable quarterly in arrears. The 2020 Notes will mature on September 30, 2025 and are subject to full or partial repayment on or after September 30, 2021. The balance of the 2020 Notes as of December 31, 2020 is presented net of unamortized issuance costs on the Consolidated Balance Sheet.

On September 24, 2020 the Bank used $5,000,000 of the proceeds for the payment of principal of the Company's previously outstanding 4.00% notes that were issued in 2017. The Company intends to use the balance of the proceeds from the 2020 Offering for general corporate purposes in the discretion of Company's management such as payment of interest on the 2020 Notes and as a contribution of additional capital to the Bank.

(dollars in thousands, except per share data)

Note 11 – Other borrowings

Short-term borrowings may consist of securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the date sold. Short-term borrowings may also include Federal funds purchased, which are unsecured overnight borrowings from other financial institutions. There was no utilization of short-term borrowings in 2020 or 2019 other than one day nominal balances to test the lines. Average balances were less than $1 for both years.

Unsecured federal fund lines and their respective limits are maintained with the following institutions: Community Bankers' Bank, $13,000, Zions Bank, $4,000, PNC Bank, $6,000 and First National Bankers' Bank, $10,000. In addition, the Bank maintains a $5,000 reverse repurchase agreement with Suntrust (Truist) whereby securities may be pledged as collateral in exchange for funds for a minimum of 30 days with a maximum of 90 days. The Bank also maintains a secured federal funds line with Community Bankers' Bank whereby it may pledge securities as collateral with no specified minimum or maximum amount or term. The current amount available on the secured line based on the securities currently pledged is $8,055.

The Bank is also a member of the Federal Home Loan Bank of Atlanta ("FHLBA"). The Bank's available credit through the FHLBA was $212,366 as of December 31, 2020, the most recent calculation. The Bank must pledge collateral in order to access the FHLBA available credit. Currently the Bank has pledged to the FHLBA approximately $38,515 in 1-4 family residential mortgages which, after adjustments for the loan-to-value requirements by the FHLBA, would allow the Bank to access up to $28,796 in credit without pledging any additional collateral.

As of December 31, 2020, and 2019 there are no outstanding balances on any of the credit facilities mentioned above.

Note 12 - Income taxes

The Company files income tax returns in the U.S. federal jurisdiction and the state of Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2017.

Income tax expense attributable to income before income tax expense is summarized as follows:

	December 31,	
	2020	2019
Current federal income tax expense	$ 2,037	$ 1,346
Deferred federal income tax expense (benefit)	(838)	(17)
Income tax expense	$ 1,199	$ 1,329

(dollars in thousands, except per share data)

Note 12 - Income taxes (continued)

Income tax expense differed from amounts computed by applying the U.S. Federal income tax rate of 21% to income before income tax expense as a result of the following:

	2020	2019
Computed "expected" income tax expense	$ 1,298	$ 1,456
Increase (reduction) in income tax resulting from:		
Non-taxable income	(94)	(143)
Non-deductible expenses	12	13
Other	(17)	3
Income tax expense	$ 1,199	$ 1,329

The tax effects of temporary differences result in deferred tax assets and liabilities as presented below:

	December 31,	
	2020	2019
Deferred tax assets		
Lease liabilities	$ 1,151	$ 1,249
Allowance for loan losses	1,503	1,015
Unrealized losses on available-for-sale securities	-	1
OREO	239	194
Non-accrual interest	130	251
Deferred Compensation	564	84
Other	27	22
Gross deferred tax assets	3,614	2,816
Deferred tax liabilities		
Right-of-use assets	1,105	1,223
Depreciation	410	312
Unrealized gains on available-for-sale securities	476	-
Other	85	104
Gross deferred tax liabilities	2,076	1,639
Net deferred tax asset	$ 1,538	$ 1,177

(dollars in thousands, except per share data)

Note 13 – Earnings per common share (EPS)

Basic EPS excludes dilution and is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, or resulted in the issuance of common stock that then shared in the earnings of the entity.

The basic and diluted earnings per share calculations are as follows:

	Years ended December 31,	
	2020	**2019**
Numerator:		
Net income available to stockholders	$ 4,980	$ 5,605
Basic EPS weighted average shares outstanding	4,341,575	4,375,814
Effect of dilutive securities:		
Incremental shares attributable to stock options	-	5,783
Diluted EPS weighted-average shares outstanding	4,341,575	4,381,597
Basic earnings per common share	$ 1.15	$ 1.28
Diluted earnings per common share	$ 1.15	$ 1.28

In 2020, all restricted stock units (RSUs) were excluded from calculating diluted earnings per share as the Company elected to settle units vesting in January 2020 wholly in cash. Going forward, management has adopted a cash settlement policy for all currently outstanding RSUs. Prior to 2020, the presumption was that the shares would be settled in common stock and the RSUs were included in the calculation of diluted EPS. There were no potentially dilutive shares excluded from the 2019 earnings per share calculation because they were anti-dilutive.

Note 14 – Employee Benefit plans

Defined contribution benefit plan. The Company adopted a 401(k) defined contribution plan on October 1, 2000, which is administered by the Virginia Bankers' Association. Participants have the right to contribute up to a maximum of 19% of pretax annual compensation or the maximum allowed under Section 401(g) of the Internal Revenue Code, whichever is less. The Company contributed $373 and $347 to the plan on behalf of the employees for the years ended December 31, 2020 and 2019, respectively.

Supplemental Executive Retirement Plan. A Supplemental Executive Retirement Plan (SERP) was established to provide participating executives (as determined by the Company's Board of Directors) with benefits that cannot be provided under the 401(k) as a result of limitations imposed by the Internal Revenue Code. The SERP will also provide benefits to eligible employees or their survivors, as applicable, if they die, retire, or are terminated under certain circumstances. SERP expense totaled $471 and $399 for the years ended December 31, 2020 and 2019, respectively.

