



March 29, 2021

Dear Fellow Shareholder,

We hope this message finds you safe and well. Since the beginning of the pandemic, we have all been adapting continuously to a steady flow of information, directives, challenges and opportunities. The pandemic forced us to move rapidly to limit our branch service to drive-through only, encourage remote online banking, and transition most of our non-branch work force to working from home. Throughout these times our primary focus has been to protect our clients and teammates. We believe that this crisis, as terrible as it's been, has given us an opportunity to really engage with clients in meaningful and lasting ways and to make those investments to emerge stronger.

During 2020, we were able to distinguish ourselves by funding \$185 million Paycheck Protection Program ("PPP") Round-1 loans, through which we helped approximately 1,500 businesses save 20,000 jobs in our community, and added a significant number of new small business clients who were in desperate need of these funds. Our ability to react nimbly allowed us to fund PPP loans in an aggregate amount equal to 43% of our outstanding loans as of December 31, 2019. We provided loan payment deferrals to both consumer and commercial clients struggling with lost jobs or business closures. Our mortgage company supported our clients through purchasing or refinancing their homes, while achieving record application volume with a partially remote work force. At the time of this writing, we are supporting the SBA's PPP Round-2 loan applications for both new and existing clients and have received SBA approval on \$70.4 million in PPP loans supporting 699 businesses in PPP Round-2. This crisis has allowed us to prove how we are different from other financial institutions. Village Bank's resolve to treat our clients like a neighbor and not a number has never shone brighter.

We will continue to pursue strategies that we believe will help us achieve our goal of delivering long-term total shareholder returns that rank in the top quartile of a nationwide peer group while pursuing our purpose to support the economic health of our community and improve our clients' lives. We will achieve this goal if we deliver top quartile return on equity, produce sustainable earnings growth, achieve best quartile earnings volatility in our industry and deliver best quartile asset quality in the worst part of the economic cycle. We successfully battled to grow earnings in 2020 in a difficult economic environment where margins were under pressure. Our efforts to fund PPP loans, control expenses, and leverage our mortgage banking segment allowed us to grow earnings and to add new clients with the potential to expand these relationships in the future. For the year, we produced a 17.98% return on average equity, 89% earnings per share growth, and maintained stable asset quality. We are particularly pleased by the outstanding contribution from our mortgage banking segment, which produced net income of \$3.9 million for 2020 compared to \$979,000 for 2019. Finally, we successfully navigated leadership transitions, both on the executive team and board of directors, mentioned in previous filings.

While this strong momentum has placed us in a more resilient position, we know we will be faced with economic headwinds in 2021 from a continued low rate environment, high levels of liquidity, competition driving spreads tighter and underwriting standards looser, and the health of the economy as the virus is brought under control. We recognize that the economic benefit provided by the PPP opportunity as well as the favorable rate environment for residential mortgage loans are not sustainable, but we see opportunity in these clients. As described in prior filings, we are expanding our relationships with the approximately 400 new clients won during the first round of PPP, leveraging our new Treasury Management Services team, increasing our presence through our new branch in the vibrant Scott's Addition area in Richmond, Virginia, encouraging mortgage loan demand, and strategically deploying

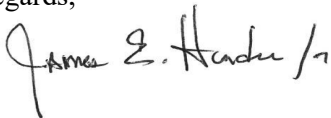
excess liquidity to support net interest margin. We are optimistic about 2021 and laying the foundation for 2022.

We cannot close out this letter without expressing our gratitude for the leadership, commitment and service of Bill Foster and Charlie Walton, our recent retirees as Chief Executive Officer and Director, respectively. We want to share a few comments on their special contributions:

We thank Bill Foster for his leadership in transforming Village into an organization that performs exceptionally well for our clients, shareholders, team members and community. His business instincts and judgment helped to create a path to recovery for the bank after the Great Recession. We are indebted to Bill for all of those things and will miss him. Charlie Walton infuses every question and observation with highly developed business instincts and judgment. With his CPA and business background, he brought a focus on the critical details that drive performance. Charlie was a source of optimism and positive energy during the difficult years following the recession. We wish them good health and a joyful journey in the years ahead.

We hope that you share our pride in how Village Bank distinguished itself in 2020 both in terms of financial results and in the depth of commitment to our community. Please join us at the virtual shareholders meeting on May 18, 2021, and thank you for your continued support.

Regards,



James E. Hendricks, Jr.
President and Chief Executive Officer



Craig D. Bell
Chairman, Board of Directors

Forward-Looking Statements

In addition to historical information, this letter may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements. There are many factors that could cause actual results to differ materially from those expressed in the forward-looking statements including, but not limited to, changes in interest rates, the effects of future economic, business and market conditions, legislative and regulatory changes, governmental monetary and fiscal policies, changes in accounting policies, rules and practices, the impact of the ongoing coronavirus (COVID-19) pandemic, and other factors described from time to time in our reports filed with the Securities and Exchange Commission (“SEC”). For further information, contact Donald M. Kaloski, Jr., Executive Vice President and Chief Financial Officer, at 804-897-3900 or dkaloski@villagebank.com.

Additional Information

This letter may be deemed to be solicitation material in respect of the Company’s 2021 annual meeting of shareholders. The Company filed a definitive proxy statement with the SEC on April 5, 2021 in connection with the annual meeting. Shareholders are urged to read the proxy statement and any other relevant documents that the Company files with the SEC because they will contain important information. The Company, its directors and certain of its executive officers will be participants in the solicitation of proxies from shareholders in connection with the annual meeting. Information about the Company’s directors and executive officers is included in the proxy statement. Investors and shareholders may obtain a copy of the proxy statement and other documents filed by the Company free of charge from the SEC’s website at www.sec.gov. Shareholders may obtain a copy of the proxy statement free of charge by writing to the Company’s Corporate Secretary, Deborah Golding, whose address is P.O. Box 330, Midlothian, Virginia, 23113-0330, or from the Company’s website at www.villagebank.com.

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

**FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2020

Commission file number 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Virginia
(State or other jurisdiction of
incorporation or organization)

16-1694602
(I.R.S. Employer
Identification No.)

13319 Midlothian Turnpike, Midlothian, Virginia
(Address of principal executive offices)

23113
(Zip Code)

Registrant's telephone number, including area code: **804-897-3900**

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

Title of each class	Trading Symbols(s)	Name of each exchange on which registered
Common Stock, \$4.00 par value	VBFC	The Nasdaq Stock Market

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

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

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

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

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

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

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

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

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

The aggregate market value of common stock held by non-affiliates of the registrant as of the last business day of the Registrant's most recent completed second fiscal quarter was approximately \$15,948,000.

The number of shares of common stock outstanding as of March 1, 2021 was 1,466,800.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be used in conjunction with the 2021 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

Village Bank and Trust Financial Corp.
Form 10-K

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PART I

In addition to historical information, the following report contains forward-looking statements that are subject to risks and uncertainties that could cause Village Bank and Trust Financial Corp.'s actual results to differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of the report. For discussion of factors that may cause our actual future results to differ materially from those anticipated, please see Item 7 – "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

ITEM 1. BUSINESS

Village Bank and Trust Financial Corp. ("Company") was incorporated in January 2003 and was organized under the laws of the Commonwealth of Virginia as a bank holding company. The Company has three active wholly owned subsidiaries: Village Bank (the "Bank"), Southern Community Financial Capital Trust I, and Village Financial Statutory Trust II. The Bank has one active wholly owned subsidiary: Village Bank Mortgage Corporation (the "Mortgage Company"), a full service mortgage banking company. The Company is the holding company of and successor to the Bank. Effective April 30, 2004, the Company acquired all of the outstanding stock of the Bank in a statutory share exchange transaction. Unless the context suggest otherwise, the terms "we", "us" and "our" refer collectively to the Company, the Bank, and the Mortgage Company.

The Bank is the primary operating business of the Company. The Bank offers a wide range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans, primarily in the Richmond, Virginia and Williamsburg, Virginia metropolitan areas. The Bank was organized in 1999 as a Virginia chartered bank to engage in a general banking business to serve the communities in and around Richmond, Virginia and expanded its services to Williamsburg, Virginia in 2017. Deposits with the Bank are insured to the maximum amount provided by the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a comprehensive range of financial services and products and specializes in providing customized financial services to small and medium sized businesses, professionals, and individuals. The Bank provides its customers with personal customized service utilizing modern technology and delivery channels.

Bank revenues are derived from interest and fees received in connection with loans, deposits, and mortgage services. Administrative and operating expenses are the major expenses, followed by interest paid on deposits and borrowings. Revenues from the Mortgage Company consist primarily of gains from the sale of loans and loan origination fees and its major expenses consist of personnel, occupancy, data processing, and other operating expenses. In 2020, revenue (after intercompany eliminations) generated by the Bank totaled \$27.7 million and the Mortgage Company generated \$13.7 million in revenue.

Segment Reporting

The Company has two reportable segments: traditional commercial banking and mortgage banking. For more financial data and other information about each of the Company's operating segments, refer to Item 7 – "Management's Discussion and Analysis of Financial Condition and Results of Operations" under "Segment Information – Commercial Banking Segment" and "Segment Information – Mortgage Banking Segment", and to Note 19 "Segment Reporting" in the "Notes to Consolidated Financial Statements" contained in Item 8 of this Form 10-K.

Business Strategy

We are pursuing strategies that we believe will help us achieve our goal of delivering long-term total shareholder returns that rank in the top quartile of a nationwide peer group. To achieve this goal, we strive to deliver a top quartile return on equity, produce sustainable earnings growth, achieve best quartile earnings

volatility in our industry and deliver best quartile asset quality in the worst part of the economic cycle. Our current business strategies include the following:

- *Build full service banking relationships with high quality local companies by being problem solvers and business builders, not just bankers.* We will continue to field a team of bankers and leaders who are both great bankers and exceptional business people. We will have the capital, capabilities and connections to help business owners achieve their goals and overcome obstacles to their success. We target win-win outcomes. We expect to be disciplined lenders during the good times so that during difficult times we can support our good clients, win high quality relationships and recruit talented bankers while other banks focus on their own challenges. Real estate lending will continue to be an important part of our business. We intend to be diligent in managing overall portfolio concentrations, and we will focus on real estate sectors and sponsors that we expect to perform better during difficult times. We target wealth building real estate investors. We will understand the needs and goals of our business clients and their owners so that we can help them fulfill those needs and achieve those goals. We will target deposit only relationships as actively as we will target full loan and deposit relationships. Wherever possible and prudent, we will purchase products and services from the companies that do business with us to support our clients and thank them for their business.
- *Build long-term, mutually beneficial banking relationships with individuals and families in our market area.* We will offer the basic financial products and services individuals and families in our communities need backed by exceptionally professional and caring service. We offer convenience and flexibility through in person, online, mobile and telephonic options for enrolling in new services, handling transactions and seeking service. We want to help our clients thrive on their journey through life. Through our own team members and business partners, we will help clients develop plans for handling the big moments they will encounter along the way. We will use technology to understand our clients, serve their needs and grow our business.
- *Grow the Mortgage Company's profitability and positive contribution to our brand.* We intend to add loan officers and production teams, more fully identify and serve the mortgage needs of bank clients, appropriately leverage available grant programs, offer portfolio mortgage products, and enhance our marketing efforts to grow mortgage banking revenues. We plan to continue to treat mortgage banking as a specialty line of business. We will continue to differentiate ourselves by treating the homeowners, realtors, builders and financial advisors who refer their clients to us with exceptionally professional and caring service.
- *Build and sustain the economics of our balance sheet, income statement and business model:*
 - Defend and expand our Net Interest Margin by improving the mix of both assets and funding wherever possible.
 - Build and grow other non-interest income services to leverage our return on assets ("ROA") and return on equity ("ROE").
 - Streamline and rationalize our processes and organization to improve productivity and efficiency.
 - Include a prudent amount of debt in our holding company capital structure to leverage a strong ROA into an even stronger ROE.
- *Achieve excellence in risk management.* We strive to achieve best quartile performance on credit quality metrics in the worst part of the business cycle and sustainable earnings growth over the long term. Risk taking is a fundamental part of banking. Top performing banks are very good at identifying, understanding, measuring, monitoring, managing, mitigating and getting paid for the risks the organization takes. We are committed to building and sustaining the culture, talent, tools, policies, processes and discipline needed to be a top performer in our risk management functions.
- *Be the place where exceptional people want to work.* We are committed to achieving great things and need teammates who share that commitment. We will sustain our fun, fulfilling and rewarding work

environment built on trust and teamwork. We know that we will achieve our goals by fielding a team of champions, not by building our business around individual stars. We are a meritocracy where every individual knows he or she can make a difference every day, where their individual contributions are valued, where we invest in our teammates, and where we hold people accountable. We will invest in technology to leverage the talents of our associates and provide the flexibility to allow them to manage their work and life priorities effectively. We will offer benefits and resources intended to help our team members be fit to thrive on their journey through life. When we make difficult business decisions, we will do so with sensitivity to and understanding of the consequences of those decisions.

- *Make a lasting difference in our communities.* We will invest our work, wisdom and wealth to help our communities prepare young people for success in life, help families navigate the complex maze of modern life and support and honor the individuals who serve and protect us. We believe that we can be particularly effective in serving our many stakeholders by being a leader in education and workforce development initiatives in our community because success in these areas will help individuals and families provide for themselves and will provide businesses with the talented employees they need to grow and prosper.

We strongly believe that there is a continuing need for banks like Village with deep community roots and that a well-run community based bank can generate attractive returns for shareholders over the long term.

Market Area

The Company, the Bank, and the Mortgage Company are headquartered in Chesterfield County and primarily serve the Central Virginia region and the Richmond and Williamsburg metropolitan statistical areas. We currently conduct business from nine full-service branch banking offices, and a mortgage loan production office in Central Virginia in the counties of Chesterfield, Hanover, Henrico, Powhatan and James City.

Banking Services

Deposit Services. Deposits are a major source of our funding. The Bank offers a full range of deposit services that are typically available in most banks and other financial institutions including checking accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer term certificates of deposit and Individual Retirement Accounts. These deposit accounts are offered at rates competitive with other institutions in our market area. We service our deposit clients in our full-service branches, at drive-up windows, at our ATMs, through our customer care team and through technology such as online banking, mobile banking applications and remote deposit capture for business clients. We have not applied for permission to establish a trust department and offer trust services. The Bank is not a member of the Federal Reserve System. Deposits are insured under the Federal Deposit Insurance Act of 1950 (the “FDI Act”) to the limits provided thereunder.

Lending Services. We offer a full range of short-to-medium term commercial and personal loans. We also provide a wide range of real estate finance services. Our primary focus is on making loans in the Central Virginia and greater Williamsburg markets where we have branch banking offices. We offer residential construction-to-permanent financing to clients of the Mortgage Company.

- *Commercial Business Lending.* We make secured and unsecured loans to small- and medium-sized businesses for purposes such as funding working capital needs (including inventory and receivables), business expansion (including acquisition of real estate and improvements) and purchase of equipment and machinery. We also make loans under Small Business Administration and state sponsored business loan programs. In our underwriting, we evaluate the earnings and cash flows of the business, guarantor support and both the need for and the protection offered by the collateral for the loan.
- *Commercial Real Estate Acquisition, Development, Construction and Mortgage Lending.* We make loans to our clients for the purposes of acquiring, developing, constructing and owning commercial real

estate. These properties may be owner-occupied or may be held for investment purposes and repaid from rental income or from the sale of the property.

- *Consumer Lending.* Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. We also originate fixed and variable rate mortgage loans and real estate construction and acquisition loans. Residential loans originated by our mortgage company are usually sold in the secondary mortgage market.
- *Loan Participations.* We sell loan participations in the ordinary course of business when a loan originated by us exceeds our legal lending limit or we otherwise deem it prudent to share the risk with another lending institution. Additionally, we purchase loan participations from other banks, usually without recourse against that bank. We underwrite purchased loan participations in accordance with normal underwriting practices.
- *Loan Purchases.* We purchase Federal Rehabilitated Student Loan portfolios when approved by the board of directors. These loans are guaranteed by the U.S. Department of Education (“DOE”) which covers approximately 98% of the principal and interest. These loans are serviced by a third party servicer that specializes in handling these types of loans.

We also purchase the guaranteed portion of United State Department of Agriculture Loans (“USDA”) which are guaranteed by the USDA for 100% of the principal and interest. The originating institution holds the unguaranteed portion of the loan and services the loan. These loans are typically purchased at a premium. In the event of a loan default or early prepayment the Bank may need to write off any unamortized premium.

Lending Limit. As of December 31, 2020, our legal lending limit for loans to one borrower was approximately \$9,858,000.

Competition

We encounter strong competition from other local commercial banks, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds, financial technology companies, and other financial institutions. A number of these competitors are well-established. Competition for loans is keen, and pricing is important. Most of our competitors have substantially greater resources and higher lending limits than ours and offer certain services, such as extensive and established branch networks and trust services, which we do not provide at the present time. Deposit competition also is strong, and we may have to pay higher interest rates to attract deposits. Nationwide banking institutions and their branches have increased competition in our markets, and federal legislation adopted in 1999 allows non-banking companies, such as insurance and investment firms, to establish or acquire banks. We believe that the Company can capitalize on recent merger activity to attract customers from the acquired institutions.

At June 30, 2020, the latest date such information is available from the FDIC, the Bank’s deposit market share in Chesterfield County was 5.27%, 4.61% in Hanover County, 9.04% in Powhatan County, 0.46% in the Richmond metropolitan statistical area, 0.12% in Henrico County and 0.70% in James City County.

Supervision and Regulation

We are subject to extensive regulation by certain federal and state agencies and receive periodic examinations by those regulatory authorities. As a consequence, our business is affected by state and federal legislation and regulations.

The discussion below is only a summary of the principal laws and regulations that comprise the regulatory framework applicable to us. The descriptions of these laws and regulations, as well as descriptions of laws

and regulations contained elsewhere herein, do not purport to be complete and are qualified in their entirety by reference to applicable laws and regulations.

