FARMERS BANK

Since 1919

ANNUAL REPORT 2016

HIGHLIGHTING INDEPENDENCE:

Taste

Taste is an award-winning specialty food store that uses its 350 employees to cultivate community through a taste of the good life. The brand has been independent and family owned since its opening in 1973. Local customers know the Taste difference comes from their food promise of using small batch, from scratch house-made foods from local and seasonal ingredients whenever possible. We at Farmers Bank have also remained independent in order to carry out our mission as a community bank. Our partnership with Taste has been rewarding as they continue to expand and uphold their dedication to the local community.

Since 1919 we have been a community bank extremely focused on our customers' needs, attentive to their desires, empathizing with their hardships, celebrating their successes, and genuinely interested in their stories. While our story entails growing from a one branch, small-town bank to seven branches located throughout the Tidewater area, we still value those personal relationships and remain involved in the evolution of our customers. We are proud to feature a few of our customers throughout this annual report who have demonstrated values similar to our own. Whether it be a retail business committed to expanding a brand, a generational manufacturer focusing on diversification, a hard working farm family, or an organization committed to helping those in need, we can service a variety of needs and respond with flexible solutions.

We value personal relationships and remain involved in the evolution of our customers.

Dear Shareholder,

One of our favorite stories of 2016 has been our financial success and ability to return a portion of that to our shareholders. Again, we are able to report record earnings of almost $4.2 million for 2016. Our board of directors and management team have remained determined and focused on our long-term objectives when making strategic decisions.

Consolidated net income of $4.2 million has increased approximately eleven percent over our 2015 net income of $3.8 million. We have been successful with improving net interest income and holding non-interest expenses consistent with the prior year. Even though economic growth in our local area is still somewhat stagnant, year over year, we were able to generate loan growth of approximately seven and a half percent and increase non-interest bearing deposits by five percent. We believe these successes are a result of our effort to build new and existing relationships that can encompass all of a customer's financial needs.

(continued on next page)

HONORING FAMILY:

Richard and Jeffrey Byrum Family Farms

Farming families hold a special place in not only our name but our mission as a local community bank. Though we have always been committed to all types of commercial and individual customers in our markets, those that bring the smell of peanuts and the beauty of cotton to our area each year are some of our most loyal customers. Richard and Jeffrey Byrum have lived and worked on their family farm for their entire lives. Their pride and dedication to the planting, growing, and harvesting process is one we admire and are honored to support. Like the Byrums, our success is a direct result of reaping what we've sowed.

COMMITMENT TO SERVICE:

Suffolk Iron Works

Since being founded in 1894, Suffolk Iron Works has been family owned and operated. Their 72 employees work to continuously meet the ever-changing demands of the steel related industry. Their services range from steel fabrication to material handling systems and crane and rigging projects. Their commitment to unmatched service, unconditional quality, and unshakable integrity makes them a perfect partner for Farmers Bank. We are both successful through valuing long-term relationships with our customers.

(continued from previous page)

We also continue to pursue expansion into eastern tidewater to capitalize on the consolidation of many community banks in the area. We feel that small businesses in these markets still have a desire for the flexibility and service a traditional, community bank can offer. By evaluating new markets in a disciplined and intentional manner, we are able to remain prudent with expenses but increase franchise value.

Of equal importance is the improvement in our stock's liquidity and value during 2016. The price of our stock increased almost 67% from December 31, 2015 to December 31, 2016. Growing our dividend payout ratio from 14% in 2015 to 22% in 2016, increasing transparency, and remaining attentive have all supported this accomplishment.

The price of our stock increased almost 67% from 2015 to 2016.

While we enjoy reflecting on the success of the past year, our sight is already set on the one that is upon us. Our board and management are a cohesive team equipped with the desire to persevere and a vision for our future. We want to thank our loyal staff for always being attentive to the needs of our customers and for coming in everyday committed to the course we have set. As always, we appreciate you, our shareholders, and the confidence you have placed in our ability to bring value to your investment.

Richard J. Holland, Jr.
Chairman and CEO

Vernon M. Towler
President

QUALITY PRODUCTS:

Turf and Garden Inc.

Turf and Garden's green thumbs go all the way back to 1906. They have been serving the turf industry with quality products for over one hundred years. As they have expanded their market, they have grown to 32 employees servicing the Hampton Roads, Powell's Point, and Grafton areas. One of their best selling products, Southern Belle, was developed by Turf and Garden and has been specifically formulated to provide the highest quality turf in the transition zone. We have found that Turf and Garden's focus and devotion to offering quality products align with Farmers Bank's guiding principles and strengthens our loyalty to each other.

SHARING VALUES:

Gethsemane Community Fellowship Church

founded in 1992

We met Dr. Houston several years ago and have been inspired by his leadership in Gethsemane Community Fellowship Church. The church was founded in 1992 and now has over 2,500 members. Their mission is to reach out to people with the saving power and love of Jesus Christ and build them up in the faith. The leaders and members of this church encourage those most needy in the Norfolk and surrounding areas and strive to raise their community up one member at a time. We at Famers Bank are privileged to feature Gethsemane as an organization that shares our same values.

Board of Directors

Richard J. Holland, Jr.*
Chairman

William A. Gwaltney, Jr.*
Vice Chairman
Indika Farms, Inc., President

G. Thomas Alphin, Jr.*
Commonwealth Gin, Co-Owner

E. Warren Beale, Jr.
Entrepreneur

Harold U. Blythe
Retired Bank CEO

William L. Chorey
Chorey & Associates Realty, Ltd., Owner/Broker

David T. Owen*
Wakefield Farm Service, Inc., President

Peter D. Pruden, III
Taste Unlimited, Co-Owner

William H. Riddick, III*
Attorney at Law - Smithfield

Kent B. Spain*
Suffolk Insurance Corporation, Executive Vice President

O. A. Spady
Retired Entrepreneur

Vernon M. Towler*
President

**Farmers Bankshares, Inc. Board Members*

Suffolk Community Board

Timothy K. Palmer, Chairman
Attorney at Law & Certified Public Accountant

James C. Adams, III
President, Featherlite Coaches

Alison Dodson Anderson
Owner, A. Dodson's

J. Clifton Harrell, Jr.
President, Suffolk Iron Works

Roy A. Runyon, III
Director of Research and Development, The Gartman Letter, L.C.

H. Hadley Whitlock, Jr.
Retired Commercial Lender

Western Tidewater Community Board

Vincent Carollo, Chairman
Anna's Ristorante & JVC Holdings, LLC

Christopher T. Alphin
Commonwealth Gin

Tammy W. Edwards
Windsor Hardware and Supply Company

Randolph H. Pack
Smithfield Station

V.S. Pittman, II
Manry Rawls, LLC

John T. Randall
Randall & Page, P.C.

Executive Management

Richard J. Holland, Jr.
Chief Executive Officer

Vernon M. Towler
President

Kristy E. DeJarnette
Executive Vice President, Chief Financial Officer

Patricia T. Allen
Senior Vice President, Director of Loan & Deposit Operations

Kathy C. Bryant
Senior Vice President, Director of Human Resources and Retail

Norman F. Carr, Jr.
Senior Vice President, Director of Financial Services

Chad A. Rountree
Senior Vice President, Western Tidewater Market Executive

Thomas L. Woodward, III
Senior Vice President, Chief Lending Officer

Bank Officers

Jeffrey S. Creekmore
Senior Vice President, Chesapeake Market Executive

P. Kelley Gowen
Senior Vice President, Chief Credit Officer

Lauren P. Harper
Senior Vice President, Loans

Elizabeth D. Jones
Senior Vice President, Smithfield Market Executive

Charles A. Powers II
Senior Vice President, Loans

James C. Saunders
Senior Vice President, Suffolk Market Executive

William N. Bailey
Vice President, Information Technology

Deborah R. Cagle
Vice President, Retail & Business Development

Kelley T. Healey, Jr.
Vice President, Loans

Sharon A. Smith
Vice President, Compliance

Andrea B. Curry
Assistant Vice President, Information Technology

Kelly D. Dewitt
Assistant Vice President, BSA, AML, OFAC & Security Officer

C. Thomas Eure, Jr.
Assistant Vice President, Branch Administration

Melanie S. Gwaltney
Assistant Vice President, Operations

Blanche E. Hecker
Assistant Vice President, Retail

Joanne F. Joyner
Assistant Vice President, Retail

Erin W. Park
Assistant Vice President, Controller

D. Renee Scott
Assistant Vice President, Retail

Meghan D. White
Assistant Vice President, Loan Operations

Susan F. Boone
Corporate Secretary

BEING GOOD CITIZENS:

Farmers Bank in the Community

Part of our mission statement includes being good corporate citizens, serving as leaders to strengthen our communities and promote their welfare. We have a great deal of pride in the numerous local organizations that devote themselves to the betterment of our communities. Though banking is our top priority, supporting local community organizations financially and with our time is a civic duty we do not take lightly. This year we were able to provide contributions and sponsorships of $370,658 to local nonprofit organizations and $15,000 in scholarships to local graduating seniors.

Renee Scott, Smithfield Branch Manager and two Smithfield High School JROTC students

Franklin-Southampton County Fair

2016 Scholarship Winners

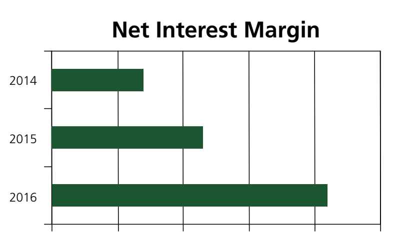
Dick Holland and Vernon Towler with area high school seniors on 2016 Bank Day

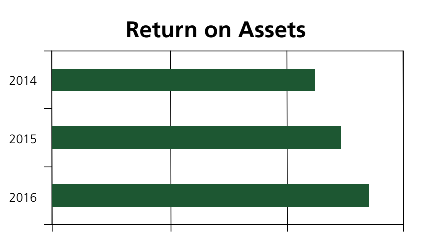
Jessica Slaba and Kristy DeJarnette with Carrsville Elementary School Principal, Clint Walters

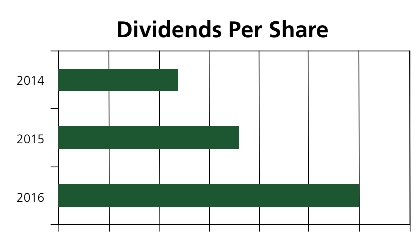
Financial Highlights

At or for the Years Ended December 31,	2016	2015	2014
		(Dollars in thousands, except per share data)	
Summary of Operations			
Interest income	**$16,062**	$16,044	$16,128
Interest expense	**2,116**	2,730	3,156
Net interest income	**13,946**	13,314	12,972
Provision for loan losses	**-**	-	(850)
Net interest income after provision for loan losses	**13,946**	13,314	13,822
Non-interest income	**2,898**	2,919	1,763
Non-interest expense	**11,528**	11,492	11,317
Income before income taxes	**5,316**	4,741	4,268
Income taxes	**1,129**	967	907
Net income	**$4,187**	$3,774	$3,361
Per Share and Shares Outstanding (1)			
Basic net income	**$1.37**	$1.24	$1.11
Book value at end of period	**$13.98**	$13.30	$12.49
Basic weighted average shares outstanding	**3,056,830**	3,053,845	3,040,195
Dividends per share	**$0.30**	$0.18	$0.12
Shares outstanding at period end	**3,056,363**	3,054,092	3,060,780
Balance Sheet Data			
Total assets	**$423,561**	$414,933	$426,791
Total loans, net	**260,202**	242,032	239,325
Total deposits	**343,911**	335,877	342,809
Borrowings	**25,000**	25,000	30,000
Selected Performance Ratios (Bank Only)			
Return on average assets	**1.09%**	0.99%	0.90%
Return on average stockholders' equity	**9.01%**	8.54%	8.20%
Net interest margin (2)	**3.82%**	3.63%	3.54%
Non-interest income as a percentage of total revenue (3)	**17.21%**	17.98%	11.97%
Efficiency ratio (4)	**63.78%**	66.68%	71.24%
Asset Quality Ratios			
Nonperforming loans to period-end loans	**0.75%**	0.55%	2.39%
Allowance for loan losses to period-end loans	**2.15%**	2.54%	3.29%
Net charge-offs to average loans outstanding	**0.22%**	0.73%	-0.68%
Capital (Bank Only)			
Tier 1 leverage ratio	**11.64%**	11.53%	10.83%
Total risk-based capital ratio	**16.53%**	18.50%	17.92%
Stockholder's equity	**$49,096**	$49,166	$48,037

(1) Computed based on the weighted average number of shares outstanding during each period.
(2) Net interest margin is net interest income divided by average interest earning assets.
(3) Total revenue consists of net interest income and non-interest income.
(4) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income.