Note 14 – Employee Benefit plans (continued)

The Company funds the plan through a modified endowment contract. Income recorded for the plan represents life insurance income as recorded based on the projected increases in cash surrender values of life insurance policies. As of December 31, 2020 and 2019, the life insurance policies had cash surrender values of approximately $16,355 and $13,686, respectively.

Employee Stock Purchase Plan. The Company adopted an Employee Stock Purchase Plan ("ESPP") in 2018 in which all employees are eligible to participate. The plan allows employees to use a portion of their salaries and wages to purchase shares of the Company common stock at the market value of shares on a monthly basis. The Company makes no contributions to the ESPP. The Company may issue common shares to plan participants or purchase common shares on the open market. Common shares are purchased on the open market at a price that based on the weighted average price of all shares purchased by the broker-dealer on the open market from each aggregate order placed by the Plan Administrator.

In 2020 and 2019, all shares purchased pursuant to the ESPP were purchased on the open market and consequently the Company issued no common shares in connection with the ESPP during the year ended December 31, 2020 and 2019.

Note 15 – Stock-based compensation plans

On March 20, 2018, the Board of Directors adopted the "2018 Bank of the James Financial Group, Inc. Equity Incentive Plan," which was approved by the shareholders on May 15, 2018. This plan allows the Company to grant stock options, restricted stock, and restricted stock units to certain officers and employees. The 2018 Incentive Plan permits the issuance of up to 250,000 shares of common stock for awards to key employees of the Company and its subsidiaries in the form of stock options, restricted stock, restricted stock units, stock awards and performance units.

On January 2, 2019, the Company granted its first block of equity compensation under the 2018 Incentive Plan consisting of 24,500 restricted stock units. The recipients of restricted stock units do not receive shares of the Company's stock immediately, but instead receive shares, or cash compensation, or some combination of the two, upon satisfying the requisite service period specified by the terms and conditions of the grant. Additionally, the recipients of restricted stock units do not enjoy the same rights as other holders of the Company's common stock until the units have vested and as such, they do not have voting rights or rights to nonforfeitable dividends. The related compensation expense is based on the fair value of the Company's stock. Shares vest over 3 years in thirds with the first one-third vesting one year from the grant date. The total expense recognized for the years ended December 31, 2020 and 2019, in connection with the restricted stock unit awards was approximately $106 in each year. There were no forfeitures during the years ended December 31, 2020 and 2019. There were no new grants in the year ended December 31, 2020. The fair value of shares which vested in 2020 was $128.

At December 31, 2020, the unrecognized stock-based compensation expense related to unvested restricted stock awards amounted to approximately $106. The unrecognized expense will be recognized ratably over the remaining vesting period of one year. The Company accounts for forfeitures as they occur.

Note 16 – Dividend Reinvestment Plan

The Company has in effect a Dividend Reinvestment Plan (DRIP) which provides an automatic conversion of dividends into common stock for enrolled shareholders. The Company may issue common shares to the DRIP or purchase common shares on the open market. Common shares are purchased on the open market at a price that based on the weighted average price of all shares purchased by the broker-dealer on the open market from each aggregate order placed by the Plan Administrator. In 2019 and 2020, all shares purchased through the DRIP were purchased on the open market and consequently the Company issued no common shares to the DRIP during the years ended December 31, 2019 and 2020.

Note 17 – Stockholders' equity

The Bank is subject to certain legal and regulatory restrictions on the amount of cash dividends it may declare. Financial is a legal entity, separate and distinct from the Bank. Financial currently does not have any significant sources of revenue other than cash dividends paid to it by its subsidiaries. Both Financial and the Bank are subject to laws and regulations that limit the payment of cash dividends, including requirements to maintain capital at or above regulatory minimums.

Note 18 - Regulatory matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2020 that the Bank meets all capital adequacy requirements to which it is subject. The Bank's actual regulatory capital amounts and ratios for December 31, 2020 and 2019 are also presented in the table below.

In addition to the minimum regulatory capital required for capital adequacy purposes the Bank is required to maintain a minimum Capital Conservation Buffer above those minimums in the form of common equity, in order to avoid restrictions on capital distributions and discretionary bonuses. The Capital Conservation Buffer was 2.5% at December 31, 2020 and 2019, and is applicable for the Common Equity Tier 1, Tier 1, and Total Capital Ratios.

As of December 31, 2020, the most recent notification from the Federal Reserve Bank of Richmond categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

To be categorized as well capitalized under the prompt corrective action regulations, the Bank must maintain minimum total risk-based, CET1 Tier I risk-based and Tier I leverage ratios as set forth in the following table.

(dollars in thousands, except per share data)

Note 18 - Regulatory matters (continued)

The capital ratios for the Bank for 2020 and 2019 are set forth in the following table:

	December 31, 2020					
	Actual		Minimum Capital Requirement		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio (1)	Amount	Ratio
Total capital (to risk-weighted assets)	$77,844	12.25%	$66,722	>10.500%	$63,545	> 10.00%
Tier I capital (to risk-weighted assets)	$70,688	11.12%	$54,013	>8.50%	$50,836	> 8.00%
Common Equity Tier 1 capital (to risk-weighted assets)	$70,688	11.12%	$44,481	>7.00%	$41,304	>6.50%
Tier I capital (leverage) (to average assets)	$70,688	8.28%	$34,142	> 4.00%	$42,678	> 5.00%

(1) Includes capital conservation buffer of 2.50% where applicable.

	December 31, 2019					
	Actual		Minimum Capital Requirement		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio (1)	Amount	Ratio
Total capital (to risk-weighted assets)	$71,090	11.54%	$64,708	>10.500%	$61,627	> 10.00%
Tier I capital (to risk-weighted assets)	$66,261	10.75%	$52,383	>8.50%	$49,302	> 8.00%
Common Equity Tier 1 capital (to risk-weighted assets)	$66,261	10.75%	$43,139	>7.00%	$40,057	>6.50%
Tier I capital (leverage) (to average assets)	$66,261	9.13%	$29,016	> 4.00%	$36,270	> 5.00%

(1) Includes capital conservation buffer of 2.50% where applicable.