General. The Company is qualified as a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and is registered as such with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). As a bank holding company, the Company is subject to supervision, regulation and examination by the Federal Reserve and is required to file various reports and additional information with the Federal Reserve. The Company is also registered under the bank holding company laws of Virginia and is subject to supervision, regulation and examination by the Bureau of Financial Institutions of the Virginia State Corporation Commission (the "BFI"). The Bank is a Virginia chartered bank and is not a member of the Federal Reserve System. The Bank is subject to regulation, supervision and examination by the FDIC and the BFI.

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

Increased Capital Standards. The Dodd-Frank Act required the federal banking agencies to establish minimum leverage and risk-based capital requirements for banks and bank holding companies. See "Capital Adequacy" below for a discussion of these requirements.

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

The Consumer Financial Protection Bureau ("CFPB"). The Dodd-Frank Act established the CFPB, an independent federal agency with broad rule-making, supervisory, and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more of assets. Smaller institutions, such as the Company, are subject to rules promulgated by the CFPB but are examined and supervised by federal banking regulators for consumer compliance purposes.

Recent Amendments to the Dodd-Frank Act. The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, which was signed into law on May 24, 2018 (the "EGRRCPA"), amended the Dodd-Frank Act to provide regulatory relief for certain smaller and regional financial institutions. The EGRRCPA, among other things, provides financial institutions with less than \$10 billion of assets with relief from certain capital requirements and exempts banks with less than \$250 billion of total consolidated assets from the enhanced prudential standards and the company-run and supervisory stress tests required under the Dodd-Frank Act. The Dodd-Frank Act has had, and may in the future have, a material impact on the Company's operations, particularly through increased compliance costs resulting from new and possible future consumer and fair lending regulations.

The future changes resulting from the Dodd-Frank Act may affect the profitability of business activities, require changes to certain business practices, impose more stringent regulatory requirements or otherwise adversely affect the business and financial condition of the Company and the Bank. These changes may also require the Company to invest significant management attention and resources to evaluate and make necessary changes to comply with new statutory and regulatory requirements.

Reporting Obligations Under Securities Laws. The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), including the requirement to file with the Securities and Exchange Commission (the “SEC”) annual, quarterly and other reports on the financial condition and performance of the organization. The Company’s common stock is listed on the Nasdaq Capital Market and, as a result, the Company is subject to the rules and listing standards adopted by The Nasdaq Stock Market, LLC (“Nasdaq”). The Company is also affected by the corporate responsibility and accounting reform legislation signed into law on July 30, 2002, known as the Sarbanes-Oxley Act of 2002 (the “SOX Act”), and the related rules and regulations. The SOX Act includes provisions that, among other things, require that periodic reports containing financial statements that are filed with the SEC be accompanied by chief executive officer and chief financial officer certifications as to the accuracy and compliance with law, additional disclosure requirements and corporate governance and other related rules. The Company has expended considerable time and money in complying with the rules and regulations of the SEC and Nasdaq, and with the SOX Act, and expects to continue to incur additional expenses in the future.

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

In determining whether a particular activity is permissible, the Federal Reserve must consider whether the performance of such an activity reasonably can be expected to produce benefits to the public that outweigh possible adverse effects. Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any activity or to terminate ownership or control of any subsidiary when the Federal Reserve has reasonable cause to believe that a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company may result from such an activity.

Support of Subsidiary Institutions. Under the Dodd-Frank Act, and previously under Federal Reserve policy, the Company is required to act as a source of financial strength for the Bank and to commit resources to support the Bank. This support can be required at times when it would not be in the best interest of the Company’s shareholders or creditors to provide it. In the event of the Company’s bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of the Bank would be assumed by the bankruptcy trustee and entitled to a priority of payment. The Company has periodically raised capital and contributed it to the Bank to support the Bank’s operations.

Privacy Legislation. Several laws, including the Right To Financial Privacy Act and the Gramm-Leach-Bliley Act, provide protections against the transfer and use of customer information by financial institutions. Financial Institutions generally are prohibited from disclosing customer information to non-affiliated third parties, unless the customer has been given the opportunity to object and has not objected to such disclosure. Financial institutions must disclose their specific privacy policies to their customers annually and must conduct an internal risk assessment of their ability to protect customer information.

Mergers and Acquisitions. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, as amended (the "Interstate Banking Act"), generally permits well capitalized and adequately managed bank holding companies to acquire banks in any state, and preempts all state laws restricting the ownership by a bank holding company of banks in more than one state. The Interstate Banking Act also permits a bank to merge with an out-of-state bank and convert any offices into branches of the resulting bank if both states have not opted out of interstate branching; and permits a bank to acquire branches from an out-of-state bank

if the law of the state where the branches are located permits the interstate branch acquisition. Under the Dodd-Frank Act, a bank holding company or bank must be well capitalized and well managed to engage in an interstate acquisition. Bank holding companies and banks are required to obtain prior Federal Reserve approval to acquire more than 5% of a class of voting securities, or substantially all of the assets, of a bank holding company, bank or savings association. The Interstate Banking Act and the Dodd-Frank Act permit banks to establish and operate de novo interstate branches to the same extent a bank chartered by the host state may establish branches. Virginia law permits branching across state lines, provided there is reciprocity with the state in which the out-of-state bank is based.

Limits on the Payment of Dividends. The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. Virtually all of the Company's cash revenues will result from dividends paid to it by the Bank, which is subject to laws and regulations that limit the amount of dividends that it can pay. Under Virginia law, a bank may not declare a dividend in excess of its accumulated retained earnings without approval by the BFI. As of December 31, 2020, the Bank did not have any accumulated retained earnings. In addition, the Bank may not declare or pay any dividend if, after making the dividend, the Bank would be "undercapitalized," as defined in FDIC regulations.

The FDIC and the state have the general authority to limit the dividends paid by insured banks if the payment is deemed an unsafe and unsound practice. Both the FDIC and the state have indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsound and unsafe banking practice.

In addition, the Company is subject to certain regulatory requirements to maintain capital at or above regulatory minimums. These regulatory requirements regarding capital affect our dividend policies. Regulators have indicated that holding companies should generally pay dividends only if the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends, and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, the Federal Reserve has issued guidelines that bank holding companies should inform and consult with the Federal Reserve in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the organization's capital structure.

Insurance of Accounts, Assessments and Regulation by the FDIC. Our deposits are insured by the FDIC up to the limits set forth under applicable law, currently \$250,000. We are subject to the deposit insurance assessments of the DIF. The deposit insurance assessment base is average total assets minus average tangible equity. The FDIC uses a "financial ratios method" based on CAMELS composite ratings to determine assessment rates for small established institutions with less than \$10 billion of assets, such as the Bank. The CAMELS rating system is a supervisory rating system designed to take into account and reflect all financial and operational risks that a bank may face, including capital adequacy, asset quality, management capability, earnings, liquidity and sensitivity to market risk ("CAMELS"). CAMELS composite ratings set a maximum assessment for CAMELS 1 and 2 rated banks, and set minimum assessments for lower rated institutions.

The FDIC is authorized to prohibit any DIF-insured institution from engaging in any activity that the FDIC determines by regulation or order to pose a serious threat to the respective insurance fund. Also, the FDIC may initiate enforcement actions against banks, after first giving the institution's primary regulatory authority an opportunity to take such action. The FDIC may terminate the deposit insurance of any depository institution if it determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed in writing by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution has no tangible capital. If deposit insurance is terminated, the deposits at the institution at the time of termination, less subsequent withdrawals, shall continue to be insured for a period from six months to two years, as determined by the FDIC. We are aware of no existing circumstances that could result in termination of our deposit insurance.

Capital Adequacy. Both the Company and the Bank are required to comply with the capital adequacy standards established by the Federal Reserve, in the case of the Company, and the FDIC, in the case of the Bank. The Federal Reserve and the FDIC have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision (the “Basel Committee”) and certain provisions of the Dodd-Frank Act (the “Basel III Capital Rules”). The Basel III Capital Rules implement minimum capital ratios and establish risk weightings that are applied to many classes of assets held by community banks, including applying higher risk weightings to certain commercial real estate loans.

The Basel III Capital Rules require banks and bank holding companies to comply with the following minimum capital ratios: (1) a ratio of common equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7%); (2) a ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (effectively resulting in a minimum Tier 1 capital ratio of 8.5%); (3) a ratio of total capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (effectively resulting in a minimum total capital ratio of 10.5%); and (4) a leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter). The phase-in of the capital conservation buffer requirement was fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking organizations with a ratio of common equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms (the standards are commonly referred to as “Basel IV”). Among other things, these standards revise the standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain “unconditionally cancellable commitments,” such as unused credit card lines of credit) and provide a new standardized approach for operational risk capital. Under the proposed framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing-in through January 1, 2027. Under the current capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Company. The impact of Basel IV on the Company and the Bank will depend on the manner in which it is implemented by the federal bank regulatory agencies.

The Company meets the eligibility criteria of a small bank holding company in accordance with the Federal Reserve’s Small Bank Holding Company Policy Statement (the “SBHC Policy Statement”). On August 28, 2018, the Federal Reserve issued an interim final rule required by the EGRRCPA that expands the applicability of the SBHC Policy Statement to bank holding companies with total consolidated assets of less than \$3 billion (up from the prior \$1 billion threshold). Under the SBHC Policy Statement, qualifying bank holding companies, such as the Company, have additional flexibility in the amount of debt they can issue and are also exempt from the Basel III Capital Rules. The SBHC Policy Statement does not apply to the Bank and the Bank must comply with the Basel III Capital Rules. The Bank must also comply with the capital requirements set forth in the “prompt corrective action” regulations pursuant to Section 38 of the FDI Act, as described below.

On September 17, 2019, the federal banking agencies jointly issued a final rule required by the EGRRCPA that permits qualifying banks and bank holding companies that have less than \$10 billion in consolidated assets to elect to be subject to a 9% leverage ratio that would be applied using less complex leverage calculations (commonly referred to as the community bank leverage ratio or “CBLR”). Under the rule, which became effective on January 1, 2020, banks and bank holding companies that opt into the CBLR framework and maintain a CBLR of greater than 9% are not subject to other risk-based and leverage capital requirements under the Basel III Capital Rules and would be deemed to have met the well capitalized ratio requirements under the “prompt corrective action” framework. These CBLR rules were modified in response to the COVID-19 pandemic. See “Coronavirus Aid, Relief, and Economic Security Act and

Consolidated Appropriations Act, 2021” below. The Bank elected not to opt into the CBLR framework as of December 31, 2020. The Bank does not expect to opt into the CBLR framework in 2021.

Prompt Corrective Action. Federal banking agencies have broad powers to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” These terms are defined under uniform regulations issued by each of the federal banking agencies regulating these institutions. An insured depository institution that is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities.

To be well capitalized under these regulations, a bank must have the following minimum capital ratios: (1) a common equity Tier 1 capital ratio of at least 6.5%; (2) a Tier 1 risk-based capital ratio of at least 8.0%; (3) a total risk-based capital ratio of at least 10.0%; and (4) a leverage ratio of at least 5.0%. At December 31, 2020, the Bank’s common equity Tier 1 capital ratio was 13.35%, its Tier 1 risk-based capital ratio was 13.35%, its total risk-based capital ratio was 14.20% and its leverage ratio was 9.28%. Accordingly, as of December 31, 2020, the Bank met the minimum ratios to be classified as well capitalized. More information concerning our regulatory ratios at December 31, 2020 is included in Note 13 to the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

As described above, on September 17, 2019, the federal banking agencies jointly issued a final rule required by the EGRRCPA that permits qualifying banks and bank holding companies that have less than \$10 billion of consolidated assets to elect to opt into the CBLR framework. Banks opting into the CBLR framework and maintaining a CBLR of greater than 9% would be deemed to have met the well capitalized ratio requirements under the “prompt corrective action” framework. These CBLR rules were modified in response to the COVID-19 pandemic. See “Coronavirus Aid, Relief, and Economic Security Act and Consolidated Appropriations Act, 2021” below. The Bank elected not to opt into the CBLR framework as of December 31, 2020. The Bank does not expect to opt into the CBLR framework in 2021.

Restrictions on Transactions with Affiliates. Both the Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of: (1) a bank’s loans or extensions of credit, including purchases of assets subject to an agreement to repurchase, to affiliates; (2) a bank’s investment in affiliates; (3) assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve; (4) the amount of loans or extensions of credit to third parties collateralized by the securities or debt obligations of affiliates; (5) transactions involving the borrowing or lending of securities and any derivative transaction that results in credit exposure to an affiliate; and (6) a bank’s guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank’s capital and surplus and, as to all affiliates combined, to 20% of a bank’s capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid acquiring low-quality assets from its affiliates.

The Company and the Bank are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

The Dodd-Frank Act also provides that an insured depository institution may not purchase an asset from, or sell an asset to a bank insider (or their related interests) unless (1) the transaction is conducted on market terms between the parties, and (2) if the proposed transaction represents more than 10% of the capital stock and surplus of the insured institution, it has been approved in advance by a majority of the institution's non-interested directors.

Incentive Compensation Policies and Restrictions. In July 2010, the federal banking agencies issued guidance that applies to all banking organizations supervised by the agencies (thereby including both the Company and the Bank). Pursuant to the guidance, to be consistent with safety and soundness principles, a banking organization's incentive compensation arrangements should: (1) provide employees with incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance including active and effective oversight by the banking organization's board of directors. Monitoring methods and processes used by a banking organization should be commensurate with the size and complexity of the organization and its use of incentive compensation. At December 31, 2020, we had not been made aware of any instances of non-compliance with this guidance. The Dodd-Frank Act requires the appropriate federal regulators to establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company or bank that provides an insider or other employee with "excessive compensation" or that could lead to a material financial loss to such firm. These standards have not yet been established.

Anti-Money Laundering Laws and Regulations. The Company is subject to several federal laws that are designed to combat money laundering, terrorist financing, and transactions with persons, companies or foreign governments designated by U.S. authorities ("AML laws"). This category of laws includes the Bank Secrecy Act of 1970, the Money Laundering Control Act of 1986, the USA PATRIOT Act of 2001, and the Anti-Money Laundering Act of 2020.

The AML laws and their implementing regulations require insured depository institutions, broker-dealers, and certain other financial institutions to have policies, procedures, and controls to detect, prevent, and report money laundering and terrorist financing. The AML laws and their regulations also provide for information sharing, subject to conditions, between federal law enforcement agencies and financial institutions, as well as among financial institutions, for counter-terrorism purposes. Federal banking regulators are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants. To comply with these obligations, the Company has implemented appropriate internal practices, procedures, and controls.

Reporting Terrorist Activities. The Office of Foreign Assets Control ("OFAC"), which is a division of the Department of the Treasury, is responsible for helping to insure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Bank actively checks high-risk OFAC areas such as new accounts, wire transfers and customer files. The Bank performs these checks utilizing software, which is updated each time a modification is made to the lists provided by OFAC and other agencies of Specially Designated Nationals and Blocked Persons.

Mortgage Banking Regulation. The Mortgage Company is subject to the rules and regulations by the Department of Housing and Urban Development, the Federal Housing Administration, the Department of Veteran Affairs and state regulatory authorities with respect to originating, processing, servicing and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers and, in some cases, restrict certain loan features, and fix maximum interest rates and fees. In addition to other federal laws, mortgage origination activities are subject to the Equal Credit

Opportunity Act, Truth-in-Lending Act, Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Home Ownership Equity Protection Act, and the regulations promulgated thereunder. These laws prohibit discrimination, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level.

Other Safety and Soundness Regulations. There are a number of obligations and restrictions imposed on depository institutions by federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event the depository institution becomes in danger of default or is in default. The Federal banking agencies also have broad powers under current Federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized, as defined by the law. Federal regulatory authorities also have broad enforcement powers over us, including the power to impose fines and other civil and criminal penalties, and to appoint a receiver in order to conserve the assets of any such institution for the benefit of depositors and other creditors. At December 31, 2020, the Bank met the ratio requirements to be classified as a well capitalized financial institution.

Loans-to-One Borrower. Under applicable laws and regulations the amount of loans and extensions of credit which may be extended by a bank to any one borrower, including related entities, generally may not exceed 15% of the sum of the capital, surplus, and loan loss reserve of the institution.

Community Reinvestment. The requirements of the Community Reinvestment Act (“CRA”) are applicable to the Company. The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution’s efforts in meeting community credit needs currently are evaluated as part of the examination process pursuant to 12 assessment factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility.

In December 2019, the FDIC and the Office of the Comptroller of the Currency jointly proposed rules that would significantly change existing CRA regulations. The proposed rules are intended to increase bank activity in low- and moderate-income communities where there is significant need for credit, more responsible lending, greater access to banking services, and improvements to critical infrastructure. The proposals change four key areas: (i) clarifying what activities qualify for CRA credit; (ii) updating where activities count for CRA credit; (iii) providing a more transparent and objective method for measuring CRA performance; and (iv) revising CRA-related data collection, record keeping, and reporting. The FDIC has not finalized the revisions to its CRA rule. We are evaluating what impact this proposed rule, if implemented, may have on the Company.

Cybersecurity. In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution’s management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution’s operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If the Company fails to observe the regulatory guidance, it could be subject to various regulatory sanctions, including financial penalties.

In December 2020, the federal banking agencies issued a notice of proposed rulemaking that would require banking organizations to notify their primary regulator within 36 hours of becoming aware of a “computer-security incident” or a “notification incident.” The proposed rule also would require specific and immediate notifications by bank service providers that become aware of similar incidents.

To date, we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, but our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers.

