

**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, 2022 or
- ☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

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)

828 Main Street, Lynchburg, VA

(Address of Principal Executive Offices)

20-0500300

(I.R.S. Employer
Identification No.)

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 Section 13 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 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 ☐

Non-accelerated filer ☒

Accelerated filer ☐

Smaller reporting company ☒

Emerging growth company ☐

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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. ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to § 240.10D-1(b). ☐

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, 2022, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$ 53,478,191 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 31, 2023 was approximately 4,575,038.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2023 Proxy Statement to be used in conjunction with the Annual Meeting of Shareholders, scheduled to be held on May 16, 2023, 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 three principal activities: (1) general retail and commercial banking through Bank of the James; (2) mortgage brokerage services through Bank of the James Mortgage, a division of the Bank (the “Mortgage Division”); and (3) investment advisory (sometimes referred to as wealth management) services through its wholly-owned subsidiary, Pettyjohn, Wood & White, Inc. (“PWW”). Because Financial acquired PWW on December 31, 2021, PWW had no effect on Financial’s net income for the period ended December 31, 2021.

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

Products and Services

Retail and Commercial Banking

The Bank currently conducts business within Virginia from 17 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”). The Mortgage Division conducts business primarily from the division’s main office located in the Forest branch of the Bank and has opened several satellite offices throughout our market area. 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 areas at rates competitive to those offered by other financial institutions in that 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

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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 or cell phone, 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.

Investment Advisory Services. We provide investment advisory services through Financial's wholly-owned subsidiary, Pettyjohn, Wood & White, Inc. ("PWW"), a Lynchburg-based investment advisor registered with the Securities and Exchange Commission. Financial purchased the issued and outstanding shares of PWW on December 31, 2021. PWW generates revenue primarily through investment advisory fees.

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 31, 2023, we had approximately 173 employees, 163 of which are full-time and ten 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 our market 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 publicly 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); Southern Air, Inc. (mechanical and HVAC contractors); Pacific Life (life insurance and other financial products); Frito-Lay, Inc. (snack foods); U.S. Pipe (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 tightened. 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 salespeople in our

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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.

Investment Advisory Business

PWW competes with national, regional, statewide, and local investment advisors, wealth management firms and brokerage firms. According to publicly available information, more than 50 investment advisors and 35 brokerage firms have physical locations in Lynchburg, many of which have greater resources than PWW. Competition for wealth management clients is intense.

SUPERVISION AND REGULATION OF THE COMPANY

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 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 and PWW. 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 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 or finalized. While 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, 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-

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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, 2021, 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

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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 2022, the Bank expensed \$500,000 in FDIC assessments which compared to \$548,000 in 2021. 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 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. A 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.

Since January 1, 2019 and the rules have required 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%), (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%), (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%), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

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 directed 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 a 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.

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, 2022, 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.

Cybersecurity. The federal bank regulatory agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a banking organization's board of directors. This guidance, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal bank regulatory agencies expect financial institutions to establish appropriate security controls and to ensure that their risk management processes address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyberattack. If we fail to meet the expectations set forth in such regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

In November 2021, the federal bank regulatory agencies issued a final rule to improve the sharing of information about cyber incidents that may affect the U.S. banking system. The rule, which became effective on May 1, 2022, requires a banking organization to notify its primary federal regulator within 36 hours of determining that a “computer-security incident” has materially affected - or is reasonably likely to materially affect - the viability of the banking organization's operations, its ability to deliver banking products and services, or the stability of the financial sector. In addition, the rule requires a bank service provider to notify affected banking organization customers as soon as possible when the provider determines that it has experienced a computer-security incident that has materially affected or is reasonably likely to materially affect banking organization customers for four or more hours.

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. In particular, we are subject to risk from decisions of the FOMC to continue to increase the fed funds target rate. Such an increase could subject us to interest rate risk by, among other things, a) requiring us to increase the rates paid on deposit accounts; and b) further decreasing the value of certain assets, including our loans and investment securities. While it is not possible to fully predict the nature or impact of future changes in monetary and fiscal policies, we anticipate that continued rate increases in 2023 could have a negative impact on our results of operations and/or financial condition.

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.

The failure of a least three regional banks has caused commentators and government officials to call for the increased regulation of the banking and financial industry. Regulation could take the form of increased capital requirements or stress tests for banks other than the systemically important financial institutions. 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.

Regulation of PWW

PWW is a registered investment adviser under the Investment Advisers Act of 1940, as amended, and as such, is supervised by the SEC. It is also subject to various other federal laws as well as licensing and/or registration requirements. These laws and regulations generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the carrying on of business for failure to comply with such laws and regulations.

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 2022, the Lynchburg MSA had an unemployment rate (not seasonally adjusted) of 2.9%, as compared to a statewide average unemployment rate of 2.6%.

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, pandemics, 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 may be, adversely affected by a resurgence of COVID-19 or other pandemics.

The COVID-19 pandemic negatively impacted the local, state, national, and world economies. The pandemic created economic and financial disruptions that have adversely affected, and have the potential to continue to adversely affect, the Company’s business, financial condition, liquidity and results of operations. Although the pandemic has subsided, a resurgence of COVID-19 or other pandemics could adversely impact our business, financial condition, liquidity and results of operations. The impact would depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the resurgence of COVID-19 or subsequent pandemics, the effectiveness of the Company’s business continuity plan, the direct and indirect impact of the resurgence or 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.

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, 2022, our allowance as a percentage of total loans was 1.02% and our allowance as a percentage of nonperforming loans was 988.78%. 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 FASB issued a new accounting standard, commonly referred to as the Current Expected Credit Losses (CECL) standard, which replaced the current approach under GAAP for establishing our allowance for loan losses. We adopted the standard on January 1, 2023. Prior to CECL, our allowance for loan losses generally considered only past events and current conditions. The CECL methodology requires a forward-looking methodology that reflects the expected credit losses over the lives of financial assets, starting when such assets are first originated or acquired. The CECL standard requires us to record, at the time of origination, credit losses expected throughout the life of our loans, as opposed to the current practice of recording losses when it is probable that a loss event has occurred. CECL requires advanced modeling techniques, heavy reliance on assumptions, and dependence on historical data that may not accurately forecast losses. CECL can result in greater volatility in the level of the allowance for credit losses, depending on various factors and assumptions applied in the model, such as the forecasted economic conditions in the foreseeable future and loan payment behaviors. Any increase in the allowance for credit losses, or expenses incurred to determine the appropriate level of the allowance for credit losses, can have an adverse effect on our financial condition and results of operations.

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. Although our portfolio of commercial and industrial loans has decreased during the past year, that category has generally increased over the past several years and we continue to focus on commercial and industrial loans.

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 efforts to increase our levels of commercial and industrial loans may be impacted by increased interest rates, recession, or other adverse economic conditions.

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 consolidated 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 any future significant 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. 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, , acts of war or terrorism or other adverse external events could significantly impact our business.

Severe weather, natural disasters, , 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. The adequacy of our allowance for loan losses is crucial in monitoring credit exposure. 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. Previously interest rate spreads had 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 again. 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.

Inflation can have an adverse impact on our customers and their ability to repay.

Inflation risk is the risk that the value of assets or income from investments will be worth less in the future as inflation decreases the value of money. Recently, there has been a pronounced rise in inflation and the Federal Reserve has raised certain benchmark interest rates in an effort to combat this trend. Our customers may also be affected by inflation and the rising costs of goods and services used in their households and businesses, which could have a negative impact on their ability to repay their loans with us.

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, we have suffered losses in the past and 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.

Further, our liquidity could be reduced because of a decrease in the value of certain assets, including loans and investment securities, caused by increases in interest rates which could in turn reduce the amount that we are able to borrow and/or reduce the proceeds from the sale of securities in our portfolio. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations or deterioration in credit markets.

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 alternatives such as other financial institutions or 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 or to other financial institutions, 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.

In an effort combat inflation, the Federal reserve raised rates in 2022. Interest rates increased rapidly. On December 31, 2021, the Fed funds rate was 0% to 0.25%. By June 30, 2022, the rate stood at 1.5% to 1.75% and by December 31, 2022 the rate was 4.25% to 4.5%. These increases generally had an adverse impact on the value of our securities available-for-sale portfolio.

From time to time, we hold as investments certain securities that have unrealized losses. As of December 31, 2022, we had unrealized losses in our available-for-sale securities portfolio net of taxes of \$26,781,000. 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 thereby 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.

Revenues and profitability from our investment advisory business may be adversely affected by any reduction in assets under management, which could reduce fees earned.

PWW, our investment advisory business derives the majority of its revenue from noninterest income, which primarily consists of investment advisory fees. Substantially all of PWW's revenues are generated from investment management contracts with clients. Under these contracts, the investment advisory fees paid to us are typically based on the market value of assets under management. Assets under management may decline for various reasons including declines in the market value of the assets, which could be caused by price declines in the securities markets. Assets under management may also decrease due to redemptions and other withdrawals by clients or termination of contracts. This could be in response to adverse market conditions or in pursuit of other investment opportunities. If the assets under management we supervise decline and there is a related decrease in fees, it will negatively affect our results of operations.

We may not be able to attract and retain investment advisory clients.

Due to strong competition, our investment advisory business may not be able to attract and retain clients. Competition is strong because there are numerous well-established and successful investment management and wealth advisory firms including commercial banks and trust companies, investment advisory firms, mutual fund companies, stock brokerage firms, and other financial companies. Many of our competitors have greater resources than we have. Our ability to successfully attract and retain investment advisory clients is dependent upon our ability to compete with competitors' investment products, level of investment performance, client services and marketing and distribution capabilities. If we are not successful, our results of operations and financial condition may be negatively impacted.

The investment advisory industry is subject to extensive regulation, supervision and examination by regulators, and any enforcement action or adverse changes in the laws or regulations governing our business could decrease our revenues and profitability.

As an investment advisor registered with the Securities and Exchange Commission, PWW is subject to regulation by a number of regulatory agencies that are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. In the event of non-compliance with regulation, governmental regulators, including the SEC, and the Financial Industry Regulatory Authority, may institute administrative or judicial proceedings that may result in censure, fines, civil penalties, the issuance of cease-and-desist orders or the deregistration or suspension of the non-compliant broker-dealer or investment adviser or other adverse consequences. The imposition of any such penalties or orders could have a material adverse effect on the wealth management segment's operating results and financial condition. We may be adversely affected as a result of new or revised legislation or regulations. Regulatory changes have imposed and may continue to impose additional costs, which could adversely impact our profitability.

If we fail to retain PWW's key employees, the growth and profitability of our investment advisory business could be adversely affected.

PWW's success is, and is expected to remain, highly dependent on its executive management team as well as other key personnel because of their role in, among other things, making investment decisions for PWW clients and managing client relations. Although each of the foregoing are subject to non-compete agreements, there are no assurances that these key personnel will remain employees of PWW.

Competition for investment advisory 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.

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, 2021, 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 and PWW. The Company currently does not have any significant sources of revenue other than cash dividends paid to it by the Bank and PWW. 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. PWW's ability to pay dividends is likewise subject to certain limits imposed by state law.

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 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 31, 2023 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

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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
4105 Boonsboro Road Lynchburg, Virginia	Full-service branch with drive thru and ATM	2022	Owned

(1) The current term of the amended and restated lease expires in three 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 previous term expired on December 31, 2021. The Bank currently leases 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, 2027.

(7) Base lease expired February 28, 2021. The Bank currently leases 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 1925 Atherholt Rd, Lynchburg, Virginia. The Bank purchased this property in 2021. The building currently houses all personnel of the Company’s wholly-owned subsidiary, PWW. PWW is currently leasing the space from the Bank on a month-to-month basis. While the Bank currently does not have a timeline for a branch at this location, the space is attractive for a branch due to its close proximity to Centra’s Lynchburg General Hospital. The investment needed to upfit the property will be minimal.

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 and apps for 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 31, 2023, there were approximately 4,575,038 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 normal 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 and PWW 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*" in Item 1 of this Report on Form 10-K. PWW's ability to pay dividends is subject to certain limits imposed by state law.

On January 17, 2023 Financial declared a cash dividend for the fourth quarter of 2022 of \$0.08 per common share. The dividend was paid on March 17, 2023 to shareholders of record at the close of business on March 3, 2023. Financial will evaluate the factors set forth above when making a determination of whether to continue to pay a cash dividend in 2023.

As set forth in the following table, during the quarter ended December 31, 2022, Financial repurchased no shares of common stock.

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	Approximate Dollar Value of Shares that May Yet be Purchased Under Plans or Programs (000's) (1)
October 1, 2022 through October 31, 2022 (2)	—	N/A	—	\$98
November 1, 2022 through November 30, 2022	—	N/A	—	\$98
December 1, 2022 through December 31, 2022	—	N/A	—	\$98
Total	—	N/A	—	\$98

(1) The company repurchased no shares during the quarter ended December 31, 2022.

(2) On July 19, 2022, the Company's board of directors approved a share repurchase program under which the Company was authorized to repurchase, from time to time as the Company deems appropriate, up to an aggregate of \$500,000 of shares of the Company's common stock. On August 18, 2022, the Company's board of directors increased this aggregate amount available for the repurchase of shares to \$1,500,000. The program, as amended, was scheduled by its terms to expire on July 18, 2023, but was terminated on February 6, 2023 when a new repurchase plan was adopted.

On February 6, 2023, the Company's board of directors approved a stock repurchase plan to purchase up to \$998,000 of the Company's common stock. The plan authorizes the Company to make purchases from March 8, 2023 through March 7, 2024, unless extended or sooner terminated. Purchases may be made in open market transactions or privately negotiated transactions, in accordance with Rule 10b5-1 and Rule 10b-18 under the Securities Exchange Act of 1934, as amended.

Item 6. [Reserved]

Item 7. 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. Bank of the James Financial Group, Inc. ("Financial") has no material operations and conducts no business other than the ownership of its operating subsidiaries, Bank of the James (and its divisions and subsidiary), and Pettyjohn, Wood & White, Inc. Because Pettyjohn, Wood & White, Inc. was acquired on December 31, 2021, Pettyjohn, Wood & White, Inc. did not impact our operating results in 2021, 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 a resurgence of COVID-19 or other 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);
- changes to statutes, regulations, or regulatory policies or practices, 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;
- adoption of new accounting standards or changes in existing standards;
- compliance or operational risks related to new products, services, ventures, or lines of business, if any, that Financial may pursue or implement;
- 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;
- the stability of the overall banking industry in the United States;
- liquidity and perceived liquidity in the banking industry in the United States;
- economic and political tensions with China, the ongoing war between Russia and Ukraine and potential expansion of combatants, and the sanctions imposed on Russia by numerous countries and private companies, all of which may have a destabilizing effect on financial markets and economic activity; and
- other risks and uncertainties set forth in this Annual Report on Form 10-K and, from time to time, in our other filings with the Securities and Exchanges Commission (“SEC”).