Farmers Bankshares, Inc.

Consolidated Financial Statements for Years Ended December 31, 2016 and 2015

Contents

Independent Auditor's Report

To the Board of Directors and Shareholders
Farmers Bankshares, Inc.
Windsor, Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Farmers Bankshares, Inc. and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers Bankshares, Inc. and Subsidiary as of December 31, 2016, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The consolidated financial statements of the Farmers Bankshares, Inc. and Subsidiary as of and for the year ended December 31, 2015 were audited by other auditors whose report, dated March 21, 2016, expressed an unmodified opinion.

Elliott Davis Decosimo, PLLC

Raleigh, North Carolina
March 10, 2017

Farmers Bankshares, Inc.
Consolidated Balance Sheets

	December 31, 2016	December 31, 2015
Assets		
Cash and cash equivalents		
Cash and due from banks	$ 8,808,046	$ 14,636,916
Federal Funds sold	2,329,302	1,648,069
Total cash and cash equivalents	11,137,348	16,284,985
Available-for-sale securities (Note 3)	125,746,703	134,739,604
Mortgage loans held for sale	1,443,960	911,050
Loans held for investment, net of allowance for loan losses of $5,755,746 and $6,343,636, respectively (Note 4)	260,202,399	242,031,797
Premises and equipment, net (Note 5)	3,477,251	3,547,672
Other real estate owned	877,278	612,798
Accrued interest	1,723,019	1,774,430
Prepaid expenses	358,741	337,341
Net deferred tax asset (Note 11)	476,106	-
Income taxes receivable	5,219	92,323
Non-marketable equity securities (Note 6)	4,676,091	4,519,175
Bank-owned annuity contract	3,026,890	-
Bank-owned life insurance	10,230,912	9,909,100
Other assets	179,118	172,930
	412,423,687	398,648,220
Total assets	$ 423,561,035	$ 414,933,205
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing deposits	$ 101,552,020	$ 96,420,933
Interest-bearing deposits (Note 7)	242,359,428	239,456,439
Total deposits	343,911,448	335,877,372
Federal Home Loan Bank borrowings (Note 9)	25,000,000	25,000,000
Capital notes (Note 8)	7,888,475	9,928,475
Securities sold under agreements to repurchase (Note 9)	1,125,881	823,102
Deferred compensation plans	1,323,644	1,240,929
Net deferred tax liability (Note 11)	-	148,656
Accrued interest	183,700	198,802
Other liabilities	1,401,122	1,108,511
Total liabilities	380,834,270	374,325,847
Stockholders' equity		
Common stock, $0.125 par value; 50,000,000 shares authorized; 3,056,363 and 3,054,092 shares issued and outstanding at December 31, 2016 and 2015, including nonvested shares of 8,223 and 13,800 shares, respectively	382,047	381,763
Capital surplus	2,775,106	2,754,141
Retained earnings	38,344,408	35,070,594
Accumulated other comprehensive income	1,225,204	2,400,860
Total stockholders' equity	42,726,765	40,607,358
Total liabilities and stockholders' equity	$ 423,561,035	$ 414,933,205

 The accompanying notes are an integral part of these consolidated financial statements.

Farmers Bankshare, Inc.
Consolidated Statements of Operations

	Years Ended December 31, 2016	2015
Interest income		
Interest and fees on loans held for investment	$ 12,275,691	$ 12,000,584
Interest on mortgage loans held for sale	25,016	21,202
Interest on available-for-sale securities	2,130,933	2,512,889
Interest on tax exempt available-for-sale securities	1,494,852	1,376,381
Interest on federal funds sold	42,293	33,505
Other interest income	93,614	99,106
Total interest and dividend income	16,062,399	16,043,667
Interest expense		
Interest on deposits	1,207,905	1,589,455
Interest on Federal Home Loan Bank advances	458,418	618,542
Interest on capital notes	441,847	517,478
Interest on repurchase agreements	7,455	4,620
Interest on federal funds purchased	135	3
Total interest expense	2,115,760	2,730,098
Net interest income	13,946,639	13,313,569
Provision of loan losses	-	-
Net interest income after provision for loan losses	13,946,639	13,313,569
Noninterest income		
Service charges	660,431	613,468
Income from automated teller machines and bank card interchange	508,393	514,642
Net gain on disposition of securities	115,948	422,821
Income on bank owned life insurance	321,813	324,118
Net gain (loss) on sale of premises and equipment	3,901	(58)
Income from investment in Manry Rawls, LLC	266,666	437,428
Income from mortgage loan sales	595,123	438,471
Other income	425,360	168,585
Total noninterest income	2,897,635	2,919,475
Noninterest expense		
Salaries and employee benefits	6,283,217	6,134,982
Equipment expense	709,078	646,016
Occupancy expense	681,131	621,718
Bank franchise tax	421,807	495,830
Advertising and marketing	588,225	321,175
Data processing	982,496	855,719
Loan related legal and other expenses	170,168	192,458
Federal Deposit Insurance Corporation assessment	179,079	246,032
Net loss (gain) on sale and write-downs of other real estate owned	(18,243)	91,469
Other real estate owned	73,136	51,218
Prepayment penalty on borrowings	-	355,592
Other	1,458,511	1,479,326
Total noninterest expense	11,528,605	11,491,535
Income before income taxes	5,315,669	4,741,509
Income tax expense (Note 11)	1,128,983	967,121
Net income attributable to common shareholders	$ 4,186,686	$ 3,774,388
Basic earnings per common share (Note 18)	$ 1.37	$ 1.24
Diluted earnings per common share	$ 1.37	$ 1.23
Cash dividends declared per common share	$ 0.30	$ 0.18

The accompanying notes are an integral part of these consolidated financial statements.

Farmers Bankshares, Inc.
Consolidated Statements of Comprehensive Income

	Years Ended December 31,	
	2016	2015
Net income	$ 4,186,686	$ 3,774,388
Other comprehensive loss:		
Unrealized holding losses on available-for-sale securities	(1,665,349)	(515,376)
Tax effect	566,219	175,228
Unrealized holding losses on available-for-sale securities, net of tax amount	(1,099,130)	(340,148)
Reclassification adjustment for realized gains	(115,948)	(422,821)
Tax effect	39,422	143,759
Reclassification adjustment for realized gains, net of tax amount	(76,526)	(279,062)
Other comprehensive loss, net of tax	(1,175,656)	(619,210)
Comprehensive income	$ 3,011,030	$ 3,155,178

The accompanying notes are an integral part of these consolidated financial statements.

Farmers Bankshares, Inc.

Consolidated Statements of Changes in Stockholders' Equity

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balances, December 31, 2014	$ 382,600	$ 2,723,028	$ 31,849,329	$ 3,020,070	$ 37,975,027
Net income	-	-	3,774,388	-	3,774,388
Changes in net unrealized loss on securities available for sale, net of reclassification adjustment and tax effect	-	-	-	(619,210)	(619,210)
Repurchase common shares	(908)	(57,416)			(58,324)
Issuance of common stock - director stock plan	502	40,098			40,600
Stock based compensation	-	48,000	-	-	48,000
Forfeiture of restricted stock	(431)	431	-	-	-
Cash dividends declared on common shares, $0.18 per share	-	-	(553,123)	-	(553,123)
Balances, December 31, 2015	$ 381,763	$ 2,754,141	$ 35,070,594	$ 2,400,860	$ 40,607,358
Net income	-	-	4,186,686	-	4,186,686
Changes in net unrealized loss on securities available for sale, net of reclassification adjustment and tax effect	-	-	-	(1,175,656)	(1,175,656)
Issuance of common stock - director stock plan	183	26,217	-	-	26,400
Stock based compensation	101	(5,252)	-	-	(5,151)
Cash dividends declared on common shares, $0.30 per share	-	-	(912,872)	-	(912,872)
Balances, December 31, 2016	$ 382,047	$ 2,775,106	$ 38,344,408	$ 1,225,204	$ 42,726,765

Farmers Bankshares, Inc.
Consolidated Statements of Cash Flows

	Years Ended December 31, 2016	2015
Cash flows from operating activities		
Net income	$ 4,186,686	$ 3,774,388
Adjustments to reconcile net income to net		
cash provided by operating activities		
Depreciation	464,346	454,801
Provision for deferred income taxes	(19,121)	92,841
Amortization of investment securities premiums	675,237	846,954
Net gain on disposition of available-for-sale securities	(115,948)	(422,821)
(Gain) loss on sales and writedowns on other real estate owned	(18,243)	91,469
(Gain) loss on sale of premises and equipment	(3,901)	58
(Gain) on mortgages held for sale	(235,135)	(210,353)
Increase in cash value of bank owned life insurance	(321,812)	(324,118)
Stock based compensation	(5,151)	48,000
Director expense for stock issuance	26,400	40,600
Change in operating assets and liabilities		
Origination of mortgage loans held for sale	(16,035,951)	(12,170,944)
Proceeds from sale of mortgage loans held for sale	15,738,176	12,456,247
Interest receivable	51,411	(49,249)
Interest payable	(15,102)	(50,427)
Prepaid expenses	(21,400)	29,126
Income taxes receivable	87,104	574,279
Other assets	(6,188)	89,488
Deferred compensation	82,715	136,614
Other liabilities	139,811	55,894
Net cash provided by operating activities	4,653,934	5,462,847
Cash flows from investing activities		
Proceeds from sales, prepayments and maturities of		
available-for-sale securities	23,753,682	28,677,043
Purchase of available-for-sale securities	(17,101,366)	(28,144,858)
Proceeds from sale of non-marketable equity securities	260,650	425,000
Purchase of annuity	(3,026,890)	-
Purchase of non-marketable equity securities	(417,566)	(588,628)
Proceeds from sale of other real estate owned	82,368	794,531
Loan originations, net of repayments	(18,499,207)	(2,706,487)
Proceeds from sale of premises and equipment	23,000	150
Purchases of premises and equipment	(413,024)	(196,235)
Net cash used in investing activities	(15,338,353)	(1,739,484)
Cash flows from financing activities		
Cash dividends paid on common shares	(760,073)	(595,893)
Repurchase of common shares	-	(58,324)
Repayment of capital notes	(2,040,000)	(1,325,000)
Proceeds from FHLB borrowings	-	5,000,000
Repayment of FHLB borrowings	-	(10,000,000)
Change in noninterest-bearing deposits	5,131,087	10,335,526
Change in interest-bearing deposits	2,902,989	(17,266,858)
Change in securities sold under agreements to repurchase	302,779	(1,106,497)
Net cash provided by or (used in) financing activities	5,536,782	(15,017,046)
Net decrease in cash and cash equivalents	(5,147,637)	(11,293,683)
Cash and cash equivalents		
Beginning of the year	16,284,985	27,578,668
End of year	$ 11,137,348	$ 16,284,985

The accompanying notes are an integral part of these consolidated financial statements.

Farmers Bankshares, Inc.
Consolidated Statements of Cash Flow (concluded)

	Years Ended December 31,	
	2016	2015
Supplemental disclosure of cash flow information		
Cash paid for		
Income taxes	$ 1,061,000	$ 300,000
Interest on deposits and other borrowings	2,130,861	2,780,525
Supplemental schedule of non-cash investing activities		
Change in unrealized gains on available-for-sale securities, net of income tax	$ (1,175,656)	$ (619,210)
Transfer of loans to other real estate owned	(328,605)	-
Income from investment in Manry Rawls, LLC	(266,666)	(437,428)

The accompanying notes are an integral part of these consolidated financial statements.

Note 1 - Organization and nature of business

Farmers Bankshares, Inc. (the "Company") was organized and incorporated under the laws of the Commonwealth of Virginia on July 26, 2013. On December 31, 2013, the Company was consummated as the Bank Holding Company of Farmers Bank, Windsor, Virginia (the "Bank") through a reorganization plan, under the laws of the Commonwealth of Virginia. As of this date, the Bank became a wholly-owned subsidiary of Farmers Bankshares, Inc. The Bank was formed on November 12, 1919 and has offices in Windsor, Smithfield, Suffolk, Chesapeake and Courtland, Virginia. Through its banking subsidiary, the Company provides a wide variety of banking services primarily in southeastern Virginia.

The Bank provides small and mid-sized businesses, professionals, corporate executives and entrepreneurs with banking services comparable to those of the large national and regional institutions. These services include loans that are priced on a deposit-based relationship, direct access to the Bank's decision makers, and quick, innovative response to customers' financial needs. If customers have credit requirements that exceed the Bank's credit limits, the Bank seeks to accommodate those customers by arranging loans on a participation basis with other financial institutions.