Coronavirus Aid, Relief, and Economic Security Act and Consolidated Appropriations Act, 2021. In response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) was signed into law on March 27, 2020 and the Consolidated Appropriations Act, 2021 (“Appropriations Act”) was signed into law on December 27, 2020. Among other things, the CARES Act and Appropriations Act include the following provisions impacting financial institutions:

- **Community Bank Leverage Ratio.** The CARES Act directed federal banking agencies to adopt interim final rules to lower the threshold under the CBLR from 9% to 8% and to provide a reasonable grace period for a community bank that falls below the threshold to regain compliance, in each case until the earlier of the termination date of the national emergency or December 31, 2020. In April 2020, the federal bank regulatory agencies issued two interim final rules implementing this directive. One interim final rule provides that, as of the second quarter 2020, banking organizations with leverage ratios of 8% or greater (and that meet the other existing qualifying criteria) may elect to use the CBLR framework. It also establishes a two-quarter grace period for qualifying community banking organizations whose leverage ratios fall below the 8% CBLR requirement, so long as the banking organization maintains a leverage ratio of 7% or greater. The second interim final rule provides a transition from the temporary 8% CBLR requirement to a 9% CBLR requirement. It establishes a minimum CBLR of 8% for the second through fourth quarters of 2020, 8.5% for 2021, and 9% thereafter, and maintains a two-quarter grace period for qualifying community banking organizations whose leverage ratios fall no more than 100 basis points below the applicable CBLR requirement.
- **Temporary Troubled Debt Restructurings Relief.** The CARES Act allowed banks to elect to suspend requirements under U.S. generally accepted accounting principles (“GAAP”) for loan modifications related to the COVID-19 pandemic (for loans that were not more than 30 days past due as of December 31, 2019) that would otherwise be categorized as a troubled debt restructuring, including impairment for accounting purposes, until the earlier of 60 days after the termination date of the national emergency or December 31, 2020. Federal banking agencies are required to defer to the determination of the banks making such suspension. The Appropriations Act extended this temporary relief until the earlier of 60 days after the termination date of the national emergency or January 1, 2022.
- **Small Business Administration Paycheck Protection Program.** The CARES Act created the Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”) and it was extended by the Appropriations Act. Under the PPP, money was authorized for small business loans to pay payroll and group health costs, salaries and commissions, mortgage and rent payments, utilities, and interest on other debt. The loans are provided through participating financial institutions, such as the Bank, that process loan applications and service the loans.

Future Legislation and Regulation. Congress may enact legislation from time to time that affects the regulation of the financial services industry, and state legislatures may enact legislation from time to time affecting the regulation of financial institutions chartered by or operating in those states. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The substance or impact of pending or future legislation or regulation, or the application thereof, cannot be predicted, although enactment of the proposed legislation could impact the regulatory structure under which we operate and may significantly increase costs, impede the efficiency of internal business processes, require an increase in regulatory capital, require modifications to business strategy, and limit the ability to pursue business opportunities in an efficient manner.

Employees

As of December 31, 2020, the Company and its subsidiaries had a total of 146 full-time employees and 6 part-time employees. None of the Company's employees is covered by a collective bargaining agreement. The Company considers its relations with its employees to be good.

The Company has a Code of Ethics for directors, officers and all employees of the Company and its subsidiaries, and a Code of Ethics applicable to the Company's Chief Executive Officer, Chief Financial Officer and other principal financial officers. The Code addresses such topics as protection and proper use of Company assets, compliance with applicable laws and regulations, accuracy and preservation of records, accounting and financial reporting and conflicts of interest. A copy of the Code will be provided, without charge, to any shareholder upon written request to the Secretary of the Company, whose address is P.O. Box 330, 13319 Midlothian Turnpike, Midlothian, Virginia 23113.

Additional Information

The Company files annual, quarterly and current reports, proxy statements and other information with the SEC. Electronic copies of our SEC filings are available on the SEC's Internet site (<http://www.sec.gov>).

The Company's Internet address is <http://www.villagebank.com>. At that address, we make available, free of charge, the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act (see "Investor Relations" section of website), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

In addition, we will provide, at no cost, paper or electronic copies of our reports and other filings made with the SEC (except for exhibits). Requests should be directed to Donald M. Kaloski, Jr., Chief Financial Officer, Village Bank and Trust Financial Corp., PO Box 330, Midlothian, VA 23113.

The information on the websites listed above is not and should not be considered to be part of this annual report on Form 10-K and is not incorporated by reference in this document.

ITEM 1A. RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. Investors should carefully consider the risks and uncertainties described below, together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that management is not aware of or focused on, or that management currently deems immaterial, may also impair our business and operations. If any of the following risks adversely affects our business, financial condition or results of operations, the value of our common stock could decline. The Risk Factor Summary that follows should be read in conjunction with the detailed description of risk factors below.

Risk Factor Summary

These risks and uncertainties include:

Risk Related to the COVID-19 Pandemic

- The impacts of COVID-19, or the outbreak of another highly infectious or contagious disease, could adversely affect the Company's business, financial condition and results of operations.

Risks related to the Company's Lending Activities

- Our credit standards and on-going credit assessment processes might not protect us from significant credit losses.
- Our allowance for loan losses may be insufficient.
- Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.
- We have a high concentration of loans secured by real estate, and a downturn in the local real estate market could materially and negatively affect our business.
- A portion of our loan portfolio consists of construction and land development loans, and a decline in real estate values and economic conditions would adversely affect the value of the collateral securing the loans and have an adverse effect on our financial condition
- We have a significant concentration of credit exposure in commercial real estate, and loans with this type of collateral are viewed as having more risk of default.
- Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.
- We rely upon independent appraisals to determine the value of the real estate which secures a significant portion of our loans, and the values indicated by such appraisals may not be realizable if we are forced to foreclose upon such loans.
- We are exposed to risk of environmental liabilities with respect to properties to which we take title.

Risk Related to Market Interest Rates

- Our business is subject to interest rate risk, and variations in interest rates may negatively affect financial performance.
- We may be required to transition from the use of the London Interbank Offered Rate ("LIBOR") index in the future.

Risks Related to the Company's Business, Industry and Markets

- We face strong and growing competition from financial services companies and other companies that offer banking and other financial services, which could negatively affect our business.
- Consumers may decide not to use banks to complete their financial transactions.
- Our ability to operate profitably may be dependent on our ability to integrate or introduce various technologies into our operations.
- Changes in economic conditions, especially in the areas in which we conduct operations, could materially and negatively affect our business.
- We may be adversely impacted by changes in market conditions.

- Our mortgage banking revenue is cyclical and is sensitive to the level of interest rates, changes in economic conditions, decreased economic activity, and slowdowns in the housing market, any of which could adversely impact our profits.

Risk Related to the Company's Operations

- Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.
- We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our operations.
- The success of our strategy depends on our ability to identify and retain individuals with experience and relationships in our markets.
- If we are unable to successfully implement and manage our growth strategy, our results of operations and financial condition may be adversely affected.
- We are subject to a variety of operational risks, including reputational risk, legal and compliance risk, and the risk of fraud or theft by employees or outsiders.
- The soundness of other financial institutions could adversely affect us
- Failure to maintain effective systems of internal and disclosure control could have a material adverse effect on our results of operation and financial condition.
- We depend on the accuracy and completeness of information about clients and counterparties and our financial condition could be adversely affected if we rely on misleading information.
- Our information systems may experience an interruption or breach in security.
- We rely on other companies to provide key components of our business infrastructure.

Risks Related to the Company's Regulatory Environment

- Changes in accounting standards could impact reported earnings.
- We operate in a highly regulated industry and the laws and regulations that govern our operations, corporate governance, executive compensation and financial accounting, or reporting, including changes in them or our failure to comply with them, may adversely affect us.
- Regulatory enacted capital standards, including the Basel III Capital Rules, may require the Company and the Bank to maintain higher levels of capital and liquid assets, which could adversely affect our profitability and return on equity or require us to raise additional capital and dilute existing shareholders.

Risk Related to the Company's Common Stock

- Our common stock is thinly traded which may limit the ability of shareholders to sell their shares and may increase price volatility.
- Our ability to pay dividends is limited, and we may be unable to pay future dividends.
- If we fail to pay interest on or otherwise default on our subordinated notes and subordinated debt securities, we will be prohibited from paying dividends or distributions on our common stock.
- Our governing documents and Virginia law contain anti-takeover provisions that could negatively impact our shareholders.
- Our largest shareholder, Kenneth R. Lehman, has significant influence over our business through his share ownership and his interests may not align with the interests of other holders of our common stock.
- If Mr. Lehman acquires more than 66.67% of the Company's outstanding shares of common stock, it will cause the acceleration of benefits under certain of our employment and benefit agreements, which will cause us to incur additional compensation expenses.

Risks Related to the COVID-19 Pandemic

The impacts of COVID-19, or the outbreak of another highly infectious or contagious disease, could adversely affect the Company's business, financial condition and results of operations.

The Company's business is dependent upon the willingness and ability of its customers to conduct banking and other financial transactions. Since the beginning of January 2020, the COVID-19 outbreak has caused significant disruption in the financial markets both globally and in the United States. The continuing spread of COVID-19 and the related government actions to mandate or encourage quarantines and social distancing has resulted in a significant decrease in commercial activity nationally and in the Company's markets, and may cause customers, vendors, and counterparties to be unable to meet existing payment or other obligations to the Company and the Bank.

The national public health crisis arising from the COVID-19 pandemic (and public expectations about it), combined with certain pre-existing factors, including, but not limited to, international trade disputes, inflation risks, and oil price volatility, could further destabilize the financial markets and the markets in which the Company operates. The resulting impacts on consumers, including the sudden increase in the unemployment rate, is expected to cause changes in consumer and business spending, borrowing needs and saving habits, which will likely affect the demand for loans and other products and services the Company offers, as well as the creditworthiness of potential and current borrowers. Borrower loan defaults that adversely affect the Company's earnings correlate with deteriorating economic conditions, which, in turn, may impact borrowers' creditworthiness and the Bank's ability to make loans.

The use of quarantines and social distancing methods to curtail the spread of COVID-19 – whether mandated by governmental authorities or recommended as a public health practice – may adversely affect the Company's operations as key personnel, employees and customers avoid physical interaction. In response to the COVID-19 pandemic, the Bank has been directing branch customers to use drive-thru windows and online banking services, and many employees are telecommuting. It is not yet known what impact these operational changes may have on the Company's financial performance. The spread could also negatively impact availability of key personnel and employee productivity, as well as the business operations of third-party service providers who perform critical services for us, which could adversely impact our ability to deliver products and services to our customers.

As a result, if COVID-19 continues to spread or the response to contain the COVID-19 pandemic is unsuccessful, the Company could experience a material adverse effect on its business, financial condition, and results of operations.

Risk Related to the Company's Lending Activities

Our credit standards and on-going credit assessment processes might not protect us from significant credit losses.

We take credit risk by virtue of making loans and extending loan commitments and letters of credit. We manage credit risk through a program of underwriting standards, the review of certain credit decisions and an ongoing process of assessment of the quality of the credit already extended. In addition, our credit administration function employs risk management techniques intended to promptly identify problem loans. While these procedures are designed to provide us with the information needed to implement policy adjustments where necessary and to take appropriate corrective actions, there can be no assurance that such measures will be effective in avoiding future undue credit risk, and credit losses will occur in the future and they may be significant.

Our allowance for loan losses may be insufficient.

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, that represents our best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio.

The level of the allowance reflects management's evaluation of the level of loans outstanding, the level of nonperforming loans, historical loan loss experience, delinquency trends, underlying collateral values, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Although we believe the allowance for loan losses is a reasonable estimate of known and inherent losses in the loan portfolio, we cannot precisely predict such losses or be certain that the loan loss allowance will be adequate in the future. Deterioration of economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside our control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies and our auditors periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. Further, if charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses.

In addition, the adoption of Accounting Standards Update ("ASU") 2016-13, as amended, could result in an increase in the allowance for loan losses as a result of changing from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. As a smaller reporting company, the Company has elected to defer adoption of ASU 2016-13 until January 2023. For information regarding recent accounting pronouncements and their effect on us, see "Recent Accounting Pronouncements" in Note 1 "Summary of Significant Accounting Policies" in the "Notes to Consolidated Financial Statements" contained in Item 8 of this Form 10-K. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly capital, and may have a material adverse effect on our financial condition and results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

Our nonperforming assets adversely affect our net income in various ways. Nonperforming assets, (which include nonaccrual loans and other real estate owned, but exclude loans past due 90 days and still accruing as these loans are rehabilitated student loans which have a 98% guarantee by the DOE of principal and interest), were \$1,913,000, or 0.27% of total assets, as of December 31, 2020. When we receive collateral through foreclosures and similar proceedings, we are required to mark the related loan to the then fair value of the collateral less estimated selling costs, which may result in a loss. An increased level of nonperforming assets also increases our risk profile and may impact the capital levels regulators believe are appropriate in light of such risks. We utilize various techniques such as workouts, restructurings and loan sales to manage problem assets. Increases in or negative changes in the value of these problem assets, the underlying collateral, or in the borrowers' performance or financial condition, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and staff, which can be detrimental to the performance of their other responsibilities, including generation of new loans. There can be no assurance that we will avoid increases in nonperforming loans in the future.

We have a high concentration of loans secured by real estate, and a downturn in the local real estate market could materially and negatively affect our business.

We offer a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, residential mortgages, home equity loans and lines of credit, consumer and other loans. Many of these loans are secured by real estate (both residential and commercial) located principally in the Commonwealth of Virginia. As of December 31, 2020, 61.92% of all loans were secured by mortgages on real property. A major change in the real estate market, such as deterioration in the value of this collateral, or in the local or national economy, could adversely affect our customers' ability to pay these loans, which in turn could impact us. If there is a decline in real estate values, especially in our market area, the collateral for loans would deteriorate and provide significantly less security. The ability to recover on defaulted loans by selling the real estate collateral could then be diminished and we would be more likely to suffer losses.

A portion of our loan portfolio consists of construction and land development loans, and a decline in real estate values and economic conditions would adversely affect the value of the collateral securing the loans and have an adverse effect on our financial condition.

At December 31, 2020, approximately 5.26% of our loan portfolio, or \$29,569,000, consisted of construction and land development loans. Construction financing typically involves a higher degree of credit risk than financing on improved, owner-occupied real estate and improved, income producing real estate. Risk of loss on a construction or land development loan is largely dependent upon the accuracy of the initial estimate of the property's value at completion of construction or development, the marketability of the property, and the bid price and estimated cost (including interest) of construction or development. If the estimate of construction or development costs proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of the value proves to be inaccurate, we may be confronted, at or prior to the maturity of the loan, with a project whose value is insufficient to assure full repayment. When lending to builders and developers, the cost breakdown of construction or development is provided by the builder or developer. Although our underwriting criteria are designed to evaluate and minimize the risks of each construction or land development loan, there can be no guarantee that these practices will have safeguarded against material delinquencies and losses to our operations. In addition, construction and land development loans are dependent on the successful completion of the projects they finance. Loans secured by vacant or unimproved land are generally riskier than loans secured by improved property. These loans are more susceptible to adverse conditions in the real estate market and local economy.

We have a significant concentration of credit exposure in commercial real estate, and loans with this type of collateral are viewed as having more risk of default.

As of December 31, 2020, we had approximately \$231,224,000 in loans secured by commercial real estate, representing approximately 41.21% of total loans outstanding at that date. The real estate consists primarily of non-owner-operated properties and other commercial properties. These types of loans are generally viewed as having more risk of default than residential real estate loans. They are also typically larger than residential real estate loans and consumer loans and depend on cash flows from the owner's business or the property to service the debt. It may be more difficult for commercial real estate borrowers to repay their loans in a timely manner, as commercial real estate borrowers' abilities to repay their loans frequently depends on the successful rental of their properties. Cash flows may be affected significantly by general economic conditions, and a downturn in the local economy or in occupancy rates in the local economy where the property is located could increase the likelihood of default. Because our loan portfolio contains a number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in our percentage of non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition.

Our banking regulators generally give commercial real estate lending greater scrutiny, and may require banks with higher levels of commercial real estate loans to implement improved underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly higher levels of allowances for losses and capital as a result of commercial real estate lending growth and exposures, which could have a material adverse effect on our results of operations.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Most of our commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the market area in which we operate negatively impact this important customer sector, our results of operations and financial condition may be adversely affected. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. The deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could have a material adverse effect on our financial condition and results of operations.

We rely upon independent appraisals to determine the value of the real estate which secures a significant portion of our loans, and the values indicated by such appraisals may not be realizable if we are forced to foreclose upon such loans.

A significant portion of our loan portfolio consists of loans secured by real estate. We rely upon independent appraisers to estimate the value of such real estate. Appraisals are only estimates of value and the independent appraisers may make mistakes of fact or judgment which adversely affect the reliability of their appraisals. In addition, events occurring after the initial appraisal may cause the value of the real estate to increase or decrease. As a result of any of these factors, the real estate securing some of our loans may be more or less valuable than anticipated at the time the loans were made. If a default occurs on a loan secured by real estate that is less valuable than originally estimated, we may not be able to recover the outstanding balance of the loan and will suffer a loss.

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business we may foreclose and take title to real estate, potentially becoming subject to environmental liabilities associated with the properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs or we may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. Costs associated with investigation or remediation activities can be substantial. If we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. These costs and claims could adversely affect our business.

Risk Related to Market Interest Rates

Our business is subject to interest rate risk, and variations in interest rates may negatively affect financial performance.

Changes in the interest rate environment may reduce our profits. It is expected that we will continue to realize income from the differential or "spread" between the interest earned on loans, securities, and other interest earning assets, and interest paid on deposits, borrowings and other interest bearing liabilities. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest earning assets and interest bearing liabilities. In addition, loan volume and yields are affected by market interest rates on loans, and rising interest rates generally are associated with a lower volume of loan originations. Management cannot ensure that it can minimize our interest rate risk. While an increase in the

general level of interest rates may increase the loan yield and the net interest margin, it may adversely affect the ability of certain borrowers with variable rate loans to pay the interest and principal of their obligations. Also, when the difference between long-term interest rates and short-term interest rates is small or when short-term interest rates exceed long-term interest rates, our margins may decline and our earnings may be adversely affected. Accordingly, changes in levels of market interest rates could materially and adversely affect the net interest spread, asset quality, loan origination volume and our overall profitability.

We may be required to transition from the use of the London Interbank Offered Rate ("LIBOR") index in the future.

In 2017, the United Kingdom's Financial Conduct Authority announced that after 2021 it would no longer compel banks to submit the rates required to calculate LIBOR. In November 2020, the administrator of LIBOR announced it will consult on its intention to extend the retirement date of certain offered rates whereby the publication of the one week and two month LIBOR offered rates will cease after December 31, 2021; but, the publication of the remaining LIBOR offered rates will continue until June 30, 2023. Given consumer protection, litigation, and reputation risks, federal bank regulators have indicated that entering into new contracts that use LIBOR as a reference rate after December 31, 2021, would create safety and soundness risks and that they will examine bank practices accordingly. Therefore, the agencies encouraged banks to cease entering into new contracts that use LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021.