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.

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 four 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”), insurance activities through BOTJ Insurance, Inc., a subsidiary of the Bank, (which we refer to as “Insurance”), and subsequent to December 31, 2021, investment advisory services through the Company’s wholly-owned subsidiary, Pettyjohn, Wood & White, Inc. (which we refer to as “PWW”).

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

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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. We anticipate that going forward, PWW will enhance our operating results by providing additional noninterest income (generally investment advisory fees less operating expenses).

As discussed in more detail below,

- For the year ended December 31, 2022, Financial had net income of \$8,959,000, an increase of \$1,370,000 from net income of \$7,589,000, for the year ended December 31, 2021;
- For the year ended December 31, 2022, earnings per basic and diluted common share were \$1.91, as compared to earnings of \$1.60 per basic and diluted common share for the year ended December 31, 2021;
- Net interest income increased to \$29,703,000 for the current year from \$27,079,000 for the year ended December 31, 2021;
- Noninterest income (exclusive of net gains on sales and calls of securities) increased to \$13,247,000 for the year ended December 31, 2022 from \$11,209,000 for the year ended December 31, 2021;
- Total assets as of December 31, 2022 were \$928,571,000 compared to \$987,634,000 at the end of 2021, a decrease of \$59,063,000 or 5.98%;
- Net loans (excluding loans held for sale), net of unearned income and the allowance for loan losses, increased to \$605,366,000 as of December 31, 2022 from \$576,469,000 as of the end of December 31, 2021, an increase of 5.01%; and
- The net interest margin increased 9 basis points to 3.23% for 2022, compared to 3.14% for 2021.

The following table sets forth selected financial ratios:

	For the Year Ended December 31,	
	2022	2021
Return on average equity	15.59%	11.34%
Return on average assets	0.91%	0.82%
Dividend yield %	2.29%	1.75%
Average equity to total average assets	5.86%	7.27%

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 posed 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 fed funds rate by an additional 100 basis points. As of March 20, 2020, the FOMC had set a current target rate range of 0% to 0.25%. The target rate remained unchanged for the remainder of 2020 and 2021. However, as a result of COVID-19 stimulus and other factors, long term rates began to trend slightly upward in the first quarter of 2021.

In response to higher inflation and supply chain issues exacerbated by the war in Ukraine, on March 17, 2022, the FOMC increased the target rate to a range of 0.25% to 0.50%. The FOMC continued to increase the target rate, including raises of 50 basis

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points on May 5, 2022, 75 basis points on each of June 16, July 27, September 30, and November 2, 2022, 50 basis points on December 14, 2022 and 25 basis points on February 1, 2023, at which point the target rate was 4.50% to 4.75%.

Prior to March 10, 2023, the FOMC had indicated that it is likely to increase the target rate one or more times in 2023 in a continued effort to bring the rate of inflation in line with Federal Reserve's target of 2.0%. In addition, many commentators had expressed a belief that the January 2023 inflation numbers will require multiple additional increases in the Fed funds target rate during 2023. Recent perceived instability in the banking industry caused in part by at least three regional bank failures has added uncertainty as to whether the FOMC will continue to raise the target rate. On March 22, 2023, the FOMC raised the target rate by 25 basis points, bringing the target rate to 4.75% to 5.0%. The FOMC indicated that it may increase the rate by an additional 25 basis points during 2023.

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. 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. The Bank uses historical loss factors as one factor in determining the inherent loss that may be present in the loan portfolio. 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 2 of the Notes to Consolidated Financial Statements for further discussion of the allowance for loan losses.

Goodwill arises from business combinations and is generally determined as the excess of fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquired entity, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently in events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company has selected September 1 of each year as the date to perform the annual impairment test. Impairment testing requires a qualitative assessment or that the fair value of each of the Company's reporting units be compared to the carrying amount of their net assets, including goodwill. If the fair value of a reporting unit is less than its carrying value, an expense may be required to write down the related goodwill to record an impairment loss. Determining fair value is subjective, requiring the use of estimates, assumptions and management judgment. Intangible assets with finite useful lives are amortized over their estimated useful lives to their estimated residual values, if any. Goodwill is the only intangible asset with an indefinite life on our consolidated balance sheet.

RESULTS OF OPERATIONS

Year Ended December 31, 2022 compared to year ended December 31, 2021

Net Income

The net income for Financial for the year ended December 31, 2022 was \$8,959,000 or \$1.91 per basic and diluted share compared with net income of \$7,589,000 or \$1.60 per basic and diluted share for the year ended December 31, 2021. All earnings per share figures have been adjusted to reflect the 10% stock dividend paid in 2021. Note 13 of the consolidated financial statements provides additional information with respect to the calculation of Financial's earnings per share.

The increase of \$1,370,000 in 2022 net income compared to 2021 was due in large part to an increase in net interest income of \$2,624,000 or 9.69%, an increase in wealth management fees to \$3,932,000 in 2022 from \$0 in 2021, and an increase in service charges, fees, and commissions to \$3,591,000 in 2022 from \$2,496,000 in 2021. These changes were partially offset by a decrease in

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gains of loans held for sale to \$5,256,000 in 2022 from \$8,265,000 in 2021 and an increase in noninterest expense of \$3,400,000, or 11.59%.

These operating results represent a return on average stockholders' equity of 15.59% for the year ended December 31, 2022 compared to 11.34% for the year ended December 31, 2021. Our return on average stockholder's equity increased because of an increase in net income and a decrease in the market value of the available-for-sale securities portfolio, which in turn decreased our equity. The return on average assets for the year ended December 31, 2022 was 0.91% compared to 0.82% in 2021 primarily due to the increase in net income and a decrease in 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, federal 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 increased to \$31,853,000 for the year ended December 31, 2022 from \$29,181,000 for the year ended December 31, 2021. This increase was due primarily to an increase in loan volume as well as an increase in the yields on average earning assets which primarily consist of loans and investment securities, as discussed below.

Net interest income for 2022 increased \$2,624,000, or 9.69%, to \$29,703,000 from \$27,079,000 in 2021. The rates charged on loans and received on investments grew faster than rates paid on deposits, which was the primary driver in the increase of our net interest income. Our interest expense increased slightly from \$2,102,000 in 2021 from \$2,150,000 in 2022. The average balance of interest bearing liabilities increased 9.44% from \$682,089,000 for the year ended December 31, 2021 to \$746,479,000 for the year ended December 31, 2022. The average interest rate paid on interest bearing liabilities decreased by 2 basis points to 0.29% in 2022 from 0.31% in 2021.

The net interest margin increased to 3.23% in 2022 from 3.14% in 2021. The average rate on earning assets increased 8 basis points from 3.38% in 2021 to 3.46% in 2022 and the average rate on interest-bearing deposits decreased from 0.25% in 2021 to 0.18% in 2022. The decrease was primarily caused by a decrease in average time deposits, which pay a higher rate than demand interest bearing and savings deposits, from \$144,206,000 for the year ended December 31, 2021 to \$134,821,000 for the year ended December 31, 2022. One of the results of the spread of COVID-19 was a sustained low interest rate environment, which negatively impacted our net interest margin in 2021. Because of Financial's asset interest rate sensitivity, we anticipate that a gradual increase in interest rates generally would have a positive impact on our results of operations.

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, 2022 and
2021
(dollars in thousands)

	2022			2021		
	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)	\$ 604,990	\$ 25,992	4.30%	\$ 601,272	\$ 26,336	4.38%
Loans held for sale	3,913	183	4.68%	5,815	193	3.32%
Federal funds sold	68,580	721	1.05%	106,310	107	0.10%
Interest-bearing bank balances	18,005	282	1.57%	18,820	33	0.18%
Securities (3)	223,137	4,628	2.07%	128,886	2,459	1.91%
Federal agency equities	1,251	66	5.28%	1,281	67	5.23%
CBB equity	116	—	0.00%	116	—	0.00%
Total earning assets	919,992	31,872	3.46%	862,500	29,195	3.38%
Allowance for loan losses	(6,715)			(7,223)		
Non-earning assets	67,230			65,197		
Total assets	\$ 980,507			\$ 920,474		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Deposits						
Demand interest bearing	454,974	480	0.11%	412,301	446	0.11%
Savings	132,318	75	0.06%	111,571	118	0.11%
Time deposits	134,821	732	0.54%	144,206	1,105	0.77%
Total interest bearing deposits	722,113	1,287	0.18%	668,078	1,669	0.25%
Other borrowed funds						
Other borrowings	10,738	440	4.10%	30	—	0.00%
Financing leases	3,593	96	2.67%	3,951	106	2.68%
Capital Notes	10,035	327	3.26%	10,030	327	3.26%
Total interest-bearing liabilities	746,479	2,150	0.29%	682,089	2,102	0.31%
Noninterest bearing deposits	166,179			165,138		
Other liabilities	10,371			6,310		
Total liabilities	923,029			853,537		
Stockholders' equity	57,478			66,937		
Total liabilities and Stockholders' equity	\$ 980,507			\$ 920,474		
Net interest earnings		\$ 29,722			\$ 27,093	
Net interest margin			3.23%			3.14%
Interest spread			3.17%			3.07%

- (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,					
	2022			2021		
	Volume Effect	Rate Effect	Change in Income/ Expense	Volume Effect	Rate Effect	Change in Income/ Expense
Loans	\$ 69	\$ (423)	\$ (354)	\$ (376)	\$ (1,116)	\$ (1,492)
Federal funds sold	(24)	638	614	10	(5)	5
Interest-bearing deposits	(1)	250	249	2	(58)	(56)
Securities	1,946	223	2,169	1,192	(132)	1,060
Restricted stock	(2)	1	(1)	(7)	(4)	(11)
Total earning assets	1,988	689	2,677	821	(1,315)	(494)
Liabilities:						
Demand interest bearing	34	—	34	261	(467)	(206)
Savings	30	(73)	(43)	62	(96)	(34)
Time deposits	(67)	(306)	(373)	(577)	(1,666)	(2,243)
Capital notes	—	—	—	78	(24)	54
Financing leases	(10)	—	(10)	(9)	—	(9)
Repurchase agreements and other borrowings	—	—	—	—	—	—
Total interest-bearing liabilities	\$ (13)	\$ (379)	\$ (392)	\$ (185)	\$ (2,253)	\$ (2,438)
Change in net interest income	\$ 2,001	\$ 1,068	\$ 3,069	\$ 1,006	\$ 938	\$ 1,944

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, fees generated by the investment services of Investment, and since January 1, 2022, income from PWV. 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 and non-conforming consumer residential mortgages 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. In addition, overall home inventory for sale decreased in our market areas. 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.

The Mortgage Division originated 798 mortgage loans, totaling approximately \$213,406,000 during the year ended December 31, 2022 as compared with 1,335 mortgage loans, totaling \$331,235,000 in 2021. The decrease in originations was due in large part to a rapid increase in mortgage rates during 2022, particularly the second half of the year. Loans for new home purchases comprised 75% of the total volume in 2022 as compared to 54% in 2021. 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, 2022, the Mortgage Division accounted for

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11.65% of Financial's total revenue as compared with 20.46% of Financial's total revenue for the year ended December 31, 2021. Mortgage contributed \$790,000 and \$2,360,000 to Financial's pre-tax net income in 2022 and 2021, respectively. Because of the uncertainty surrounding current and near-term economic conditions, management cannot predict future mortgage rates. Management also anticipates that in the near to medium term if rates continue to stay above 5% to 6% and prices remain relatively steady or increase, refinancing opportunities will be scarce and the majority of the loan mix will continue to lean towards new home purchases and away from refinancing.

Recently, the Mortgage Division has established a presence in the Wytheville market area. Management expects that 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 market share and, in the longer term, revenue.

Service charges and fees and commissions increased to \$3,591,000 for the year ended December 31, 2022 from \$2,496,000 for the year ended December 31, 2021 primarily due to increases related to commissions on the sales of securities, debit card fees, and 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 2023.

In the third quarter of 2008, we began providing insurance and annuity products to Bank customers and others, through the Bank's Insurance subsidiary. 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 2023.

We conduct our investment advisory business through PWW, which Financial acquired on December 31, 2021. PWW is a Lynchburg, Virginia-based investment advisory firm that had approximately \$650 million in assets under management and advisement at the time of the acquisition. PWW operates as a subsidiary of Financial. PWW generates revenue primarily through investment advisory fees. The investment advisory fees will vary based on the value of assets under management. Assets under management may fluctuate due to both client action and fluctuations in the equity and debt markets. Despite the potential for fluctuation, we anticipate that PWW will continue to contribute meaningfully to the Company's consolidated net income. For the year ended December 31, 2022, its first year of operations as a subsidiary of Financial, PWW had fee income of \$3,932,000. For the year ended December 31, 2022, PWW accounted for 8.72% of Financial's total revenue. In 2021 PWW did not contribute any revenue to Financial.

Noninterest income, exclusive of gains and losses on the sale and call of securities, increased to \$13,247,000 in 2022 from \$11,209,000 in 2021. Inclusive of gains and losses on the sale and call of securities, noninterest income increased to \$13,244,000 in 2022 from \$11,209,000 in 2021. The following table summarizes our noninterest income for the periods indicated.

	Noninterest Income	
	(dollars in thousands)	
	December 31,	
	2022	2021
Gains on sale of loans held for sale	\$ 5,256	\$ 8,265
Service charges, fees and commissions	3,591	2,496
Wealth management fees	3,932	—
Life insurance income	452	430
Other	16	18
Loss on sales and calls of securities, net	(3)	—
Total noninterest income	\$ 13,244	\$ 11,209

The increase in noninterest income for 2022 as compared to 2021 was due to an increase in service charges, fees and commissions and wealth management fees and was offset by a decrease in gain on sales of loans held for sale. The increase in noninterest income was driven primarily by wealth management fees following the acquisition of PWW and an increase in overdraft fees, debit card income, which resulted from an increased volume of debit card transactions. The decrease in the gain on sales of loans held for sale was caused by an increase in mortgage loan rates.