Note 2 - Summary of significant accounting policies

Basis of presentation and consolidation - The consolidated financial statements of the Company are prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and cash equivalents - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks and federal funds sold, all of which mature within 90 days or less. The Company is required by the Federal Reserve to maintain average reserve balances. For the final quarterly reporting period in 2016 and 2015, the aggregate amount of daily-required balances was $85,000 and $98,000, respectively.

Investment securities - Investments in debt securities classified as held-to-maturity, if any, are stated at cost, adjusted for amortization of premiums and accretion of discounts using the interest method. The Company held no such securities during the periods reported in the financial statements.

Investments in debt securities classified as trading, if any, are stated at fair value. Such securities are purchased and held principally for the purpose of selling them in the near term. Unrealized holding gains and losses for trading securities are included in the statements of operations. The Company held no such securities during the periods reported on in the financial statements.

Investments not classified as either held-to-maturity or trading are classified as available-for-sale. Debt securities classified as available-for-sale are stated at fair value with unrealized holding gains and losses excluded from earnings and reported as a component of accumulated other comprehensive income until realized. The income statement line items impacted by the reclassification of realized gains (losses) on the sale of securities are the gains (losses) on disposition of securities and income tax expense line items in the statement of operations.

Gains and losses on the sale of securities are determined using the specific identification method and are recognized on a trade date basis. Other than temporary declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost, if any, are included in earnings as realized losses. Other-than-temporarily impaired ("OTTI") guidance for investment states that an impairment is OTTI if any of the following conditions exist: the entity intends to sell the security; it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis; or, the entity does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell).

Note 2 - Summary of significant accounting policies (continued)

Loans - The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial and consumer mortgage loans throughout Southeastern Virginia. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans held for investment that management has the intent and ability to hold for the foreseeable future or until maturity generally are stated at their outstanding unpaid principal balances. Loans held for sale are originated and intended for sale in the secondary market. These loans are carried at the lower of cost or market in the aggregate. Net unrealized losses, if any, are recognized through charges to income. Interest income is accrued on the unpaid principal balance for all loan classes. Discounts and premiums are amortized to income using the interest method. Net deferred fees and costs are amortized over the lives of the applicable loans using the effective interest rate method.

Allowance for loan losses - The allowance for loan losses is established as losses are estimated to have occurred 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 collectibility 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 a specific, a historic and a qualitative, general component. The specific component relates to loans that are considered impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of an impaired loan are lower than the carrying value of that loan. The historic component covers non-classified and criticized loans and is based on historical loss experience adjusted for qualitative factors. The qualitative reserve of the allowance reflects adjustments to historical experience to account for current conditions impacting the loan portfolio.

For all classes, a loan is considered impaired when, based on current information and events, it is probable that the Bank 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 for loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

The allowance model is applied to determine the specific allowance balance for impaired loans and the general allowance balance for unimpaired loans grouped by loan type.

The Bank's loan charge-off policy for all loan classes is to charge down loans to net realizable value once a portion of the loan is determined to be uncollectible, and the underlying collateral shortfall is assessed. Loans are moved to nonaccrual status when the loan becomes 90 days delinquent or a portion of the loan is determined to be uncollectible and supporting collateral is not considered to be sufficient to cover potential losses.

Note 2 - Summary of significant accounting policies (continued)

Allowance for loan losses (concluded) - Nonaccrual loans are reviewed monthly to determine if all or a portion of the loan is uncollectible. Nonaccrual loans that are determined to be solely collateral dependent are monitored for possible charge downs to net realizable value upon determination that they are impaired.

Income recognition on impaired and non-accrual loans - All classes of loans are generally classified as non-accrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. All classes of loans that are on a current payment status or past due less than 90 days may also be classified as non-accrual, if repayment in full of principal and/or interest is in doubt.

All classes of loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal.

When all classes of loans are classified as non-accrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a non-accrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Other real estate owned - Real estate acquired through, or in lieu of, foreclosure is held for sale and is initially recorded at fair value less estimated cost to sell at the date of foreclosure, establishing a new cost basis. Principal and interest losses existing at the time of acquisition of such assets are charged against the allowance for loan losses and interest income, respectively. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Revenue and expenses from operations associated with other real estate owned and the impact of any subsequent changes in the carrying value are included in other expenses.

Premises and equipment - Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. For financial reporting purposes, assets are depreciated over their estimated useful lives using the straight-line method. Useful lives for these assets are within the following ranges, buildings from 10-39 years, equipment, furniture and fixtures 3-15 years, computer equipment 3-7 years and software 3-5 years. For income tax purposes, the accelerated cost recovery system and the modified accelerated cost recovery system are used.

Non-marketable equity securities - Non-marketable equity securities are restricted securities, carried at cost, and periodically evaluated for impairment. These securities are restricted, do not have a readily determinable fair value, and lack a market. Because of the redemption provisions of the Federal Reserve Bank and Federal Home Loan Bank stock, the Bank estimated that the fair value equaled or exceeded the cost of these investments and the investments were not impaired. In April 2014, the Bank invested approximately $1.4 million in return for a one-third ownership in Manry Rawls, LLC. Manry Rawls, LLC is a local and independent regional insurance agency offering a wide array of insurance products. The Bank's propionate share of Manry Rawls' income is recorded as an increase in the investment and directly to other non-interest income. Any cash distributions made by Manry Rawls' would lower the recorded investment at the time of payment. The difference between the carrying value of the investment and the underlying equity in net assets amounts to approximately $923,000 and is considered equity method goodwill. Equity method investments are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable. No such impairment was identified in 2016.

Note 2 - Summary of significant accounting policies (continued)

Income taxes - Income taxes are provided for the tax effects of transactions reported in the financial statements, and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of investment securities, deferred loan fees, allowance for loan losses, deferred compensation, interest on non-performing loans and accumulated depreciation for financial and income tax reporting.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered in income. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized. Management has evaluated all other tax positions that could have a significant effect on the financial statements and determined the Company had no uncertain income tax positions at December 31, 2016 and 2015. The years ending on or after December 31, 2013 remain subject to examination by federal and state tax authorities. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Deferred compensation plans - The Company maintains deferred compensation and retirement arrangements with certain officers. The Company's policy is to accrue the estimated amounts to be paid under the contracts over the expected period of active employment. The Company purchased life insurance contracts to fund the expected liabilities under the contracts.

Earnings per common share - Basic earnings per share (EPS) are computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted earnings per share reflect the potential dilution if restricted stock, or other common stock equivalents, would result in the issuance of additional shares of common stock that share in earnings. Potential common shares that may be issued by the Company relate solely to outstanding non-vested restricted stock.

Off-balance sheet financial instruments - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commitments under credit card arrangements, commercial letters of credit, standby letters of credit, and financial guarantees written. Such financial instruments are generally recorded in the financial statements when they become payable. A reserve for these off-balance sheet financial instruments is considered immaterial as is the fair value of the financial guarantees.

Use of estimates - The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Estimation of fair values - The following notes summarize the major methods and assumptions used in estimating the fair value of financial instruments:

Short-term financial instruments are valued at their carrying amounts included in the Company’s balance sheet, which are reasonable estimates of fair value due to the relatively short period to maturity of the instruments. This approach applies to cash and cash equivalents, deposits in other banks, federal funds sold, and short-term borrowings.

Loans are valued on the basis of estimated future receipts of principal and interest, discounted at various rates. Loan prepayments are assumed to occur at the same rate as in previous periods when interest rates were at levels similar to current levels. Future cash flows for homogeneous categories of consumer loans are estimated on a portfolio basis and discounted at current rates offered for similar loan terms to new borrowers with similar credit profiles.

Note 2 - Summary of significant accounting policies (continued)

Estimation of fair values (concluded) – A liquidity discount is not considered in determining the fair value of the loan portfolio.

Investment securities are valued at quoted market prices, if available. The fair value of equity investments in the restricted stock of the FRB and FHLB approximates the carrying value due to the redemptive provisions of these securities.

For unquoted securities, the fair value is estimated by the Company on the basis of financial and other information.

The carrying amounts of accrued interest approximate fair value.

The fair value of demand deposits and deposits with no defined maturity is taken to be the amount payable on demand at the reporting date. The fair value of fixed-maturity deposits is estimated using discounted cash flow analyses and rates currently offered for deposits of similar remaining maturities. The intangible value of long-term relationships with depositors is not taken into account in estimating the fair values disclosed.

Fair values of capital notes are based on market prices for debt securities having similar maturity and interest rate characteristics. The impact of the Company's assessment of its own credit risk is not factored into the fair value of the notes.

The carrying amounts of federal funds purchased and borrowings under repurchase agreements approximate their fair values.

The fair values of the Company's Federal Home Loan Bank advances are estimated using discounted cash flow analyses based on current rates offered on similar debt instruments.

It is not practicable to separately estimate the fair values for off-balance-sheet credit commitments, including standby letters of credit and guarantees written, due to the lack of cost-effective, reliable measurement methods for these instruments.

Certain significant estimates - Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of other real estate owned. Management uses available information to recognize losses on loans and other real estate owned. Future additions to the allowances may be necessary based on changes in local economic conditions and other factors. Management believes the allowances recorded at December 31, 2016 and 2015 are sufficient to cover inherent losses in the portfolio.

Note 2 - Summary of significant accounting policies (continued)

Recent accounting pronouncements - In June 2014, the Financial Accounting Standards Board ("FASB") issues Accounting Standards Update ("ASU") No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2015; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2016, and interim period beginning after March 15, 2015. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on our consolidated financial statements, but new disclosures were added.

In February 2015, FASB issued ASU No. 2015-02, "Consolidation: Topic 810: Amendments to the Consolidation Analysis." The amendments to this ASU changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendments include: (1) modifying the evaluation of limited partnerships and similar legal entities, (2) amending when fees paid to a decision maker should be included in the variable interest entity analysis, (3) amending the related party relationship guidance, and (4) providing a scope exception from the consolidation guidance for reporting entities with interest in certain investment funds. The ASU is effective for interim and annual reporting periods beginning after December 15, 2015, although early adoption is permitted. The adoption of this standard did not have a material impact on the consolidated financial statements of the Company.

In August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers: Topic 606". This ASU is an update to the original ASU No. 2014-09 and the deferral of the effective date. Both ASU's apply to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition", most industry-specific guidance, and some cost guidance Table of Contents 10 included in Subtopic 605-35, "Revenue Recognition-Construction-Type and Production-Type Contracts". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017 for public business entities. Early adoption is permitted but not before the original public entity effective date, i.e. annual periods beginning after December 15, 2017. The Company is currently evaluating the impact of this standard.

Note 2 - Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued) - In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall: Subtopic 825-10: Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation and disclosure. The amendments in this ASU (1) require equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplify the impairment assessment of equity investments without readily determinable fair value; (3) require public business entities to use exit prices, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (4) require separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (5) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value for financial statements measured at amortized cost on the balance sheet; (6) require separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) state that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The ASU only permits early adoption of the instrument-specific credit risk provision. The Company is currently evaluating the impact of this standard.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." This ASU replaces ASC 840, Leases and was issued in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. For leases with a term of twelve months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. The ASU is effective for interim and annual periods beginning after December 15, 2018, using a modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact of this standard.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), which is intended to improve the accounting for share-based payment transactions as part of the FASB's simplification initiative. ASU 2016-09 changes seven aspects of the accounting for share-based payment award transactions, including: (1) accounting for income taxes; (2) classification of excess tax benefits on the statement of cash flows; (3) forfeitures; (4) minimum statutory tax withholding requirements; (5) classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes; (6) practical expedient - expected term (nonpublic entities only); and (7) intrinsic value (nonpublic entities only). ASU 2016-09 is effective for fiscal years beginning after December 15, 2016 and interim periods within those years. Early adoption is permitted in any interim or annual period provided that the entire ASU 2016-09 is adopted. The Company is currently evaluating the impact of this standard.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instructions." This ASU changes the way entities recognize impairment of many financial assets by requiring immediate recognition of estimated credit losses expected to occur over the remaining life. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in ASU 2016-13 replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The changes are effective for annual and interim periods in fiscal years beginning after December 15, 2020. An entity may early adopt the standard for annual and interim periods in fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact of this standard.

Note 2 - Summary of significant accounting policies (concluded)

Recent accounting pronouncements (concluded) - In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flow.” This ASU is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The guidance addresses: (1) debt prepayment on debt extinguishment costs; (2) settlement of zero-coupon debt instruments; (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) distributions received from equity method investments; (7) beneficial interest in securitizations transactions; and (8) separately identifiable cash flows and application of the predominance principle. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of this standard.

In December 2016, the FASB issued ASU 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.” The corrections in this ASU is intended to make a limited number of revisions to several pieces of the revenue recognition standard issued in 2014. The effective date and transition requirements for the technical corrects will be effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those years. Early application is not permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Reclassifications - Certain reclassifications have been made to prior period balances to conform to the current year presentation with no impact on net income or stockholders’ equity as previously recorded.