Regulators, industry groups, and others have, among other things, published recommended replacement language for LIBOR-linked financial instruments, identified recommended alternatives for certain LIBOR rates (e.g., the Secured Overnight Financing Rate), and proposed implementations of the recommended alternatives in floating rate instruments. There is not yet any consensus on what recommendations and proposals will be broadly accepted.

We have a number of loans, borrowings and other financial instruments with attributes that are either directly or indirectly dependent on LIBOR. The transition from LIBOR could create considerable costs and additional risk. Since proposed alternative rates are calculated differently, payments under contracts referencing new rates will differ from those referencing LIBOR. The transition will change our market risk profiles, requiring changes to risk and pricing models, valuation tools, product design and hedging strategies. Furthermore, failure to adequately manage this transition process with our customers could adversely impact our reputation. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

Risks Related to the Company's Business, Industry and Markets

We face strong and growing competition from financial services companies and other companies that offer banking and other financial services, which could negatively affect our business.

We encounter substantial competition from other financial institutions in our market area and competition is increasing. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer the same banking services that we offer in our service area. These competitors include national, regional and community banks. We also face competition from many other types of financial institutions, including finance companies, mutual and money market fund providers, brokerage firms, insurance companies, credit unions, financial subsidiaries of certain industrial corporations, financial technology ("fintech") companies and mortgage companies. In particular, the activity of fintech companies has grown significantly over recent years and is expected to continue to grow. Fintech companies have and may continue to offer bank or bank-like products and some fintech companies have applied for bank charters. In addition, other fintech companies have partnered with existing banks to allow them to offer deposit products to their customers. Increased competition may result in reduced business for us.

Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain loans and deposits, and range and quality of products and services provided, including new technology-driven products and services. If we are unable to attract and retain banking customers, we may be unable to continue to grow loan and deposit portfolios and our results of operations and financial condition may otherwise be adversely affected.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. The activity and prominence of so-called marketplace lenders and other technological financial service companies have grown significantly over recent years and are expected to continue growing. In addition, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds, digital wallets or general-purpose reloadable prepaid cards. Consumers can also complete transactions, such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as “disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. If we are unable to address the competitive pressures that we face, we could lose market share, which could result in reduced net revenue and profitability and lower returns. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Our ability to operate profitably may be dependent on our ability to integrate or introduce various technologies into our operations.

The market for financial services, including banking and consumer finance services, is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, online banking and tele-banking. Our ability to compete successfully in our market may depend on the extent to which we are able to exploit such technological changes. If we are not able to afford such technologies, properly or timely anticipate or implement such technologies, or effectively train our staff to use such technologies, our business, financial condition or operating results could be adversely affected.

Changes in economic conditions, especially in the areas in which we conduct operations, could materially and negatively affect our business.

Our business is directly impacted by economic conditions, legislative and regulatory changes, changes in government monetary and fiscal policies, and inflation, all of which are beyond our control. A deterioration in economic conditions, whether caused by global, national or local concerns, especially within our market area, could result in the following potentially material consequences: loan delinquencies increasing; problem assets and foreclosures increasing; demand for products and services decreasing; low cost or non-interest bearing deposits decreasing; and collateral for loans, especially real estate, declining in value, in turn reducing customers’ borrowing power, and reducing the value of assets and collateral associated with existing loans. An economic downturn could result in losses that materially and adversely affect our business.

We may be adversely impacted by changes in market conditions.

We are directly and indirectly affected by changes in market conditions. Market risk generally represents the risk that values of assets and liabilities or revenues will be adversely affected by changes in market conditions. As a financial institution, market risk is inherent in the financial instruments associated with our operations and activities, including loans, deposits, securities, short-term borrowings, long-term debt and trading account assets and liabilities. A few of the market conditions that may shift from time to time, thereby exposing us to market risk, include fluctuations in interest rates, equity and futures prices, and price deterioration or changes in value due to changes in market perception or actual credit quality of issuers.

Our investment securities portfolio, in particular, may be impacted by market conditions beyond our control, including rating agency downgrades of the securities, defaults of the issuers of the securities, lack of market pricing of the securities, and inactivity or instability in the credit markets. Any changes in these conditions, in current accounting principles or interpretations of these principles could impact our assessment of fair value and thus the determination of other-than-temporary impairment of the securities in the investment securities portfolio.

Our mortgage banking revenue is cyclical and is sensitive to the level of interest rates, changes in economic conditions, decreased economic activity, and slowdowns in the housing market, any of which could adversely impact our profits.

Mortgage banking income, net of commissions, represented approximately 79.48% of total noninterest income for the year ended December 31, 2020. The success of our mortgage company is dependent upon our ability to originate loans and sell them to investors at or near current volumes. Loan production levels are sensitive to changes in the level of interest rates and changes in economic conditions. Any sustained period of decreased activity caused by fewer refinancing transactions, higher interest rates, housing price pressure or loan underwriting restrictions would adversely affect our mortgage originations and, consequently, could significantly reduce our income from mortgage banking activities. As a result, these conditions would also adversely affect our results of operations.

Risk Related to the Company's Operations

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. The liquidity of the Company is used to service its debt. The liquidity of the Bank is used to make loans and leases and to repay deposit liabilities as they become due or are demanded by customers. Our overall liquidity position is regularly monitored to ensure that various alternative strategies exist to cover unanticipated events that could affect liquidity. An inability to raise funds through deposits, borrowings and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically, or the financial services industry or economy in general. Factors that could negatively impact our access to liquidity sources include a decrease in the level of our business activity as a result of an economic downturn in the market area in which our loans are concentrated; adverse regulatory action against us; or our inability to attract and retain deposits.

Our ability to borrow could be impaired by factors that are not specific to us or our region, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our operations.

We are a relationship-driven organization, and currently depend heavily on the services of a number of key management and business development personnel. These officers have primary contact with our customers and are extremely important in maintaining personalized relationships with our customer base and producing new business, which is a key aspect of our business strategy and earnings momentum. The unexpected loss of key personnel could materially and adversely affect our results of operations and financial condition.

The success of our strategy depends on our ability to identify and retain individuals with experience and relationships in our markets.

In order to be successful, we must identify and retain experienced key management members and sales staff with local expertise and relationships. Competition for qualified personnel is intense and there is a limited number of qualified persons with knowledge of and experience in the community banking and mortgage industry in our chosen geographic market. Even if we identify individuals that we believe could assist us in building our franchise, we may be unable to recruit these individuals away from their current employers. In addition, the process of identifying and recruiting individuals with the combination of skills and attributes required to carry out our strategy is often lengthy. Our inability to identify, recruit and retain talented personnel could limit our growth and could materially adversely affect our business, financial condition and results of operations.

If we are unable to successfully implement and manage our growth strategy, our results of operations and financial condition may be adversely affected.

We may not be able to successfully implement our growth strategy if we are unable to identify attractive markets, locations or opportunities to expand in the future. In addition, the ability to manage growth successfully depends on whether we can maintain adequate capital levels, cost controls and asset quality, and successfully integrate any acquired branch offices or banks. We cannot assure you that any integration efforts relating to our growth strategy will be successful. In implementing our growth strategy by opening new branches or acquiring branches or banks, we expect to incur increased personnel, occupancy and other operating expenses. In the case of new branches, we must absorb those higher expenses while we begin to generate new deposits; there is also further time lag involved in redeploying new deposits into attractively priced loans and other higher yielding earning assets.

We may consider acquiring other businesses or expanding into new product lines that we believe will help us fulfill our strategic objectives. We expect that other banking and financial companies, some of which have significantly greater resources, will compete with us to acquire financial services businesses. This competition could increase prices for potential acquisitions that we believe are attractive. Acquisitions may also be subject to various regulatory approvals. If we fail to receive the appropriate regulatory approvals, we will not be able to consummate acquisitions that we believe are in our best interests.

When we enter into new markets or new lines of business, our lack of history and familiarity with those markets, clients and lines of business may lead to unexpected challenges or difficulties that inhibit our success. Our plans to expand could depress earnings in the short run, even if we efficiently execute a growth strategy leading to long-term financial benefits.

We are subject to a variety of operational risks, including reputational risk, legal and compliance risk, and the risk of fraud or theft by employees or outsiders.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees, operational errors, clerical or record-keeping errors, and errors resulting from faulty or disabled computer or communications systems.

Reputational risk, or the risk to our earnings and capital from negative public opinion, could result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers and employees and can expose us to litigation and regulatory action.

Further, if any of our financial, accounting, or other data processing systems fail or have other significant issues, we could be adversely affected. We depend on internal systems and outsourced technology to support these data storage and processing operations. Our inability to use or access these information systems at critical points in time could unfavorably impact the timeliness and efficiency of our business operations. We could be adversely affected if one of our employees causes a significant operational breakdown or failure, either as a result of human error or where an individual purposefully sabotages or

fraudulently manipulates our operations or systems. We are also at risk of the impact of natural disasters, terrorism and international hostilities on our systems and from the effects of outages or other failures involving power or communications systems operated by others. We may also be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or communications outages), which may give rise to disruption of service to customers and to financial loss or liability. In addition, there have been instances where financial institutions have been victims of fraudulent activity in which criminals pose as customers to initiate wire and automated clearinghouse transactions out of customer accounts. Although we have policies and procedures in place to verify the authenticity of our customers, we cannot guarantee that such policies and procedures will prevent all fraudulent transfers. Such activity can result in financial liability and harm to our reputation.

If any of the foregoing risks materialize, it could have a material adverse effect on our business, financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due us. There is no assurance that any such losses would not materially and adversely affect our results of operations.

Failure to maintain effective systems of internal and disclosure control could have a material adverse effect on our results of operation and financial condition.

Effective internal and disclosure controls are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. As part of our ongoing monitoring of internal control, we may discover material weaknesses or significant deficiencies in our internal control that require remediation. A “material weakness” is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company’s annual or interim financial statements will not be prevented or detected on a timely basis.

Our inability to maintain the operating effectiveness of the controls described above could result in a material misstatement to our financial statements or other disclosures, which could have an adverse effect on our business, financial condition or results of operations. In addition, any failure to maintain effective controls or to timely effect any necessary improvement of our internal and disclosure controls could, among other things, result in losses from fraud or error, harm our reputation or cause investors to lose confidence in our reported financial information, all of which could have a material adverse effect on our results of operation and financial condition.

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

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information, which we do not independently verify. We also may rely on

representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to clients, we may assume that a client's audited financial statements conform with GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of that client. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements that do not comply with GAAP or are materially misleading.

We rely on other companies to provide key components of our business infrastructure.

Third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, internet connections and network access. While we have selected these third party vendors carefully, we do not control their actions. Any problem caused by these third parties, including poor performance of services, failure to provide services, disruptions in communication services proved by a vendor and failure to handle current or higher volumes, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business, and may harm our reputation. Financial or operational difficulties of a third party vendor could also hurt our operations if those difficulties interface with the vendor's ability to serve us. Replacing these third party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an unavoidable inherent risk to our business operations.

Our information systems may experience an interruption or breach in security.

In the ordinary course of business, we collect and store sensitive data, including proprietary business information and personally identifiable information of our customers and employees, in systems and on networks. The secure processing, maintenance and use of this information is critical to operations and our business strategy. While we have policies and procedures designed to protect our networks, computers and data from failure, interruption, damage or unauthorized access, there can be no assurance that a breach will not occur or, if it does, that it will be adequately addressed. The occurrence of any failure, interruption, damage or security breach of our communications and information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability, any of which could adversely affect our business.

Risk Related to the Company's Regulatory Environment

Changes in accounting standards could impact reported earnings.

From time to time there are changes in the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can materially impact how we record and report our financial condition and results of operations. In some instances, we could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements. For information regarding recent accounting pronouncements and their effect on us, see "Recent Accounting Pronouncements" in Note 1 "Summary of Significant Accounting Policies" in the "Notes to Consolidated Financial Statements" contained in Item 8 of this Form 10-K.

We operate in a highly regulated industry and the laws and regulations that govern our operations, corporate governance, executive compensation and financial accounting, or reporting, including changes in them or our failure to comply with them, may adversely affect us.

We are subject to extensive regulation and supervision that govern almost all aspects of our operations. These laws and regulations, among other matters, prescribe minimum capital requirements, impose limitations on our business activities, limit the dividends or distributions that we can pay, restrict the ability of institutions to guarantee our debt and impose certain specific accounting requirements that may be more restrictive and may result in greater or earlier charges to earnings or reductions in our capital than GAAP. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional compliance costs.

We are currently facing increased regulation and supervision of our industry as a result of the financial crisis in the banking and financial markets. The Dodd-Frank Act instituted major changes to the banking and financial institutions regulatory regimes. Other changes to statutes, regulations or regulatory policies or supervisory guidance, including changes in interpretation or implementation of statutes, regulations, policies or supervisory guidance, could affect us in substantial and unpredictable ways. Such additional regulation and supervision has increased, and may continue to increase, our costs and limit our ability to pursue business opportunities. Further, our failure to comply with these laws and regulations, even if the failure was inadvertent or reflects a difference in interpretation, could subject us to restrictions on our business activities, fines and other penalties, any of which could adversely affect our results of operations, capital base and the price of our securities. Further, any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect our business and financial condition.

Regulatory enacted capital standards, including the Basel III Capital Rules, may require the Company and the Bank to maintain higher levels of capital and liquid assets, which could adversely affect our profitability and return on equity or require us to raise additional capital and dilute existing shareholders.

We are subject to capital adequacy guidelines and other regulatory requirements specifying minimum amounts and types of capital that the Company and the Bank must maintain. From time to time, regulators implement changes to these regulatory capital adequacy guidelines. If we fail to meet these minimum capital guidelines and/or other regulatory requirements, our financial condition would be materially and adversely affected. The Basel III Capital Rules require bank holding companies and their subsidiaries to maintain significantly more capital as a result of higher required capital levels and more demanding regulatory capital risk weightings and calculations. While the Company is exempt from these capital requirements under the SBHC Policy Statement, the Bank is not exempt and must comply. The Bank must also comply with the capital requirements set forth in the “prompt corrective action” regulations pursuant to Section 38 of the FDI Act. Satisfying capital requirements may require us to limit our banking operations, retain net income or reduce dividends to improve regulatory capital levels, which could negatively affect our business, financial condition and results of operations. As described in Item 1 – “Business” under “Supervision and Regulation – Capital Adequacy,” banks and bank holding companies that opt into the CBLR framework and maintain a CBLR of greater than 9% are not subject to other risk-based and leverage capital requirements under the Basel III Capital Rules and would be deemed to have met the well capitalized ratio requirements under the “prompt corrective action” framework. These CBLR rules were modified in response to the COVID-19 pandemic. See “Coronavirus Aid, Relief, and Economic Security Act and Consolidated Appropriations Act, 2021” above. The Bank elected not to opt into the CBLR framework as of December 31, 2020. The Bank does not expect to opt into the CBLR framework in 2021.

Risk Related to the Company’s Common Stock

Our common stock is thinly traded which may limit the ability of shareholders to sell their shares and may increase price volatility.

Our common stock is listed on the Nasdaq Capital Market under the symbol “VBFC.” Our common stock is thinly traded and has substantially less liquidity than the average trading market for many other publicly traded companies. Mr. Lehman’s significant share ownership also limits the number of shares available to other investors and the liquidity of our common stock. We cannot assure you that a more active trading market for our common stock will develop or be sustained. The development of a liquid public market depends on the existence of willing buyers and sellers, the presence of which is not within our control. The number of active buyers and sellers of our common stock at any particular time may be limited. Therefore, our shareholders may not be able to sell their shares at the volume, prices, or times that they desire. Shareholders should be financially prepared and able to hold shares for an indefinite period.

In addition, thinly traded stocks can be more volatile than more widely traded stocks. Our stock price has been volatile in the past and several factors could cause the price to fluctuate substantially in the future.

These factors include, but are not limited to, changes in analysts' recommendations or projections, developments related to our business, operations, stock performance of other companies deemed to be peers, news reports of trends, concerns, irrational exuberance on the part of investors, and other issues related to the financial services industry. Our stock price may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector of the economy, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices.

Our ability to pay dividends is limited, and we may be unable to pay future dividends.

Our ability to pay dividends is limited by regulatory restrictions and our need to maintain sufficient capital. The ability of the Bank to pay dividends to the Company also will be limited by the Bank's obligations to maintain sufficient capital, earnings and liquidity and by other general restrictions on its dividends under federal and state bank regulatory requirements. Under Virginia law, a bank may not declare a dividend in excess of its accumulated retained earnings without approval by the BFI. As of December 31, 2020, the Bank did not have any accumulated retained earnings. Any future financing arrangements that we enter into may also limit our ability to pay dividends to our shareholders. If we do not satisfy these regulatory requirements or arrangements, we will be unable to pay dividends on our common stock. Further, even if we have earnings and available cash in an amount sufficient to pay dividends to our shareholders, the board of directors, in its sole discretion, may decide to retain them and therefore not pay dividends in the future.

If we fail to pay interest on or otherwise default on our subordinated notes and subordinated debt securities, we will be prohibited from paying dividends or distributions on our common stock.

As of December 31, 2020, we had \$5,628,000 of net subordinated notes and \$8,764,000 of subordinated debt securities outstanding. The agreements under which the subordinated notes and subordinated debt securities were issued prohibit us from paying any dividends on our common stock or making any other distributions to our shareholders upon our failure to make any required payment of principal or interest or during the continuance of an event of default under the applicable agreement. Events of default generally consist of, among other things, certain events of bankruptcy, insolvency or liquidation relating to us. If we were to fail to make a required payment of principal or interest on our subordinated notes or subordinated debt securities, it could have a material adverse effect on the market value of our common stock.

Our governing documents and Virginia law contain anti-takeover provisions that could negatively impact our shareholders.