Noninterest Expense of Financial

Noninterest expenses increased from \$29,337,000 for the year ended December 31, 2021 to \$32,737,000 for the year ended December 31, 2022. The following table summarizes our noninterest expense for the periods indicated.

	Noninterest Expense (dollars in thousands)	
	December 31,	
	2022	2021
Salaries and employee benefits	\$ 17,682	\$ 16,377
Occupancy	1,814	1,673
Equipment	2,553	2,526
Supplies	521	471
Professional and other outside expenses	2,589	2,286
Data processing	2,467	1,808
Marketing	920	934
Credit expense	923	1,103
Other real estate expenses, net	214	102
FDIC insurance expense	500	548
Amortization of intangibles	560	—
Other	1,994	1,509
Total noninterest expense	\$ 32,737	\$ 29,337

The increase in noninterest expense was due in large part to an increase in compensation and benefits, primarily related to the addition of PWW, and professional, data processing and other outside expenses, professional, data processing, and other outside expense increased primarily due to increased charges by our core service provider relating to the additional volume of transactions in 2022. Our compensation and benefits expense has a variable component related to mortgage origination, which offset some of the increase noted above due to lower mortgage volume in 2022. In addition, noninterest expense increased in part due to an increase in other expenses, primarily related to an isolated check forgery that resulted in a charge of \$362,000. We have filed a proof of loss with our insurance carrier and are waiting for a coverage determination.

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 76.62% in 2021 to 76.23% in 2022. Our efficiency ratio decreased because the increase in interest income and wealth management fees were greater than the increase in noninterest expense. This is a non-GAAP financial measure that the Company believes provides investors with important information regarding operational efficiency. No non-recurring adjustments were made to the calculation of the efficiency ratio.

Income Tax Expense

For the year ended December 31, 2021, Financial had federal income tax expense of \$1,862,000, as compared to a federal income tax expense of \$2,151,000 in 2022, which equates to effective tax rates of 19.70% and 19.36%, respectively. Our effective tax rate was lower than the statutory corporate tax rate in 2021 and 2022 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 2021 and 2022 federal income tax expense and deferred tax accounts.

ANALYSIS OF FINANCIAL CONDITION

As of December 31, 2022 and December 31, 2021

General

Our total assets were \$928,571,000 at December 31, 2022, a decrease of \$59,063,000 or 5.98% from \$987,634,000 at December 31, 2021, primarily due to a decrease in federal funds sold which was partially offset by increases in securities available-for-sale, loans, net of allowance for loan losses, and other assets. As explained in more detail below, deposits decreased from \$887,056,000 on December 31, 2021 to \$848,138,000 on December 31, 2022. Loans, net of unearned income and the allowance, increased to \$605,366,000 on December 31, 2022 from \$576,469,000 on December 31, 2021.

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 \$605,366,000 on December 31, 2022 from \$576,469,000 on December 31, 2021. Total loans, including loans held for sale increased to \$614,048,000 on December 31, 2022 from \$585,012,000 on December 31, 2021. The increase in total loans was in large part due to demand for commercial and residential mortgage loans. Competition for qualified borrowers remains strong.

As of December 31, 2022, the Bank had \$633,000, or 0.10% of its total loans, in non-accrual status compared with \$954,000, or 0.16% of its total loans, at December 31, 2021. Management is continuing its efforts to reduce non-performing assets through enhanced collection efforts and the liquidation of underlying collateral when applicable. 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 an increase in unemployment, adverse housing market conditions, and overall economic conditions at the local, regional and national levels. See "*Asset Quality*" below.

The following table summarizes net charge-offs, average loan balance and the percentage of net (charge-offs) recoveries to average loan balance for each of the Company's loan segments at the end of the period:

Loan Portfolio <i>(dollars in thousands)</i> December 31,				
	(Recovery of) Provision for Loan Losses	Net (Charge-offs) Recoveries	Average Loans	Ratio of Annualized Net (Charge-offs) Recoveries to Average Loans
2022				
Commercial	\$ (473)	\$ 104	\$ 101,734	0.10%
Commercial real estate	(810)	75	350,424	0.02%
Consumer	51	(7)	94,702	-0.01%
Residential	332	72	58,130	0.12%
Total loans	<u>\$ (900)</u>	<u>\$ 244</u>	<u>\$ 604,990</u>	<u>0.04%</u>
2021				
Commercial	\$ (589)	\$ 59	\$ 126,162	0.05%
Commercial real estate	15	72	326,591	0.02%
Consumer	1	(9)	91,489	-0.01%
Residential	73	137	57,030	0.24%
Total loans	<u>\$ (500)</u>	<u>\$ 259</u>	<u>\$ 601,272</u>	<u>0.04%</u>

The following table sets forth the maturities of the loan portfolio at December 31, 2022:

Remaining Maturities of Selected Loans <i>(dollars in thousands)</i> At December 31, 2022					
	Less than One Year	After One but Within Five Years	After Five but Within Fifteen Years	After Fifteen Years	Total
Commercial	\$ 16,639	\$ 41,466	\$ 16,736	\$ 21,044	\$ 95,885
Commercial real estate	15,635	16,051	134,577	187,762	354,025
Consumer	4,476	23,945	55,074	14,464	97,959
Residential	20,759	399	3,436	39,162	63,756
Total	\$ 57,509	\$ 81,861	\$ 209,823	\$ 262,432	\$ 611,625
Loans with fixed interest rates:					
Commercial	\$ 2,937	\$ 22,967	\$ 3,423	\$ 1,786	\$ 31,113
Commercial real estate	9,239	11,044	35,006	566	55,855
Consumer	536	13,000	17,562	9,212	40,310
Residential	15,645	399	2,706	767	19,517
Total	\$ 28,357	\$ 47,410	\$ 58,697	\$ 12,331	\$ 146,795
Loans with variable interest rates:					
Commercial	\$ 13,702	\$ 18,499	\$ 13,313	\$ 19,258	\$ 64,772
Commercial real estate	6,396	5,007	99,571	187,196	298,170
Consumer	3,940	10,945	37,512	5,252	57,649
Residential	5,114	—	730	38,395	44,239
Total	\$ 29,152	\$ 34,451	\$ 151,126	\$ 250,101	\$ 464,830

Deposits

We experienced a decrease in deposits from \$887,056,000 at December 31, 2021 to \$848,138,000 at December 31, 2022, for a decrease of 4.39%. Noninterest-bearing deposits decreased \$7,402,000 or 4.56% from \$162,286,000 at December 31, 2021 to \$154,884,000 at December 31, 2022. The decrease in noninterest-bearing deposits was due to customers moving funds to higher rate accounts both within and outside the Bank. The decrease was offset by our growth in the Charlottesville, Harrisonburg, Roanoke, Appomattox, and Rustburg markets, 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 including certificates of deposit decreased \$31,516,000, or 4.35%, from \$724,770,000 at December 31, 2021 to \$693,254,000 at December 31, 2022.

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,			
	2022		2021	
	Amount	Rate	Amount	Rate
Noninterest-bearing deposits	\$ 166,179	—	\$ 165,138	—
Interest-bearing deposits				
Interest checking	\$ 356,160	0.09%	\$ 333,974	0.10%
Money market	98,814	0.15%	78,327	0.15%
Savings	132,318	0.06%	111,571	0.11%
Time deposits				
Less than or equal to \$250,000	118,053	0.53%	125,242	0.76%
Greater than \$250,000	16,768	0.63%	18,964	0.81%
Total interest-bearing deposits	\$ 722,113	0.18%	\$ 668,078	0.25%
Total deposits	\$ 888,292		\$ 833,216	

The following table includes a summary of maturities of CDs greater than \$250,000:

	Maturities of CD's Greater than \$ 250,000 (dollars in thousands)				
	Less than Three Months	Three to Six Months	Six to Twelve Months	Greater than One Year	Total
At December 31, 2022	\$ 1,531	\$ 1,993	\$ 2,630	\$ 10,375	\$ 16,529

The total amount of all deposit categories in excess of the FDIC \$250,000 insurance limit was \$185,848,000 and \$118,315,000 as of December 31, 2022 and 2021, respectively.

Cash and Cash Equivalents

Cash and cash equivalents decreased from \$183,153,000 on December 31, 2021 to \$61,762,000 on December 31, 2022. Federal funds sold amounted to \$31,737,000 on December 31, 2022 compared to \$153,816,000 on December 31, 2021. The decrease in the balance of federal funds sold is due in part to the decrease in deposits, the use of cash and cash equivalents to fund loans, and the purchase of available-for-sale securities to take advantage of increased available yields. In addition, fluctuations in federal funds sold generally are related to fluctuations in transactional accounts and professional settlement accounts. The large decrease in cash and cash equivalents in 2022 can be directly attributed to the decrease in federal funds sold.

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,	
	2022	2021
Held-to-maturity		
U.S. agency obligations	\$ 3,135	\$ 4,006
Available-for-sale		
U.S. treasuries	\$ 4,741	\$ 2,002
U.S. agency obligations	59,273	58,470
Mortgage - backed securities	67,842	37,438
Municipals	37,855	50,204
Corporates	16,076	13,153
Total available-for-sale	\$ 185,787	\$ 161,267

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 and in anticipation of rising rates. Management believes that this strategy will allow us to maximize interest margins while maintaining appropriate levels of liquidity.

Securities held-to-maturity at amortized cost decreased slightly from \$3,655,000 as of December 31, 2021 to \$3,639,000 as of December 31, 2022. 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 \$185,787,000 as of December 31, 2022 from \$161,267,000 as of December 31, 2021. The increase was due to the deployment of federal funds sold into fixed income securities in an attempt secure higher yields on our investments. The increase was offset in part by a decrease in the fair value of available-for-sale securities of \$25,395,000 (net of tax) caused by rising interest rates. The Bank realized \$11,718,000 from pay-downs related to the normal amortization of principal related to the Bank's mortgage backed securities, calls, and maturities. During 2022, the Bank sold \$7,681,000 in available-for-sale securities. During 2022, the Bank purchased \$76,562,000 of available-for-sale securities.

The following table shows the maturities of held-to-maturity and available-for-sale securities at fair value at December 31, 2022 and 2021 and approximate weighted average yields of such securities. Weighted average yields on all securities including state and political subdivision securities are shown on a pre-tax 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, 2022					
	Less than One Year	One to Five Years	Five to Ten Years	Greater than Ten Years	Total
Held-to-maturity					
U.S. Agency					
Fair value	\$ —	\$ —	\$ 2,131	\$ 1,004	\$ 3,135
Weighted average yield			2.88%	3.25%	
Available-for-sale securities					
U.S. Treasury					
Fair value	\$ —	\$ 4,741	\$ —	\$ —	\$ 4,741
Weighted average yield		1.73%			
U.S. Agency					
Fair value	\$ —	\$ 30,842	\$ 26,728	\$ 1,703	\$ 59,273
Weighted average yield		1.44%	1.61%	2.07%	
Mortgage Backed Securities					
Fair value	\$ 40	\$ 657	\$ 12,179	\$ 54,966	\$ 67,842
Weighted average yield	1.00%	2.00%	1.68%	2.23%	
Municipals					
Fair value	\$ 790	\$ 682	\$ 10,413	\$ 25,970	\$ 37,855
Weighted average yield	2.02%	1.84%	2.00%	2.44%	
Corporates					
Fair value	\$ 1,482	\$ 4,138	\$ 10,456	\$ —	\$ 16,076
Weighted average yield	2	2.61%	3.85%		
Total portfolio					
Fair value	\$ 2,312	\$ 41,060	\$ 61,907	\$ 83,643	\$ 188,922
Weighted average yield	2.08%	1.61%	2.07%	2.31%	

Securities Portfolio Maturity Distribution / Yield Analysis
(dollars in thousands)
At December 31, 2021

	Less than One Year	One to Five Years	Five to Ten Years	Greater than Ten Years	Total
Held-to-maturity					
U.S. Agency					
Fair value	\$ —	\$ —	\$ 2,634	\$ 1,372	\$ 4,006
Weighted average yield			2.88%	3.23%	
Available-for-sale securities					
U.S Treasury					
Fair value	\$ 2,002	\$ —	\$ —	\$ —	\$ 2,002
Weighted average yield	1.37%				
U.S. Agency					
Fair value	\$ —	\$ 6,131	\$ 47,884	\$ 4,455	\$ 58,470
Weighted average yield		1.21%	1.42%	1.62%	
Mortgage Backed Securities					
Fair value	\$ —	\$ 1,178	\$ 6,843	\$ 29,417	\$ 37,438
Weighted average yield		2.32%	1.58%	1.82%	
Municipals					
Fair value	\$ 734	\$ 1,563	\$ 7,480	\$ 40,427	\$ 50,204
Weighted average yield	2.41%	1.94%	1.90%	2.27%	
Corporates					
Fair value	\$ —	\$ 4,162	\$ 8,503	\$ 488	\$ 13,153
Weighted average yield		2.29%	3.75%	2.00%	
Total portfolio					
Fair value	\$ 2,736	\$ 13,033	\$ 73,345	\$ 76,159	\$ 165,273
Weighted average yield	1.64%	1.74%	2.06%	1.93%	

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, 2022, the BOLI had a cash surrender value of \$19,237,000, an increase of \$452,000 from the cash surrender value of \$18,785,000 as of December 31, 2021. The Company did not purchase any additional BOLI during 2022. 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.

Goodwill and Other Intangible Assets

Goodwill arises from business combinations and is generally determined as the excess of fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquired entity, over the fair value of the nets assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently in events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company has selected September 1 of each year as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

On December 31, 2021, Financial completed its acquisition of Pettyjohn, Wood & White, Inc. ("PWW"), a Lynchburg, Virginia-based investment advisory firm with approximately \$650 million in assets under management and advisement at the time of the acquisition. PWW operates as a subsidiary of Financial. The acquisition date fair value of consideration transferred totaled \$10.5 million, which was paid in cash.

In connection with the transaction, the Company recorded intangibles relating to customer relationships and the resultant goodwill, representing the excess of the fair value of the consideration transferred over the fair value of the assets acquired and liabilities assumed in accordance with the acquisition method of accounting. Other assets acquired and liabilities assumed in the combination were not significant. Refer to Note 26. Acquisitions, included in Item 8 of this Annual Report on Form 10-K for additional information.