Note 18 - Regulatory matters (continued)

The above tables set forth the capital position and analysis for the Bank only. Because total assets on a consolidated basis are less than $3 billion, Financial is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, Financial does not calculate its financial ratios on a consolidated basis. If calculated, the capital ratios for the Company on a consolidated basis would no longer be comparable to the capital ratios of the Bank because the proceeds of the private placement do not qualify as equity capital on a consolidated basis.

Note 19 - Financial instruments with off-balance-sheet risk

The Bank is not a party to derivative financial instruments with off-balance-sheet risks such as futures, forwards, swaps and options. The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These instruments may involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Credit risk is defined as the possibility of sustaining a loss because the other party to a financial instrument fails to perform in accordance with the terms of the contract. The Bank's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Bank requires collateral or other security to support financial instruments when it is deemed necessary. The Bank evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Types of collateral vary but may include marketable securities, accounts receivable, inventory, and property, plant and equipment.

At December 31, 2020, the Bank had rate lock commitments to originate mortgage loans through its Mortgage Division amounting to approximately $34,952 and loans held for sale of $7,102. The Bank has entered into corresponding commitments with third party investors to sell each of these loans that close. No other obligation exists.

(dollars in thousands, except per share data)

Note 19 - Financial instruments with off-balance-sheet risk (continued)

Financial instruments whose contract amounts represent credit risk are as follows:

	Contract Amounts at December 31,	
	2020	**2019**
Commitments to extend credit	$ 152,834	$ 134,186
Standby letters of credit	$ 3,552	$ 3,469

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

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is generally less than that involved in extending loans to customers because the Bank generally holds deposits equal to the commitment. Management does not anticipate any material losses as a result of these transactions.

Note 20 – Concentration of credit risk

The Bank has a diversified loan portfolio consisting of commercial, real estate and consumer (installment) loans. Substantially all of the Bank’s customers are residents or operate business ventures in its market area consisting primarily of the Lynchburg metropolitan area. Therefore, a substantial portion of its debtors’ ability to honor their contracts and the Bank’s ability to realize the value of any underlying collateral, if needed, is influenced by the economic conditions in this market area.

The Bank maintains a significant portion of its cash balances with one financial institution. Uninsured cash balances as of December 31, 2020 were approximately $5,544 which consisted of the total balances in one account at the Federal Home Loan Bank of Atlanta (FHLBA), as well as the balances (net of $250 FDIC coverage) held in one account at Community Bankers’ Bank, one account at Suntrust (now Truist), one account at Zions Bank, and one account held at First National Bankers’ Bank. Uninsured cash balances as of December 31, 2019 were approximately $6,300 which consisted of the total balances in the same accounts referenced for 2020 above.

Note 21 – Fair value measurements

Determination of Fair Value

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

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

Fair Value Hierarchy

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

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Securities

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow.

Note 21 – Fair value measurements (continued)

Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company's securities are considered to be Level 2 securities.

Derivatives Assets/Liabilities – Interest Rate Lock Commitments (IRLCs)

Beginning in 2020, the Company recognizes IRLCs at fair value based on the price of the underlying loans obtained from an investor for loans that will be delivered on a best efforts basis while taking into consideration the probability that the rate lock commitments will close. All of the Company's IRLCs are classified as Level 3. The fair value of interest rate lock commitments was considered immaterial at December 31, 2019

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

Note 21 – Fair value measurements (continued)

Description	Balance as of December 31, 2020	Fair Value at December 31, 2020: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasuries	$ 2,027	$ -	$ 2,027	$ -
U.S. agency obligations	41,320	-	41,320	-
Mortgage-backed securities	15,696	-	15,696	-
Municipals	24,773	-	24,773	-
Corporates	6,369	-	6,369	-
Total available-for-sale securities	$ 90,185	$ -	$ 90,185	$ -
IRLCs – asset	425	-	-	425
Total assets at fair value	$ 90,610	$ -	$ 90,185	$ 425

Description	Balance as of December 31, 2019	Fair Value at December 31, 2019: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasuries	$ 1,964	$ -	$ 1,964	$ -
U.S. agency obligations	32,108	-	32,108	-
Mortgage-backed securities	10,264	-	10,264	-
Municipals	11,222	-	11,222	-
Corporates	4,097	-	4,097	-
Total available-for-sale securities	$ 59,655	$ -	$ 59,655	$ -

The following table provides additional quantitative information about assets measured at fair value on a recurring basis and for which we have utilized Level 3 inputs to determine fair value:

Quantitative information about Level 3 Fair Value Measurements for December 31, 2020
(dollars in thousands)

	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average) (1)
Assets				
IRLCs - asset	$ 425	Market approach	Range of pull through rate	85%

Note 21 – Fair value measurements (continued)

Loans held for sale

Loans held for sale are measured at lower of cost or fair value. Under ASC 820, market value is to represent fair value. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions. Premiums received or to be received on the quotes or bids are indicative of the fact that cost is lower than fair value. Because quotes and bids on loans held for sale are available in active markets, loans held for sale are considered to be Level 2. No nonrecurring fair value adjustments were recorded during the years ended December 31, 2020 and 2019. Gains and losses on the sale of loans are recorded in noninterest income on the Consolidated Statements of Income.

Impaired loans

ASC 820 applies to loans measured for impairment at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. The carrying values of all impaired loans are considered to be Level 3.

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. We believe that the fair value component in its valuation follows the provisions of ASC 820.

Real estate acquired through foreclosure is transferred to other real estate owned ("OREO"). The measurement of loss associated with OREO at the date of transfer from loans is based on the fair value of the collateral less anticipated selling costs compared to the unpaid loan balance. Subsequent changes in fair value are recorded in noninterest expense on the Consolidated Statements of Income. The value of OREO collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using market data.

(dollars in thousands, except per share data)

Note 21 – Fair value measurements (continued)

Any fair value adjustments are recorded in the period incurred and expensed against current earnings. The carrying values of all OREO are considered to be Level 3.

The following table summarizes the Company's impaired loans and OREO measured at fair value on a nonrecurring basis during the period.