Our articles of incorporation and bylaws and the Virginia Stock Corporation Act contain certain provisions designed to enhance the ability of our board of directors to deal with attempts to acquire control of the Company. These provisions, among others, provide that a plan of merger, share exchange, sale of all or substantially all of our assets, or similar transaction must be approved and recommended by the affirmative vote of two-thirds of the directors in office or by the affirmative vote of 80% or more of all of the votes entitled to be cast on such transaction by each voting group entitled to vote, and limit the ability of shareholders to call a special meeting. These provisions and the ability to set the voting rights, preferences and other terms of any series of preferred stock that may be issued, may be deemed to have an anti-takeover effect and may discourage takeovers (which certain shareholders may deem to be in their best interest). To the extent that such takeover attempts are discouraged, temporary fluctuations in the market price of our common stock resulting from actual or rumored takeover attempts may be inhibited. These provisions also could discourage or make more difficult a merger, tender offer or proxy contest, even though such transactions may be favorable to the interests of shareholders, and could potentially adversely affect the market price of our common stock.

Our largest shareholder, Kenneth R. Lehman, has significant influence over our business through his share ownership and his interests may not align with the interests of other holders of our common stock.

According to the Form 4 filed by Mr. Lehman with the SEC on December 14, 2020, Mr. Lehman owns 768,379 shares, or approximately 52.39%, of the Company's outstanding common stock. Due to this ownership, he is able to influence the outcome of any matter submitted to a vote of our shareholders. In addition, Mr. Lehman previously served on the boards of directors of the Company and the Bank and management regularly seeks guidance and perspective from him given his extensive industry experience. Mr. Lehman owns significant shares of other financial institutions, some of which may compete with us. These affiliations may create conflicts of interest that could incentivize him to take or approve actions with respect to other institutions that may have a negative impact on us (e.g. marketing efforts, product pricing, lending policies, business combination transactions, etc.). While we believe Mr. Lehman's significant investment in the Company provides some protection in this regard, Mr. Lehman's interests may not directly align with the interests of other holders of our common stock.

If Mr. Lehman acquires more than 66.67% of the Company's outstanding shares of common stock, it will cause the acceleration of benefits under certain of our employment and benefit agreements, which will cause us to incur additional compensation expenses.

Certain of our employment and benefit agreements include customary provisions that provide for additional or accelerated compensation in the event of a change of control of the Company. If Mr. Lehman acquires more than 66.67% of the Company's outstanding shares of common stock, it will cause the acceleration of benefits under some of these agreements. As described above, Mr. Lehman owned approximately 52.39% of our outstanding common stock as of December 14, 2020.

Our stock incentive plan provides for "single-trigger" acceleration of change of control benefits, which means certain employees will receive benefits upon a change of control of the Company, regardless of whether the change of control affects their employment with the Company or any successor. These change of control benefits include accelerated vesting of restricted stock awards. If Mr. Lehman's ownership of the Company's common stock had exceeded 66.67% as of December 31, 2020, we would have recognized approximately \$837,000 in related compensation expenses in 2020.

Our change of control agreements provide for "double-trigger" acceleration of change of control benefits, which means the benefits are only payable if the employee experiences a qualifying termination of employment in connection with a change of control. Mr. Lehman's acquisition of more than 66.67% of the Company's outstanding common stock would not automatically result in the payment or acceleration of change of control benefits under these agreements. However, under certain circumstances, if the Company were to terminate these employees or the employees were to voluntarily resign following Mr. Lehman's acquisition of more than 66.67% of the Company's outstanding common stock, the Company would incur significant additional expenses.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable

ITEM 2. PROPERTIES

Our executive and administrative offices are owned by the Bank and are located at 13319 Midlothian Turnpike, Midlothian, Virginia 23113 in Chesterfield County. The current location also houses the principal office of the Mortgage Company.

In addition to its executive offices, the Bank owns six full service branch buildings including the land on those buildings and leases an additional three full service branch buildings. Three of our branch offices are located in Chesterfield County, with two branch offices in Hanover County, two in Henrico County, one in Powhatan County and one in James City County.

Our properties are maintained in good operating condition and we believe they are suitable and adequate for our operational needs.

ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of its operations, the Company is a party to various legal proceedings. As of the date of this report, there are no pending or threatened proceedings against the Company that, if determined adversely, would have a material effect on the business, results of operations, or financial position of the Company.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market and Dividend Information

Shares of the Company's common stock trade on the Nasdaq Capital Market under the symbol "VBFC".

The Company has not paid any dividends on its common stock. We intend to retain all of our earnings to finance the Company's operations and we do not anticipate paying cash dividends in the near term. Any decision made by the board of directors to declare dividends in the future will depend on the Company's future earnings, capital requirements, financial condition and other factors deemed relevant by the board. A discussion of certain restrictions and limitations on the ability of the Bank to pay dividends to the Company, and the ability of the Company to pay dividends to shareholders of its common stock, is set forth in Item 1 – "Business" under "Supervision and Regulation."

During 2019, the Company received approval from state and federal regulators allowing the Bank to pay a special dividend, totaling \$1,000,000, to the Company for the purpose of servicing the Company's trust preferred securities and subordinated debt.

During 2020, the Company received approval from state and federal regulators allowing the Bank to pay two special dividends, totaling \$1,250,000, to the Company for the purpose of servicing the Company's trust preferred securities and subordinated debt.

Holders

At March 1, 2021, there were 1,466,800 shares of common stock outstanding held by approximately 940 shareholders of record.

For information concerning the Company's Equity Compensation Plans, see Item 12 – "Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters."

Purchases of Equity Securities

The Company did not repurchase any of its common stock during 2020 or 2019.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company, consisting of the parent company and its wholly-owned subsidiary, the Bank. This discussion should be read in conjunction with the consolidated financial statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements

In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement, that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy and financial and other goals. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to:

- changes in assumptions underlying the establishment of allowances for loan losses, and other estimates;
- the risks of changes in interest rates on levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities, and interest sensitive assets and liabilities;
- the effects of future economic, business and market conditions;
- legislative and regulatory changes, including the Dodd-Frank Act and other changes in banking, securities, and tax laws and regulations and their application by our regulators, and changes in scope and cost of FDIC insurance and other coverages;
- our inability to maintain our regulatory capital position;
- the Company's computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions despite security measures implemented by the Company;
- changes in market conditions, specifically declines in the residential and commercial real estate market, volatility and disruption of the capital and credit markets, soundness of other financial institutions with which we do business;
- risks inherent in making loans such as repayment risks and fluctuating collateral values;
- changes in operations of the Mortgage Company as a result of the activity in the residential real estate market;
- exposure to repurchase loans sold to investors for which borrowers failed to provide full and accurate information on or related to their loan application or for which appraisals have not been acceptable or when the loan was not underwritten in accordance with the loan program specified by the loan investor;
- governmental monetary and fiscal policies;
- changes in accounting policies, rules and practices;
- reliance on our management team, including our ability to attract and retain key personnel;
- competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources;
- demand, development and acceptance of new products and services;
- problems with technology utilized by us;

- natural disasters, war, terrorist activities, pandemics, and their effects on economic and business environments in which the Company operates;
- adverse effects due to COVID-19 on the Company and its customers, counterparties, employees, and third-party service providers, and the adverse impacts to our business, financial position, results of operations, and prospects;
- changing trends in customer profiles and behavior; and
- other factors described from time to time in our reports filed with the SEC.

For additional information on factors that could materially influence the forward-looking statements included in this report, see the risk factors in Item 1A – “Risk Factors” in this report. These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

General

The Company’s primary source of earnings is net interest income and income from mortgage banking activities, and its principal market risk exposure is interest rate risk. The Company is not able to predict market interest rate fluctuations and its asset/liability management strategy may not prevent interest rate changes from having a material adverse effect on the Company’s results of operations and financial condition.

Although we endeavor to minimize the credit risk inherent in the Company’s loan portfolio, we must necessarily make various assumptions and judgments about the collectability of the loan portfolio based on our experience and evaluation of economic conditions. If such assumptions or judgments prove to be incorrect, the current allowance for loan losses may not be sufficient to cover loan losses and additions to the allowance may be necessary, which would have a negative impact on net income.

Response to COVID-19

As the circumstances with the COVID-19 pandemic began to unfold, the Company rapidly mobilized over 80% of non-branch team members to work-from-home, went to drive-thru only at our branches with lobby access by appointment, and actively worked with borrowers to defer loan payments to allow operations to return to some level of normalcy. With the continued uncertainty around the COVID-19 pandemic, we continue to take the necessary measures to protect the health and wellbeing of our employees and customers as well as working with our borrowers who continue to be impacted by the COVID-19 pandemic. We continue to believe that we are well positioned to weather the economic storm created by the COVID-19 pandemic and have built the balance sheet around a philosophy of prudent risk taking.

Small Business Administration Paycheck Protection Program

The Company was successful in getting SBA PPP funds out to our community under the CARE Act, which was designed to protect jobs and provide economic relief to small businesses that were negatively impacted by the COVID-19 pandemic. Through December 31, 2020, the Bank had funded approximately \$185 million in PPP loans, which provided essential funds to over 1,500 businesses and nonprofits and protected more than 20,000 jobs in our community. As of December 31, 2020, the Bank had submitted 413 applications to the SBA for forgiveness totaling \$63,251,000 and received proceeds of approximately \$47,987,000 on 345 of those applications. The Bank is participating in the second round of PPP funding approved by Congress and signed into law by the President of the United States of America on December 27, 2020. The Bank expects the approval for forgiveness on PPP loans to pick up in the first half of 2021. This will result in the recognition of unamortized deferred fee income, net of deferred cost, associated with the PPP loans to occur at a higher rate in the first half of 2021 when compared to the second half of 2020.

Supporting customers through payment deferrals

In response to the COVID-19 pandemic, we began deferring payments for up to six months for impacted customers under the CARES Act, as amended by the CAA, which permits financial institutions to suspend requirements under GAAP for loan modifications to borrowers affected by COVID-19 that would otherwise be characterized as TDRs and suspend any determination related thereto if (i) the loan modification is made between March 1, 2020 and the earlier of January 1, 2022 or 60 days after the end of the COVID-19 emergency declaration and (ii) the applicable loan was not more than 30 days past due as of December 31, 2019. In addition, federal bank regulatory authorities have issued guidance to encourage financial institutions to make loan modifications for borrowers affected by COVID-19 and have assured financial institutions that they will neither receive supervisory criticism for such prudent loan modifications, nor be required by examiners to automatically categorize COVID-19-related loan modifications as TDRs. As of December 31, 2020, the Company had approximately \$38.0 million in loans still under their modified terms. The Company's modification program primarily included payment deferrals and interest only modifications. Below is a breakdown of the loan portfolio showing the percentage of loans deferred in each category at the dates indicated (dollars in thousands):

Loan Type	December 31, 2020			September 30, 2020	
	Balance 2020 ⁽¹⁾	Deferred Loans ⁽²⁾ \$ Def	% Def	Deferred Loans ⁽²⁾ \$ Def	% Def
C&I + Owner occupied commercial real estate	\$ 144,198	\$ 8,988	6.23%	\$ 27,715	19.22%
Nonowner occupied commercial real estate	131,440	26,835	20.42%	44,652	33.97%
Acquisition, development and construction	29,569	-	0.00%	5,534	18.72%
Total commercial loans	305,207	35,823	11.74%	77,901	25.52%
Consumer/Residential	86,580	2,205	2.55%	6,434	7.43%
Student	29,657	-	0.00%	-	0.00%
Other	2,885	-	0.00%	-	0.00%
Total loans	\$ 424,329	\$ 38,028	8.96%	\$ 84,335	19.87%

⁽¹⁾ The table excludes PPP loans of \$136,674 as the inclusion of these loans dilutes the impact of the deferral program.

⁽²⁾ The SBA provided a financial reprieve to small business as a result of the COVID-19 pandemic. The SBA automatically paid the principal, interest, and fees on current SBA 7(a) loans for a period of six months. These loans have been excluded from the September 30, 2020 metrics; however, as of December 31, 2020, six loans with a total outstanding balance of \$3,407,000 went into a deferred payment status and were included in the deferred loan amount above.

Below is a breakdown of the loan portfolio showing the percentage of loans in deferral within select industry categories at the dates indicated (dollars in thousands):

Select Industries	December 31, 2020			September 30, 2020	
	Balance 2020	Deferred Loans ⁽¹⁾ \$ Def	Amount	Deferred Loans ⁽¹⁾ \$ Def	Amount
Hotels	\$ 29,718	\$ 24,979	84.05%	20,568	69.21%
Food Service	20,300	606	2.99%	7,413	36.52%
Retail ⁽²⁾	20,273	3,782	18.66%	3,804	18.76%
Medical and Child Care	12,149	-	0.00%	2,724	22.42%
Real Estate and Leasing	147,103	2,833	1.93%	29,329	19.94%
Arts and Entertainment	7,602	2,024	26.62%	5,968	78.51%
Total	\$ 237,145	\$ 34,224	14.43%	\$ 69,806	29.44%

⁽¹⁾ The SBA provided a financial reprieve to small business as a result of the COVID-19 pandemic. The SBA automatically paid the principal, interest, and fees on current SBA 7(a) loans for a period of six months. These loans have been excluded from the September 30, 2020 metrics; however, as of December 31, 2020, six loans with a total outstanding balance of \$3,407,000 went into a deferred payment status and were included in the deferred loan amount and number above.

⁽²⁾ Loans within this group include business such as grocery, convenience stores, drug stores, consumer durables, apparel, and personal services.

Liquidity Risk Management

Over the past eight years, the Company has worked to fund the balance sheet with core deposits and reserve wholesale funding capacity for short periods of rapid loan growth or for crises such as the current economic environment.

During the three month period ended March 31, 2020, the Company took aggressive measures to bolster its liquidity to ensure it could meet customer demands in the event customers made significant deposit withdrawals and fully drew on lines of credit. The Company increased liquid assets by \$20,155,000, or 30.12% from \$66,904,000 at December 31, 2019 to \$87,059,000 at March 31, 2020 which was partially accomplished by raising an additional \$3,733,000 in internet listing service time deposits, \$15,000,000 in FHLB advances and \$6,136,000 in brokered time deposits, which were at zero at December 31, 2019.

From March 31, 2020 through December 31, 2020, the Company did not experience excessive demand for deposit withdrawals or advances under lines of credit; however, the Company did experience significant growth in low cost relationship deposits (i.e. noninterest bearing, NOW, money market and savings). This growth in low cost relationship deposits was the result of the Company converting a significant portion of non-customer PPP loan applicants into customers and the migration of customer funds from time deposits into money market deposits during the periods. During this period, the Company acquired \$45,120,000 in funds through the Federal Reserve's Paycheck Protection Program Liquidity Facility ("PPPLF") to support the origination of PPP loans. As of December 31, 2020, the PPPLF totaled \$41,529,000. As a result of the growth in low cost relationship deposits, the Company prepaid its remaining \$31,000,000 in FHLB advances during the three month period ended December 31, 2020.

As of December 31, 2020, the Company had on balance sheet liquid assets of \$84,295,000, which the Company believes are sufficient to cover its current liquidity needs. However, if the need were to arise the Company could access liquidity of approximately \$95,145,000 in the PPPLF through March 31, 2021, it could pledge additional collateral to the FHLB in order to increase its available borrowing capacity up to 25% of assets, it could access the two federal funds lines of credit with correspondent banks totaling \$15,000,000, and it could add additional funding through raising internet listing service and brokered time deposits. There were no borrowings with the FHLB or against the lines of credit at December 31, 2020.

Capital Risk Management

The Bank remains in a strong, well-capitalized position with a common equity Tier 1 capital ratio of 13.35%, a Tier 1 risk-based capital ratio of 13.35%, a total risk-based capital ratio of 14.20% and a leverage ratio of 9.28% as of December 31, 2020. The most significant risk to capital as a result of the COVID-19 pandemic is the risk of default within our loan portfolio and the potential loan losses as a result of those defaults. The Company has taken several steps to mitigate this risk to our capital by building a diversified loan portfolio over the years to be capable of sustaining through a crisis, working with our customers during this time to defer loan payments for up to six months to allow time for economic stabilization and participating in the SBA PPP loan program to help provide much needed funds to our borrowers and the community. While there will be pressure on capital levels as a result of the COVID-19 pandemic, the Company believes the actions we are taking will protect our capital levels and allow the Company to support all stakeholders through this difficult time.

While the long-term economic impacts from the COVID-19 pandemic are unknown at this time, we believe that our culture of disciplined and conservative risk taking across the balance sheet has the Company well positioned to not only carry through the current crisis but to be a pillar of support for our employees, our customers, and our communities.

Results of Operations

The following presents management's discussion and analysis of the financial condition of the Company at December 31, 2020 and 2019, and results of operations for the Company for the years ended December 31, 2020 and 2019. This discussion should be read in conjunction with the Company's audited Consolidated Financial Statements and the notes thereto appearing elsewhere in this Annual Report.

Summary

The Company recorded net income of \$8,554,000, or \$5.86 per fully diluted share, in 2020, compared to net income of \$4,477,000, or \$3.10 per fully diluted share, in 2019.

Net interest income

Net interest income, which represents the difference between interest earned on interest-earning assets and interest incurred on interest-bearing liabilities, is the Company's primary source of earnings. Net interest income can be affected by changes in market interest rates as well as the level and composition of assets, liabilities and shareholders' equity. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net yield on interest-earning assets ("net interest margin") is calculated by dividing tax equivalent net interest income by average interest-earning assets. Generally, the net interest margin will exceed the net interest spread because a portion of interest-earning assets are funded by various noninterest-bearing sources, principally noninterest-bearing deposits and shareholders' equity.