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 and PWV. 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, borrowers, creditors, and others. 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. Specifically,

- Additional borrowings may be obtained through the FHLBA. The Bank's remaining available credit through the FHLBA was \$229,637,000 as of December 31, 2022, the most recent calculation. Currently the Bank has in place pledged collateral in the amount of approximately \$21,907,000 against which \$0 was drawn and outstanding on December 31, 2022. Additional collateral would be required to be pledged in order for the full amount to be available.
- 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.
- 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.

In response to the failures of Silicon Valley Bank and Signature Bank, the Federal Reserve authorized all 12 regional reserve banks to make additional funding available to eligible depository institutions, including the Bank, through the Bank Term Funding Program (the "Program") in order to help assure the depository institutions that they have an additional source of liquidity to meet the needs of their depositors. Under the Program, eligible depository institutions may pledge eligible collateral (which includes direct obligations of the U.S. Department of Treasury and most federal agencies and mortgage-backed securities issued and/or fully guaranteed by Ginnie Mae, Freddie Mac, and Fannie Mae) in exchange for advances equal to 100% of the par value of the collateral pledged. The advances have a term of one year and bear interest at a fixed rate equal to the one-year overnight swap index rate plus 10 basis points. As of March, the Bank has approximately \$100,000,000 of collateral available to pledge under the Program.

At December 31, 2022, liquid assets, which include cash, interest-bearing and noninterest-bearing deposits with banks, federal funds sold, and securities available-for-sale totaled \$247,549,000 as compared to \$344,420,000 at December 31, 2021. Management deems liquidity to be sufficient. Investment securities traditionally provide a secondary source of liquidity because they can be converted into cash in a timely manner. However, approximately \$30,166,000 (current market value) of these securities are pledged to secure public deposits and \$5,210,000 (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.

While we have not experienced any unusual pressure on our deposit balances or our liquidity position as a result of increased interest rates or recent turmoil in the banking system, management continues to monitor our sources and uses of funds in order to meet our cash needs and cash flow requirements while maximizing profits.

Management believes that the Bank has the ability to meet its liquidity needs.

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

Funding Sources <i>(dollars in thousands)</i>			
Source	December 31, 2022		
	Capacity	Outstanding	Available
Federal funds purchased lines (unsecured)	\$ 33,000	\$ —	\$ 33,000
Federal funds purchased lines (secured)	4,689	—	4,689
Reverse repurchase agreements	5,000	—	5,000
Borrowings from FHLB Atlanta (1)	229,637	—	229,637
Total	\$ 272,326	\$ —	\$ 272,326

Source	December 31, 2021		
	Capacity	Outstanding	Available
Federal funds purchased lines (unsecured)	\$ 33,000	\$ —	\$ 33,000
Federal funds purchased lines (secured)	7,294	—	7,294
Reverse repurchase agreements	5,000	—	5,000
Borrowings from FHLB Atlanta	235,788	—	235,788
Total	\$ 281,082	\$ —	\$ 281,082

- (1) Currently the Bank has in place pledged collateral in the form of 1-4 family residential mortgages in the amount of approximately \$21,907,000 against which \$0 was drawn and outstanding on December 31, 2022. Additional collateral would be required to be pledged in order for the full \$229,637,000 to be available.

At the end of 2022, approximately 29.56%, or \$180,811,000 of the loan portfolio could mature or could reprice within a one-year period. At December 31, 2022, non-deposit sources of available funds totaled \$272,326,000, which included \$229,637,000 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. A 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.

Since January 1, 2019 the rules have required the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus the 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%), (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%), (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%), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

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, 2022 and 2021.

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

Analysis of Capital (in 000's)	December 31, 2022	December 31, 2021
Tier 1 capital		
Common Stock	\$ 3,742	\$ 3,742
Surplus	22,325	22,325
Retained earnings	57,840	52,821
Total Tier 1 capital	<u>\$ 83,907</u>	<u>\$ 78,888</u>
Common Equity Tier 1 Capital (CET1)	<u>\$ 83,907</u>	<u>\$ 78,888</u>
Tier 2 capital		
Allowance for loan losses	\$ 6,259	\$ 6,915
Total Tier 2 capital:	<u>\$ 6,259</u>	<u>\$ 6,915</u>
Total risk-based capital	<u>\$ 90,166</u>	<u>\$ 85,803</u>
Risk weighted assets	\$ 752,515	\$ 693,400
Average total assets	\$ 934,277	\$ 959,794

	Actual		Regulatory Benchmarks	
	December 31, 2022	December 31, 2021	For Capital Adequacy Purposes (1)	For Well Capitalized Purposes
Capital Ratios:				
Tier 1 capital to average total assets	8.98%	8.22%	4.000%	5.000%
Common Equity Tier 1 capital	11.15%	11.38%	7.000%	6.500%
Tier 1 risk-based capital ratio	11.15%	11.38%	8.500%	8.000%
Total risk-based capital ratio	11.98%	12.37%	10.500%	10.000%

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

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 second and third 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 June 30, 2025 and are subject to full or partial repayment on or after June 30, 2021. The balance of the 2020 Notes as presented on the December 31, 2022 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 unregistered debts securities issued by Financial in 2017. The Company has used the balance of the proceeds from the 2020 Offering for general corporate purposes. Such uses have included payment of interest on the 2020 Notes and the 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 of the Company’s decision to contribute a portion of the debt offerings to the Bank.

Stockholders' Equity

Stockholders' equity decreased by \$19,203,000 from \$69,429,000 on December 31, 2021 to \$50,226,000 on December 31, 2022. The decrease was due to a decrease in the market value (mark to market) of available-for-sale securities of \$32,146,000. This decrease is attributable to changes in market rates of interest rather than the credit worthiness of the issuers. Financial does not expect to realize the losses as it has the intent and ability to hold the securities until their recovery, which may be at maturity. The decrease was partially offset by net income of \$8,959,000, less cash dividends paid.

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 decreased to \$633,000 on December 31, 2022 from \$954,000 on December 31, 2021. Total charge-offs during 2022 were \$162,000 compared to \$91,000 in 2021. In 2022, the Bank recovered \$406,000 in loans previously charged-off as compared with recoveries of \$350,000 in 2021.

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, 2022 the Bank neither acquired nor disposed of any OREO properties and as of December 31, 2022 was carrying two (2) OREO properties at a value of \$566,000, as compared to two (2) properties with a value of \$761,000 as of December 31, 2021. 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 2022 and 2021.

	OREO Changes (dollars in thousands)	
	Year Ended December 31,	
	2022	2021
Balance at the beginning of the year (net)	\$ 761	\$ 1,105
Transfers from Loans	—	111
Capitalized costs	—	—
Valuation Adjustment	(195)	—
Sales proceeds	—	(368)
Gain (loss) on disposition	—	(87)
Balance at the end of the year (net)	\$ 566	\$ 761

Non-accrual loans plus OREO decreased to \$1,199,000 on December 31, 2022 from \$1,715,000 on December 31, 2021, a decrease of 30.09%.

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 increased to \$431,000 on December 31, 2022 from \$372,000 on December 31, 2021.

The following table sets forth the number of outstanding TDR contracts and the total amount of the Bank's TDRs as of December 31, 2022 and 2021.

Troubled Debt Restructurings
(dollars in thousands)

	December 31,	
	2022	2021
Number of performing TDR contracts	1	3
Number of nonperforming TDR contracts	—	—
Total number of TDR contracts	1	3
Amount of performing TDR contracts	\$ 431	\$ 372
Amount of nonperforming TDR contracts	—	—
Total amount of TDRs contracts	\$ 431	\$ 372

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 probable 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 loan in the Bank's portfolio.

The Bank's allowance for loan losses decreased 9.49% from \$6,915,000 on December 31, 2021 to \$6,259,000 on December 31, 2022, primarily due to a decrease in the general reserves, which led to a \$900,000 recovery of loan loss provision. At December 31, 2022, the allowance for loan losses was 1.02% of total loans outstanding, versus 1.19% of total loans outstanding at December 31, 2021. A decline in historical loss experience, improved delinquency and other asset quality trends, and other net improvements in qualitative factors, including those relating to the Company's consideration of the COVID-19 pandemic, all contributed to the reduction in the Company's allowance for loan losses since December 31, 2021. There were no specific reserves recorded at either period end.

Management intends to continue to be proactive in quantifying and mitigating the ongoing risk associated with all asset classes. If interest rates continue to rise and/or the U.S. economy experiences a recession, 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.

No non-accrual loans were excluded from impaired loans at December 31, 2022 and 2021. If interest on these loans had been accrued, such income cumulatively would have approximated \$79,000 and \$177,000 at December 31, 2022 and 2021, 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:

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,

	2022		2021	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
Commercial	\$ 1,102	15.68%	\$ 1,471	18.01%
Commercial real estate	2,902	57.88%	3,637	57.97%
Consumer	904	16.02%	860	15.27%
Residential	1,351	10.42%	947	8.75%
Total	\$ 6,259	100.00%	\$ 6,915	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,	
		2022	2021
Nonaccrual loans			
Commercial	\$	—	\$ 25
Commercial Real Estate		518	640
Consumer		20	127
Residential		95	163
Total nonaccrual loans	\$	<u>633</u>	<u>\$ 955</u>
Foreclosed Properties			
Commercial		—	695
Commercial Real Estate		500	—
Consumer		—	66
Residential		66	—
Total foreclosed properties	\$	<u>566</u>	<u>\$ 761</u>
Reposessed Assets			
		—	—
Total Nonperforming assets	\$	<u>1,199</u>	<u>\$ 1,716</u>

Total nonperforming loans as a percentage of total loans	0.10%	0.16%
Total nonperforming loans as a percentage of total assets	0.07%	0.10%
Allowance for loan losses on loans as a percentage of nonperforming loans	989.42%	724.08%
Allowance for loan losses on loans as a percentage of period end loans	1.02%	1.19%
Total nonaccrual loans as a percentage of total loans	0.10%	0.16%
Allowance for loan losses on loans as a percentage of nonaccrual loans	989.42%	724.08%

The allowance for loan losses as a percentage of nonaccrual loans increased from 2021 to 2022 due to the sharp decrease in nonaccrual loans for the same periods.

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

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 June 30, 2025 and are subject to full or partial repayment on or after June 30, 2021. The balance of the 2020 Notes as presented on the December 31, 2022 consolidated balance sheet is net of unamortized issuance costs.

On December 29, 2021 Financial borrowed \$11,000,000 from National Bank of Blacksburg pursuant to a secured promissory note (the "NBB Note"). The NBB Note bears interest at the rate of 4.00%, and is being amortized over a fifteen year period with a balloon payment of approximately \$9,375,000 due on December 31, 2024. The note is secured by a first priority lien on approximately 4.95% of the Bank's common stock. The balance of the NBB Note is presented on the December 31, 2022 consolidated balance sheet under "other borrowings" and is net of unamortized issuance costs. A portion of the proceeds were used to purchase 100% of the capital stock of PWW. On June 30, 2022, NBB agreed to modify the terms of the NBB Note effective July 1, 2022. Pursuant to the modification, the balloon payment date was extended to December 31, 2026 from December 31, 2024 and the interest rate was lowered to 3.90% from 4.00%. The approximate amount of the balloon payment on December 31, 2026 will be \$8,104,000.

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, 2022 and December 31, 2021. As set forth under "*Analysis of Financial Condition - Liquidity*," above, the Bank has the ability to borrow funds from a number of sources. The Bank had no amounts outstanding on these facilities as of December 31, 2022 and 2021.

Off-Balance Sheet Arrangements

At December 31, 2022, the Bank had rate lock commitments to originate mortgage loans through its Mortgage Division amounting to approximately \$11,200,000 and loans held for sale of \$2,423,000. The Bank recorded \$117,000 in other assets in relation to its interest rate lock commitments at December 31, 2022. The Bank has entered into corresponding commitments with third party investors to sell each of these loans that close. No other obligation exists.

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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,	
	2022	2021
Commitments to extend credit	\$ 196,218	\$ 179,953
Standby letters of credit	3,606	4,335
Total	\$ 199,824	\$ 184,288

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.

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.

Atherholt Road, Lynchburg, Virginia. On December 31, 2021, the Bank purchased real property located at 1925 Atherholt Road, Lynchburg, Virginia. The building currently serves as the offices for Financial's wholly-owned subsidiary, PWW. PWW is currently leasing the space from the Bank on a month-to-month basis. While the Bank currently does not have a timeline for a branch at this location, the space is attractive for a branch due to its close proximity to Centra's Lynchburg General Hospital. Management expects that the investment needed to upfit the property will be minimal.