		Fair Value at December 31, 2020		
Description	**Balance as of December 31, 2020**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans*	$ 1,829	$ -	$ -	$ 1,829
Other real estate	$ 1,105	$ -	$ -	$ 1,105

*Includes loans charged down to the net realizable value of the collateral.

		Fair Value at December 31, 2019		
Description	**Balance as of December 31, 2019**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans*	$ 1,239	$ -	$ -	$ 1,239
Other real estate	$ 2,339	$ -	$ -	$ 2,339

*Includes loans charged down to the net realizable value of the collateral.

The following table sets forth information regarding the quantitative inputs used to value assets classified as Level 3:

Note 21 – Fair value measurements (continued)

Quantitative information about Level 3 Fair Value Measurements for
December 31, 2020
(dollars in thousands)

	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Impaired loans	$ 1,829	Discounted appraised value	Selling cost	0% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 20% (6%)
OREO	$ 1,105	Discounted appraised value	Selling cost	10%
			Discount for lack of marketability and age of appraisal	0% - 27% (26%)

Quantitative information about Level 3 Fair Value Measurements for
December 31, 2019
(dollars in thousands)

	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Impaired loans	$ 1,239	Discounted appraised value	Selling cost	0% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 20% (6%)
OREO	$ 2,339	Discounted appraised value	Selling cost	0% - 10% (6%)
			Discount for lack of marketability and age of appraisal	0% - 25% (15%)

Financial Instruments

FASB ASC 825, Financial Instruments, requires disclosure about fair value of financial instruments, including those financial assets and financial liabilities that are not required to be measured and reported at fair value on a recurring or nonrecurring basis. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company. The carrying amounts and estimated fair values of the Company's financial instruments are presented in the following tables whether or not recognized on the Consolidated Balance Sheets at fair value. Fair values for December 31, 2020 and 2019 were estimated using an exit price notion.

(dollars in thousands, except per share data)

Note 21 – Fair value measurements (continued)

		Fair Value Measurements at December 31, 2020 using			
Assets	Carrying Amounts	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
Cash and due from banks	$ 31,683	$ 31,683	$ -	$ -	$ 31,683
Fed funds sold	69,203	69,203	-	-	69,203
Securities					
Available-for-sale	90,185	-	90,185	-	90,185
Held-to-maturity	3,671	-	4,192	-	4,192
Restricted stock	1,551	-	1,551	-	1,551
Loans, net	601,934	-	-	598,745	598,745
Loans held for sale	7,102	-	7,102	-	7,102
Interest receivable	2,350	-	2,350	-	2,350
BOLI	16,355	-	16,355	-	16,355
Derivaties	425	-	-	425	425
Liabilities					
Deposits	$ 764,967	$ -	$ 766,212	$ -	$ 766,212
Capital notes	10,027	-	9,003	-	9,003
Interest payable	85	-	85	-	85

		Fair Value Measurements at December 31, 2019 using			
Assets	Carrying Amounts	(Level 1)	(Level 2)	(Level 3)	Balance
Cash and due from banks	$ 30,794	$ 30,794	$ -	$ -	$ 30,794
Fed funds sold	8,317	8,317	-	-	8,317
Securities					
Available-for-sale	59,655	-	59,655	-	59,655
Held-to-maturity	3,688	-	3,861	-	3,861
Restricted stock	1,506	-	1,506	-	1,506
Loans, net	573,274	-	-	569,850	569,850
Loans held for sale	4,221	-	4,221	-	4,221
Interest receivable	1,866	-	1,866	-	1,866
BOLI	13,686	-	13,686	-	13,686
Liabilities					
Deposits	$ 649,459	$ -	$ 651,479	$ -	$ 651,479
Capital notes	5,000	-	4,795	-	4,795
Interest payable	173	-	173	-	173

Note 22 – Revenue Recognition

Substantially all of the Company's revenue from contracts with customers that is within the scope of ASC 606, "Revenue from Contracts with Customers" is reported within noninterest income. Certain other in-scope such as gains and losses on OREO and gains and losses on premises and equipment are recorded in noninterest expense. The recognition of interest income and certain sources of noninterest income (e.g. gains on securities transactions, bank-owned life insurance income, gains on loans held-for-sale, etc.) are governed by other areas of U.S. GAAP. Significant revenue streams that are within the scope of ASC 606 and included in noninterest income are discussed in the following paragraphs.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or at the end of the month through a direct charge to customers' accounts.

Fees, Exchange, and Other Service Charges

Fees, exchange, and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, treasury services income and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Treasury services income primarily represents fees charged to customers for sweep, positive pay and lockbox services. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or at the end of the month.

Other

Other noninterest income consists of other recurring revenue streams such as commissions from sales of mutual funds and other investments, safety deposit box rental fees, and other miscellaneous revenue streams. Commissions from the sale of mutual funds and other investments are recognized on trade date, which is when the Company has satisfied its performance obligation. The Company also receives periodic service fees (i.e., trailers) from mutual fund companies typically based on a percentage of net asset value. Trailer revenue is recorded over time, usually monthly or quarterly, as net asset value is determined. Safe deposit box rental fees are charged to the

Note 22 – Revenue Recognition (continued)

customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation.

Note 23 – Leases

On January 1, 2019, the Company adopted ASU No. 2016-02 *"Leases (Topic 842)"* and all subsequent ASUs that modified Topic 842. The Company elected the prospective application approach provided by ASU 2018-11 and did not adjust prior periods for ASC 842. The Company also elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. Implementation of the standard resulted in recognition of right-of-use assets and lease liabilities of $3.0 million at the date of adoption, which were related to the Company's lease of premises used in operations. The right-of-use assets and lease liabilities are included in other assets and other liabilities, respectively, in the Consolidated Balance Sheets.

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The Company currently leases five of its operating locations under long-term leases (greater than 12 months). Leases for three of these locations are classified as operating leases and two are classified as financing leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably certain of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The Bank leases its principal Lynchburg, Virginia, location from Jamesview Investments, LLC, a legal entity which is wholly-owned by William C. Bryant III, a member of the Board of Directors of both Financial and the Bank. This lease is classified as a finance lease and the related lease liability totaled $3.4 million at December 31, 2020.