	Year Ended December 31,		
	2020	2019	Change
	<i>(dollars in thousands)</i>		
Average interest-earning assets	\$ 626,868	\$ 494,003	\$ 132,865
Interest income	\$ 25,826	\$ 23,487	\$ 2,339
Yield on interest-earning assets	4.12%	4.75%	(0.63)%
Average interest-bearing liabilities	\$ 420,516	\$ 360,560	\$ 59,956
Interest expense	\$ 4,433	\$ 5,330	\$ (897)
Cost of interest-bearing liabilities	1.05%	1.48%	(0.42)%
Net interest income	\$ 21,393	\$ 18,157	\$ 3,236
Net interest margin	3.41%	3.68%	(0.26)%

Interest income on earning assets increased by \$2,339,000 compared to the same period in 2019 as a result of the following:

- During 2020, the Company originated \$185,137,000 in PPP loans which resulted in SBA fees of \$6,584,000. The SBA fee is being amortized, based on the term of the loan through net income, net of \$1,052,000 in deferred costs associated with the origination of the PPP loans. The recognition of the fees, net of deferred costs, will be accelerated as loans are forgiven by the SBA. As of December 31, 2020, the Bank had recognized through interest income \$2,762,000 in SBA fee income, net of deferred costs as a result of normal amortization and the receipt of \$47,987,000 in funds from loans forgiven by the SBA.
- The yield on average earning assets contracted by 63 basis points to 4.12% for the year-ended December 31, 2020 vs. 4.75% for the year-ended December 31, 2019, primarily because of the 150 basis points Federal Reserve rate cut in March 2020 and the significant level of PPP loans originated by the Bank during 2020.

Interest expense on interest-bearing liabilities decreased by \$897,000 compared to the same period in 2019 as a result of the following:

- The cost of interest bearing liabilities dropped by 42 basis points to 1.05% for the year-ended December 31, 2020 compared to 1.48% for the year-ended December 31, 2019, as a result of the Company's continued efforts to build low cost relationship deposits and its disciplined approach to deposit pricing. Low cost relationship deposits grew by \$86,372,000, or 49.42%, from December 31, 2019, while higher cost time deposits decreased by \$32,275,000, or 23.52%, from December 31, 2019.

The following table illustrates average balances of total interest-earning assets and total interest-bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted-average yields and rates (dollars in thousands). The average balances used in these tables and other statistical data were calculated using daily average balances. We have no tax exempt assets for the periods presented.

Average Balance Sheets, Income and Expense, Yields and Rates

	Year Ended December 31, 2020			Year Ended December 31, 2019		
	Average Balance	Interest Income/Expense	Yield Rate	Average Balance	Interest Income/Expense	Yield Rate
Loans						
Commercial	\$ 162,160	\$ 5,826	3.59%	\$ 40,772	\$ 1,935	4.75%
Real estate – residential	87,554	4,304	4.92%	89,542	4,896	5.47%
Real estate – commercial	227,979	11,094	4.87%	216,482	11,090	5.12%
Real estate – construction	32,789	1,450	4.42%	34,932	1,624	4.65%
Student loans	31,646	1,339	4.23%	36,312	1,792	4.94%
Consumer	2,834	190	6.70%	2,261	169	7.47%
Gross loans	544,962	24,203	4.44%	420,301	21,506	5.12%
Investment securities	41,140	983	2.39%	44,853	1,117	2.49%
Loans held for sale	18,415	581	3.16%	13,279	539	4.06%
Federal funds and other	22,351	59	0.26%	15,570	325	2.09%
Total interest earning assets	626,868	25,826	4.12%	494,003	23,487	4.75%
Allowance for loan losses	(3,618)			(3,064)		
Cash and due from banks	9,607			9,960		
Premises and equipment, net	12,735			13,464		
Other assets	20,683			18,843		
Total assets	\$ 666,275			\$ 533,206		
Interest bearing deposits						
Interest checking	56,817	96	0.17%	48,123	85	0.18%
Money market	133,386	830	0.62%	101,037	838	0.83%
Savings	28,554	48	0.17%	23,381	40	0.17%
Certificates	130,643	2,124	1.63%	150,513	2,889	1.92%
Total deposits	349,400	3,098	0.89%	323,054	3,852	1.19%
Borrowings						
Long-term debt - trust preferred securities	8,773	228	2.60%	8,779	372	4.24%
FHLB advances	27,785	603	2.17%	22,693	692	3.05%
Subordinated debt, net	5,610	403	7.18%	5,578	403	7.22%
Other borrowings	28,948	101	0.35%	456	11	2.41%
Total interest bearing liabilities	420,516	4,433	1.05%	360,560	5,330	1.48%
Noninterest bearing deposits	192,660			127,667		
Other liabilities	5,527			4,868		
Total liabilities	618,703			493,095		
Equity capital	47,572			40,111		
Total liabilities and capital	\$ 666,275			\$ 533,206		
Net interest income before provision for loan losses		\$ 21,393			\$ 18,157	
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities			3.06%			3.27%
Net interest margin (net interest income expressed as a percentage of average earning assets)			3.41%			3.68%

Interest income and interest expense are affected by changes in both average interest rates and average volumes of interest-earning assets and interest-bearing liabilities. The following table analyzes changes in net interest income attributable to changes in the volume of interest-sensitive assets and liabilities compared to changes in interest rates. Nonaccrual loans are included in average loans outstanding. The changes in interest due to both rate and volume have been allocated to changes due to volume and changes due to rate in proportion to the relationship of the absolute dollar amounts of the changes in each (dollars in thousands).

	2020 vs. 2019		
	Increase (Decrease)		
	Due to Changes in		
	Volume	Rate	Total
Interest income			
Loans	\$ 3,925	\$ (1,228)	\$ 2,697
Investment securities	(90)	(44)	(134)
Loans held for sale	99	(57)	42
Fed funds sold and other	264	(530)	(266)
Total interest income	4,198	(1,859)	2,339
Interest expense			
Deposits			
Interest checking	14	(3)	11
Money market accounts	(36)	28	(8)
Savings accounts	9	(1)	8
Certificates of deposit	(354)	(411)	(765)
Total deposits	(367)	(386)	(754)
Borrowings			
Long-term debt	-	(144)	(144)
FHLB Advances	312	(401)	(89)
Subordinated debt, net	-	-	-
Other borrowings	90	-	90
Total interest expense	36	(932)	(897)
Net interest income	\$ 4,162	\$ (927)	\$ 3,236

Provision for loan losses

The amount of the loan loss provision is determined by an evaluation of the level of loans outstanding, the level of nonperforming loans, historical loan loss experience, delinquency trends, underlying collateral values, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions.

The level of the allowance reflects changes in the size of the portfolio or in any of its components as well as management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, and present economic, political and regulatory conditions. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company recorded a provision for loan losses of \$950,000 for the year ended December 31, 2020, as a result of growth in the loan portfolio and an increase in the qualitative factors due to the anticipated economic impact of COVID-19. The increase in the qualitative factors due to COVID-19 were a result of deterioration in local economic factors such as the higher levels of unemployment and the increased credit risk due to loan payment deferrals under the CARES Act. The Company believes the current level of

allowance for loan loss reserves are adequate to cover incurred losses. However, the full economic impact of the COVID-19 pandemic remains unknown and the Company will continue to monitor the loan portfolio for indicators that would warrant additional provisions for loan losses through 2021 and beyond. The Company recorded a provision for loan losses of \$135,000 for the year ended December 31, 2019 because of an increase in the specific reserves associated with a relationship evaluated individually for impairment.

For more financial data and other information about the provision for loan losses refer to section, “Balance Sheet Analysis” under this Item 7 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, and Note 4 “Allowance for Loan Losses” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Noninterest income

Noninterest income includes service charges and fees on deposit accounts, fee income related to loan origination, gains and losses on sale of mortgage loans and securities held for sale. The most significant noninterest income item has been mortgage banking income, net of commissions, representing 79% for the year ended December 31, 2020 and 64% for the year ended December 31, 2019.

	For the Year Ended		Change	
	December 31,		\$	%
	2020	2019		
	<i>(dollars in thousands)</i>			
Service charges and fees	\$ 2,073	\$ 2,099	\$ (26)	(1.2)%
Mortgage banking income, net	9,732	5,039	4,693	93.1%
Gain on sale of asset held for sale	1	-	1	100.0%
Gain on sale of investment securities	12	101	(89)	(88.1)%
Gain on sale of SBA loans	86	288	(202)	(70.1)%
Other	341	381	(40)	(10.5)%
Total noninterest income	<u>\$ 12,245</u>	<u>\$ 7,908</u>	<u>\$ 4,337</u>	<u>54.8%</u>

- The increase in mortgage banking income, net is a result of increased loan originations and sales compared to the prior year due to the low rate environment.
- The Company sold approximately \$8,000,000 and \$6,500,000 in investment securities resulting in a net gain of \$12,000 and \$101,000 during the years ended December 31, 2020 and 2019, respectively.
- The Company made the decision not to sell any SBA loan guarantee strips after the first quarter of 2020 which resulted in the recognition of \$86,000 for the year ended December 31, 2020, compared to the recognition of \$288,000 gain on sale for the year ended December 31, 2019.

Noninterest expense

Noninterest expense includes all expenses of the Company with the exception of interest expense on deposits and borrowings, provision for loan losses and income taxes. Some of the primary components of noninterest expense are salaries and benefits, occupancy and equipment costs and professional and outside services. Over the last two years, the most significant noninterest expense item has been salaries and benefits, representing 62% and 60% of noninterest expense in 2020 and 2019, respectively.

	For the Year Ended		Change	
	December 31,			
	2020	2019	\$	%
	<i>(dollars in thousands)</i>			
Salaries and benefits	\$ 12,920	\$ 12,241	\$ 679	5.5%
Occupancy	1,290	1,346	(56)	(4.2)%
Equipment	881	852	29	3.4%
Write down of assets held for sale	-	22	(22)	(100.0)%
Supplies	188	193	(5)	(2.6)%
Professional and outside services	3,104	3,036	68	2.2%
Advertising and marketing	365	293	72	24.6%
Foreclosed assets, net	(149)	17	(166)	(976.5)%
FDIC insurance premium	217	158	59	37.3%
Loss on debt extinguishment	696	-	696	100%
Other operating expense	2,137	2,131	6	0.3%
Total noninterest expense	\$ 21,649	\$ 20,289	\$ 1,360	6.7%

- The increase in salaries and benefits expense of \$679,000 was primarily driven by an increase in expenses related to mortgage production, as well as an increase in employee count to support several initiatives including expanding treasury management services, supporting information technology growth, and resources supporting PPP loan administration. These increases were offset by the deferral of \$1,052,000 in salary and benefits costs associated with the origination of over 1,500 PPP loans during 2020. The deferred costs will be recognized over the life of the PPP loans as a component of interest income along with the origination fees. This level of deferred costs is not expected to be recognized in future quarters and the recognition of the deferred costs and fees will accelerate as PPP loans are forgiven or repaid.
- The decrease in foreclosed assets, net expense was the result of the sale of two foreclosed properties resulting in a gain of \$175,000 during 2020.
- The increase in the FDIC insurance premium is related to the receipt of the small bank credit from the FDIC during 2019.
- The Loss on debt extinguishment during 2020 was the result of the Company prepaying the \$31,000,000 outstanding of its FHLB advances during three month period ended December 31, 2020. This pre-payment resulted in the recognition of approximately \$696,000 in prepayment fees. The pre-payment of the advances will save the Company approximately \$983,000 in interest expense over the remaining life of those advances, and will save approximately \$519,000 in interest expense during 2021.

Income taxes

The Company's effective tax rate, income tax as a percent of pre-tax income, may vary significantly from the statutory rate due to permanent difference and available tax credits. Income tax expense for the years ended December 31, 2020 and 2019, was \$2,485,000 and \$1,164,000, respectively, resulting in an effective tax rate of 22.5% and 20.6%, respectively. The increase in the effective tax rate was primarily related to a reduction in the tax credit received related to state taxes attributed to the Company and the mortgage banking segment. The Bank is not subject to Virginia income taxes, and instead is subject to a franchise tax based on bank capital.

The Company has a net deferred tax asset which is included in other assets on the balance sheet. For more financial data and other information about income taxes refer to Note 1 "Summary of Significant Accounting Policies" and Note 9 "Income Taxes" in the "Notes to Consolidated Financial Statements" contained in Item 8 of this Form 10-K.

Balance Sheet Analysis

Investment securities

At December 31, 2020 and 2019, all of our investment securities were classified as available for sale.

For more financial data and other information about investment securities refer to Note 1 “Summary of Significant Accounting Policies” and Note 2 “Investment Securities Available for Sale” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Loans

One of management’s objectives is to improve the quality of the loan portfolio. The Company seeks to achieve this objective by maintaining rigorous underwriting standards coupled with regular evaluation of the creditworthiness of and the designation of lending limits for each borrower. The portfolio strategies include seeking industry, loan type and loan size diversification in order to minimize credit concentration risk. Management also focuses on originating loans in markets with which the Company is familiar.

Approximately 62% of all loans are secured by mortgages on real property located principally in the Commonwealth of Virginia. Approximately 5% of the loan portfolio consists of rehabilitated student loans purchased by the Bank from 2014 to 2017 (see discussion following). The Company’s commercial and industrial loan portfolio represents approximately 32% of all loans. Loans in this category are typically made to individuals and small and medium-sized businesses, and range between \$250,000 and \$2.5 million. Based on underwriting standards, commercial and industrial loans may be secured in whole or in part by collateral such as liquid assets, accounts receivable, equipment, inventory, and real property. The collateral securing any loan may depend on the type of loan and may vary in value based on market conditions. The remainder of our loan portfolio is in consumer loans which represent less than 1% of the total.

The following tables present the composition of our loan portfolio at the dates indicated (dollars in thousands).

	December 31, 2020		December 31, 2019	
	Amount	%	Amount	%
Construction and land development				
Residential	\$ 8,103	1.44%	\$ 7,887	1.84%
Commercial	21,466	3.82%	24,063	5.60%
	<u>29,569</u>	<u>5.26%</u>	<u>31,950</u>	<u>7.44%</u>
Commercial real estate				
Owner occupied	99,784	17.79%	98,353	22.91%
Non-owner occupied	121,184	21.60%	116,508	27.14%
Multifamily	9,889	1.75%	13,332	3.10%
Farmland	367	0.07%	156	0.04%
	<u>231,224</u>	<u>41.21%</u>	<u>228,349</u>	<u>53.19%</u>
Consumer real estate				
Home equity lines	18,394	3.28%	21,509	5.01%
Secured by 1-4 family residential,				
First deed of trust	57,089	10.18%	55,856	13.01%
Second deed of trust	11,097	1.98%	10,411	2.43%
	<u>86,580</u>	<u>15.44%</u>	<u>87,776</u>	<u>20.45%</u>
Commercial and industrial loans (except those secured by real estate)	181,088	32.28%	45,074	10.50%
Guaranteed student loans	29,657	5.29%	33,525	7.81%
Consumer and other	<u>2,885</u>	<u>0.52%</u>	<u>2,621</u>	<u>0.61%</u>
Total loans	561,003	<u>100.0%</u>	429,295	<u>100.0%</u>
Deferred fees and costs, net	(2,048)		764	
Less: allowance for loan losses	<u>(3,970)</u>		<u>(3,186)</u>	
	<u>\$ 554,985</u>		<u>\$ 426,873</u>	

The Bank originated \$185,137,000 in PPP loans as of December 31, 2020. These loans have provided essential funds to approximately 1,500 businesses and nonprofits and protected more than 20,000 jobs in our community. The Bank is participating in the second round of PPP funding approved by Congress and signed into law by the President of the United States of America on December 27, 2020. The processing fees earned on the PPP loans will help to support the Bank’s loan deferral program and potential credit losses associated with the COVID-19 pandemic. Below is a breakdown of PPP loans by loan size as of December 31, 2020 (dollars in thousands):

Loan Size	# of Loans	\$ of Loans
< \$350,000	1,172	\$ 72,526
\$350,000 - \$2 million	57	41,046
> \$2 million	6	23,102
Total	1,235	\$ 136,674

For more financial data and other information about loans refer to Note 1 “Summary of Significant Accounting Policies” and Note 3 “Loans” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Allowance for loan losses

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. For more financial data and other information about loans refer to Note 1 “Summary of Significant Accounting Policies” and Note 4 “Allowance for Loan Losses” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Asset quality

The following table summarizes asset quality information at the dates indicated (dollars in thousands).

	December 31,	
	2020	2019
Nonaccrual loans	\$ 1,577	\$ 1,868
Foreclosed properties	336	526
Total nonperforming assets	\$ 1,913	\$ 2,394
Restructured loans (not included in nonaccrual loans above)	\$ 6,550	\$ 7,059
Loans past due 90 days and still accruing ⁽¹⁾	\$ 2,193	\$ 2,567
Nonperforming assets to loans ⁽²⁾	0.34%	0.56%
Nonperforming assets to total assets	0.27%	0.44%
Allowance for loan losses to nonaccrual loans	251.75%	170.57%

⁽¹⁾ All loans 90 days past due and still accruing are rehabilitated student loans which have a 98% guarantee by the DOE.

⁽²⁾ Loans are net of unearned income and deferred cost.

Nonperforming assets totaled \$1,913,000 at December 31, 2020, compared to \$2,394,000 at December 31, 2019. Nonperforming assets at December 31, 2020 consisted primarily of \$1,577,000 in nonaccrual loans, compared to \$1,868,000 at December 31, 2019

The following table presents an analysis of the changes in nonperforming assets for 2020 (in thousands).

	Nonaccrual		
	Loans	OREO	Total
Balance December 31, 2019	\$ 1,868	\$ 526	\$ 2,394
Additions	1,446	-	1,446
Loans placed back on accrual	(1,080)	-	(1,080)
Transfers to OREO	-	-	-
Repayments	(191)	-	(191)
Charge-offs	(466)	(16)	(482)
Sales	-	(174)	(174)
Balance December 31, 2020	\$ 1,577	\$ 336	\$ 1,913

Nonperforming restructured loans are included in nonaccrual loans. Until a nonperforming restructured loan has performed in accordance with its restructured terms for a minimum of six months, it will remain on nonaccrual status.

Interest is accrued on outstanding loan principal balances, unless the Company considers collection to be doubtful. Commercial and unsecured consumer loans are designated as nonaccrual when the Company considers collection of expected principal and interest doubtful. Mortgage loans and most other types of consumer loans past due 90 days or more may remain on accrual status if management determines that concern over our ability to collect principal and interest is not significant. When loans are placed in nonaccrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received. Interest accruals are resumed on such loans only when in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

There were no specific allowances associated with the total nonaccrual loans of \$1,577,000 at December 31, 2020 that were considered impaired. This compares to \$1,868,000 in nonaccrual loans at December 31, 2019 of which one loan had specific allowances for loan losses of \$135,000. This loan was charged off during 2020.