Note 3 - Available-for-sale securities

At December 31, 2016 and 2015, securities are as follows:

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal	$ 44,666,648	$ 1,280,172	$ 219,016	$ 45,727,804
Residential mortgage-backed securities	20,900,403	18,158	228,874	20,689,687
Collateralized mortgage obligations	35,523,943	276,319	330,722	35,469,540
Small Business Administration Pools	22,799,340	1,060,332	-	23,859,672
	$ 123,890,334	$ 2,634,981	$ 778,612	$ 125,746,703

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal	$ 41,640,706	$ 2,209,085	$ 15,586	$ 43,834,205
Residential mortgage-backed securities	15,946,319	27,472	88,728	15,885,063
Collateralized mortgage obligations	46,427,399	445,531	403,312	46,469,618
Small Business Administration Pools	27,087,514	1,463,204	-	28,550,718
	$ 131,101,938	$ 4,145,292	$ 507,626	$ 134,739,604

Note 3 - Available-for-sale securities (continued)

At December 31, 2016 and 2015, gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position, are as follows:

December 31, 2016	Approximate Market Value	Continuous Unrealized Losses Existing for: Less than 12 Months	Continuous Unrealized Losses Existing for: More than 12 Months	Total Losses
Available-for-sale securities:				
State and municipal	$ 7,180,210	$ 204,603	$ 14,413	$ 219,016
Residential mortgage-backed securities	17,317,089	228,874	-	228,874
Collateralized mortgage obligations	21,853,226	134,214	196,508	330,722
Total temporarily impaired investment securities	$ 46,350,525	$ 567,691	$ 210,921	$ 778,612

December 31, 2015	Approximate Market Value	Continuous Unrealized Losses Existing for: Less than 12 Months	Continuous Unrealized Losses Existing for: More than 12 Months	Total Losses
Available-for-sale securities:				
State and municipal	$ 521,665	$ 15,586	$ -	$ 15,586
Residential mortgage-backed securities	14,269,851	88,728	-	88,728
Collateralized mortgage obligations	23,041,626	77,196	326,116	403,312
Total temporarily impaired investment securities	$ 37,833,142	$ 181,510	$ 326,116	$ 507,626

State and municipal - The Company's unrealized losses on state and municipal securities were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because of the Company's intent to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Residential mortgage-backed securities and collateralized mortgage obligations- The Company's unrealized losses on residential mortgage-backed securities and collateralized mortgage obligations were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are Government Sponsored Entities ("GSE"), or are collateralized by securities backed by these agencies, and because of the Company's intent to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Note 3 - Available-for-sale securities (concluded)

At December 31, 2016 and 2015, securities with a carrying value of approximately $33,536,180 and $27,905,116, respectively, are pledged to the Commonwealth of Virginia to secure public deposits. In addition, at December 31, 2016 and 2015, securities with a carrying value of $7,880,087 and $14,632,536, respectively, are pledged to the Federal Home Loan Bank to secure advances. Investment securities with carrying values of $3,263,403 and $4,030,844 are pledged to secure repurchase agreements at December 31, 2016 and 2015, respectively.

At December 31, 2016, the amortized cost and fair value of debt securities by maturity date are as follows:

	Amortized Cost	Fair Value
Due in one year or less	$ 968,551	$ 989,856
Due from one to five years	7,115,544	7,437,657
Due from five to ten years	12,556,757	13,075,397
Due after ten years	103,249,482	104,243,793
Total debt securities	$ 123,890,334	$ 125,746,703

Gross realized gains on available-for-sale securities were:

	2016	2015
State and municipal	$ 115,948	$ 20,870
Residential mortgage-backed securities	-	295,885
Collateralized mortgage obligations	-	106,066
Total gross realized gains	$ 115,948	$ 422,821

There were no gross realized losses on available-for-sale securities during 2016 or 2015.

Proceeds from the sale of available-for-sale securities totaled $1,282,802 and $10,516,241 for the years ended December 31, 2016 and 2015, respectively.

Note 4 - Loans and Allowance for Loan Losses

General - The Bank provides to its customers a full range of short- to medium-term commercial, agricultural, Small Business Administration guaranteed, mortgage, home equity, and personal loans, both secured and unsecured. The Bank also makes real estate mortgage and construction loans. At December 31, 2016 and 2015, loans held for investment consisted of the following:

	2016	2015
Mortgage loans on real estate:		
Construction	$ 37,231,654	$ 32,098,516
Commercial Real Estate:		
Non-owner occupied	33,505,956	32,488,510
Owner occupied	68,475,757	60,588,745
Residential 1-4 family	40,695,206	42,636,675
Multifamily	4,897,337	5,223,426
Equity lines of credit	12,697,734	12,388,863
Total mortgage loans on real estate	197,503,644	185,424,735
Commercial and industrial	46,050,448	40,233,731
Agricultural	20,942,170	20,859,784
Individuals	1,475,755	1,839,447
Total loans	265,972,017	248,357,697
Less: Allowance for loan losses	(5,755,746)	(6,343,636)
Net deferred loan fees and costs	(13,872)	17,736
Loans, net	$ 260,202,399	$ 242,031,797

Real Estate Loans - Real estate loans include construction and land development loans, commercial real estate loans, home equity lines of credit and residential mortgages.

Construction/development lending totaled $37.2 million and $32.1 million at December 31, 2016 and 2015, respectively. The Bank originates one-to-four family residential construction loans for the construction of custom homes (where the home buyer is the borrower) and provides financing to builders and consumers for the construction of pre-sold homes. The Bank generally receives a pre-arranged permanent financing commitment from an outside banking entity prior to financing the construction of pre-sold homes. The Bank also makes commercial real estate construction loans, primarily for owner-occupied properties. The Bank limits its construction lending risk through adherence to established underwriting procedures. Residential one-to-four family loans amounted to $40.7 million and $42.6 million at December 31, 2016 and 2015, respectively.

Commercial real estate loans totaled $102.0 million and $93.1 million at December 31, 2016 and 2015, respectively. This lending has involved loans secured by owner-occupied commercial buildings for office, storage and warehouse space, as well as non-owner occupied commercial buildings. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Multifamily loans totaled $4.9 million and $5.2 million at December 31, 2016 and 2015, respectively. These loans are residential housing projects containing five or more rental units. Traditional multifamily projects charge market rents and are located in both city and suburban markets. Equity lines of credit are open-ended revolving lines of credit secured by the equity in a borrower's residence. Equity lines of credit totaled $12.7 million and $12.4 million at December 31, 2016 and 2015, respectively.

Note 4 – Loans and Allowance for Loan Losses (continued)

Commercial and Industrial Loans - At December 31, 2016 and 2015, the Bank's commercial loan portfolio totaled $46.1 million and $40.2 million, respectively. Commercial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans are secured by accounts receivable, inventory and/or equipment. The Bank also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment. Commercial loans generally provide greater yields and re-price more frequently than other types of loans, such as real estate loans.

Agricultural Loans – Agricultural loans totaled $20.9 million and $20.9 million at December 31, 2016 and 2015, respectively and include loans secured by farm equipment, inventory and farm land. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. Payments on such loans are often dependent on successful operation or management of the farming operation.

Loans to Individuals - Loans to individuals (consumer loans) include automobile loans, boat and recreational vehicle financing, and miscellaneous secured and unsecured personal loans and totaled $1.5 million and $1.8 million at December 31, 2016 and 2015, respectively. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Bank manages the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

Loan Approvals - The Bank's loan policies and procedures establish the basic guidelines governing its lending operations. The guidelines address the type of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Bank, including any indebtedness as a guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan reviews by independent, outside professionals experienced in loan review. Responsibility for loan review and loan underwriting resides with the Chief Credit Officer position. This position is responsible for loan underwriting and approval. On an annual basis, the Board of Directors of the Bank determines officers' lending authority. Authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors.

Substantially all of the Bank's loans have been granted to customers in the Hampton Roads area of Virginia.

Credit Review and Evaluation - The Bank outsources the credit risk review function which reports to the Board of Directors. The focus of the engagement is on policy compliance and proper grading of higher credit risk loans as well as new and existing loans on a sample basis. Additional reporting for problem/criticized assets has been developed along with an after-the-fact loan review.

The Bank uses a risk grading program to facilitate the evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses. In this program, risk grades are initially assigned by loan officers, reviewed by the Chief Credit Officer and reviewed by credit review analysts on a test basis. The Bank strives to maintain the loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of the Bank's market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies.

Note 4 - Loans and Allowance for Loan Losses (continued)

Credit Review and Evaluation (concluded) - All loans are risk graded on a scale from 1 (highest quality) to 9 (loss). Acceptable loans at inception are grades 1 through 5. These grades have underwriting requirements that at least meet the minimum requirements of a secondary market source. If borrowers do not meet credit history requirements, other mitigating criteria such as substantial liquidity and low loan-to-value ratios could be considered and would generally have to be met in order to make the loan. The Bank's loan policy states that a guarantor may be necessary if reasonable doubt exists as to the borrower's ability to repay.

The Board of Directors has authorized the loan officers to have individual approval authority for risk grade 1 through 5 loans up to maximum exposure limits for each customer. New or renewed loans that are graded 6 (special mention) or lower must have approval from the Chief Credit Officer and Chief Lending Officer. Any changes in risk assessments as determined by loan officers, credit administrators, regulatory examiners and management are also considered.

The risk grades, normally assigned by the loan officers when the loan is originated and reviewed by the Chief Credit Officer, are based on several factors including historical data, current economic factors, composition of the portfolio, and evaluations of the total loan portfolio and assessments of credit quality within specific loan types. In some cases the risk grades are assigned by the Chief Credit Officer or the Chief Lending Officer, depending upon dollar exposure. Because these factors are dynamic, the provision for loan losses can fluctuate. Credit quality reviews are based primarily on analyses of borrowers' cash flows, with asset values considered only as a second source of payment. Credit analysts work with lenders in underwriting, structuring and risk grading the Bank's credits. The Chief Lending Officer and the Chief Credit Officer focus on lending policy compliance, credit risk grading, and credit risk reviews on larger dollar exposures. Management uses the information developed from the procedures above in evaluating and grading the loan portfolio. This continual grading process is used to monitor the credit quality of the loan portfolio and to assist management in determining the appropriate levels of the allowance for loan losses. The following is a summary of the credit risk grade definitions for all loan types:

"1" — Prime – Credits in this category are virtually risk-free and are well-collateralized by cash or cash-equivalent instruments held by the Bank. The repayment program is well-defined and achievable, and repayment sources are numerous. No material documentation deficiencies or exceptions exist.

"2" — Good – This grade is reserved for loans secured by readily marketable collateral, or loans within guidelines to borrowers with liquid financial statements. A liquid financial statement is generally a financial statement with substantial liquid assets, particularly relative to the debts. These loans have excellent sources of repayment, with no significant identifiable risk of collection, and conform in all respects to Bank policy, guidelines, underwriting standards, and Federal and State regulations (no exceptions of any kind).

"3" — Acceptable 1 – This grade is reserved for the Bank's high quality loans. These loans have excellent sources of repayment, with no significant identifiable risk of collection. Generally, loans assigned this risk grade will demonstrate the following characteristics:

- Conformity in all respects with Bank policy, guidelines, underwriting standards, and Federal and State regulations (no exceptions of any kind).
- Documented historical cash flow that meets or exceeds required minimum Bank guidelines, or that can be supplemented with verifiable cash flow from other sources.
- Adequate secondary sources to liquidate the debt, including combinations of liquidity, liquidation of collateral, or liquidation value to the net worth of the borrower or guarantor.

Note 4 - Loans and Allowance for Loan Losses (continued)

"4" — Acceptable 2 – This grade is given to acceptable loans. These loans have adequate sources of repayment, with little identifiable risk of collection. Loans assigned this risk grade will demonstrate the following characteristics:

- General conformity to the Bank's underwriting requirements, with limited exceptions to the Bank's policy, product or underwriting guidelines. All exceptions noted have documented mitigating factors that offset any additional risk associated with the exceptions noted.
- Documented historical cash flow that meets or exceeds required minimum Bank guidelines, or that can be supplemented with verifiable cash flow from other sources.
- Adequate secondary sources to liquidate the debt, including combinations of liquidity, liquidation of collateral, or liquidation value to the net worth of the borrower or guarantor.