Note 23 – Leases (continued)

The following table represents information about the Company's operating leases:

	December 31,	
(Dollars in thousands)	**2020**	**2019**
Lease liabilities	$ 1,390	$ 1,524
Right-of-use assets	$ 1,360	$ 1,508
Weighted average remaining lease term	14.7 years	14.9 years
Weighted average discount rate	3.44%	3.39%

The following table represents information about the Company's finance leases:

	December 31,	
(Dollars in thousands)	**2020**	**2019**
Lease liabilities	$ 4,093	$ 4,422
Right-of-use assets	$ 3,902	$ 4,316
Weighted average remaining lease term	10.2 years	11.2 years
Weighted average discount rate	2.70%	2.70%

	For the Year Ended December 31,	
Lease cost (in thousands)	**2020**	**2019**
Operating lease cost	$ 197	$ 365
Finance lease cost:		
Amortization of right-of-use assets	414	242
Interest on lease liabilities	115	71
Total lease cost	$ 726	$ 678
Cash paid for amounts included in measurement of operating lease liabilities	$ 183	$ 348
Cash paid for amounts included in measurement of finance lease liabilities	$ 444	$ 206

Note 23 – Leases (continued)

A maturity analysis of operating and finance lease liabilities and reconciliation of the undiscounted cash flows to the total of lease liabilities is as follows:

Lease payments due (in thousands)	Operating Lease Liabilities **As of December 31, 2020**	Finance Lease Liabilities **As of December 31, 2020**
Twelve months ending December 31, 2021	$ 111	$ 454
Twelve months ending December 31, 2022	110	454
Twelve months ending December 31, 2023	110	454
Twelve months ending December 31, 2024	110	479
Twelve months ending December 31, 2025	110	515
Thereafter	1,242	2,366
Total undiscounted cash flows	$ 1,793	$ 4,722
Discount	(403)	(629)
Lease liabilities	$ 1,390	$ 4,093

Note 24 - Impact of recently issued accounting standards

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The FASB has issued multiple updates to ASU 2016-13 as codified in Topic 326, including ASU's 2019-04, 2019-05, 2019-10, 2019-11, 2020-02, and 2020-03. These ASU's have provided for various minor technical corrections and improvements to the codification as well as other transition matters. Smaller reporting companies who file with the U.S. Securities and Exchange Commission (SEC) and all other entities who do not file with the SEC are required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The Company has been in discussions with its core processor to coordinate plans for implementation and has contracted with an additional vendor to begin implementation.

Effective November 25, 2019, the SEC adopted Staff Accounting Bulletin (SAB) 119. SAB 119 updated portions of SEC interpretative guidance to align with FASB ASC 326, "Financial Instruments – Credit Losses." It covers topics including (1) measuring current expected credit losses; (2) development, governance, and documentation of a systematic methodology; (3) documenting the results of a systematic methodology; and (4) validating a systematic methodology.

Note 24 - Impact of recently issued accounting standards (continued)

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes." The ASU is expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers' application of certain income tax-related guidance. This ASU is part of the FASB's simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-12 will have on its consolidated financial statements.

On March 12, 2020, the SEC finalized amendments to its "accelerated filer" and "large accelerated filer" definitions. The amendments increase the threshold criteria for meeting these filer classifications and were effective on April 27, 2020. Any changes in filer status are to be applied beginning with the filer's first annual report filed with the SEC subsequent to the effective date. The rule change revises the definition of "accelerated filers" to exclude entities with public float of less than $700 million and less than $100 million in annual revenues. The Company expects to continue to meet this expanded category of small reporting company and will remain a non-accelerated filer.

In October 2020, the FASB issued ASU 2020-08, "Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable fees and Other Costs." This ASU clarifies that an entity should reevaluate whether a callable debt security is within the scope of ASC paragraph 310-20-35-33 for each reporting period. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. Early adoption is not permitted. All entities should apply ASU No. 2020-08 on a prospective basis as of the beginning of the period of adoption for existing or newly purchased callable debt securities. The Company does not expect the adoption of ASU 2020-06 to have a material impact on its consolidated financial statements.

In March 2020 (Revised in April 2020), various regulatory agencies, including the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, ("the agencies") issued an interagency statement on loan modifications and reporting for financial institutions working with customers affected by the Coronavirus. The interagency statement was effective immediately and impacted accounting for loan modifications. Under Accounting Standards Codification 310-40, "Receivables – Troubled Debt Restructurings by Creditors," ("ASC 310-40"), a restructuring of debt constitutes a troubled debt restructuring ("TDR") if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies confirmed with the staff of the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers

Note 24 - Impact of recently issued accounting standards (continued)

considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented. In August 2020, a joint statement on additional loan modifications was issued. Among other things, the Interagency Statement addresses accounting and regulatory reporting considerations for loan modifications, including those accounted for under Section 4013 of the Coronavirus Aid, Relief, and Economic Security ("CARES") Act. The CARES Act was signed into law on March 27, 2020 to help support individuals and businesses through loans, grants, tax changes and other types of relief. The most significant impacts of the Act related to accounting for loan modifications and establishment of the Paycheck Protection Program ("PPP"). On December 21, 2020, the Consolidated Appropriates Act of 2021 ("CAA") was passed. The CAA extends or modifies many of the relief programs first created by the CARES Act, including the PPP and treatment of certain loan modifications related to the COVID-19 pandemic. Note 26 in the financial statements discusses COVID-19 and Current Economic Conditions.