Cumulative interest income that would have been recorded had nonaccrual loans been performing would have been \$84,000 and \$136,000 for 2020 and 2019, respectively. Student loans totaling \$2,193,000 and \$2,567,000 at December 31, 2020 and 2019, respectively, were past due 90 days or more and interest was still being accrued as principal and interest on such loans have a 98% guarantee by the DOE. The 2% not covered by the DOE guarantee is provided for in the allowance for loan losses.

Deposits

The following table gives the composition of our deposits at the dates indicated (dollars in thousands).

	December 31, 2020		December 31, 2019	
	Amount	%	Amount	%
Demand accounts	\$ 222,305	37.8%	\$ 131,228	29.6%
Interest checking accounts	70,342	11.9%	48,427	10.9%
Money market accounts	152,726	26.0%	99,955	22.6%
Savings accounts	38,083	6.5%	26,396	6.0%
Time deposits of \$250,000 and over	16,014	2.7%	22,327	5.0%
Other time deposits	88,912	15.1%	114,875	25.9%
Total	\$ 588,382	100.0%	\$ 443,208	100.0%

Total deposits increased by \$145,174,000, or 32.76%, from December 31, 2019. Variances of note are as follows:

- Noninterest bearing demand account balances increased \$91,077,000 from December 31, 2019, and represented 37.78% of total deposits at December 31, 2020 compared to 29.61% as of December 31, 2019. The increase in noninterest bearing deposits from December 31, 2019 was primarily a result of the Bank converting a significant portion of non-customer PPP loan applicants into customers.
- Low cost relationship deposits (i.e. interest checking, money market, and savings) balances increased \$86,372,000, or 49.42%, from December 31, 2019. The increase in these accounts during 2020 was primarily a result of continued growth in accounts from non-customer PPP loan applicants and the migration of customer funds from time deposits.
- Time deposits decreased by \$32,275,000, or 23.52%, from December 31, 2019. The decrease in time deposits was a result of our disciplined approach to deposit pricing to reduce our overall cost of funds and the migration of customers from time deposits to lower cost deposit products.

The variety of deposit accounts that we offer has allowed us to be competitive in obtaining funds and has allowed us to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of funds away from depository institutions such as banking institutions into direct investment vehicles such as government and corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, and is expected to continue to be, significantly affected by money market conditions.

Borrowings

The Company prepaid all \$31 million of its outstanding FHLB advances during the three month period ended December 31, 2020. This pre-payment resulted in the recognition of a loss on debt extinguishment of approximately \$696,000. The pre-payment of the advances will save the Company approximately \$983,000 in interest expense over the remaining life of those advances, and will save approximately \$519,000 in interest expense during 2021.

We utilize borrowings to supplement deposits to address funding or liability duration needs. For more financial data and other information about borrowings refer to Note 8 “Borrowings” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Off-balance sheet arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. For more financial data and other information about loans refer to Note 12 “Commitments and Contingencies” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Capital resources

Shareholders’ equity at December 31, 2020 was \$51,996,000, compared to \$42,914,000 at December 31, 2019. The \$9,082,000 increase in shareholders’ equity during 2020 is primarily due to net income for the year of \$8,554,000.

The following table presents the composition of regulatory capital and the capital ratios for the Bank at the dates indicated (dollars in thousands).

	December 31,	
	2020	2019
Tier 1 capital		
Total bank equity capital	\$ 62,183	\$ 53,768
Net unrealized gain on available-for-sale securities	(466)	(186)
Defined benefit postretirement plan	36	44
Disallowed deferred tax asset	-	(759)
Total Tier 1 capital	<u>61,753</u>	<u>52,867</u>
Tier 2 capital		
Allowance for loan losses	3,970	3,186
Tier 2 capital deduction	-	(1,400)
Total Tier 2 capital	<u>3,970</u>	<u>1,786</u>
Total risk-based capital	<u>65,723</u>	<u>54,653</u>
Risk-weighted assets	<u>\$ 462,690</u>	<u>\$ 435,082</u>
Average assets	<u>\$ 665,172</u>	<u>\$ 545,567</u>
Capital ratios		
Leverage ratio (Tier 1 capital to average assets)	9.28%	9.69%
Common equity tier 1 capital ratio (CET 1)	13.35%	12.15%
Tier 1 capital to risk-weighted assets	13.35%	12.15%
Total capital to risk-weighted assets	14.20%	12.56%
Equity to total assets	8.81%	10.00%

For more financial data and other information about capital resources refer to Note 13 “Shareholders’ Equity and Regulatory Matters” and Note 15 “Trust Preferred Securities” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

Liquidity

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time

investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

At December 31, 2020 and 2019, our liquid assets, consisting of cash, cash equivalents and investment securities available for sale, totaled \$84,295,000 and \$66,904,000, or 11.94% and 12.38% of total assets, respectively. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner.

Our holdings of liquid assets plus the ability to maintain and expand our deposit base and borrowing capabilities serve as our principal sources of liquidity. We plan to meet our future cash needs through the liquidation of temporary investments, the generation of deposits, and from additional borrowings. In addition, we will receive cash upon the maturity and sale of loans and the maturity of investment securities. We maintain two federal funds lines of credit with correspondent banks totaling \$15 million for which there were no borrowings against at December 31, 2020 and \$5,317,000 borrowings against the lines at December 31, 2019.

We are also a member of the Federal Home Loan Bank of Atlanta (“FHLB”), from which applications for borrowings can be made. The FHLB requires that securities, qualifying mortgage loans, and stock of the FHLB owned by the Bank be pledged to secure any advances from the FHLB. The unused borrowing capacity currently available from the FHLB at December 31, 2020 was \$50.3 million, based on the Bank's qualifying collateral available to secure any future borrowings. However, we are able to pledge additional collateral to the FHLB in order to increase our available borrowing capacity up to 25% of assets.

We also have access to the Federal Reserve’s PPPLF, from which applications for borrowings can be made. The Federal Reserve requires that PPP loans be pledged to secure any advances from the PPPLF. The Company currently has \$41,529,000 in borrowings against the PPPLF and an unused borrowing capacity of \$95,145,000 based on unpledged PPP loans available to secure any future borrowings. The Company has access to this facility until March 31, 2021 at which time the Federal Reserve will no longer take requests for borrowings.

Liquidity provides us with the ability to meet normal deposit withdrawals, while also providing for the credit needs of customers. We are committed to maintaining liquidity at a level sufficient to protect depositors, provide for reasonable growth, and fully comply with all regulatory requirements.

At December 31, 2020, we had commitments to originate \$150,974,000 of loans. Fixed commitments to incur capital expenditures were approximately \$400,000 at December 31, 2020. Certificates of deposit scheduled to mature or reprice in the 12-month period ending December 31, 2021 total \$75,413,000. We believe that a significant portion of such deposits will remain with us. We further believe that deposit growth, loan repayments and other sources of funds will be adequate to meet our foreseeable short-term and long-term liquidity needs.

Interest Rate Sensitivity

An important element of asset/liability management is the monitoring of our sensitivity to interest rate movements. In order to measure the effects of interest rates on our net interest income, management takes into consideration the expected cash flows from the securities and loan portfolios and the expected magnitude of the repricing of specific asset and liability categories. We evaluate interest sensitivity risk and then formulate guidelines to manage this risk based on management’s outlook regarding the economy, forecasted interest rate movements and other business factors. Our goal is to maximize and stabilize the net interest margin by limiting exposure to interest rate changes.

Contractual principal repayments of loans do not necessarily reflect the actual term of our loan portfolio. The average lives of mortgage loans are substantially less than their contractual terms because of loan prepayments and because of enforcement of due-on-sale clauses, which gives us the right to declare a loan immediately due and payable in the event, among other things, the borrower sells the real property subject

to the mortgage and the loan is not repaid. In addition, certain borrowers increase their equity in the security property by making payments in excess of those required under the terms of the mortgage.

The sale of fixed rate loans is intended to protect us from precipitous changes in the general level of interest rates. The valuation of adjustable rate mortgage loans is not as directly dependent on the level of interest rates as is the value of fixed rate loans. As with other investments, we regularly monitor the appropriateness of the level of adjustable rate mortgage loans in our portfolio and may decide from time to time to sell such loans and reinvest the proceeds in other adjustable rate investments.

Impact of inflation and changing prices

The Company's financial statements included herein have been prepared in accordance with GAAP, which require the Company to measure financial position and operating results primarily in terms of historical dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities.

LIBOR and Other Benchmark Rates

Following the announcement by the U.K.'s Financial Conduct Authority in July 2017 that it will no longer persuade or require banks to submit rates for LIBOR after 2021, central banks and regulators around the world have commissioned working groups to find suitable replacements for Interbank Offered Rates ("IBOR") and other benchmark rates and to implement financial benchmark reforms more generally. These actions have resulted in uncertainty regarding the use of alternative reference rates ("ARRs") and could cause disruptions in a variety of markets, as well as adversely impact our business, operations and financial results.

To facilitate an orderly transition from IBORs and other benchmark rates to ARRs, the Company has established a company-wide initiative led by senior management. The objective of this initiative is to identify and assess the Company's exposure and develop an appropriate action plan to address this exposure prior to transition.

Critical Accounting Policies and Estimates

General

The accounting and reporting policies of the Company and the Bank are in accordance with GAAP and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities, and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's consolidated financial position and/or results of operations.

The more critical accounting and reporting policies include the Company's accounting for the allowance for loan losses and income taxes. The Company's accounting policies are fundamental to understanding the Company's consolidated financial position and consolidated results of operations. Accordingly, the Company's significant accounting policies are discussed in detail in Note 1 "Summary of Significant

Accounting Policies” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

The following is a summary of the Company’s critical accounting policies that are highly dependent on estimates, assumptions, and judgments.

Allowance for loan losses

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. We maintain policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance they are maintained in accordance with GAAP; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system.

The allowance reflects management’s best estimate of probable losses within the existing loan portfolio and of the risk inherent in various components of the loan portfolio, including loans identified as impaired as required by Financial Accounting Standards Board Codification Topic 310: Receivables. Loans evaluated individually for impairment include nonperforming loans, such as loans on nonaccrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment.

Loans are grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon historical net charge-off rates, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amounts of estimated impairment for individually evaluated loans and groups of loans are added together for a total estimate of loan losses. This estimate of losses is compared to our allowance for loan losses as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and evaluated by management. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the financial statements.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, 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 or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance may be established. Management considers the determination of this valuation allowance to be a critical accounting policy due to the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These

judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amounts of taxes recoverable through loss carry forwards decline, or if management projects lower levels of future taxable income.

New accounting standards

For information regarding recent accounting pronouncements and their effect on us, see “New Accounting Pronouncements” in Note 1 “Summary of Significant Accounting Policies” in the “Notes to Consolidated Financial Statements” contained in Item 8 of this Form 10-K.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements and related footnotes of the Company are presented following.



Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors
Village Bank and Trust Financial Corp.
Midlothian, Virginia

Opinion on the Consolidated Financial Statements

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

Basis for Opinion

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

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion.

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

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our

especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses – Qualitative Factors

As described in Note 1 – Summary of Significant Accounting Policies and Note 4 – Allowance for Loan Losses to the consolidated financial statements, the Corporation maintains an allowance for loan losses that represents management’s best estimate of probable losses inherent in the loan portfolio. For loans that are not specifically identified for impairment, management determines the allowance for loan losses based on historical loss experience adjusted for qualitative factors. Qualitative adjustments to the historical loss experience are established by applying a loss percentage to the loan segments established by management based on their assessment of shared risk characteristics within groups of similar loans.

Qualitative factors are determined based on management’s continuing evaluation of inputs and assumptions underlying the quality of the loan portfolio. Management evaluates qualitative factors by loan segment, primarily considering changes in lending policies and procedures, current economic conditions, the nature and volume of loans, the experience and depth of the lending team, delinquency trends, the loan review system, collateral values, the existence and effect of concentrations, and other external factors. Qualitative factors contribute significantly to the allowance for loan losses. Management exercised significant judgment when assessing the qualitative factors in estimating the allowance for loan losses. We identified the assessment of the qualitative factors as a critical audit matter as auditing the qualitative factors involved especially complex and subjective auditor judgment in evaluating management’s assessment of the inherently subjective estimates.

The primary audit procedures we performed to address this critical audit matter included:

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

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

We have served as the Company's auditor since 2018.

Richmond, Virginia
March 19, 2021

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
December 31, 2020 and 2019

(in thousands, except share and per share data)

	2020	2019
Assets		
Cash and due from banks	\$ 12,709	\$ 19,967
Federal funds sold	30,742	-
Total cash and cash equivalents	43,451	19,967
Investment securities available for sale, at fair value	40,844	46,937
Restricted stock, at cost	825	2,035
Loans held for sale	34,421	12,722
Loans		
Outstandings	561,003	429,295
Allowance for loan losses	(3,970)	(3,186)
Deferred fees and costs, net	(2,048)	764
Total loans, net	554,985	426,873
Other real estate owned, net of valuation allowance	336	526
Assets held for sale	-	514
Premises and equipment, net	11,779	12,036
Bank owned life insurance	7,806	7,612
Accrued interest receivable	4,943	2,597
Other assets	6,846	8,494
	\$ 706,236	\$ 540,313
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing demand	\$ 222,305	\$ 131,228
Interest bearing	366,077	311,980
Total deposits	588,382	443,208
Federal Home Loan Bank advances	-	29,000
Long-term debt - trust preferred securities	8,764	8,764
Subordinated debt, net	5,628	5,595
Other borrowings	41,529	5,317
Accrued interest payable	194	221
Other liabilities	9,743	5,294
Total liabilities	654,240	497,399
Shareholders' equity		
Common stock, \$4 par value, 10,000,000 shares authorized;		
1,466,516 shares issued and outstanding at December 31, 2020 and		
1,435,009 shares issued and outstanding at December 31, 2019	5,794	5,779
Additional paid-in capital	54,510	54,285
Accumulated deficit	(8,738)	(17,292)
Stock in directors rabbi trust	(771)	(856)
Directors deferred fees obligation	771	856
Accumulated other comprehensive income	430	142
Total shareholders' equity	51,996	42,914
	\$ 706,236	\$ 540,313

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Income
Years Ended December 31, 2020 and 2019
(in thousands, except per share data)

	2020	2019
Interest income		
Loans	\$ 24,784	\$ 22,045
Investment securities	983	1,117
Federal funds sold	59	325
Total interest income	<u>25,826</u>	<u>23,487</u>
Interest expense		
Deposits	3,098	3,852
Borrowed funds	1,335	1,478
Total interest expense	<u>4,433</u>	<u>5,330</u>
Net interest income	21,393	18,157
Provision for loan losses	950	135
Net interest income after provision for loan losses	<u>20,443</u>	<u>18,022</u>
Noninterest income		
Service charges and fees	2,073	2,099
Mortgage banking income, net	9,732	5,039
Gain on sale of asset held for sale	1	-
Gain on sale of investment securities, net	12	101
Gain on sale of Small Business Administration loans	86	288
Other	341	381
Total noninterest income	<u>12,245</u>	<u>7,908</u>
Noninterest expense		
Salaries and benefits	12,920	12,241
Occupancy	1,290	1,346
Equipment	881	852
Write down of assets held for sale	-	22
Supplies	188	193
Professional and outside services	3,104	3,036
Advertising and marketing	365	293
Foreclosed assets, net	(149)	17
FDIC insurance premium	217	158
Loss on debt extinguishment	696	-
Other operating expense	2,137	2,131
Total noninterest expense	<u>21,649</u>	<u>20,289</u>
Income before income tax expense	11,039	5,641
Income tax expense	2,485	1,164
Net income	<u>8,554</u>	<u>4,477</u>
Earnings per share, basic	\$ 5.86	\$ 3.10
Earnings per share, diluted	<u>\$ 5.86</u>	<u>\$ 3.10</u>

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2020 and 2019

(in thousands)

	2020	2019
Net income	\$ 8,554	\$ 4,477
Other comprehensive income		
Unrealized holding gains arising during the period	365	1,218
Tax effect	(77)	(256)
Net change in unrealized holding gains on securities available for sale, net of tax	288	962
Reclassification adjustment		
Reclassification adjustment for gains realized in income	(12)	(101)
Tax effect	3	21
Reclassification for gains included in net income, net of tax	(9)	(80)
Minimum pension adjustment	14	14
Tax effect	(5)	(5)
Minimum pension adjustment, net of tax	9	9
Total other comprehensive income	288	891
Total comprehensive income	\$ 8,842	\$ 5,368

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2020 and 2019

(in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Common Stock Warrant	Stock in Directors Rabbi Trust	Directors Deferred Fees Obligation	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2018	\$ 5,707	\$ 53,212	\$ (21,769)	\$ 732	\$ (883)	\$ 883	\$ (749)	\$ 37,133
Restricted stock redemption	-	-	-	-	27	(27)	-	-
Vesting of restricted stock	72	(72)	-	-	-	-	-	-
Stock based compensation	-	413	-	-	-	-	-	413
Expiration of common stock warrant	-	732	-	(732)	-	-	-	-
Net income	-	-	4,477	-	-	-	-	4,477
Other comprehensive income	-	-	-	-	-	-	891	891
Balance, December 31, 2019	\$ 5,779	\$ 54,285	\$ (17,292)	\$ -	\$ (856)	\$ 856	\$ 142	\$ 42,914
Vesting of restricted stock	15	(15)	-	-	85	(85)	-	-
Stock based compensation	-	240	-	-	-	-	-	240
Net income	-	-	8,554	-	-	-	-	8,554
Other comprehensive income	-	-	-	-	-	-	288	288
Balance, December 31, 2020	\$ 5,794	\$ 54,510	\$ (8,738)	\$ -	\$ (771)	\$ 771	\$ 430	\$ 51,996

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2020 and 2019

(in thousands)