"5" — Weak Pass – This grade is given to acceptable loans that show signs of weakness in either adequate sources of repayment or collateral, but have demonstrated mitigating factors that minimize the risk of delinquency or loss. Loans assigned this grade may demonstrate some or all of the following characteristics:

- Additional exceptions to the Bank's policy requirements, product guidelines or underwriting standards that present a higher degree of risk to the Bank. Although the combination and/or severity of identified exceptions is greater for this risk grade, the exceptions may be properly mitigated by other documented factors that offset any additional risks.
- Unproved, insufficient or marginal primary sources of repayment that appear sufficient to service the debt at this time. Repayment weaknesses may be due to minor operational issues, financial trends, or reliance on projected (not historic) performance.
- Marginal or unproven secondary sources to liquidate the debt, including combinations of liquidation of collateral and liquidation value to the net worth of the borrower or guarantor.

"6" — Special Mention – Special Mention loans include the following characteristics:

- Loans with underwriting guideline tolerances and/or exceptions and with no mitigating factors;
- Extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Bank's position at some future date. Potential weaknesses are the result of deviations from prudent lending practices; or
- Loans where adverse economic conditions have developed subsequent to the loan origination that do not jeopardize liquidation of the debt, but do substantially increase the level of risk, may also warrant this rating.

"7" — Substandard – A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans consistently not meeting the repayment schedule should be downgraded to substandard. Loans in this category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action. The weaknesses may include, but are not limited to:

- High debt to worth ratios
- Declining or negative earnings trends
- Declining or inadequate liquidity
- Questionable repayment sources
- Lack of well-defined secondary repayment source, and
- Unfavorable competitive comparisons.

Such loans are no longer considered to be adequately protected due to the borrower's declining net worth, lack of earnings capacity, declining collateral margins and/or unperfected collateral positions. A possibility of loss of a portion of the loan balance cannot be ruled out. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.

Note 4 - Loans and Allowance for Loan Losses (continued)

"8" — Doubtful – Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus 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. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Among these events are:

- Injection of capital
- Alternative financing
- Liquidation of assets or the pledging of additional collateral.

The ability of the borrower to service the debt is extremely weak, overdue status is constant, the debt has been placed on non-accrual status, and no definite repayment schedule exists. Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off.

"9" — Loss – Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be effected in the future. Probable Loss portions of problem assets should be charged against the Allowance for Loan Losses. Loans may reside in this classification for administrative purposes for a period not to exceed the earlier of thirty (30) days or calendar quarter-end.

The following is a summary of credit quality indicators by class at December 31, 2016 and 2015:

Real Estate Credit Exposure as of December 31, 2016

		Commercial Real Estate				
	Construction	Non-owner occupied	Owner occupied	Residential 1-4 Family	Multifamily	Equity lines of credit
			(in thousands)			
Prime	$ -	$ -	$ -	$ -	$ -	$ -
Good	-	-	-	29	-	82
Acceptable 1	2,549	3,662	5,702	7,826	33	6,513
Acceptable 2	19,093	12,139	30,439	19,319	3,671	4,727
Weak Pass	13,532	15,332	28,267	9,746	1,193	781
Special Mention	1,473	2,026	731	2,471	-	124
Substandard	585	347	3,337	1,304	-	471
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
	$ 37,232	$ 33,506	$ 68,476	$ 40,695	$ 4,897	$ 12,698

Note 4 - Loans and Allowance for Loan Losses (continued)

Other Credit Exposures as of December 31, 2016

	Commerical and industrial	Agricultural	Individuals	Total
	(in thousands)			
Prime	$ -	$ -	$ -	$ -
Good	-	-	-	111
Acceptable 1	2,143	4,164	266	32,858
Acceptable 2	30,764	12,126	586	132,864
Weak Pass	12,377	3,836	266	85,330
Special Mention	232	766	358	8,181
Substandard	534	50	-	6,628
Doubtful	-	-	-	-
Loss	-	-	-	-
	$ 46,050	$ 20,942	$ 1,476	$ 265,972

Real Estate Credit Exposure as of December 31, 2015

		Commercial Real Estate				
	Construction	Non-owner occupied	Owner occupied	Residential 1-4 Family	Multifamily	Equity lines of credit
			(in thousands)			
Prime	$ -	$ -	$ -	$ -	$ -	$ -
Good	-	106	59	56	-	117
Acceptable 1	2,924	5,291	9,445	9,231	51	6,630
Acceptable 2	14,118	10,899	25,870	18,479	5,132	4,258
Weak Pass	13,210	10,986	19,355	9,917	40	1,014
Special Mention	1,548	5,123	705	3,380	-	148
Substandard	298	84	4,941	1,574	-	222
Doubtful	-	-	214	-	-	-
Loss	-	-	-	-	-	-
	$ 32,098	$ 32,489	$ 60,589	$ 42,637	$ 5,223	$ 12,389

Note 4 - Loans and Allowance for Loan Losses (continued)

Other Credit Exposures as of December 31, 2015

	Commerical and industrial	Agricultural	Individuals	Total
	(in thousands)			
Prime	$ -	$ -	$ -	$ -
Good	-	-	-	338
Acceptable 1	2,145	4,368	676	40,761
Acceptable 2	23,293	12,376	497	114,922
Weak Pass	12,840	3,125	294	70,781
Special Mention	254	991	372	12,521
Substandard	1,702	-	-	8,821
Doubtful	-	-	-	214
Loss	-	-	-	-
	$ 40,234	$ 20,860	$ 1,839	$ 248,358

Nonaccrual loans and past due loans - Nonperforming assets include loans classified as nonaccrual, foreclosed bank-owned property and loans past due 90 days or more on which interest is still being accrued. There were no financing receivables past due over 90 days accruing interest as of December 31, 2016 or 2015. Nonaccrual loans as of December 31, 2016 totaled $2.0 million, or 0.76% of total loans, compared with $1.4 million, or 0.55% of total loans, as of December 31, 2015. The Bank aggressively pursues the collection and repayment of all loans. Other nonperforming assets, such as repossessed and foreclosed collateral are aggressively liquidated by the Bank's management. The total number of loans on nonaccrual status as of December 31, 2016 and 2015 was 12.

For the years ended December 31, 2016 and 2015, the Bank recognized $1,741 and $-0- in interest income on nonaccrual loans. If interest on those loans had been accrued in accordance with the original terms, interest income would have increased by approximately $99,748 and $114,677 for the years ended December 31, 2016 and 2015, respectively.

The following is a breakdown of nonaccrual loans as of December 31, 2016 and 2015:

	2016	2015
Mortgage loans on real estate:		
Construction	$ 287,691	$ 297,846
Commercial real estate:		
Non-owner occupied	184,929	-
Owner occupied	756,874	311,615
Residential 1-4 family	451,676	733,616
Multifamily	-	-
Equity lines of credit	336,482	24,813
Commerical and industrial	-	-
Agricultural	-	-
Individuals	-	-
Total	$ 2,017,652	$ 1,367,890

Notes to Consolidated Financial Statements
For Years Ended December 31, 2016 and 2015

Note 4 - Loans and Allowance for Loan Losses (continued)

Nonaccrual loans and past due loans (concluded) - All classes of loans are considered past due if the required principal and interest income have not been received as of the date such payments were due. The following tables present the Bank's aged analysis of past due loans as of December 31, 2016 and 2015:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Greater Than 90 Days Still	Total Past Due	Current	Total Loans
December 31, 2016				(in thousands)			
Mortgage loans on real estate:							
Construction	$ -	$ -	$ -	$ -	$ -	$ 37,232	$ 37,232
Commercial real estate:							
Non-owner occupied	18	-	79	-	97	33,409	33,506
Owner occupied	-	-	757	-	757	67,719	68,476
Residential 1-4 family	147	16	151	-	314	40,381	40,695
Multifamily	-	-	-	-	-	4,897	4,897
Equity lines of credit	28	-	-	-	28	12,670	12,698
Commercial and industrial	3	-	-	-	3	46,047	46,050
Agricultural	-	-	-	-	-	20,942	20,942
Individuals	2	-	-	-	2	1,474	1,476
Total	$ 198	$ 16	$ 987	$ -	$ 1,201	$ 264,771	$ 265,972

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Greater Than 90 Days Still Accruing	Total Past Due	Current	Total Loans
December 31, 2015				(in thousands)			
Mortgage loans on real estate:							
Construction	$ 19	$ -	$ 298	$ -	$ 317	$ 31,781	$ 32,098
Commercial real estate:							
Non-owner occupied	-	-	-	-	-	32,489	32,489
Owner occupied	-	-	312	-	312	60,277	60,589
Residential 1-4 family	126	108	601	-	835	41,802	42,637
Multifamily	-	-	-	-	-	5,223	5,223
Equity lines of credit	51	-	-	-	51	12,338	12,389
Commercial and industrial	9	-	-	-	9	40,225	40,234
Agricultural	-	-	-	-	-	20,860	20,860
Individuals	-	-	-	-	-	1,839	1,839
Total	$ 205	$ 108	$ 1,211	$ -	$ 1,524	$ 246,834	$ 248,358

Note 4 - Loans and Allowance for Loan Losses (continued)

Troubled Debt Restructurings - In order to maximize the collection of loan balances, the Bank evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized where there is a reasonable chance that an appropriate modification would allow the Bank's customers to continue servicing debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: 1) a creditor has granted a concession to the debtor, and, 2) the debtor is experiencing financial difficulties. Non-accruing loans that are modified can be placed back on accrual status when both principal and interest are current and it is probable that the Bank will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement and a sustained period of payment performance is demonstrated. Interest on troubled debt restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur and a sustained payment performance period is obtained. For the years ended December 31, 2016 and 2015, the following table presents a breakdown of the types of concession made by loan class:

	Year ended December 31, 2016			Year ended December 31, 2015		
	Number of loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Extended payment terms						
Mortgage loans on real estate:						
Construction	1	$ 297,500	$ 297,500	-	$ -	$ -
Commercial real estate:						
Non-owner occupied	-	-	-	-	-	-
Owner occupied	-	-	-	2	2,499,716	2,499,716
Residential 1-4 family	1	143,575	143,575	-	-	-
Multifamily	-	-	-	-	-	-
Equity lines of credit	-	-	-	-	-	-
Commercial and industrial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Individuals	-	-	-	-	-	-
Total	2	$ 441,075	$ 441,075	2	$ 2,499,716	$ 2,499,716

The restructured loans generally include terms to reduce the interest rate and extend payment terms. The Bank did not forgive any principal associated with any of the above loans during 2016 or 2015. Within the last 12 months, no loans that were restructured in 2015 or 2014, subsequently defaulted and were foreclosed upon. These modifications resulted in specific reserves in the Bank's allowance for loan losses of $-0- and $592,950 as of December 31, 2016 and 2015, respectively.

Note 4 - Loans and Allowance for Loan Losses (continued)

Troubled Debt Restructurings (concluded) - There were two TDRs that were on non-accrual status and have a total current principal balance of $836,041 as of December 31, 2016. There was one TDRs that was on non-accrual status and had a total current principal balance of $297,846 as of December 31, 2015. Fifteen TDRs with a current principal balance of $5.4 million and eighteen TDRs with current principal balance of $10.5 million were considered performing loans and are accruing interest based on their sustained payment performance as of December 31, 2016 and 2015, respectively.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio.

Other real estate owned - At December 31, 2016 and 2015 the Company held $50,160 and $-0-, respectively of foreclosed residential real estate. The recorded investment in one-to-four family residential loans secured by residential real estate properties where formal foreclosure procedures were in process as of December 31, 2016 and 2015 was $-0- and $279,832, respectively.

Impaired Loans - Management considers certain loans graded "doubtful" (loans graded 8) or "loss" (loans graded 9) to be individually impaired and may consider "substandard" loans (loans graded 7) individually impaired depending on the borrower's payment history. Any loans classified as troubled debt restructurings regardless of loan grade are also classified as impaired loans. The Bank measures impairment based upon discounted expected cash flows or the value of the collateral. Collateral value is assessed based on collateral value trends, liquidation value trends, and other liquidation expenses to determine logical and credible discounts that may be needed. Updated appraisals are required for all impaired loans and typically at renewal or modification of larger loans if the appraisal is more than 12 months old.

Impaired loans for all classes of loans typically include nonaccrual loans, loans over 90 days past due still accruing, troubled debt restructured loans and other problem loans considered impaired based on other underlying factors. Potential problem loans totaled $8.1 million and $12.0 million as of December 31, 2016 and 2015, respectively. These totals include loans which are currently performing and are not included in nonaccrual or restructured loans above, but about which we have serious doubts as to the borrower's ability to comply with present repayment terms. These loans are likely to be included later in nonaccrual, past due or troubled debt restructured loans, so they are considered by management in assessing the adequacy of the allowance for loan losses. No additional funds are committed to be advanced in connection with impaired loans.