(dollars in thousands, except per share data)

Note 25 - Condensed financial statements of parent company

Financial information pertaining only to Bank of the James Financial Group, Inc. is as follows:

Balance Sheet

	December 31,	
	2020	**2019**
Assets		
Cash	$ 4,400	$ 212
Taxes receivable	74	15
Investment in subsidiaries	72,482	66,256
Other assets	10	8
Total assets	$ 76,966	$ 66,491
Liabilities and stockholders' equity		
Capital notes	$ 10,027	$ 5,000
Other liabilities	207	46
Total Liabilities	$ 10,234	$ 5,046
Common stock $2.14 par value	$ 9,286	$ 9,325
Additional paid-in-capital	30,989	31,225
Retained earnings	24,665	20,900
Accumulated other comprehensive income (loss)	1,792	(5)
Total stockholders' equity	$ 66,732	$ 61,445
Total liabilities and stockholders' equity	$ 76,966	$ 66,491

(dollars in thousands, except per share data)

Note 25 – Condensed financial statements of parent company (continued)

Statements of Income

	Years Ended December 31,	
	2020	**2019**
Income		
Dividends from subsidiary	$ 1,000	$ 1,800
Operating expenses		
Interest on capital notes	273	200
Legal and professional fees	159	166
Other expense	136	147
Total expenses	568	513
Income tax (benefit)	(119)	(108)
Income before equity in undistributed income of subsidiaries	551	1,395
Equity in undistributed income of subsidiaries	4,429	4,210
Net income	$ 4,980	$ 5,605

(dollars in thousands, except per share data)

Note 25 – Condensed financial statements of parent company (continued)

Statements of Cash Flows

	Years Ended December 31, 2020	2019
Cash flows from operating activities		
Net income	$ 4,980	$ 5,605
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of debt issuance costs	2	-
(Increase) decrease in income taxes receivable	(59)	10
(Increase) decrease in other assets	(2)	11
Increase (decrease) in other liabilities	161	(12)
Equity in undistributed net (income) of subsidiaries	(4,429)	(4,210)
Net cash provided by operating activities	$ 651	$ 1,404
Cash flows from financing activities		
Dividends paid to common stockholders	$ (1,215)	$ (1,226)
Retirement of capital notes	(5,000)	-
Proceeds from sale of capital notes, net of issuance costs	10,025	-
Repurchase of common stock	(275)	(315)
Net cash provided by (used in) financing activities	$ 3,537	$ (1,541)
Increase (decrease) in cash and cash equivalents	$ 4,188	$ (137)
Cash and cash equivalents at beginning of period	212	349
Cash and cash equivalents at end of period	$ 4,400	$ 212

Note 26 – COVID-19 and Current Economic Conditions

Beginning in March 2020 and through the end of the year, the COVID-19 pandemic had a significant impact on our communities, customers, and operations. COVID-19 continues to have an impact in 2021, however, the duration and extent of its effects over the longer term are dependent on future developments and cannot be reasonably estimated at this time. Risks arising from the pandemic may impact the future earnings, cash flows, and financial condition of the Company. These risks, which are inherently uncertain, primarily include: the financial impact of the pandemic on our customers, the ability of those customers to fulfill their financial obligations to the Company, potential operational disruptions, the Company's ability to generate demand for its products and services, and adverse changes in the valuation of collateral or other assets which may result in impairment charges. Accordingly, estimates used in the preparation of our financial statements may be subject to significant adjustments in future periods due to the unprecedented and evolving nature of the pandemic. The greater the duration and severity of the pandemic, the more likely that estimates will be materially impacted by its effects.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

There has been no change in the independent accountants engaged to audit the financial statements of the Company and its subsidiaries during the last two fiscal years ended December 31, 2020. There have been no disagreements with such independent accountants during the last two fiscal years ended December 31, 2020, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Item 9A. Controls and Procedures

Financial's management, including Financial's principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") as of December 31, 2020. Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, Financial's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that Financial files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Company's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Company or its subsidiary to disclose material information required to be set forth in the Company's periodic reports.

Management's annual report on internal control over financial reporting is incorporated herein by reference to Financial's audited Consolidated Financial Statements set forth in Item 8 of this Annual Report on Form 10-K.

There have been no significant changes during the quarter ended December 31, 2020, in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) or in other factors that could have significantly affected those controls subsequent to the date of our most recent evaluation of internal controls over financial reporting, including any corrective actions with regard to significant deficiencies and material weaknesses.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Part of the response to this Item will be included in the information set forth under the headings "Nominees and Continuing Directors," "Corporate Governance and the Board of Directors Matters," "Director and Officer Biographical Information," and "Committees of the Board of Directors of Financial" in Financial's definitive Proxy Statement for its 2021 Annual Meeting of Shareholders, which Proxy Statement will be filed with the SEC within 120 days of the end of the Financial's 2020 fiscal year (the "2021 Proxy Statement"), and such information is hereby incorporated by reference

Financial has adopted a code of ethics that applies to Financial's directors, executive officers (including the principal financial officer, principal accounting officer or controller, or persons performing similar functions), and senior officers. The code of ethics has been posted under the "Investor Relations" section on Financial's website: www.bankofthejames.bank.

Item 11. Executive Compensation

The response to this Item will be included in the information set forth under the headings “Compensation of Directors and Executive Officers,” “Corporate Governance and the Board of Directors Matters,” and “Committees of the Board of Directors of Financial” in the 2021 Proxy Statement and such information is hereby incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item will be included in the information set forth under the headings “Securities Authorized for Issuance Under Equity Compensation Plans,” “Corporate Governance and the Board of Directors Matters – Independence of Directors,” and “Security Ownership of Management” in the 2021 Proxy Statement and is hereby incorporated by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The response to this Item will be included in the information set forth under the heading “Transactions with Related Parties” in the 2021 Proxy Statement and is hereby incorporated by reference.

Item 14. Principal Accounting Fees and Services

The response to this Item will be included in the information set forth under the heading “Independent Registered Public Accounting Firm” in the 2021 Proxy Statement and is hereby incorporated by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Financial Statements. Listed and included in Part II, Item 8.

(2) Financial Statement Schedules. Not applicable.