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, 2022 and December 31, 2021

Statements of Income, Years Ended December 31, 2022 and December 31, 2021

Statements of Comprehensive Income (Loss), Years Ended December 31, 2022 and December 31, 2021

Statements of Changes in Stockholders’ Equity, Years Ended December 31, 2022 and December 31, 2021

Statements of Cash Flows, Years Ended December 31, 2022 and December 31, 2021

Notes to Consolidated Financial Statements



Report of Independent Registered Public Accounting Firm

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

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, 2022 and 2021, the related consolidated statements of income, comprehensive income (loss), 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, 2022 and 2021, 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 Matter

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, 2022, the allowance for loan losses totaled \$6.26 million. The general component of the allowance 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 31, 2023

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

Assets	December 31, 2022	December 31, 2021
Cash and due from banks	\$ 30,025	\$ 29,337
Federal funds sold	31,737	153,816
Total cash and cash equivalents	61,762	183,153
Securities held-to-maturity, at amortized cost (fair value of \$3,135 in 2022 and \$4,006 in 2021)	3,639	3,655
Securities available-for-sale, at fair value	185,787	161,267
Restricted stock, at cost	1,387	1,324
Loans, net of allowance for loan losses of \$6,259 in 2022 and \$6,915 in 2021	605,366	576,469
Loans held for sale	2,423	1,628
Premises and equipment, net	17,974	18,351
Interest receivable	2,736	2,064
Cash value - bank owned life insurance	19,237	18,785
Other real estate owned	566	761
Customer relationship intangibles	7,845	8,406
Goodwill	2,054	3,001
Other assets	17,795	8,770
Total assets	\$ 928,571	\$ 987,634
Liabilities and Stockholders' Equity		
Deposits		
Noninterest bearing demand	\$ 154,884	\$ 162,286
NOW, money market and savings	560,479	582,000
Time deposits	132,775	142,770
Total deposits	848,138	887,056
Capital notes	10,037	10,031
Other borrowings	10,457	10,985
Interest payable	89	46
Other liabilities	9,624	10,087
Total liabilities	\$ 878,345	\$ 918,205
Commitments and Contingencies		
Stockholders' equity		
Preferred stock; authorized 1,000,000 shares; none issued and outstanding	\$ -	\$ -
Common stock \$2.14 par value; authorized 10,000,000 shares; issued and outstanding 4,628,657 and 4,740,657 as of December 31, 2022 and 2021	9,905	10,145
Additional paid-in-capital	36,068	37,230
Retained earnings	31,034	23,440
Accumulated other comprehensive loss	(26,781)	(1,386)
Total stockholders' equity	\$ 50,226	\$ 69,429
Total liabilities and stockholders' equity	\$ 928,571	\$ 987,634

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,	
	2022	2021
Interest Income		
Loans	\$ 26,175	\$ 26,529
Securities		
US Government and agency obligations	1,235	875
Mortgage backed securities	1,656	462
Municipals - taxable	1,079	813
Municipals - tax exempt	73	52
Dividends	66	67
Other (Corporates)	566	243
Interest bearing deposits	282	33
Federal Funds sold	721	107
Total interest income	\$ 31,853	\$ 29,181
Interest Expense		
Deposits		
NOW, money market savings	555	564
Time Deposits	732	1,105
Finance leases	96	106
Capital notes	327	327
Other borrowings	440	-
Total interest expense	2,150	2,102
Net interest income	29,703	27,079
Recovery of loan losses	(900)	(500)
Net interest income after recovery of loan losses	30,603	27,579
Noninterest income		
Gain on sales of loans held for sale	5,256	8,265
Service charges, fees and commissions	3,591	2,496
Wealth management fees	3,932	-
Life insurance income	452	430
Other	16	18
Loss on sales and calls of securities, net	(3)	-
Total noninterest income	13,244	11,209
Noninterest expenses		
Salaries and employee benefits	17,682	16,377
Occupancy	1,814	1,673
Equipment	2,553	2,526
Supplies	521	471
Professional and other outside expenses	2,589	2,286
Data processing	2,467	1,808
Marketing	920	934
Credit expense	923	1,103
Other real estate expenses, net	214	102
FDIC insurance expense	500	548
Amortization of intangibles	560	-
Other	1,994	1,509
Total noninterest expenses	32,737	29,337
Income before income taxes	11,110	9,451

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share amounts)

Income tax expense	2,151	1,862
Net Income	\$ 8,959	\$ 7,589
Weighted average shares outstanding - basic and diluted	4,698,041	4,747,821
Earnings per common share - basic and diluted	\$ 1.91	\$ 1.60

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(dollars in thousands)

	For the Year Ended December 31,	
	2022	2021
Net Income	\$ 8,959	\$ 7,589
Other comprehensive loss:		
Unrealized losses on securities available-for-sale	(32,151)	(4,022)
Tax effect	6,754	844
Reclassification adjustment for losses included in net income (1)	3	-
Tax effect (2)	(1)	-
Other comprehensive loss, net of tax	(25,395)	(3,178)
Comprehensive (loss) income	\$ (16,436)	\$ 4,411

(1) Gains are included in "loss on sales and calls of 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)

	<u>Shares Outstanding</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>	<u>Total</u>
Balance at December 31, 2020	<u>4,339,436</u>	<u>\$ 9,286</u>	<u>\$ 30,989</u>	<u>\$ 24,665</u>	<u>\$ 1,792</u>	<u>\$ 66,732</u>
Net Income	-	-	-	7,589	-	7,589
Dividends paid on common stock (\$0.28 per share)	-	-	-	(1,271)	-	(1,271)
Repurchase of common stock	(28,900)	(62)	(365)	-	-	(427)
10% Stock dividend	430,121	923	6,620	(7,543)	-	-
Cash in lieu of fractional shares	-	(2)	(14)	-	-	(16)
Other comprehensive loss	-	-	-	-	(3,178)	(3,178)
Balance at December 31, 2021	<u>4,740,657</u>	<u>\$ 10,145</u>	<u>\$ 37,230</u>	<u>\$ 23,440</u>	<u>\$ (1,386)</u>	<u>\$ 69,429</u>
Net Income	-	-	-	8,959	-	8,959
Dividends paid on common stock (\$0.29 per share)	-	-	-	(1,365)	-	(1,365)
Repurchase of common stock	(112,000)	(240)	(1,162)	-	-	(1,402)
Other comprehensive loss	-	-	-	-	(25,395)	(25,395)
Balance at December 31, 2022	<u>4,628,657</u>	<u>\$ 9,905</u>	<u>\$ 36,068</u>	<u>\$ 31,034</u>	<u>\$ (26,781)</u>	<u>\$ 50,226</u>

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

	For the Year Ended December 31,	
	2022	2021
Cash flows from operating activities		
Net Income	\$ 8,959	\$ 7,589
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,049	2,059
Stock based compensation expense	-	106
Net amortization and accretion of premiums and discounts on securities	508	516
Amortization of debt issuance costs	10	4
Loss on sales of available-for-sale securities	3	-
Gain on sales of loans held for sale	(5,256)	(8,265)
Proceeds from sales of loans held for sale	217,867	344,974
Origination of loans held for sale	(213,406)	(331,235)
Recovery of loan losses	(900)	(500)
Loss on sale of other real estate owned	-	87
Impairment of other real estate owned	195	-
Gain on sales of equipment	(18)	-
(Benefit) expense for deferred income taxes	(10)	114
Bank owned life insurance income	(452)	(430)
(Increase) decrease in interest receivable	(672)	286
(Increase) decrease in other assets	(62)	295
Increase (decrease) in interest payable	43	(39)
Amortization of intangibles	560	-
(Decrease) increase in other liabilities	(106)	788
Net cash provided by operating activities	\$ 9,312	\$ 16,349
Cash flows from investing activities		
Purchases of securities available-for-sale	\$ (76,562)	\$ (83,964)
Proceeds from maturities, calls and paydowns of securities available-for-sale	11,718	8,360
Proceeds from sale of securities available-for-sale	7,681	-
Purchases of bank owned life insurance	-	(2,000)
(Redemption) purchase of Federal Home Loan Bank stock	(63)	227
Proceeds from sale of other real estate owned	-	368
Origination of loans, net of principal collected	(27,997)	25,854
Cash paid in acquisition, net of cash received	(818)	(10,400)
Purchases of premises and equipment	(1,191)	(2,909)
Proceeds from sale of equipment	30	-
Purchase of other investments	(927)	(564)
Net cash (used in) investing activities	\$ (88,129)	\$ (65,028)
Cash flows from financing activities		
Net (decrease) increase in deposits	\$ (38,918)	\$ 122,089
Principal payments on finance lease obligations	(357)	(414)
Repurchase of common stock	(1,402)	(427)
Cash in lieu of fractional shares	-	(16)
Dividends paid to common stockholders	(1,365)	(1,271)
Proceeds from bank loan	-	10,985
Principal payments on bank loan	(532)	-

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

Net cash (used in) provided by financing activities	\$	(42,574)	\$	130,946
(Decrease) increase in cash and cash equivalents		(121,391)		82,267
Cash and cash equivalents at beginning of period	\$	183,153	\$	100,886
Cash and cash equivalents at end of period	\$	61,762	\$	183,153
Non cash transactions				
Transfer of loans to other real estate owned	\$	-	\$	111
Fair value adjustment for securities available-for-sale		(32,148)		(4,022)
Cash transactions				
Cash paid for interest	\$	2,107	\$	2,141
Cash paid for income taxes		2,180		2,550
Transactions related to acquisition:				
Assets acquired, net of cash received	\$	-	\$	9,296
Liabilities assumed		-		1,797

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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”). On December 31, 2021, Financial acquired all of the issued and outstanding stock of Pettyjohn, Wood & White, Inc. (“PWW”) through which it conducts its investment advisory business. 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.

On December 31, 2021, Financial completed its acquisition of PWW, a Lynchburg, Virginia-based investment advisory firm. Because the acquisition of PWW was effective on December 31, 2021, PWW had no impact on the consolidated statements of income and was primarily reflected on the consolidated balance sheet at December 31, 2021 through balances recorded for Customer relationship intangibles and Goodwill.

Note 2 - Summary of significant accounting policies (dollars in thousands)

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

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.

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.

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

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, less impairment, if any.

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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

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, 2021, the Company had 107 PPP loans with outstanding balances totaling \$8.15 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 were accreted to interest income over the lives of the loans until they were forgiven by the SBA. As of December 31, 2022 there were no longer any PPP loans outstanding.

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

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.

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.

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 \$431 and \$372 classified as TDRs as of December 31, 2022 and 2021, respectively.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

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.

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 the Bank – 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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

Business Segments

As of December 31, 2022, we operated three business segments, community banking, mortgage banking, and investment advisory services. 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. The investment advisory segment provides investment management for a fee through PWW. For additional 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.

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, 2022 and 2021, 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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

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 2022 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.

Business Combinations

Business combinations are accounted for under ASC 805, Business Combinations, using the acquisition method of accounting. The acquisition method of accounting requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. To determine the fair values, the Company utilizes third party valuations based on discounted cash flow analysis or other valuation techniques. Acquisition costs are costs the Company incurs to effect a business combination. Those costs include advisory, legal, accounting, valuation, and other professional or consulting fees. Some other examples of costs to the Company include systems conversions, integration planning consultants, contract terminations, and advertising costs. The Company will account for acquisition costs in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities will be recognized in accordance with other applicable accounting guidance. These acquisition-related costs are included on the Company's Consolidated Statements of Income classified within "Other" in the noninterest expense caption.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (continued)

Goodwill and Intangible Assets

Goodwill is subject to at least an annual assessment for impairment. Additionally, acquired intangible assets (such as customer relationship intangibles) are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful lives. The cost of customer relationships, based on independent valuation, are being amortized over their estimated lives of fifteen years.

The Company records as goodwill the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. The Company will review the carrying value of the goodwill at least annually or more frequently if certain impairment indicators exist. In testing goodwill for impairment, the Company may first consider qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we conclude that it is more likely than not that the fair value of a reporting unit is not less than its carrying amount, then no further testing is required and the goodwill of the reporting unit is not impaired. If the Company elects to bypass the qualitative assessment or if we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the fair value of the reporting unit is compared with its carrying value to determine whether an impairment exists. The Company has selected September 1 of each year as the date to perform the annual impairment test. Based upon Financial's qualitative assessment in September 2022, it was concluded that no impairment was present.

Marketing

The Company expenses advertising costs as incurred. Advertising expenses were \$920 and \$934 for 2022 and 2021, respectively.

Note 3 - Restrictions on cash

To comply with Federal Reserve regulations, the Bank may be required to maintain certain average cash reserve balances. There were no daily average cash reserve requirements for the weeks including December 31, 2022 and 2021, 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 decision came as the COVID-19 pandemic began to impact much of the way financial institutions both operate and serve their customers.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Securities

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

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
Held-to-maturity				
U.S. agency obligations	\$ 3,639	\$ —	\$ (504)	\$ 3,135
Available-for-sale				
U.S. Treasuries	\$ 4,912	\$ —	\$ (171)	\$ 4,741
U.S. agency obligations	68,833	—	(9,560)	59,273
Mortgage-backed securities	78,955	—	(11,113)	67,842
Municipals	49,951	—	(12,096)	37,855
Corporates	17,037	—	(961)	16,076
	<u>\$ 219,688</u>	<u>\$ —</u>	<u>\$ (33,901)</u>	<u>\$ 185,787</u>
	December 31, 2021			
	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
Held-to-maturity				
U.S. agency obligations	\$ 3,655	\$ 351	\$ —	\$ 4,006
Available-for-sale				
U.S. Treasuries	\$ 2,000	\$ 2	\$ —	\$ 2,002
U.S. agency obligations	59,144	575	(1,249)	58,470
Mortgage-backed securities	38,017	75	(654)	37,438
Municipals	50,806	368	(970)	50,204
Corporates	13,053	169	(69)	13,153
	<u>\$ 163,020</u>	<u>\$ 1,189</u>	<u>\$ (2,942)</u>	<u>\$ 161,267</u>

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 of time that individual securities have been in a continuous unrealized loss position, at December 31, 2022 and 2021:

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 –Securities (continued)

December 31, 2022	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	\$ 3,135	\$ 504	\$ —	\$ —	\$ 3,135	\$ 504
Available-for-sale						
U.S. Treasuries	4,741	171	—	—	4,741	171
U.S. agency obligations	27,708	2,838	31,565	6,722	59,273	9,560
Mortgage-backed securities	42,024	5,656	25,818	5,457	67,842	11,113
Municipals	10,847	2,245	27,008	9,851	37,855	12,096
Corporates	6,568	469	1,508	492	8,076	961
Total temporarily impaired securities	<u>\$ 95,023</u>	<u>\$ 11,883</u>	<u>\$ 85,899</u>	<u>\$ 22,522</u>	<u>\$ 180,922</u>	<u>\$ 34,405</u>
December 31, 2021						
	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	21,893	379	15,233	870	37,126	1,249
Mortgage-backed securities	28,019	402	6,382	252	34,401	654
Municipals	28,028	635	7,952	335	35,980	970
Corporates	1,931	69	—	—	1,931	69
Total temporarily impaired securities	<u>\$ 79,871</u>	<u>\$ 1,485</u>	<u>\$ 29,567</u>	<u>\$ 1,457</u>	<u>\$ 109,438</u>	<u>\$ 2,942</u>

U.S. Treasuries and agency obligations. The unrealized losses on the 33 investments in U.S. agency obligations at December 31, 2022 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 likely that the Bank will not 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, 2022. Each of these 33 investments carries an S&P investment grade rating of AA or better.

Mortgage-backed securities. The unrealized losses on the 23 investments in U.S. government agency mortgage-backed securities at December 31, 2022 were 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 likely

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 –Securities (continued)

that the Bank will not 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, 2022. Each of these 23 investments carries an S&P investment grade rating of AAA.

Municipals. The unrealized losses on the 52 investments in municipal obligations at December 31, 2022 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 likely that the Bank will not 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, 2022. Each of these 52 investments carries an S&P investment grade rating of AA or above.