Note 4 - Loans and Allowance for Loan Losses (continued)

The following tables present the Bank's investment in loans considered to be impaired and related information on those impaired loans as of December 31, 2016 and 2015:

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date Average Recorded Investment	Year to Date Interest Income Recognized
			(in thousands)		
Impaired loans without a related allowance for loan losses					
Mortgage loans on real estate:					
Construction	$ 590	$ 590	$ -	$ 579	$ 31
Commercial real estate:					
Non-owner occupied	286	286	-	217	7
Owner occupied	833	1,729	-	1,749	67
Residential 1-4 family	696	763	-	858	19
Multifamily	-	-	-	-	-
Equity lines of credit	134	604	-	141	6
Commercial and industrial	250	250	-	250	10
Agricultural	50	50	-	50	3
Individuals	-	-	-	-	-
Impaired loans with a related allowance for loan losses					
Mortgage loans on real estate:					
Construction	1,154	1,154	112	1,203	58
Commercial real estate:					
Non-owner occupied	106	106	18	109	7
Owner occupied	2,703	2,703	172	2,764	111
Residential 1-4 family	944	944	146	959	58
Multifamily	-	-	-	-	-
Equity lines of credit	336	673	107	343	14
Commercial and industrial	-	-	-	-	-
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
Total impaired loans					
Mortgage loans on real estate:					
Construction	$ 1,744	$ 1,744	$ 112	$ 1,782	$ 89
Commercial real estate:					
Non-owner occupied	392	392	18	326	14
Owner occupied	3,536	4,432	172	4,513	178
Residential 1-4 family	1,640	1,707	146	1,817	77
Multifamily	-	-	-	-	-
Equity lines of credit	470	1,277	107	484	20
Commercial and industrial	250	250	-	250	10
Agricultural	50	50	-	50	3
Individuals	-	-	-	-	-
Total impaired loans	$ 8,082	$ 9,852	$ 555	$ 9,222	$ 391

Note 4 - Loans and Allowance for Loan Losses (continued)

December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date Average Recorded Investment	Year to Date Interest Income Recognized
			(in thousands)		
Impaired loans without a related allowance for loan losses					
Mortgage loans on real estate:					
Construction	$ -	$ -	$ -	$ -	$ -
Commercial real estate:					
Non-owner occupied	129	129	-	130	8
Owner occupied	1,745	2,032	-	2,100	77
Residential 1-4 family	417	749	-	764	2
Multifamily	-	-	-	-	-
Equity lines of credit	-	-	-	-	-
Commercial and industrial	-	-	-	-	-
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
Impaired loans with a related allowance for loan losses					
Mortgage loans on real estate:					
Construction	1,503	1,503	108	1,535	75
Commercial real estate:					
Non-owner occupied	1,304	1,304	57	1,326	71
Owner occupied	5,302	5,302	637	5,338	254
Residential 1-4 family	1,323	1,323	322	1,341	68
Multifamily	-	-	-	-	-
Equity lines of credit	25	25	25	26	-
Commercial and industrial	250	250	2	250	10
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
Total impaired loans					
Mortgage loans on real estate:					
Construction	$ 1,503	$ 1,503	$ 108	$ 1,535	$ 75
Commercial real estate:					
Non-owner occupied	1,433	1,433	57	1,456	79
Owner occupied	7,047	7,334	637	7,438	331
Residential 1-4 family	1,740	2,072	322	2,105	70
Multifamily	-	-	-	-	-
Equity lines of credit	25	25	25	26	-
Commercial and industrial	250	250	2	250	10
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
Total impaired loans	$ 11,998	$ 12,617	$ 1,151	$ 12,810	$ 565

Note 4 - Loans and Allowance for Loan Losses (continued)

Allowance for Loan Losses - The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate for probable losses that have been incurred within the existing portfolio of loans. The primary risks inherent in the Bank's loan portfolio, including the adequacy of the allowance or reserve for loan losses, are based on management's assumptions regarding, among other factors, general and local economic conditions, which are difficult to predict and are beyond the Bank's control. In estimating these risks, and the related loss reserve levels, management also considers the financial conditions of specific borrowers and credit concentrations with specific borrowers, groups of borrowers, and industries.

The allowance for loan losses is adjusted by direct charges to provision expense. Losses on loans are charged against the allowance for loan losses in the accounting period in which they are determined by management to be uncollectible. Recoveries during the period are credited to the allowance for loan losses. The Bank realized no provisions for the years ended December 31, 2016 and 2015, respectively. The provision expense is determined by the Bank's allowance for loan losses model. The components of the model are specific reserves for impaired loans and a general allocation for unimpaired loans. The general allocation has three components, an estimate based on historical loss experience, an additional estimate based on internal and external environmental factors due to the uncertainty of historical loss experience in predicting current embedded losses in the portfolio that will be realized in the future and an unallocated portion to cover uncertainties that could affect management's estimate of probable losses.

In determining the general allowance allocation, the ratios from the actual loss history for the various categories are applied to the homogeneous pools of loans in each category.

The portion of the general allocation on environmental factors includes estimates of losses related to the following:

- Current national and local economic conditions
- Composition of the nature and volume of the portfolio
- Changes in the trend or volume of past due, watch list and classified loans
- The existence and effect of concentrations or changes in concentrations upon the portfolio
- The existence and effect of granularity in the size of credits in the portfolio
- The existence and effect of loan to values in excess of regulatory guidance – percentage of loans in each category with regulatory exceptions
- Cumulative effect of other factors such as loan portfolio quality, underwriting strength and general determinations about the portfolio held by executive management.

Markets served by the Bank continue to experience some uncertainty from the general economy and a slow real estate market. Other factors impacting the allowance at December 31, 2016 were watch list trends, unemployment rate trends, government spending expectations and underwriting and servicing assessments.

Note 4 - Loans and Allowance for Loan Losses (continued)

Allowance for Loan Losses (continued) - The following table's present changes in the allowance for loan losses for the years ended December 31, 2016 and 2015:

	December 31, 2015	Charge-offs	Recoveries	Provision	December 31, 2016
			(in thousands)		
Mortgage loans on real estate:					
Construction	$ 1,101	$ 41	$ -	$ (514)	$ 546
Commercial real estate:					
Non-owner occupied	514	-	-	24	538
Owner occupied	1,931	896	224	756	2,015
Residential 1-4 family	1,425	159	55	(208)	1,113
Multifamily	99	-	267	(301)	65
Equity lines of credit	163	46	1	159	277
Commercial and industrial	756	-	6	139	901
Agricultural	330	-	-	(51)	279
Individuals	25	1	2	(4)	22
	$ 6,344	$ 1,143	$ 555	$ -	$ 5,756

	December 31, 2014	Charge-offs	Recoveries	Provision	December 31, 2015
			(in thousands)		
Mortgage loans on real estate:					
Construction	$ 1,108	$ -	$ -	$ (7)	$ 1,101
Commercial real estate:					
Non-owner occupied	684	-	-	(170)	514
Owner occupied	2,620	542	-	(147)	1,931
Residential 1-4 family	1,939	1,559	379	666	1,425
Multifamily	308	189	12	(32)	99
Equity lines of credit	208	-	56	(101)	163
Commercial and industrial	713	-	8	35	756
Agricultural	575	-	-	(245)	330
Individuals	27	4	1	1	25
	$ 8,182	$ 2,294	$ 456	$ -	$ 6,344

Note 4 - Loans and Allowance for Loan Losses (concluded)

Allowance for Loan Losses (concluded) - The activity in the allowance for loan loss for 2016 and 2015 are summarized by loan class as follows:

As of December 31, 2016	Reserves for loans individually evaluated for impairment	Loans individually evaluated for impairment	Reserves for loans collectively evaluated for impairment	Loans collectively evaluated for impairment
		(in thousands)		
Mortgage loans on real estate:				
Construction	$ 112	$ 1,744	$ 434	$ 35,488
Commercial real estate:				
Non owner occupied	18	392	520	33,114
Owner occupied	172	3,536	1,843	64,940
Residential 1-4 family	146	1,640	967	39,055
Multifamily	-	-	65	4,897
Equity lines of credit	107	470	170	12,228
Commercial and industrial	-	250	901	45,800
Agricultural	-	50	279	20,892
Individuals	-	-	22	1,476
	$ 555	$ 8,082	$ 5,201	$ 257,890

As of December 31, 2015	Reserves for loans individually evaluated for impairment	Loans individually evaluated for impairment	Reserves for loans collectively evaluated for impairment	Loans collectively evaluated for impairment
		(in thousands)		
Mortgage loans on real estate:				
Construction	$ 108	$ 1,503	$ 993	$ 30,595
Commercial real estate:				
Non owner occupied	57	1,433	457	31,056
Owner occupied	637	7,047	1,294	53,542
Residential 1-4 family	322	1,740	1,103	40,897
Multifamily	-	-	99	5,223
Equity lines of credit	25	25	138	12,364
Commercial and industrial	2	250	754	39,984
Agricultural	-	-	330	20,860
Individuals	-	-	25	1,839
	$ 1,151	$ 11,998	$ 5,193	$ 236,360

Note 5 - Premises and equipment

At December 31, 2016 and 2015, premises and equipment consist of the following:

	2016	2015
Land	$ 456,450	$ 456,450
Buildings	6,139,694	5,877,372
Equipment, furniture and fixtures	2,801,652	2,723,595
Computer equipment	243,988	213,776
Software	457,799	457,799
	10,099,583	9,728,992
Less accumulated depreciation	(6,622,332)	(6,181,320)
Total premises and equipment, net	$ 3,477,251	$ 3,547,672

For 2016 and 2015, depreciation charged to operating expense was $464,346 and $454,801, respectively.

Note 6 - Non-marketable equity securities

Non-marketable equity securities consist of the following at December 31, 2016 and 2015:

	2016	2015
Federal Home Loan Bank stock	$ 1,436,100	$ 1,446,500
Federal Reserve Bank stock	399,150	398,250
Community Bankers' Bank stock	61,300	61,300
Bankers Title, LLC	99,178	99,178
Manry Rawls, LLC	2,030,363	2,013,947
Plexus Captial, LLC	150,000	-
Senior Housing Crime Prevention Foundation stock	500,000	500,000
Total non-marketable equity securities	$ 4,676,091	$ 4,519,175

Note 7 - Interest-bearing deposits

Interest-bearing deposits consist of the following:

	2016	2015
NOW accounts	$ 23,462,873	$ 31,768,251
Money market accounts	93,516,154	88,156,146
Business interest checking	15,559,801	-
Savings accounts	26,919,065	24,655,033
Certificates of deposits and IRAs $250,000 and over	11,626,545	12,733,288
Certificates of deposit and IRAs under $250,000	71,274,990	82,143,721
Total interest-bearing deposits	$ 242,359,428	$ 239,456,439

Note 7 - Interest-bearing deposits (concluded)

At December 31, 2016, the scheduled maturities of time deposits are as follows:

2017	$ 29,312,238
2018	23,294,929
2019	14,003,521
2020	7,857,180
2021	8,433,667
Thereafter	-
Total time deposits	$ 82,901,535

For 2016 and 2015, time deposits individually in excess of $250,000 was $11.63 million and $12.73 million.

Note 8 – Capital notes

During the fourth quarter of 2013, the Company closed the private placement of unregistered debt securities (the "2013 Offering") pursuant to which the Company issued approximately $11.3 million in principal of notes (the "2013 Notes"). The 2013 Notes have not been and will not be registered under the Securities Act of 1933 and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The 2013 Notes bear interest at the rate of 5% per year with interest payable quarterly in arrears. The 2013 Notes mature on December 31, 2018, but are subject to prepayment in whole or in part on or after December 31, 2014 at the Company's sole discretion on 30 days written notice to the holders. There are no assets pledged as collateral for the 2013 Notes.

During 2016 and 2015, the Company repaid $2.040 million and $1.325 million of capital notes to accommodate investor's liquidity needs and to reduce our debt service obligations. In 2016 and 2015, $600,000 and $925,000 of the capital notes were redeemed at a premium price of 102%, equating to total premium paid of $12,000 and $18,500. An additional $1.440 million and $400,000 of capital notes were redeemed at the original investment price during 2016 and 2015.

Of these capital notes, $-0- and $400,000 is due to executive officers and board members of the Bank as of December 31, 2016 and 2015, respectively. Interest expense of $6,201 and $25,188 was paid to these related parties on the capital notes for the years ended December 31, 2016 and 2015, respectively.

Note 9 - Securities sold under agreements to repurchase and other borrowings

The Bank utilizes securities sold under agreement to repurchase to facilitate the needs of customers. Securities sold under agreements to repurchase, are classified as secured borrowings, generally mature within one day from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The average interest rate was 0.50% and 0.27% during the years ended December 31, 2016 and 2015, respectively.