(3) Exhibits. The following exhibits are filed as a part of this Form 10-K and this list includes the Exhibit Index:

No.	Description
2.1	Agreement and Plan of Share Exchange dated October 9, 2003 between Bank of the James Financial Group, Inc. and Bank of the James, dated as of October 9, 2003 (incorporated by reference to Exhibit 2.1 to Form 8-K12g-3 filed on January 13, 2004)
3.1	Amended and Restated Articles of Incorporation of Bank of the James Financial Group, Inc. (incorporated by reference to Exhibit 3(i) to Form 8-K filed on August 12, 2009)
3.2	Bylaws of Bank of the James Financial Group, Inc. (incorporated by reference to Exhibit 3.2 to Form 8-K filed February 19, 2021)
4.1	Specimen Common Stock Certificate of Bank of the James Financial Group, Inc. (incorporated by reference to Exhibit 4.1 to Form 10-KSB filed on March 26, 2004)
10.1	Amended and Restated Deed of Lease effective as of June 1, 2019 by and between Bank of the James and Jamesview Investments LLC (incorporated by reference to Exhibit 10.1 to Form 8-K filed on March 10, 2020

10.2 Form of Securities Purchase Agreement, made as of November 23, 2015, between Bank of the James Financial Group, Inc. and each institutional investor purchasing common shares of Bank of the James Financial Group, Inc. in the private placement that closed on December 3, 2015 (incorporated by reference to Exhibit 10.1 to Form 8-K filed on November 24, 2015)

10.3 Salary Continuation Agreement dated as of August 6, 2009 by and between the Bank and Robert R. Chapman III (incorporated by reference to Exhibit 10.7 to Form 8-K filed on August 12, 2009)

10.4 Salary Continuation Agreement dated as of August 6, 2009 by and between the Bank and J. Todd Scruggs (incorporated by reference to Exhibit 10.8 to Form 8-K filed on August 12, 2009)

10.5 Salary Continuation Agreement dated as of August 6, 2009 by and between the Bank and Harry P. Umberger (incorporated by reference to Exhibit 10.9 to Form 8-K filed on August 12, 2009)

10.6 First Amended Salary Continuation Agreement dated effective as of October 1, 2016 by and between the Bank and Robert R. Chapman III (incorporated by reference to Exhibit 10.1 to Form 8-K filed on October 21, 2016)

10.7 First Amended Salary Continuation Agreement dated effective as of October 1, 2016 by and between the Bank and J. Todd Scruggs (incorporated by reference to Exhibit 10.2 to Form 8-K filed on October 21, 2016)

10.8 First Amended Salary Continuation Agreement dated effective as of October 1, 2016 by and between the Bank and Harry P. Umberger (incorporated by reference to Exhibit 10.3 to Form 8-K filed on October 21, 2016)

10.9 2016 Salary Continuation Agreement dated effective as of October 1, 2016 by and between the Bank and Harry P. Umberger (incorporated by reference to Exhibit 10.4 to Form 8-K filed on October 21, 2016)

10.10 Dividend Reinvestment Plan (Incorporated by reference to Registration Statement on Form S-3, filed on August 21, 2017)

10.11 2018 Bank of the James Financial Group, Inc. Equity Incentive Plan (incorporated by reference to Schedule 14A Proxy Statement Pursuant to Section 14(a) filed on April 9, 2018).

10.12 2018 Bank of the James Financial Group, Inc. Employee Stock Purchase Plan (incorporated by reference to Schedule 14A Proxy Statement Pursuant to Section 14(a) filed on April 9, 2018).

21.1 List of subsidiaries (filed herewith)

23.1 Consent of Yount, Hyde and Barbour, P.C. (filed herewith)

31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a) (filed herewith)

31.2 Certification pursuant to Rule 13a-14(a)/15d-14(a) (filed herewith)

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act Of 2002 (filed herewith)

101 Pursuant to Rule 405 of Regulation S-T, the following materials from Bank of the James Financial Group, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2020, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets as of December 31, 2020 and 2019; (ii) Consolidated Statements of Income For the Years ended December 31, 2020 and 2019; (iii) Consolidated Statements of Cash Flows for the Years ended

December 31, 2020 and 2019 (iv) Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income For the Years ended December 31, 2020 and 2019; (v) Notes to Consolidated Financial Statements.

Item 16. **Form 10–K Summary** - Not required

SIGNATURES

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities as of March 29, 2021.

Signature	Capacity
/S/ Robert R. Chapman III Robert R. Chapman III	President (Principal Executive Officer) and Director
/S/ J. Todd Scruggs J. Todd Scruggs	Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer) and Director
/S/ Thomas W. Pettyjohn, Jr. Thomas W. Pettyjohn, Jr.	Director, Chairman
/S/ Lewis C. Addison Lewis C. Addison	Director
/S/ John R. Alford, Jr. John R. Alford, Jr.	Director
/S/ William C. Bryant III William C. Bryant III	Director
/S/ A. Douglas Dalton III A. Douglas Dalton III	Director
/S/ James F. Daly James F. Daly	Director
/S/ Julie P. Doyle Julie P. Doyle	Director
/S/ Watt R. Foster, Jr. Watt R. Foster, Jr.	Director
/S/ Phillip C. Jamerson Phillip C. Jamerson	Director
/S/ Lydia K. Langley Lydia K. Langley	Director
/S/ Augustus A. Petticolas, Jr. Augustus A. Petticolas, Jr.	Director

Exhibit 21.1

List of Subsidiaries

Subsidiary	Jurisdiction or State of Incorporation	Names Under Which Subsidiary Does Business
Bank of the James	Virginia	Bank of the James Bank of the James Mortgage Bank of the James Mortgage, a Division of Bank of the James BOTJ Investment Services
BOTJ Insurance, Inc.	Virginia	BOTJ Insurance, Inc.
BOTJ Investment Group, Inc.	Virginia	Inactive

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in Registration Statement (No. 333-220084) on Form S-3 and Registration Statement (No. 333-226222) on Form S-8 of Bank of the James Financial Group, Inc. of our report dated March 29, 2021, relating to our audit of the consolidated financial statements included in the Annual Report on Form 10-K of Bank of the James Financial Group, Inc. for the year ended December 31, 2020.