Corporates. The unrealized losses on 10 investments in domestic corporate issued securities at December 31, 2022 were caused by an increase in interest rates. The contractual terms of those investments do not permit the issuers 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 likely that the Bank will not be required to sell the investments before recovery of the amortized cost basis, which may be maturity, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2022. Each of these 10 investments carries an S&P investment grade rating of BBB or above.

The amortized costs and fair values of securities at December 31, 2022, 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	\$ —	\$ —	\$ 2,339	\$ 2,312
Due after one year through five years	—	—	44,918	41,061
Due after five years through ten years	2,425	2,131	69,531	59,777
Due after ten years	1,214	1,004	102,900	82,637
	<u>\$ 3,639</u>	<u>\$ 3,135</u>	<u>\$ 219,688</u>	<u>\$ 185,787</u>

The Bank received \$7,681 and \$0 in proceeds from sales of securities available-for-sale in 2022 and 2021, respectively. Gross realized gains amounted to \$0 in 2022 and 2021, respectively. Gross realized losses amounted to \$3 and \$0 in 2022 and 2021, respectively.

At December 31, 2022 and 2021, securities with a carrying value of \$35,879 and \$32,159, respectively, were pledged as collateral for public deposits and for other purposes as required or permitted by law.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

<u>Loan Segments:</u>	<u>Loan Classes:</u>
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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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:

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2022	2021
Commercial	\$ 95,885	\$ 105,067
Commercial real estate	354,025	338,149
Consumer	97,959	89,102
Residential	63,756	51,066
Total loans (1)	611,625	583,384
Less allowance for loan losses	6,259	6,915
Net loans	<u>\$ 605,366</u>	<u>\$ 576,469</u>

(1) Includes net deferred costs/premiums of \$1,114 and \$372 as of December 31, 2022 and 2021, respectively.

The amounts of overdrafts reclassified as loans were \$45 and \$182 as of December 31, 2022 and 2021, 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, 2022 and 2021 were \$10,738 and \$11,200 respectively. The beginning balance was adjusted during 2022 to include \$52 in loans to two new executive officers that were not included as related-party loans at the end of 2021. During 2022, new loans and advances amounted to \$3,907 and repayments amounted to \$4,369.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2022 and 2021:

Loans on Non-Accrual Status

	As of December 31,	
	2022	2021
Commercial	\$ —	\$ 25
Commercial Real Estate:		
Commercial Mortgages-Owner Occupied	—	501
Commercial Mortgages-Non-Owner Occupied	518	138
Commercial Construction	—	—
Consumer		
Consumer Unsecured	—	—
Consumer Secured	20	127
Residential:		
Residential Mortgages	95	163
Residential Consumer Construction	—	—
Totals	<u>\$ 633</u>	<u>\$ 954</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Impaired Loans (dollars in thousands)				
	As of and For the Year Ended December 31, 2022				
2022	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With No Related Allowance Recorded:					
Commercial	\$ -	\$ -	\$ -	9	\$ -
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	554	581	-	1,573	48
Commercial Mortgage Non-Owner Occupied	518	526	-	310	23
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	249	249	-	154	12
Residential					
Residential Mortgages	1,345	1,428	-	1,331	54
Residential Consumer Construction	-	-	-	-	-
With an Allowance Recorded:					
Commercial	\$ -	\$ -	\$ -	-	\$ -
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	-	-	-	-	-
Commercial Mortgage Non-Owner Occupied	-	-	-	-	-
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	-	-	-	-	-
Residential					
Residential Mortgages	-	-	-	-	-
Residential Consumer Construction	-	-	-	-	-
Totals:					
Commercial	\$ -	\$ -	\$ -	9	\$ -
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	554	581	-	1,573	48
Commercial Mortgage Non-Owner Occupied	518	526	-	310	23
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	249	249	-	154	12
Residential					
Residential Mortgages	1,345	1,428	-	1,331	54
Residential Consumer Construction	-	-	-	-	-
	<u>\$ 2,666</u>	<u>\$ 2,784</u>	<u>\$ -</u>	<u>\$ 3,377</u>	<u>\$ 137</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Impaired Loans (dollars in thousands) As of and For the Year Ended December 31, 2021				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2021					
With No Related Allowance Recorded:					
Commercial	\$ 17	\$ 67	\$ -	\$ 179	\$ 5
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	2,592	2,971	-	2,368	154
Commercial Mortgage Non-Owner Occupied	102	102	-	371	13
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	59	60	-	201	2
Residential					
Residential Mortgages	1,316	1,390	-	1,332	47
Residential Consumer Construction	-	-	-	-	-
With an Allowance Recorded:					
Commercial	\$ -	\$ -	\$ -	\$ 2	\$ -
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	-	-	-	-	-
Commercial Mortgage Non-Owner Occupied	-	-	-	-	-
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	-	-	-	-	-
Residential					
Residential Mortgages	-	-	-	-	-
Residential Consumer Construction	-	-	-	-	-
Totals:					
Commercial	\$ 17	\$ 67	\$ -	\$ 181	\$ 5
Commercial Real Estate					
Commercial Mortgages-Owner Occupied	2,592	2,971	-	2,368	154
Commercial Mortgage Non-Owner Occupied	102	102	-	371	13
Commercial Construction	-	-	-	-	-
Consumer					
Consumer Unsecured	-	-	-	-	-
Consumer Secured	59	60	-	201	2
Residential					
Residential Mortgages	1,316	1,390	-	1,332	47
Residential Consumer Construction	-	-	-	-	-
	<u>\$ 4,086</u>	<u>\$ 4,590</u>	<u>\$ -</u>	<u>\$ 4,453</u>	<u>\$ 221</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2022 and 2021:

Allowance for Loan Losses and Recorded Investment in Loans (dollars in thousands) As of and For the Year Ended December 31, 2022					
2022	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for Loan Losses:					
Beginning Balance	\$ 1,471	\$ 3,637	\$ 860	\$ 947	\$ 6,915
Charge-Offs	-	(137)	(25)	-	(162)
Recoveries	104	212	18	72	406
Provision (recovery of provision)	(473)	(810)	51	332	(900)
Ending Balance	1,102	2,902	904	1,351	6,259
Ending Balance: Individually evaluated for impairment	-	-	-	-	-
Ending Balance: Collectively evaluated for impairment	1,102	2,902	904	1,351	6,259
Totals:	<u>\$ 1,102</u>	<u>\$ 2,902</u>	<u>\$ 904</u>	<u>\$ 1,351</u>	<u>\$ 6,259</u>
Financing Receivables:					
Ending Balance: Individually evaluated for impairment	-	1,072	249	1,345	2,666
Ending Balance: Collectively evaluated for impairment	95,885	352,953	97,710	62,411	608,959
Totals:	<u>\$ 95,885</u>	<u>\$ 354,025</u>	<u>\$ 97,959</u>	<u>\$ 63,756</u>	<u>\$ 611,625</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2021					
2021	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for Loan Losses:					
Beginning Balance	\$ 2,001	\$ 3,550	\$ 868	\$ 737	\$ 7,156
Charge-Offs	(53)	-	(38)	-	(91)
Recoveries	112	72	29	137	350
Provision (recovery of provision)	(589)	15	1	73	(500)
Ending Balance	1,471	3,637	860	947	6,915
Ending Balance: Individually evaluated for impairment	-	-	-	-	-
Ending Balance: Collectively evaluated for impairment	1,471	3,637	860	947	6,915
Totals:	<u>\$ 1,471</u>	<u>\$ 3,637</u>	<u>\$ 860</u>	<u>\$ 947</u>	<u>\$ 6,915</u>
Financing Receivables:					
Ending Balance: Individually evaluated for impairment	17	2,694	59	1,316	4,086
Ending Balance: Collectively evaluated for impairment	105,050	335,455	89,043	49,750	579,298
Totals:	<u>\$ 105,067</u>	<u>\$ 338,149</u>	<u>\$ 89,102</u>	<u>\$ 51,066</u>	<u>\$ 583,384</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The following tables set forth the age analysis of past due loans as of the years ended December 31, 2022 and 2021:

Age Analysis of Past Due Loans as of December 31, 2022							
2022	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	\$ 52	\$ 194	\$ —	\$ 246	\$ 95,639	\$ 95,885	\$ —
Commercial Real Estate:							
Commercial Mortgages-Owner Occupied	—	—	—	—	135,189	135,189	—
Commercial Mortgages-Non-Owner Occupied	55	—	—	55	206,646	206,701	—
Commercial Construction	—	397	—	397	11,738	12,135	—
Consumer:							
Consumer Unsecured	15	—	—	15	2,813	2,828	—
Consumer Secured	62	—	13	75	95,056	95,131	—
Residential:							
Residential Mortgages	139	—	95	234	42,815	43,049	—
Residential Consumer Construction	—	—	—	—	20,707	20,707	—
Total	\$ 323	\$ 591	\$ 108	\$ 1,022	\$ 610,603	\$ 611,625	\$ —
Age Analysis of Past Due Loans as of December 31, 2021							
2021	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	\$ —	\$ 1	\$ 25	\$ 26	\$ 105,041	\$ 105,067	\$ —
Commercial Real Estate:							
Commercial Mortgages-Owner Occupied	464	—	501	965	127,869	128,834	—
Commercial Mortgages-Non-Owner Occupied	1,310	—	—	1,310	177,803	179,113	—
Commercial Construction	—	—	—	—	30,202	30,202	—
Consumer:							
Consumer Unsecured	8	1	—	9	2,596	2,605	—
Consumer Secured	111	3	118	232	86,265	86,497	—
Residential:							
Residential Mortgages	948	—	163	1,111	30,814	31,925	—
Residential Consumer Construction	—	—	—	—	19,141	19,141	—
Total	\$ 2,841	\$ 5	\$ 807	\$ 3,653	\$ 579,731	\$ 583,384	\$ —

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The following tables set forth the credit quality information by segment as of December 31, 2022 and 2021:

Credit Quality Information - by Class December 31, 2022						
2022	Pass	Monitor	Special Mention	Substandard	Doubtful	Totals
Commercial	\$ 89,889	\$ 4,418	\$ 1,465	\$ 113	\$ —	\$ 95,885
Commercial Real Estate:						
Commercial Mortgages-Owner Occupied	132,686	1,931	—	572	—	135,189
Commercial Mortgages-Non-Owner Occupied	204,810	—	1,182	709	—	206,701
Commercial Construction	12,126	9	—	—	—	12,135
Consumer						
Consumer Unsecured	2,809	—	19	—	—	2,828
Consumer Secured	94,788	—	—	343	—	95,131
Residential:						
Residential Mortgages	41,591	—	—	1,458	—	43,049
Residential Consumer Construction	19,178	1,529	—	—	—	20,707
Totals	\$ 597,877	\$ 7,887	\$ 2,666	\$ 3,195	\$ —	\$ 611,625

Credit Quality Information - by Class December 31, 2021						
2021	Pass	Monitor	Special Mention	Substandard	Doubtful	Totals
Commercial	\$ 92,789	\$ 7,965	\$ 4,262	\$ 51	\$ —	\$ 105,067
Commercial Real Estate:						
Commercial Mortgages-Owner Occupied	116,098	5,986	4,130	2,620	—	128,834
Commercial Mortgages-Non-Owner Occupied	176,291	2,506	—	316	—	179,113
Commercial Construction	30,202	—	—	—	—	30,202
Consumer						
Consumer Unsecured	2,581	—	23	1	—	2,605
Consumer Secured	86,265	—	—	232	—	86,497
Residential:						
Residential Mortgages	30,486	—	—	1,439	—	31,925
Residential Consumer Construction	19,141	—	—	—	—	19,141
Totals	\$ 553,853	\$ 16,457	\$ 8,415	\$ 4,659	\$ —	\$ 583,384

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Troubled Debt Restructurings (TDRs)

There was one loan modification during the twelve months ended December 31, 2022 that was classified as a Troubled Debt Restructuring (TDR). The commercial owner-occupied real estate loan was modified to allow for multiple payment deferrals.

During the twelve months ended December 31, 2021 there no loan modifications classified as TDRs.

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, 2022 and December 31, 2021, 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, 2022 and 2021.

Note 6 - Other real estate owned

At December 31, 2022 and 2021, OREO was \$566 and \$761 respectively and was comprised of non-residential properties associated with commercial relationships. As of December 31, 2022 and 2021 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 2022 and 2021.

	OREO Changes	
	Year Ended December 31,	
	2022	2021
Balance at the beginning of the year	\$ 761	\$ 1,105
Transfers from Loans	—	111
Capitalized costs	—	—
Valuation adjustments	(195)	—
Sales	—	(368)
Loss on sales	—	(87)
Balance at the end of the year	<u>\$ 566</u>	<u>\$ 761</u>

There were no residential properties being carried in OREO as of December 31, 2022 and 2021.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 – Premises and equipment

Premises and equipment at December 31, 2022 and 2021 are summarized as follows:

	December 31,	
	2022	2021
Land	\$ 3,882	\$ 3,302
Building and improvements	14,040	12,400
Property for future expansion	52	1,931
Furniture and equipment	9,033	8,407
Leasehold improvements	3,056	3,021
Software	2,000	1,974
	<u>32,063</u>	<u>31,035</u>
Less accumulated depreciation	<u>14,089</u>	<u>12,684</u>
Net premises and equipment	<u>\$ 17,974</u>	<u>\$ 18,351</u>

Total depreciation and amortization expense related to premises and equipment for the years ended December 31, 2022 and 2021 was \$1,556 and \$1,566, respectively.

Note 8 - Deposits

A summary of deposit accounts is as follows:

	December 31,	
	2022	2021
Demand		
Noninterest bearing	\$ 154,884	\$ 162,286
Interest bearing	428,027	459,920
Savings	132,452	122,080
Time, \$250,000 or more	17,529	19,526
Other time	115,246	123,244
	<u>\$ 848,138</u>	<u>\$ 887,056</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Deposits (continued)

At December 31, 2022, maturities of time deposits are scheduled as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2023	\$ 61,302
2024	26,628
2025	16,199
2026	7,783
2027 and thereafter	20,863
	<u>\$ 132,775</u>

The Bank held deposits from the Company's officers, directors and their related interests of \$17,928 and \$14,426 at December 31, 2022 and 2021, respectively.