The Bank monitors collateral levels on a continuous basis and maintains records of each transaction specifically describing the applicable security and the customer's fractional interest in that security, and the Bank segregates the security from its general assets in accordance with regulations governing custodial holding of securities. The primary risk with the Bank's repurchase agreements is market risk associated with the investments securing the transactions, as the Bank may be required to provide additional collateral based on air value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with the Bank's safekeeping agent. The carrying value of available for sale investment securities pledged as collateral under repurchase agreement was $3,263,403 and $4,090,844 at December 31, 2016 and 2015, respectively.

Note 9 - Securities sold under agreements to repurchase and other borrowings (continued)

The remaining contractual maturity of the securities sold under agreements to repurchase by class of collateral pledged included in short-term borrowings in the Consolidated Balance Sheets as of December 31, 2016 and December 31, 2015 is presented in the following tables.

December 31, 2016	Overnight and continuous	Up to 30 Days	30-90 Days	Greater than 90	Total
			(in thousands)		
Repurchase agreements:					
Small Business Administration Pools	$ 1,126	$ -	$ -	$ -	$ 1,126
Total borrowings	$ 1,126	$ -	$ -	$ -	$ 1,126
Gross amount of recognized liabilities for repurchase agreements					$ 1,126

December 31, 2015	Overnight and continuous	Up to 30 Days	30-90 Days	Greater than 90	Total
			(in thousands)		
Repurchase agreements:					
Small Business Administration Pools	$ 823	$ -	$ -	$ -	$ 823
Total borrowings	$ 823	$ -	$ -	$ -	$ 823
Gross amount of recognized liabilities for repurchase agreements					$ 823

The Bank has arrangements with various banks which enables the Bank to borrow up to $30,000,000 in federal funds on an unsecured basis, at a variable rate. At December 31, 2016 and 2015, the Bank had no outstanding federal funds purchased.

The Bank also has arrangements with the Federal Home Loan Bank which enables the Bank to borrow up to twenty-five percent of total assets.

At December 31, 2016 and 2015, Federal Home Loan Bank advances were as follows:

December 31, 2016

Maturity date	Call Feature	Amount	Rate
January 9, 2017	-	$ 5,000,000	0.990%
January 8, 2019	-	5,000,000	1.977%
September 3, 2019	-	5,000,000	1.999%
April 15, 2020	-	2,500,000	2.040%
July 29, 2020	-	5,000,000	1.944%
October 13, 2020	-	2,500,000	2.176%
Total FHLB borrowings/weighted average rate		$ 25,000,000	1.800%

Note 9 - Securities sold under agreements to repurchase and other borrowings (concluded)

December 31, 2015

Maturity date	Call Feature	Amount	Rate
January 9, 2017	-	$ 5,000,000	0.990%
January 8, 2019	-	5,000,000	1.977%
September 3, 2019	-	5,000,000	1.999%
April 15, 2020	-	2,500,000	2.040%
July 29, 2020	-	5,000,000	1.944%
October 13, 2020	-	2,500,000	2.176%
Total FHLB borrowings/weighted average rate		$ 25,000,000	1.800%

The carrying value of loans pledged as collateral to the Federal Home Loan Bank were $30,933,711 and $32,310,989 at December 31, 2016 and 2015, respectively.

During 2015, the Company prepaid $5 million in FHLB advances with a weighted average rate of 3.69%. These advances were paid prior to their maturity date in order to enhance future earning by way of reduction in interest expense. These repayments resulted in a prepayment penalty on borrowings equaling $355,592. During 2016, there were no repayments of FHLB advances.

Note 10 - Employee benefit plans

Profit sharing plan - The Company has a profit sharing plan covering substantially all employees. Contributions to the plan are determined annually by the Compensation Committee and are the lesser of 10% of the participants' base compensation or 10% of the net income of the Bank. Employee benefits expense included $400,010 and $378,300 for the plan for 2016 and 2015, respectively.

Post-retirement benefits - The Company has entered into deferred compensation arrangements with certain key personnel which call for the payment of benefits upon the retirement or death of the individuals. In 2016, the Company amended one of these plans and froze the other plan while creating a new plan for this executive, such that upon the executives' retirement, the Company will provide for a monthly retirement payment for their lifetime. The agreements provide that a retirement benefit is payable upon a defined normal retirement age while in service to the Company and a lesser benefit is payable upon early retirement. Other benefits are payable upon disability, death or change in control.

The agreements are unfunded arrangements maintained primarily to provide supplemental retirement benefits and comply with Section 409A of the Internal Revenue Code. However, the Company has elected to finance the retirement benefits by purchasing annuities that have been designed to provide a future source of funds for the lifetime retirement benefits of the agreements. The primary impetus for utilizing these annuities is a substantial savings in compensation expense for the Company as opposed to a typically designed supplemental retirement plan.

The liabilities associated with these deferred compensation arrangements were $1,323,644 and $1,240,929 as of December 31, 2016 and 2015, respectively. The annuity had a balance of $3,026,890 and $-0- as of December 31, 2016 and 2015, respectively, and is recorded at amortized cost. Salaries and employee benefits expense included $86,715 and $140,614 of expense related to these arrangements for 2016 and 2015, respectively.

Note 11 - Income taxes

The principal components of the income tax expense as of December 31, 2016 and 2015 are as follows:

	2016	2015
Federal - current tax provision	$ 1,148,104	$ 874,280
Federal - deferred (benefit)	(19,121)	92,841
	$ 1,128,983	$ 967,121

The differences between expected federal income taxes at statutory rates and actual income tax expense are summarized as follows:

	2016	2015
Income tax expense computed at federal statutory rate (34%)	$ 1,807,328	$ 1,612,112
Tax effects of:		
Tax-exempt interest	(589,815)	(550,810)
Non-taxable bank owned life insurance	(100,205)	(102,512)
Non-deductible expenses	16,940	7,594
Other	(5,265)	737
Total income tax expense	$ 1,128,983	$ 967,121

The Bank's deferred tax assets and liabilities and their components are included on the balance sheets. The components of these deferred tax assets and liabilities are as follows:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 1,074,456	$ 1,074,456
Deferred compensation	450,039	421,916
Interest on non-performing loans	20,768	10,257
Other	8,809	11,733
Total deferred tax asset	1,554,072	1,518,362
Deferred tax liabilities:		
Available-for-sale investment securities	(631,166)	(1,236,806)
Accumulated depreciation	(306,899)	(288,462)
Accumulated accretion	(136,635)	(133,272)
Net unamortized deferred fees and expenses	(3,266)	(8,478)
Total deferred tax liability	(1,077,966)	(1,667,018)
Net deferred tax asset (liability)	$ 476,106	$ (148,656)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax asset will not be realized. Management considers recoverable taxes paid in prior years, projected future taxable income, and tax planning strategies in making this assessment. It is management's belief that the realization of the net deferred tax assets is more likely than not.

Note 11 - Income taxes (concluded)

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions.

The Company and its subsidiaries file income tax returns with the federal government. With few exceptions, the Company is no longer subject to federal income tax examinations by tax authorities for years before 2013.

Note 12 - Commitments and contingencies

The Company leases banking premises and various equipment for periods extending through February 2026. Total rental expense was $207,083 and $179,854 for 2016 and 2015, respectively.

Pursuant to the terms of non-cancelable lease agreements in effect at December 31, 2016, pertaining to bank premises and equipment, future minimum rental commitments under various operating leases are as follows:

2017	$ 219,731
2018	207,047
2019	167,265
2020	161,641
2021	157,630
Thereafter	36,898
	$ 950,212

Various legal claims also arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

Note 13 - Related party transactions

In the ordinary course of business, the Bank has loan and deposit transactions with its executive officers and directors, and with companies in which the officers and directors have a significant financial interest. These transactions are at substantially the same rates as similarly situated customers. A summary of related party loan activity during 2016 and 2015 is as follows:

	2016	2015
Beginning balance, January 1	$ 3,379,712	$ 4,079,553
Originations	2,495,310	963,765
Repayments	(1,178,799)	(1,663,606)
Ending balance, December 31	$ 4,696,223	$ 3,379,712

Commitments to extend credit to related parties amounted to $7,468,000 and $8,685,848 at December 31, 2016 and 2015, respectively.

Deposits from related parties held by the Bank amounted to $5,166,750 and $5,227,190 at December 31, 2016 and 2015, respectively.

The Bank currently has a loan outstanding to Manry Rawls, LLC with a current principal balance of $1,860,388 and

Note 13 - Related party transactions (concluded)

$2,260,211 as of December 31, 2016 and 2015, respectively. This loan is at substantially the same terms as similarly situated customers.

See Note 8 for additional disclosures of related party transactions.

Note 14 - Credit commitments and concentrations of credit risk

Commitments to extend credit are agreements to lend funds 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. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer. Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Commercial and 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. Essentially all letters of credit issued have expiration dates within one year.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments if deemed necessary.

The Bank also has commitments, as detailed below, to invest in a private investment fund that focuses on investments and partnerships with middle market businesses that need capital for growth.

The amounts of loan commitments, guarantees and standby letters of credit are set out in the following table as of December 31, 2016 and 2015. Because many commitments and almost all standby letters of credit and guarantees expire without being funded in whole or in part, the contract amounts are not estimates of future cash flows. A summary of loan commitments and standby letters of credit is as follows:

	2016	2015
Loan commitments	$ 59,231,100	$ 50,152,525
Standby letters of credit and guarantees written	$ 359,038	$ 726,327
Capital commitment to private investment funds	$ 1,850,000	$ -

Standby letters of credit outstanding at December 31, 2016 expire during 2017 and 2020.

Loan commitments, standby letters of credit and written guarantees have off-balance sheet credit risk because only origination fees and accruals for probable losses, if any, are recognized in the statements of financial position until the commitments are fulfilled or the standby letters of credit or guarantees expire. Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. The credit risk amounts are equal to the contractual amounts, assuming that the amounts are fully advanced and collateral or other security is of no value. The Bank's policy is to require customers to provide collateral prior to the disbursement of approved loans. For retail loans, the Bank usually retains a security interest in the property or products financed, which provides repossession rights in the event of default by the customer. For business loans and financial guarantees, collateral is usually in the form of inventory or marketable securities (held in trust) or property (notations on title).

Note 14 - Credit commitments and concentrations of credit risk (concluded)

Concentrations of credit risk (whether on or off-balance sheet) arising from financial instruments exist in relation to certain groups of customers. A group concentration arises when a number of counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. A group concentration exists as most of the Bank's customers are located within southeastern Virginia.

The credit risk amounts represent the maximum accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted and any collateral or security proved to be of no value. The Bank has experienced little difficulty in accessing collateral when required.

Note 15 - 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 Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

In July 2013, the FDIC and other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). On January 1, 2015, the Company became subject to the Basel III Capital Rules which revises definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provision and timelines. The revised rules now require the bank to maintain (i) a minimum ratio of Common Tier 1 capital to risk-weighted assets of at least 4.5%, plus 2.5% "capital conservation buffer" (conservation buffer will be phased in), (ii) minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, (iii) a minimum ratio of total capital to risk-weighted assets of at 8.0%, and (iv) a minimum leverage ratio of 4.0%. A transition period for the capital conservation buffer under Basel III for all banking organizations began on January 1, 2016 and end January 1, 2019. The conservation buffer will begin at the 0.625% level and be phased in over a four-year period (increasing on each subsequent January 1, until it reaches 2.5% on January 1, 2019). As of January 1, 2017, the capital conservation buffer was 8.525%.

Management believes, as of December 31, 2016 and 2015, the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2016, the most recent notification from the Board of Governors of the Federal Reserve Board categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, Common Equity risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

Note 15 - Regulatory matters (concluded)

The Bank's actual capital amounts (dollars in thousands) and ratios are presented in the table below:

	Actual		For Capital Adequacy Purposes		Under Prompt Corrective Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016:			*(Dollars in thousands)*			
Total Capital						
(to Risk-Weighted Assets)	$ 51,814	16.4%	$ 25,229	8.0%	$ 31,536	10.0%
Tier I Risk-Based Capital						
(to Risk-Weighted Assets)	47,872	15.2%	18,922	6.0%	25,229	8.0%
Common Equity Risk-Based Capital						
(to Risk-Weighted Assets)	47,872	15.2%	14,191	4.5%	20,498	6.5%
Tier I Leverage Ratio						
(to Average Assets)	47,872	11.6%	16,452	4.0%	20,565	5.0%
As of December 31, 2015:						
Total Capital						
(to Risk-Weighted Assets)	$ 50,194	18.5%	$ 21,709	8.0%	$ 21,137	10.0%
Tier I Risk-Based Capital						
(to Risk-Weighted Assets)	46,766	17.2%	16,282	6.0%	21,709	8.0%
Common Equity Risk-Based Capital						
(to Risk-Weighted Assets)	46,766	17.2%	12,211	4.5%	17,639	6.5%
Tier I Leverage Ratio						
(to Average Assets)	46,766	11.5%	16,226	4.0%	20,283	5.0%

The above tables set forth the capital position and analysis for the Bank only. Because total assets on a consolidated basis are less than $500 million, the Company is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, the Company 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 capital notes do not qualify as equity capital on a consolidated basis.