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

Winchester, Virginia
March 29, 2021

Exhibit 31.1

Certification—Principal Executive Officer

I, Robert R. Chapman III, President of Bank of the James Financial Group, Inc. certify that:

(1) I have reviewed this Form 10-K of Bank of the James Financial Group, Inc.;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 29, 2021

By /S/ Robert R. Chapman III
Robert R. Chapman III
President (Principal Executive Officer) and Director

Exhibit 31.2

Certification—Principal Financial Officer and Principal Accounting Officer

I, J. Todd Scruggs, Secretary and Treasurer of Bank of the James Financial Group, Inc., certify that:

(1) I have reviewed this Form 10-K of Bank of the James Financial Group, Inc.;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting.

(5) The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: March 29, 2021

By /S/ J. Todd Scruggs
J. Todd Scruggs
Secretary and Treasurer (Principal Financial Officer
and Principal Accounting Officer) and Director

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Robert R. Chapman III, Chief Executive Officer of Bank of the James Financial Group, Inc., a Virginia corporation (the “Company”) and J. Todd Scruggs, Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer), each certify in his capacity as an officer of the Company that he has reviewed the annual report on Form 10-K for the year ended December 31, 2020 (the “Report”) and to the best of his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of the Company as of the dates and for the periods covered by the Report.

BANK OF THE JAMES FINANCIAL GROUP, INC.

Date: March 29, 2021

By /S/ Robert R. Chapman III
Robert R. Chapman III
President and Director (Principal Executive Officer)

Date: March 29, 2021

By /S/ J. Todd Scruggs
J. Todd Scruggs
Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer)

Where Community and Banking Come Together

LEADERSHIP

EXECUTIVE MANAGEMENT TEAM

Robert R. Chapman III
President and Chief Executive Officer

Brian E. Cash
President
Bank of the James Mortgage

Brandon P. Farmer
Executive Vice President and
Chief Operations Officer

Angelia R. Johnson
Executive Vice President
Human Resources and
Retail Administration

J. Todd Scruggs
Executive Vice President and
Chief Financial Officer

Michael A. Syrek
Executive Vice President and
Chief Loan Officer

Harry P. "Chip" Umberger
Executive Vice President and Chief
Credit Officer

REGIONAL MARKET PRESIDENTS

Trevania F. Cottrill
Market President, Lexington

Jared R. Feury
Market President, Charlottesville

Bradford K. Harris
Market President, Roanoke

Thomas D. Rea
Market President,
Harrisonburg/Shenandoah Valley

BOTJ INVESTMENT SERVICES

Kenneth L. Harvey
Senior Vice President

BOARD OF DIRECTORS

The continued support and guidance of our Board of Directors has been critical to the success of Bank of the James. Their collective expertise and experience serves as an exceptional resource, offering insight and a connection to the markets we serve.

Lewis C. Addison
Retired Chief Financial Officer
Centra Health, Inc.

John R. Alford, Jr.
Vice President and Partner
Caskie & Frost, P.C.

William C. Bryant III
President
The Counts Realty and
Auction Group

Robert R. Chapman III
President and Chief Executive Officer
Bank of the James
President
Bank of the James Financial Group, Inc.

A. Douglas Dalton III
Operations Manager
English Construction Co., Inc.

James F. Daly
President
Daly Seven, Inc.

Julie P. Doyle
President and Executive Director
The Education & Research
Foundation, Inc.

Watt R. Foster, Jr.
President and Chief Executive Officer
Foster Fuels, Inc.

Phillip C. Jamerson
Retired Co-Owner and Founder
Jamerson-Lewis Construction

Lydia K. Langley
Retired Owner
Langley Rentals

Augustus A. Petticolas, Jr., D.D.S.
Dentist
Vice Chairman, Board of Directors
Bank of the James

Thomas W. Pettyjohn, Jr.
Retired Investment Advisor
Chairman, Board of Directors
Bank of the James

J. Todd Scruggs
Executive Vice President and
Chief Financial Officer
Bank of the James
Secretary-Treasurer
Bank of the James Financial Group, Inc.

Where Community and Banking Come Together

SHAREHOLDER and CORPORATE INFORMATION

CORPORATE HEADQUARTERS

Bank of the James Financial Group, Inc.
828 Main Street
Lynchburg, Virginia 24504

Telephone: (434) 846-2000
Toll Free: 1 (877) 266-0765

INDEPENDENT PUBLIC ACCOUNTANTS

Yount, Hyde & Barbour, P.C.
www.yhbcpa.com

LEGAL COUNSEL

Woods Rogers, PLC
www.woodsrogers.com

STOCK EXCHANGE LISTING

Bank of the James Financial Group, Inc. common stock is listed on the NASDAQ Capital Market under the symbol BOTJ. There were approximately 1,500 active shareholders of record of Bank of the James Financial Group, Inc. on December 31, 2020.

ANNUAL MEETING

Please refer to the proxy materials for information on how to attend. Financial will also provide information on how to attend the meeting on the Bank's website, www.bankofthejames.bank, under Investor Relations.

INVESTOR INQUIRIES

Financial analysts and portfolio managers may contact:
J. Todd Scruggs
Executive Vice President and
Chief Financial Officer

Telephone: (434) 846-2000 or
1 (877) 266-0765

tscruggs@bankofthejames.com

NEWS AND MEDIA REPRESENTATIVES SHOULD CONTACT:

James T. Davis III
Vice President and
Marketing Director

Telephone: (434) 846-2000 or
1 (877) 266-0765

jdavis@bankofthejames.com

Requests for printed materials including annual reports, proxy statements, 10-K and 10-Q reports: visit our investor relations feature under www.bankofthejames.bank or visit www.sec.gov.

STOCK TRANSFER AGENT

Broadridge Corporate Issuer
Solutions, Inc.
Post Office Box 1342
Brentwood, New York 11717

Telephone: 1 (877) 830-4936
Email: shareholder@broadridge.com

www.shareholder.broadridge.com

INTERNET ADDRESS

Additional information regarding Bank of the James Financial Group, Inc. and Bank of the James is available on the internet at www.bankofthejames.bank.

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