Note 9 – Business Segments

The Company has three reportable business segments: (i) a traditional full-service community banking segment, (ii) a mortgage loan origination business, and (iii) a registered investment advisory business (sometimes referred to as the wealth management business). The community banking business segment includes Bank of the James which provides loans, deposits, investments and insurance to retail and commercial customers throughout Region 2000 and other areas within Central Virginia. The mortgage segment provides a variety of mortgage loan products principally within Region 2000. Mortgage loans are originated and sold in the secondary market through purchase commitments from investors with servicing released. Because of the pre-arranged purchase commitments, there is minimal risk to the Company. The investment advisory business offers investment advisory services through Financial's wholly-owned subsidiary, Pettyjohn, Wood & White, Inc.

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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 – Business Segments (continued)

Information about reportable business segments and reconciliation of such information to the consolidated financial statements as of and for the years ended December 31, 2022 and 2021 was as follows:

Business Segments

	Community Banking	Mortgage	Investment Advisory Services	Total
For the year ended December 31, 2022				
Net interest income	\$ 29,703	\$ -	\$ -	\$ 29,703
(Recovery of) loan losses	(900)	-	-	(900)
Net interest income after (recovery of) loan losses	30,603	-	-	30,603
Noninterest income	4,056	5,256	3,932	13,244
Noninterest expenses	26,035	4,466	2,236	32,737
Income before income taxes	8,624	790	1,696	11,110
Income tax expense	1,628	166	357	2,151
Net income	6,996	624	1,339	8,959
Total assets as of December 31, 2022	914,420	2,916	11,235	928,571
For the year ended December 31, 2021				
Net interest income	\$ 27,079	\$ -	\$ -	\$ 27,079
Provision for loan losses	(500)	-	-	(500)
Net interest income after provision for loan losses	27,579	-	-	27,579
Noninterest income	2,944	8,265	-	11,209
Noninterest expenses	23,432	5,905	-	29,337
Income before income taxes	7,091	2,360	-	9,451
Income tax expense	1,366	496	-	1,862
Net income	\$ 5,725	1,864	-	7,589
Total assets as of December 31, 2021	\$ 985,521	2,113	-	987,634

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 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 June 30, 2025 and are currently subject to full or partial call by the Company on thirty days notice. The balance of the 2020 Notes as of December 31, 2022 and 2021 is presented net of unamortized issuance costs on the Consolidated Balance Sheet.

On September 24, 2020 the Bank used \$5,000 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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 2022 or 2021 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 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 \$4,689.

The Bank is also a member of the Federal Home Loan Bank of Atlanta ("FHLBA"). The Bank's available credit through the FHLBA was \$238,033 as of December 31, 2022, 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 \$21,907 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 \$14,046 in credit without pledging any additional collateral.

As of December 31, 2022, and 2021 there were no outstanding balances on any of the credit facilities mentioned above.

On December 29, 2021, Financial borrowed \$11,000,000 from National Bank of Blacksburg (NBB) pursuant to a secured promissory note (the "NBB Note"). Prior to the modification discussed below, the NBB Note bore interest at the rate of 4.00%, and was being amortized over a fifteen year period with a balloon payment of approximately \$9,375,000 due on December 31, 2024. The note is secured by a first priority lien on approximately 4.95% of the Bank's common stock. The balance of the NBB Note is presented on the Consolidated Balance Sheets under "other borrowings" and is net of unamortized issuance costs. A portion of the proceeds were used to purchase 100% of the capital stock of PWW.

On June 30, 2022, NBB agreed to modify the terms of the NBB Note effective July 1, 2022. Pursuant to the modification, the balloon payment date was extended to December 31, 2026 from December 31, 2024 and the interest rate was lowered to 3.90% from 4.00%. The approximate amount of the balloon payment on December 31, 2026 will be \$8,104,000.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 2019.

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

	December 31,	
	2022	2021
Current federal income tax expense	\$ 2,161	\$ 1,748
Deferred federal income tax (benefit) expense	(10)	114
Income tax expense	<u>\$ 2,151</u>	<u>\$ 1,862</u>

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:

	2022	2021
Computed "expected" income tax expense	\$ 2,333	\$ 1,985
Increase (reduction) in income tax resulting from:		
Non-taxable income	(110)	(101)
Non-deductible expenses	13	12
Other	(85)	(34)
Income tax expense	<u>2,151</u>	<u>1,862</u>

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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Income taxes (continued)

	December 31,	
	2022	2021
Deferred tax assets		
Lease liabilities	\$ 976	\$ 1,065
Allowance for loan losses	1,314	1,452
Unrealized losses on available-for-sale securities	7,119	368
OREO	137	96
Non-accrual interest	91	121
Deferred Compensation	782	665
Other	21	40
Gross deferred tax assets	<u>10,440</u>	<u>3,807</u>
Deferred tax liabilities		
Right-of-use assets	898	1,002
Depreciation	303	352
Intangibles	—	1,765
Other	<u>113</u>	<u>88</u>
Gross deferred tax liabilities	<u>1,314</u>	<u>3,207</u>
Net deferred tax asset	<u>\$ 9,126</u>	<u>\$ 600</u>

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,	
	2022	2021
Net income	\$ 8,959	\$ 7,589
Weighted average number of shares outstanding - basic and diluted	<u>4,698,041</u>	<u>4,747,821</u>
Earnings per common shares - basic and diluted	<u>\$ 1.91</u>	<u>\$ 1.60</u>

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 – Earnings per common share (EPS) (continued)

All restricted stock units (RSUs) were excluded from calculating diluted earnings per share as the Company elected to settle units vesting in 2022 and 2021 wholly in cash. There are currently no outstanding RSUs as of December 31, 2022. There were no potentially dilutive shares outstanding in 2022 and 2021. Consequently, the weighted average shares and weighted average diluted shares were identical. Weighted average and per share amounts for all periods have been adjusted to reflect a 10% stock dividend declared on May 18, 2021.

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 \$454 and \$411 to the plan on behalf of the employees for the years ended December 31, 2022 and 2021, 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 \$561 and \$477 for the years ended December 31, 2022 and 2021, respectively. The related liability totaled \$3,726 and \$3,165 at December 31, 2022 and 2021, respectively.

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, 2022 and 2021, the life insurance policies had cash surrender values of approximately \$19,237 and \$18,785, 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 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 2022 and 2021, 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 years ended December 31, 2022 and 2021.

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. 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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15 – Stock-based compensation plans(continued)

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 vested 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, 2022 and 2021, in connection with the restricted stock unit awards was approximately \$0 and \$106 in each year, respectively. There were no forfeitures during the years ended December 31, 2022 and 2021. There were no new grants in the year ended December 31, 2022. The fair value of shares which vested in 2022 and 2021 was \$127 and \$100, respectively.

At December 31, 2022, there was no remaining unrecognized stock-based compensation expense remaining as all awards have vested and were cash settled.

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 2022 and 2021, 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, 2022 and 2021.

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,

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Regulatory matters (continued)

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 Common Equity Tier 1 capital 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, 2022 that the Bank met all capital adequacy requirements to which it is subject. The Bank's actual regulatory capital amounts and ratios for December 31, 2022 and 2021 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, 2022 and 2021, and is applicable for the Common Equity Tier 1, Tier 1, and Total Capital Ratios.

As of December 31, 2022, 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 1 risk-based and Tier 1 leverage ratios as set forth in the following table.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Regulatory matters (continued)

The capital ratios for the Bank for 2022 and 2021 are set forth in the following table:

December 31, 2022						
	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)	\$ 90,166	11.98%	\$ 79,014	>10.50%	\$ 75,252	> 10.00%
Tier 1 capital (to risk-weighted assets)	\$ 83,907	11.15%	\$ 63,964	>8.50%	\$ 60,201	> 8.00%
Common Equity Tier 1 capital (to risk-weighted assets)	\$ 83,907	11.15%	\$ 52,676	>7.00%	\$ 48,913	>6.50%
Tier 1 capital (leverage) (to average assets)	\$ 83,907	8.98%	\$ 37,371	> 4.00%	\$ 46,714	> 5.00%

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

December 31, 2021						
	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)	\$ 85,803	12.37%	\$ 72,807	>10.50%	\$ 69,340	> 10.00%
Tier 1 capital (to risk-weighted assets)	\$ 78,888	11.38%	\$ 58,939	>8.50%	\$ 55,472	> 8.00%
Common Equity Tier 1 capital (to risk-weighted assets)	\$ 78,888	11.38%	\$ 48,538	>7.00%	\$ 45,071	>6.50%
Tier 1 capital (leverage) (to average assets)	\$ 78,888	8.22%	\$ 38,392	> 4.00%	\$ 47,990	> 5.00%

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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2022, the Bank had rate lock commitments to originate mortgage loans through its Mortgage Division amounting to approximately \$11,200 and loans held for sale of \$2,423. The Bank has entered into corresponding commitments with third party investors to sell each of these loans that close. No other obligation exists.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2022	2021
Commitments to extend credit	\$ 196,902	\$ 179,953
Standby letters of credit	\$ 2,923	\$ 4,335

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, 2022 were approximately \$13,674 which consisted of the total balances in one account at the Federal Home Loan Bank of Atlanta (FHLBA), as well as the balances (all net of \$250 FDIC coverage) held in one account at Community Bankers' Bank, one account at Truist Bank, one account at Zions Bank, one account held at First National Bankers' Bank, and one account held at PNC Bank. Uninsured cash balances as of December 31, 2021 were approximately \$4,162 which consisted of the total balances in the same accounts referenced for 2022 above.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements

Financial instruments measured at fair value on recurring basis.

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

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.

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)

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

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

Description	Balance as of December 31, 2022	Fair Value at December 31, 2022		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasuries	\$ 4,741	\$ —	\$ 4,741	\$ —
U.S. agency obligations	59,273	—	59,273	—
Mortgage-backed securities	67,842	—	67,842	—
Municipals	37,855	—	37,855	—
Corporates	16,076	—	16,076	—
Total available-for-sale securities	\$ 185,787	\$ —	\$ 185,787	\$ —
IRLCs – asset	91	—	—	91
Total assets at fair value	\$ 185,878	\$ —	\$ 185,787	\$ 91

Description	Balance as of December 31, 2021	Fair Value at December 31, 2021		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasuries	\$ 2,002	\$ —	\$ 2,002	\$ —
U.S. agency obligations	58,470	—	58,470	—
Mortgage-backed securities	37,438	—	37,438	—
Municipals	50,204	—	50,204	—
Corporates	13,153	—	13,153	—
Total available-for-sale securities	\$ 161,267	\$ —	\$ 161,267	\$ —
IRLCs – asset	144	—	—	144
Total assets at fair value	\$ 161,411	\$ —	\$ 161,267	\$ 144

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

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, 2022 (dollars in thousands)				
	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Assets				
IRLCs - asset	\$ 91	Market approach	Range of pull through rate	85%

Quantitative information about Level 3 Fair Value Measurements for December 31, 2021 (dollars in thousands)				
	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Assets				
IRLCs - asset	\$ 144	Market approach	Range of pull through rate	85%

Assets measured at fair value on a nonrecurring basis.

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, 2022 and 2021. 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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

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 properties 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.

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.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

Description	Balance as of December 31, 2022	Fair Value at December 31, 2022		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans*	\$ 854	\$ —	\$ —	\$ 854
Other real estate	\$ 566	\$ —	\$ —	\$ 566

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

Description	Balance as of December 31, 2021	Fair Value at December 31, 2021		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans*	\$ 1,802	\$ —	\$ —	\$ 1,802
Other real estate	\$ 761	\$ —	\$ —	\$ 761

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

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

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

**Quantitative information about Level 3 Fair Value Measurements for
December 31, 2022
(dollars in thousands)**

	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 854	Discounted appraised value	Selling cost	0% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 20% (6%)
OREO	\$ 566	Discounted appraised value	Selling cost	26%
			Discount for lack of marketability and age of appraisal	0% - 27% (26%)

**Quantitative information about Level 3 Fair Value Measurements for
December 31, 2021
(dollars in thousands)**

	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 1,802	Discounted appraised value	Selling cost	0% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 20% (6%)
OREO	\$ 761	Discounted appraised value	Selling cost	10%
			Discount for lack of marketability and age of appraisal	0% - 27% (26%)

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, 2022 and 2021 were estimated using an exit price notion.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Fair value measurements (continued)

Fair Value Measurements at December 31, 2022 using					
	Carrying Amounts	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
Assets					
Cash and due from banks	\$ 30,025	\$ 30,025	\$ —	\$ —	\$ 30,025
Fed funds sold	31,737	31,737	—	—	31,737
Securities					
Available-for-sale	185,787	—	185,787	—	185,787
Held-to-maturity	3,639	—	3,135	—	3,135
Restricted stock	1,387	—	1,387	—	1,387
Loans, net	605,366	—	—	564,802	564,802
Loans held for sale	2,423	—	2,423	—	2,423
Interest receivable	2,736	—	2,736	—	2,736
BOLI	19,237	—	19,237	—	19,237
Derivatives	91	—	—	91	91
Liabilities					
Deposits	\$ 848,138	\$ —	\$ 850,102	\$ —	\$ 850,102
Capital notes	10,037	—	9,200	—	9,200
Other borrowings	10,457	—	9,438	—	9,438
Interest payable	89	—	89	—	89

Fair Value Measurements at December 31, 2021 using					
	Carrying Amounts	(Level 1)	(Level 2)	(Level 3)	Balance
Assets					
Cash and due from banks	\$ 29,337	\$ 29,337	\$ —	\$ —	\$ 29,337
Fed funds sold	153,816	153,816	—	—	153,816
Securities					
Available-for-sale	161,267	—	161,267	—	161,267
Held-to-maturity	3,655	—	4,006	—	4,006
Restricted stock	1,324	—	1,324	—	1,324
Loans, net	576,469	—	—	565,543	565,543
Loans held for sale	1,628	—	1,628	—	1,628
Interest receivable	2,064	—	2,064	—	2,064
BOLI	18,785	—	18,785	—	18,785
Derivatives	144	—	—	144	144
Liabilities					
Deposits	\$ 887,056	\$ —	\$ 887,955	\$ —	\$ 887,955
Capital notes	10,031	—	10,711	—	10,711
Other borrowings	10,985	—	11,465	—	11,465
Interest payable	46	—	46	—	46

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 revenue 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, wealth management 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 or in the case of wealth management fees, at the end of a quarter.

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 customer on an annual basis and recognized upon receipt of payment.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22 – Revenue Recognition (continued)

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

The Company's leases are recorded under ASC Topic 842 "Leases." 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 four of its operating locations under long-term leases (greater than 12 months). Leases for two 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 \$2.7 million at December 31, 2022.