Note 16 - Fair value measurements

The Company refers to the *Fair Value Measurements and Disclosures* Topic of the FASB Accounting Standards Codification (ASC 820) to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. This guidance clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The fair market value measurement specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions.

Note 16 - Fair value measurements (continued)

The three levels of the fair value hierarchy are based on these two types of inputs are as follows:

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

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

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

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

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

The following table presents the balances of available-for-sale securities measured at fair value on a recurring basis as of December 31, 2016 and 2015:

Description	Balance as of December 31, 2016	Level 1	Level 2	Level 3
State and municipal	$ 45,727,804	$ -	$ 45,727,804	$ -
Residential mortgage-backed securities	20,689,687	-	20,689,687	-
Collateralized mortgage obligations	35,469,540	-	35,469,540	-
Small Business Administration Pools	23,859,672	-	23,859,672	-
	$ 125,746,703	$ -	$ 125,746,703	$ -

Description	Balance as of December 31, 2015	Level 1	Level 2	Level 3
State and municipal	$ 43,834,205	$ -	$ 43,834,205	$ -
Residential mortgage-backed securities	15,885,063	-	15,885,063	-
Collateralized mortgage obligations	46,469,618	-	46,469,618	-
Small Business Administration Pools	28,550,718	-	28,550,718	-
	$ 134,739,604	$ -	$ 134,739,604	$ -

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

Note 16 - Fair value measurements (continued)

Impaired Loans - Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on the observable market price of the loan, the fair value of the collateral or by using the discounted cash flow method. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate.

The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company. The Company records impaired loans secured by real estate as Level 3 assets. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports are recorded as Level 3 assets. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Statements of Operations.

Other real estate owned - Other real estate owned is considered held for sale and is adjusted to fair value less estimated selling costs upon transfer of the loan to foreclosed assets. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. The Company considers the other real estate owned as nonrecurring Level 3.

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

Description	Balance as of December 31, 2016	Level 1	Level 2	Level 3
Assets				
Other real estate owned	$ 877,278	$ -	$ -	$ 877,278
Impaired loans	4,688,019	-	-	4,688,019
Total assets	$ 5,565,297	$ -	$ -	$ 5,565,297

Description	Balance as of December 31, 2015	Level 1	Level 2	Level 3
Assets				
Other real estate owned	$ 612,798	$ -	$ -	$ 612,798
Impaired loans	8,556,119	-	-	8,556,119
Total assets	$ 9,168,917	$ -	$ -	$ 9,168,917

The following table summarized quantitative information about Level 3 fair value measurements:

Description	Fair Value at December 31, 2016	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets				
Other real estate owned	$ 877,278	Discounted appraisals	Collateral discounts	10-20%
Impaired loans	4,688,019	Discounted appraisals	Collateral discounts	10-30%
		Discounted cash flows	Discount rate	6%
Total assets	$ 5,565,297			

Note 16 - Fair value measurements (concluded)

Description	Fair Value at December 31, 2015	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets				
Other real estate owned	$ 612,798	Discounted appraisals	Collateral discounts	10-20%
Impaired loans	8,556,119	Discounted appraisals	Collateral discounts	10-30%
		Discounted cash flows	Discount rate	6%
Total Assets	$ 9,168,917			

The following table presents the carrying amounts and fair value of the Company's financial instruments as of December 31, 2016 and 2015. FASB Accounting Standards Codification's *Financial Instruments* (ASC 825), defines the fair value of financial instruments as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The carrying amounts in the table are included in the balance sheets under the indicated captions. The capital notes are valued at amortized cost based on the lack of marketability due to transfer restrictions.

	2016		2015	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(Dollars in thousands)			
Financial assets:				
Cash and cash equivalents	$ 11,137	$ 11,137	$ 16,285	$ 16,285
Investment securities, available-for-sale	125,747	125,747	134,740	134,740
Loans held for sale	1,444	1,444	911	911
Loans held for investment, net	260,202	261,680	242,032	242,453
Accrued interest receivable	1,723	1,723	1,774	1,774
Annuity	3,027	3,027	-	-
Financial liabilities:				
Demand deposits, NOW, savings and money market accounts	261,010	261,010	241,000	241,000
Time deposits	82,902	82,355	94,877	94,933
Accrued interest payable	184	184	199	199
FHLB Advances	25,000	25,172	25,000	25,220
Capital notes	7,888	7,888	9,928	9,928
Securities sold under agreement to repurchase	1,126	1,126	823	823

Note 17 - Stock incentive plan

The Board approved a stock incentive plan effective January 1, 2007. The plan authorizes the grant of awards for a period of ten years. The number of shares authorized for issuance under the plan is limited to 2.25% of the total authorized and unissued shares of common stock. Three types of awards may be granted under the plan: Incentive Stock Options, Nonqualified Stock Options and Restricted Stock. The Bank granted restricted stock awards during 2016. The Bank accounts for this plan in accordance with the *Stock Compensation* Topic of the FASB Accounting Standards Codification (ASC 718). The non-vested equity share or non-vested equity share unit awarded to an employee is measured at its fair value on the grant date. The compensation expense is recognized over the requisite service period.

Note 17 - Stock incentive plan (concluded)

The vesting requirements are five years. The compensation expense recognized for the years ended December 31, 2016 and 2015 was $30,000 and $48,000, respectively. The expected future expense related to vesting issuances is $8,000. Members of the Board of Directors of the Bank can elect to receive a portion or all of their director's fees in the form of common stock. During the year ended December 31, 2016 and 2015, the expense related to these issuances was $26,400 and $40,600, respectively.

A summary of the status of the non-vested shares in relation to our restricted stock awards as of December 31, 2016 and 2015, and changes during the years ended December 31, 2016 and 2015, is presented below; the weighted average price is the weighted average fair value at the date of grant:

	2016		2015	
Restricted Share Awards	Shares	Weighted Average Price	Shares	Weighted Average Price
Nonvested - Beginning of the year	13,800	$ 8.70	17,250	$ 8.70
Granted	2,703	11.10	-	-
Vested	8,280	8.70	-	-
Forfeited	-	-	3,450	8.70
Nonvested - End of year	8,223	$ 8.96	13,800	$ 8.70

Note 18 - Earnings per share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential dilutive common stock had no effect on income attributable to common shareholders.

	2016	2015
Basic		
Net income, as reported	$ 4,186,686	$ 3,774,388
Preferred stock dividends and accretion of discount	-	-
Net income attributable to common shareholders	$ 4,186,686	$ 3,774,388
Average common shares outstanding	3,056,830	3,053,845
Basic earnings per share amount	$ 1.37	$ 1.24
Diluted		
Net income attributable to common shareholders	$ 4,186,686	$ 3,774,388
Average common shares outstanding	3,056,830	3,053,845
Effect of dilutive unvested restricted stock awards	2,274	5,271
Average diluted shares outstanding	3,059,104	3,059,116
Diluted earnings per share	$ 1.37	$ 1.23

Note 19 – Condensed financial statements of parent company

On July 26, 2013, the Board of Directors of the Bank approved an Agreement and Plan of Reorganization and Share Exchange (the "Agreement") whereby the Bank would become a subsidiary of Farmers Bankshares, Inc., a company incorporated in Virginia on July 26, 2013 for the purpose of becoming a holding company for the Bank. The Agreement provided for the statutory share exchange of all of the Bank's common stock held by stockholders for the common stock of Farmers Bankshares, Inc., on a one-for-one basis.

The Agreement was approved by the Bank's stockholders at a special meeting of the Bank's stockholders held on September 26, 2013 (the "Special Stockholders' Meeting"). The holding company reorganization was consummated on December 31, 2013 (see Note 1). Prior to the holding company reorganization, Farmers Bankshares, Inc. conducted no operations other than obtaining regulatory approval for the holding company reorganization. As this event is considered reorganization under common control, the consolidated financial statements, discussion of the statements and all other information presented herein for the years ended December 31, 2016 and 2015 are presented for the Company as a consolidated entity.

Financial information pertaining only to Farmers Bankshares, Inc. is as follows:

Balance Sheets

	December 31, 2016	December 31, 2015
Assets		
Cash	$ 954,569	$ 954,727
Taxes receivable	554,082	398,991
Investment in Farmers Bank	49,096,744	49,167,346
Other assets	314,660	166,783
Total assets	$ 50,920,055	$ 50,687,847
Liabilities and Stockholders' Equity		
Liabilities		
Capital notes, 5% due December 31, 2018	$ 7,888,475	$ 9,928,475
Other liabilities	304,815	152,014
Total liabilities	8,193,290	10,080,489
Stockholders' equity		
Common stock, $0.125 par value	382,047	381,763
Capital surplus	2,775,106	2,754,141
Retained earnings	38,344,408	35,070,594
Accumulated other comprehensive income	1,225,204	2,400,860
Total stockholders' equity	42,726,765	40,607,358
Total liabilities and stockholders' equity	$ 50,920,055	$ 50,687,847

Note 19 – Condensed financial statements of parent company (concluded)

Statements of Operations

	Years Ended December 31, 2016	2015
Income	$ 3,401,796	$ 2,409,178
Operating expenses		
Interest expense	441,847	517,478
Other expenes	12,158	18,500
Total expenses	454,005	535,978
Allocated income tax benefits	(155,091)	(182,233)
Income before equity in undistrbuted income of subsidiary	3,102,882	2,055,433
Equity in undistributed income - Farmers Bank	1,083,804	1,718,955
Net income	$ 4,186,686	$ 3,774,388

Statements of Cash Flows

	Years Ended December 31, 2016	2015
Cash flows from operating activities		
Net income	$ 4,186,686	$ 3,774,388
Adjustments to reconcile net income to net cash provided by operating activities		
Taxes receivable	(155,091)	(182,233)
Other assets	(147,876)	47,693
Other liabilities	-	-
Equity in undistributed net income of Farmers Bank	(1,083,804)	(1,718,955)
Net cash provided by operating activities	2,799,915	1,920,893
Cash flows from financing activities		
Cash dividends paid on common shares	(760,073)	(595,893)
Redemption of capital notes	(2,040,000)	(1,325,000)
Net cash (used in) financing activities	(2,800,073)	(1,920,893)
Decrease in cash and cash equivalents	(158)	-
Cash and cash equivalents		
Beginning of the year	954,727	954,727
End of year	$ 954,569	$ 954,727

Note 21 – Subsequent events

The Company has evaluated subsequent events through March 10, 2017, in connection with the preparation of these financial statements which is the date the financial statements were available to be issued. On February 10, 2017 the Bank entered into an agreement to purchase a 15% ownership in Tidewater Home Funding, LLC, a licensed mortgage lender headquartered in Chesapeake, Virginia. The Bank paid $473,850 for the Class B Membership Interest and $350,000 for the Class A Membership Interest. The Class A Membership Interest bears interest at a rate of 6.00% annually.

This page intentionally left blank.

Branch Locations

Chesapeake
1403 Greenbrier Parkway, Suite 110

Courtland
28319 Southampton Parkway, Suite D

Smithfield
1119 South Church Street, PO Box 888

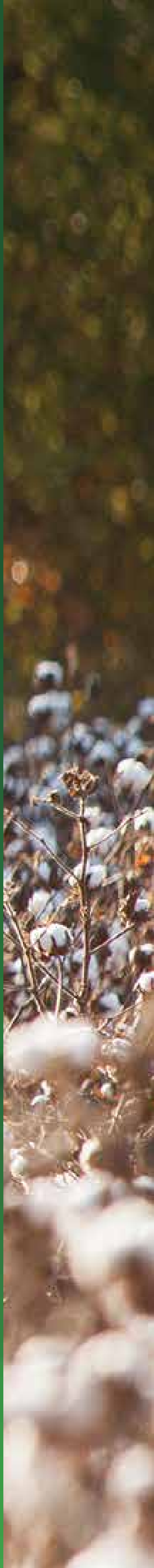
Suffolk – Harbour View
6255 College Drive, Suite L

Suffolk – Hillpoint
3100 Godwin Boulevard

Suffolk – Lakeside
1008 West Washington Street

Windsor
50 East Windsor Boulevard, PO Box 285

www.farmersbankva.com
757-242-6111



FARMERS BANK

Since 1919

www.farmersbankva.com