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

(Dollars in thousands)	December 31,	
	2022	2021
Lease liabilities	\$ 1,260	\$ 1,325
Right-of-use assets	\$ 1,204	\$ 1,282
Weighted average remaining lease term	12.7 years	13.7 years
Weighted average discount rate	3.44%	3.44%

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 23 – Leases (continued)

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

	December 31,	
	2022	2021
(Dollars in thousands)		
Lease liabilities	\$ 3,389	\$ 3,746
Right-of-use assets	\$ 3,074	\$ 3,488
Weighted average remaining lease term	8.2 years	9.2 years
Weighted average discount rate	2.70%	2.70%
	For the Year Ended December 31,	
	2022	2021
Lease cost (in thousands)		
Operating lease cost	\$ 121	\$ 125
Finance lease cost:		
Amortization of right-of-use assets	414	414
Interest on lease liabilities	96	106
Total lease cost	\$ 631	\$ 645
Cash paid for amounts included in measurement of operating lease liabilities	\$ 112	\$ 112
Cash paid for amounts included in measurement of finance lease liabilities	\$ 453	\$ 453

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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:

	Operating Lease Liabilities As of December 31, 2022	Finance Lease Liabilities As of December 31, 2022
Lease payments due (in thousands)		
Twelve months ending December 31, 2023	\$ 110	\$ 454
Twelve months ending December 31, 2024	111	479
Twelve months ending December 31, 2025	112	515
Twelve months ending December 31, 2026	116	515
Twelve months ending December 31, 2027	125	517
Thereafter	1,000	1,333
Total undiscounted cash flows	\$ 1,574	\$ 3,813
Discount	(314)	(424)
Lease liabilities	\$ 1,260	\$ 3,389

Note 24 - Impact of recently issued accounting standards

During June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The ASU, as amended, requires an entity to measure expected credit losses for financial assets carried at amortized cost based on historical experience, current conditions, and reasonable and supportable forecasts. Among other things, the ASU also amended the impairment model for available for sale securities and addressed purchased financial assets with deterioration. The Company adopted ASU 2016-13 as of January 1, 2023 in accordance with the required implementation date. Transition adjustments during the first quarter of 2023, will include increases in the allowance for credit losses and the reserve for credit losses on unfunded commitments to extend credit as well as a reduction of total equity, net of taxes. This reduction of equity capital may, at the Bank's election, be phased-in over a three year period in accordance with regulatory guidelines. The final cumulative effect of the transition adjustments is still subject to completion by the Company but is estimated to reduce opening retained earnings on January 1, 2023 by a reasonable range of \$1.25 million to \$1.75 million. Subsequent to adoption, the Company will record adjustments to its allowance for credit losses and reserves for unfunded commitments through the provision for credit losses in the consolidated statements of income.

The Company is utilizing a third-party model to tabulate its estimate of current expected credit losses, using a discounted cash-flow methodology. In accordance with ASC 326, the Company has segmented its loan portfolio based on similar risk characteristics. The Company primarily utilizes measurable economic trends (including local, state and national unemployment), in its reasonable and supportable forecasting of current expected credit losses. To further adjust the allowance for credit losses for expected losses not already included within the quantitative component of the calculation, the Company may consider the following qualitative adjustment factors: recent changes in lending policies, procedures, and personnel, changes in the nature and volume of the loan portfolio, and changes in the underlying value of collateral for collateral dependent loans, among other

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

factors. The Company's CECL implementation process was overseen by our Chief Credit Officer, Chief Financial Officer, Controller and General Counsel and included an assessment of data availability and gap analysis, data collection, consideration and analysis of multiple loss estimation methodologies, an assessment of relevant qualitative factors and correlation analysis of multiple potential loss drivers and their impact on the Company's historical loss experience. During 2022, the Company calculated its current expected credit losses model in parallel to its incurred loss model in order to further refine the methodology and model. In addition, the Company engaged a third-party to perform a comprehensive model validation.

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.

In December 2022, the FASB issued ASU 2022-06, "Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848". ASU 2022-06 extends the period of time preparers can utilize the reference rate reform relief guidance in Topic 848. The objective of the guidance in Topic 848 is to provide relief during the temporary transition period, so the FASB included a sunset provision within Topic 848 based on expectations of when the London Interbank Offered Rate (LIBOR) would cease being published. In 2021, the UK Financial Conduct Authority (FCA) delayed the intended cessation date of certain tenors of USD LIBOR to June 30, 2023.

In March 2022, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2022-02, "Financial Instruments-Credit Losses (Topic 326), Troubled Debt Restructurings and Vintage Disclosures." ASU 2022-02 addresses areas identified by the FASB as part of its post-implementation review of the credit losses standard (ASU 2016-13) that introduced the CECL model. The amendments eliminate the accounting guidance for troubled debt restructurings by creditors that have adopted the CECL model and enhance the disclosure requirements for loan refinancings and restructurings made with borrowers experiencing financial difficulty. In addition, the amendments require a public business entity to disclose current-period gross write-offs for financing receivables and net investment in leases by year of origination in the vintage disclosures. The amendments in this ASU should be applied prospectively, except for the transition method related to the recognition and measurement of TDRs, an entity has the option to apply a modified retrospective transition method, resulting in a cumulative-effect adjustment to retained earnings in the period of adoption. For entities that have not yet adopted ASU 2016-13, the effective dates for ASU 2022-02 are the same as the effective dates in ASU 2016-13. The Company is currently assessing the impact that ASU 2022-02 will have on its consolidated financial statements.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2022	2021
Assets		
Cash	\$ 2,913	\$ 2,744
Taxes receivable	76	9
Investment in subsidiaries	67,967	88,003
Other assets	19	17
Total assets	\$ 70,975	\$ 90,773
Liabilities and stockholders' equity		
Capital notes	\$ 10,037	\$ 10,031
Other borrowings	10,457	10,985
Other liabilities	255	328
Total Liabilities	\$ 20,749	\$ 21,344
Common stock \$2.14 par value	\$ 9,905	\$ 10,145
Additional paid-in-capital	36,068	37,230
Retained earnings	31,034	23,440
Accumulated other comprehensive (loss)	(26,781)	(1,386)
Total stockholders' equity	\$ 50,226	\$ 69,429
Total liabilities and stockholders' equity	\$ 70,975	\$ 90,773

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Statements of Income

	Years Ended December 31,	
	2022	2021
Income		
Dividends from subsidiaries	\$ 5,318	\$ —
Operating expenses		
Interest on capital notes and other borrowings	767	327
Legal and professional fees	237	259
Other expense	135	138
Total expenses	1,139	724
Income tax (benefit)	(239)	(114)
Income (loss) before equity in undistributed income of subsidiaries	4,418	(610)
Equity in undistributed income of subsidiaries	4,541	8,199
Net income	\$ 8,959	\$ 7,589

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Statements of Cash Flows

	Years Ended December 31,	
	2022	2021
Cash flows from operating activities		
Net income	\$ 8,959	\$ 7,589
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Amortization of debt issuance costs	10	4
(Increase) decrease in income taxes receivable	(67)	65
(Increase) in other assets	(2)	(7)
(Decrease) increase in other liabilities	(73)	121
Equity in undistributed net (income) of subsidiaries	(4,541)	(8,199)
Net cash provided by (used in) operating activities	\$ 4,286	\$ (427)
Cash flows from investing activities		
Cash paid in acquisition of subsidiary	(818)	(10,500)
Net cash used in investing activities	\$ (818)	\$ (10,500)
Cash flows from financing activities		
Dividends paid to common stockholders	\$ (1,365)	\$ (1,271)
Principal payments on other borrowings	(532)	—
Proceeds from other borrowings	—	10,985
Repurchase of common stock	(1,402)	(427)
Cash payment in lieu of fractional shares related to 10% stock dividend	—	(16)
Net cash (used in) provided by financing activities	\$ (3,299)	\$ 9,271
Increase (decrease) in cash and cash equivalents	\$ 169	\$ (1,656)
Cash and cash equivalents at beginning of period	2,744	4,400
Cash and cash equivalents at end of period	\$ 2,913	\$ 2,744

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 26 – Acquisitions

On December 31, 2021, Financial completed its acquisition of all the outstanding shares of Pettyjohn, Wood & White, Inc. ("PWW"), a Lynchburg, Virginia-based investment advisory firm with approximately \$650 million in assets under management and advisement at the time of the acquisition. The acquisition was undertaken to enhance Financial's service line offerings as well as augment its noninterest income streams. Subsequent to its acquisition, PWW operates as a subsidiary of Financial. The transaction was accounted for using the acquisition method of accounting, and accordingly, assets acquired, liabilities assumed, and consideration transferred were recorded at their estimated fair values on the acquisition date. The fair values were subject to refinement for up to one year after the closing date of the acquisition.

The acquisition date fair value of the consideration transferred upon closing on December 31, 2021 totaled \$10.5 million, which was paid in cash. The preliminary fair values of the assets acquired and liabilities assumed were \$9.3 million and \$1.8 million, respectively, resulting in an acquisition date balance of goodwill totaling approximately \$3.0 million. The principal component of the assets acquired was \$8.4 million of amortizable intangible assets, which primarily relate to the value of customer relationships acquired with the acquisition of PWW. The Company is amortizing these intangible assets over a 15-year period using the straight-line method.

In accordance with the acquisition agreement, a working capital adjustment was paid in 2022 totaling approximately \$818 thousand to the former owners of PWW. As such, Financial adjusted the total consideration transferred by increasing its investment in PWW by the amount of cash paid and also recorded a corresponding increase to the balance of goodwill. Additionally, in 2022, it was determined a valid IRC 338(h)(10) election was filed, which in effect, will treat the acquisition of PWW's outstanding shares as an asset acquisition for tax purposes. The balance of goodwill was reduced by \$1.8 million with a corresponding increase to deferred income taxes (included in the other assets caption) to appropriately reflect this determination. The adjusted balance of goodwill of \$2.1 million is expected to be deductible for income tax purposes.

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, 2022. There have been no disagreements with such independent accountants during the last two fiscal years ended December 31, 2022, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Item 9A. Controls and Procedures

a) Evaluation of Disclosures and Controls Procedures

Management of the Company is responsible for establishing and maintaining disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

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, 2022. 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 subsidiaries to disclose material information required to be set forth in the Company's periodic reports.

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.

b) Report of Management's Assessment of Internal Controls over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange act. 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. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

As of December 31, 2022, management has assessed the effectiveness of the internal control over financial reporting based on the criteria for effective internal control over financial reporting established in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework (2013)*. Based on the assessment, Management determined that it maintained effective internal control over the financial reporting as of December 31, 2022, based on the 2013 framework criteria.

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, 2022. 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.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

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.

d) **Changes in Internal Control over Financial Reporting**

There have been no significant changes during the quarter ended December 31, 2022, 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.

Item 9B. Other Information

None.

Item 9C. Disclosure Regarding Foreign Jurisdictions that Prevent Inspections

Not applicable.

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 2023 Annual Meeting of Shareholders, which Proxy Statement will be filed with the SEC within 120 days of the end of the Financial’s 2022 fiscal year (the “2023 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 2023 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 2023 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 2023 Proxy Statement and is hereby incorporated by reference.

Item 14. Principal Accountant 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 2023 Proxy Statement and is hereby incorporated by reference. Our independent registered public accounting firm is Yount, Hyde & Barbour, Winchester, Virginia, US PCAOB Auditor Firm I.D.: 613

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:

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<u>No.</u>	<u>Description</u>
2.1	<u>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)</u>
3.1	<u>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)</u>
3.2	<u>Bylaws of Bank of the James Financial Group, Inc. (incorporated by reference to Exhibit 3.2 to Form 8-K filed February 19, 2021)</u>
4.1	<u>Description of Registrant's Securities (incorporated by reference to Exhibit 4.1 to Form 10-K filed on March 29, 2022)</u>
10.1	<u>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)</u>
10.2	<u>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)</u>
10.3	<u>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)</u>
10.4	<u>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)</u>
10.5	<u>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)</u>
10.6	<u>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)</u>
10.7	<u>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)</u>
10.8	<u>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)</u>
10.9	<u>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)</u>
10.10	<u>Salary Continuation Agreement dated effective as of January 29, 2013 by and between the Bank and Michael A. Syrek (incorporated by reference to Exhibit 10.10 to Form 10-K filed on March 29, 2022)</u>
10.11	<u>Salary Continuation Agreement dated effective as of January 1, 2023 by and between the Bank and Eric J. Sorenson, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K filed on January 6, 2023)</u>
10.12	<u>Dividend Reinvestment Plan (Incorporated by reference to Registration Statement on Form S-3, filed on August 21, 2017)</u>
10.13	<u>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)</u>
10.14	<u>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)</u>
21.1	<u>List of subsidiaries (filed herewith)</u>
23.1	<u>Consent of Yount, Hyde and Barbour, P.C. (filed herewith)</u>
31.1	<u>Certification pursuant to Rule 13a-14(a)/15d-14(a) (filed herewith)</u>
31.2	<u>Certification pursuant to Rule 13a-14(a)/15d-14(a) (filed herewith)</u>

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, 2022, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets as of December 31, 2022 and 2021; (ii) Consolidated Statements of Income For the Years ended December 31, 2022 and 2021; (iii) Consolidated Statements of Cash Flows for the Years ended December 31, 2022 and 2021 (iv) Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income (Loss) For the Years ended December 31, 2022 and 2021; (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 indicated as of March 31, 2023.

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

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.
Pettyjohn, Wood & White, Inc.	Virginia	Pettyjohn, Wood & White, Inc. Pettyjohn, Wood & White
BOTJ Investment Group, Inc.	Virginia	Inactive



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 31, 2023, 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, 2022.

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

Winchester, Virginia
March 31, 2023

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 31, 2023

By /S/ Robert R. Chapman III

Robert R. Chapman III

President (Principal Executive Officer) and Director

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 31, 2023

By /S/ J. Todd Scruggs

J. Todd Scruggs

Secretary and Treasurer (Principal Financial Officer and
Principal Accounting Officer) and Director

**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, 2022 (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 31, 2023

By /S/ Robert R. Chapman III

Robert R. Chapman III

President and Director (Principal Executive Officer)

Date: March 31, 2023

By /S/ J. Todd Scruggs

J. Todd Scruggs

Secretary and Treasurer (Principal Financial Officer and
Principal Accounting Officer)