	2020	2019
Cash Flows from Operating Activities		
Net income	\$ 8,554	\$ 4,477
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	586	644
Amortization of debt issuance costs	32	32
Deferred income taxes	2,393	1,197
Provision for loan losses	950	135
Write-down of other real estate owned	16	40
Gain on sale of investment securities	(12)	(101)
Gain on sales of loans held for sale	(11,703)	(6,205)
Gain on sale of assets held for sale	(1)	-
Gain on sale of other real estate owned	(175)	-
Losses on debt extinguishment	696	-
Stock compensation expense	240	413
Proceeds from sale of mortgage loans	361,393	203,108
Origination of mortgage loans held for sale	(371,389)	(203,497)
Amortization of premiums and accretion of discounts on securities, net	209	218
Increase in bank owned life insurance	(194)	(171)
Net change in:		
Interest receivable	(2,346)	65
Other assets	(810)	(2,366)
Interest payable	(27)	-
Other liabilities	4,449	2,156
Net cash (used in) provided by operating activities	(7,139)	145
Cash Flows from Investing Activities		
Purchases of available for sale securities	(11,914)	(13,352)
Proceeds from the sale of available for sale securities	7,936	6,491
Proceeds from the sale of assets held for sale	515	-
Proceeds from maturities, calls and paydowns of available for sale securities	10,227	5,177
Net increase in loans	(129,062)	(14,916)
Proceeds from sale of other real estate owned	349	-
Purchases of premises and equipment, net	(329)	(225)
Redemptions (purchase) of restricted stock, net	1,210	(374)
Net cash used in investing activities	(121,068)	(17,199)
Cash Flows from Financing Activities		
Net increase in deposits	145,174	4,161
Proceeds from issuance (repayments) of Federal Home Loan Bank advances	(29,696)	8,000
Net increase in other borrowings	36,213	5,317
Net cash provided by financing activities	151,691	17,478
Net increase in cash and cash equivalents	23,484	424
Cash and cash equivalents, beginning of period	19,967	19,543
Cash and cash equivalents, end of period	\$ 43,451	\$ 19,967
Supplemental Disclosure of Cash Flow Information		
Cash payments for interest	\$ 5,156	\$ 3,958
Supplemental Schedule of Non-Cash Activities		
Unrealized gains on securities available for sale	\$ 353	\$ 1,117
Right of use assets obtained in exchange for new operating lease liabilities	\$ 303	\$ 1,405
Minimum pension adjustment	\$ 14	\$ 14

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Notes to Consolidated Financial Statements
Years Ended December 31, 2020 and 2019

Note 1. Summary of Significant Accounting Policies

The accounting and reporting policies of Village Bank and Trust Financial Corp. and subsidiary (the “Company”) conform to accounting principles generally accepted in the United States of America (“GAAP”) and to general practice within the banking industry. The following is a description of the more significant of those policies:

Business

The Company is the holding company of Village Bank (the “Bank”). The Bank opened to the public on December 13, 1999 as a traditional community bank offering deposit and loan services to individuals and businesses in the Richmond, Virginia metropolitan area. In 2017, the Bank entered the Williamsburg, Virginia market by opening a full service branch. Village Bank Mortgage Corporation (the “Mortgage Company”) is a full service mortgage banking company wholly-owned by the Bank.

The Bank is subject to regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. As a consequence of the extensive regulation of commercial banking activities, the Bank’s business is susceptible to being affected by state and federal legislation and regulations.

The majority of the Company’s real estate loans are collateralized by properties in the Richmond, Virginia metropolitan area. Accordingly, the ultimate collectability of those loans collateralized by real estate is particularly susceptible to changes in market conditions in the Richmond area.

Basis of presentation and consolidation

The consolidated financial statements include the accounts of the Company, the Bank and the Mortgage Company. All material intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior year financial statements to conform to current year presentation. The results of the reclassifications are not considered material.

Use of estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the balance sheets dates and revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses and its related provision, including impaired loans, the valuation of deferred tax assets, and the estimate of the fair value of assets held for sale.

Securities

At the time of purchase, debt securities are classified into the following categories: held to maturity, available for sale or trading. Debt securities that the Company has both the positive intent and ability to hold to maturity are classified as held to maturity. Held to maturity securities are stated at amortized cost adjusted for amortization of premiums and accretion of discounts on purchase using a method that approximates the effective interest method. Investments classified as trading or available for sale are stated at fair value. Changes in fair value of trading investments are included in current earnings while changes in fair value of available for sale investments are excluded from current earnings and reported, net of taxes,

as a separate component of other comprehensive income. Presently, the Company does not maintain a portfolio of trading securities or held to maturity.

The fair value of investment securities available for sale is estimated based on quoted prices for similar assets determined by bid quotations received from independent pricing services. Declines in the fair value of securities below their amortized cost that are other than temporary are reflected in earnings or other comprehensive income, as appropriate. For those debt securities whose fair value is less than their amortized cost basis, we consider our intent to sell the security, whether it is more likely than not that we will be required to sell the security before recovery and if we do not expect to recover the entire amortized cost basis of the security. In analyzing an issuer's financial condition, we may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition.

Restricted stock, at cost. The Company is required to maintain an investment in the capital stock of certain correspondent banks. The Company's investment in these securities is recorded at cost.

Interest income is recognized when earned. Realized gains and losses for securities classified as available-for-sale are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Mortgage Banking and Derivatives

Loans held for sale. The Company, through the Bank's mortgage banking subsidiary, the Mortgage Company, originates residential mortgage loans for sale in the secondary market. Residential mortgage loans held for sale are sold to the permanent investor with the mortgage servicing rights released. During the first quarter of 2020, the Company elected to begin using fair value accounting for its entire portfolio of loans held for sale ("LHFS") in accordance with Accounting Standards Codification ("ASC") 820 - Fair Value Measurement and Disclosures. Fair value of the Company's LHFS is based on observable market prices for the identical instruments traded in the secondary mortgage loan markets in which the Company conducts business and totaled \$34.4 million as of December 31, 2020, of which \$32.9 million is related to unpaid principal. The Company's portfolio of LHFS is classified as Level 2. These loans were previously carried as of December 31, 2019 at the lower of cost or estimated fair value on an aggregate basis as determined by outstanding commitments from investors and totaled \$12.7 million.

Interest Rate Lock Commitments and Forward Sales Commitments. The Company, through the Mortgage Company, enters into commitments to originate residential mortgage loans in which the interest rate on the loan is determined prior to funding, termed interest rate lock commitments ("IRLCs"). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. Upon entering into a commitment to originate a loan, the Company protects itself from changes in interest rates during the period prior to sale by requiring a firm purchase agreement from a permanent investor before a loan can be closed (forward sales commitment). The Company locks in the loan and rate with an investor and commits to deliver the loan if settlement occurs on a best efforts basis, thus limiting interest rate risk. Certain additional risks exist if the investor fails to meet its purchase obligation; however, based on historical performance and the size and nature of the investors the Company does not expect them to fail to meet their obligation. The Company determines the fair value of IRLCs based on the price of the underlying loans obtained from an investor for loans that will be delivered on a best efforts basis while taking into consideration the probability that the rate lock commitments will close. The fair value of these derivative instruments is reported in "Other Assets" in the Consolidated Balance Sheet at December 31, 2020, and totaled \$1.6 million, with a notional amount of \$38.9 million and total positions of 150. The fair value of IRLCs was considered immaterial at December 31, 2019. Changes in fair value are recorded as a component of mortgage banking income, net in the Consolidated Income Statement for the period ended December 31, 2020. The Company's IRLCs are classified as Level 2. At December 31, 2020 and December 31, 2019, each IRLC and all LHFS were subject to a forward sales commitment on a best efforts basis.

During the first quarter of 2020, the Company elected to begin using fair value accounting for its forward sales commitments related to IRLCs and LHFS under ASC 825-10-15-4(b). The fair value of forward sales commitments is reported in “Other Liabilities” in the Consolidated Balance Sheet at December 31, 2020, and totaled \$3.1 million, with a notional amount of \$71.7 million and total positions of 289. The fair value of the forward sales commitments was considered immaterial at December 31, 2019.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank and put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets. Our transfers of financial assets are limited to commercial loan participations sold, which were insignificant for 2020 and 2019, and the sale of residential mortgage loans in the secondary market; the extent of which are disclosed in the Consolidated Statements of Cash Flows.

Loans

Loans are stated at the principal amount outstanding, net of unearned income. Loan origination fees and certain direct loan origination costs are deferred and amortized to interest income over the life of the loan as an adjustment to the loan’s yield over the term of the loan.

A loan’s past due status is based on the contractual due date of the most delinquent payment dates. Interest is accrued on outstanding principal balances, unless the Company considers collection to be doubtful. Commercial and unsecured consumer loans are designated as nonaccrual when payment is delinquent 90 days or at the point which the Company considers collection doubtful, if earlier. Mortgage loans and most other types of consumer loans past due 90 days or more may remain on accrual status if management determines that such amounts are collectible. When loans are placed in nonaccrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received as long as the remaining recorded investment in the loan is deemed fully collectible. Loans may be placed back on accrual status when, in the opinion of management, the circumstances warrant such action such as a history of timely payments subsequent to being placed on nonaccrual status, additional collateral is obtained or the borrowers cash flows improve.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The total contractual amount of standby letters of credit, whose contract amounts represent credit risk, was approximately \$4,934,000 at December 31, 2020 and approximately \$6,732,000 at December 31, 2019.

Below is a summary of the current loan segments:

Construction and land development loans consist primarily of loans for the purchase or refinance of unimproved lots or raw land. Additionally, the Company finances the construction of real estate projects typically where the permanent mortgage will remain with the Company. Specific underwriting guidelines are delineated in the Bank’s loan policies. Construction and land development loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those specific to real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on cash flows, collateral, geography and risk grade criteria. Commercial real estate loans carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because the repayment of these loans may be dependent upon the profitability and cash flows of the business or project.

Consumer real estate loans include consumer purpose 1-to-4 family residential properties and home equity loans. Consumer purpose loans have underwriting standards that are heavily influenced by statutory requirements, which include, but are not limited to, documentation requirements, limits on maximum loan-to-value percentages, and collection remedies. Loans to finance 1-4 family investment properties are primarily dependent upon rental income generated from the property and secondarily supported by the borrower's personal income. The Company typically originates residential mortgages through our mortgage company and these loans are sold to secondary mortgage market correspondents. Consumer real estate loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

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

Consumer and other loans are generally small loans spread across many borrowers and are underwritten after determining the ability of the consumer borrower to repay their obligations as agreed. The underwriting standards are influenced by credit history, ability to repay, and loan-to-value. Consumer loans may be secured or unsecured and are comprised of revolving lines, installment loans and other consumer loans. Consumer and other loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral, or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

Guaranteed student loans The Bank purchases Federal Rehabilitated Student Loan portfolios when approved by the Board of Directors. These loans are guaranteed by the U.S. Department of Education ("DOE") which covers approximately 98% of the principal and interest. These loans are serviced by a third party servicer that specializes in handling these types of loans.

We also purchase the guaranteed portion of United State Department of Agriculture Loans ("USDA") which are guaranteed by the USDA for 100% of the principal and interest. The originating institution holds the unguaranteed portion of the loan and services the loan. These loans are typically purchased at a premium. In the event of a loan default or early prepayment the Bank may need to write off any unamortized premium. These loans are included in the commercial and industrial loan segment.

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 probable. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of general and specific components. The general component covers non-classified loans and is based on historical loss experience and risk characteristics (i.e. trends in delinquencies and other nonperforming loans, changes in economic conditions on both a local and national level, and changes in the categories of loans comprising the loan portfolio) adjusted for qualitative factors. The specific component relates to loans that we have concluded, based on the value of collateral, guarantees and any other pertinent factors, have known losses. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

Troubled debt restructurings

A loan or lease is accounted for as a TDR if we, for economic or legal reasons related to the borrower's financial condition, grant a significant concession to the borrower that we would not otherwise consider. A TDR may involve the receipt of assets from the debtor in partial or full satisfaction of the loan or lease, or a modification of terms such as a reduction of the stated interest rate or balance of the loan or lease, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. TDRs generally remain categorized as nonperforming loans and leases until a six-month payment history has been maintained.

In accordance with current accounting guidance, loans modified as troubled debt restructurings are, by definition, considered to be impaired loans. Impairment for these loans is measured on a loan-by-loan basis similar to other impaired loans as described above under "*Allowance for loan losses*". Certain loans modified as TDRs may have been previously measured for impairment under a general allowance

methodology (i.e., pooling), thus at the time the loan is modified as a TDR the allowance will be impacted by the difference between the results of these two measurement methodologies. Loans modified as TDRs that subsequently default are factored into the determination of the allowance in the same manner as other defaulted loans.

Loan modifications made under the March 22 Joint Guidance and CARES Act, as amended by the CAA, were suspended from TDR evaluation.

Other real estate owned

Real estate acquired through or in lieu of foreclosure is initially recorded at estimated fair value less estimated selling costs establishing a new cost basis. Subsequent to the date of acquisition, it is carried at the lower of cost or fair value, adjusted for net selling costs. If fair value declines subsequent to foreclosure a valuation allowance is recorded through expense. Operating costs after acquisition are expensed as incurred. The valuation allowance was \$10,000 and \$52,000 at December 31, 2020 and 2019, respectively. Costs relating to the development and improvement of such property are capitalized when appropriate, whereas those costs relating to holding the property are expensed.

Assets held for sale

There were no assets held for sale at December 31, 2020. Assets held for sale at December 31, 2019 included a branch building we previously closed. The Company periodically evaluates the value of assets held for sale and records an impairment charge for any subsequent declines in fair value less selling costs.

Premises and equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation of buildings and improvements is computed using the straight-line method over the estimated useful lives of the assets of 39 years. Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets ranging from three to seven years. Amortization of premises (leasehold improvements) is computed using the straight-line method over the term of the lease or estimated lives of the improvements, whichever is shorter.

Supplemental Executive Retirement Plan

The Company recognizes the unfunded status of its Supplemental Executive Retirement Plan (the “SERP”) as a liability in its Consolidated Balance Sheets, measured at the projected benefit obligation as of December 31, 2020 and 2019. Net periodic pension costs are recorded each period based on actuarially determined amounts in accordance with GAAP and recognized in salaries and employment benefits in the Consolidated Statements of Income. Actuarial determinations of net periodic pension cost are based on assumptions related to discount rates, employee compensation and mortality and interest crediting rates. Other changes in the status of the plan are recorded in the year in which the changes occur through other comprehensive income.

Income taxes

Deferred income taxes are recognized for the tax consequences of “temporary differences” by applying enacted tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on recorded deferred income taxes of a change in tax laws or rates is recognized in income in the period that includes the enactment date. To the extent that available evidence about the future raises doubt about the realization of a deferred income tax asset, a valuation allowance is established. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit

is recorded. Interest and penalties associated with unrecognized tax benefits are classified as taxes other than income in the statement of income. The Company has no uncertain tax positions.

Consolidated statements of cash flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, due from banks (including cash items in process of collection), interest-bearing deposits with banks and federal funds sold. Generally, federal funds are purchased and sold for one-day periods. Cash flows from loans originated by the Bank for investment and deposits are reported net. The Company did not pay income taxes in 2020 and 2019.

Comprehensive income

Total comprehensive income consists of net income and other comprehensive income. At December 31, 2020 and 2019, the accumulated other comprehensive income was comprised of unrealized gains on securities available for sale of \$466,000 and \$186,000 and unfunded pension liability of (\$36,000) and (\$44,000) net of tax, respectively.

Earnings per common share

Basic earnings per common share represent net income available to common shareholders, which represents net income less dividends paid or payable to preferred stock shareholders, divided by the weighted-average number of common shares outstanding during the period, inclusive of unvested restricted shares (Note 10). For diluted earnings per common share, net income available to common shareholders is divided by the weighted average number of common shares issued and outstanding for each period plus amounts representing the dilutive effect of stock options, as well as any adjustment to income that would result from the assumed issuance. The effects of stock options and warrants are excluded from the computation of diluted earnings per common share in periods in which the effect would be antidilutive. Stock options and warrants are antidilutive if the underlying average market price of the stock that can be purchased for the period is less than the exercise price of the option or warrant. Potential dilutive common shares that may be issued by the Company relate solely to outstanding stock options and warrants and are determined using the treasury stock method.

Stock incentive plan

On May 26, 2015, the Company's shareholders approved the adoption of the Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (the "2015 Plan") authorizing the issuance of up to 60,000 shares of common stock. On May 19, 2020, the Company's shareholders approved an amendment to the 2015 Plan authorizing the issuance of up to 120,000 shares of common stock. See Note 14 for more information on the 2015 Plan.

Fair values of financial instruments

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability (exit price) shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are independent, knowledgeable, able to transact and willing to transact. See Note 18 for the methods and assumptions the Bank uses in estimating fair values of financial instruments.

Revenue recognition

The Company recognizes revenue as it is earned and noted no impact to its revenue recognition policies as a result of the adoption of ASU 2014-09. The following discussion is of revenues that are within the scope of the new revenue guidance:

- *Debit and credit interchange fee income* - Card processing fees consist of interchange fees from consumer debit and credit card networks and other card related services. Interchange fees are based on purchase volumes and other factors and are recognized as transactions occur.
- *Service charges on deposit accounts* - Revenue from service charges on deposit accounts is earned through deposit-related services, as well as overdraft, non-sufficient funds, account management and other deposit related fees. Revenue is recognized for these services either over time, corresponding with deposit accounts' monthly cycle, or at a point in time for transactional related services and fees.
- *Service charges on loan accounts* - Revenue from loan accounts consists primarily of fees earned on prepayment penalties. Revenue is recognized for the services at a point in time for transactional related services and fees.
- *Gains/Losses on sale of OREO* - The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer.
- *Gains/Losses on sale of assets held for sale* - The Company records a gain or loss from the sale of assets held for sale when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of assets held for sale to the buyer, the Company assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probably. Once these criteria are met, the asset held for sale is derecognized and the gain or loss on sale is recorded upon transfer of control of the property to the buyer.

Segments

The Company has two reportable segments: traditional commercial banking and mortgage banking. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage LHFS, gains on sales of loans in the secondary mortgage market, and loan origination fee income, net of commissions paid.

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on the commercial banking segment's cost of funds. Additionally, the mortgage banking segment leases premises from the commercial banking segment. These transactions are eliminated in the consolidation process. See additional information at Note 19, Segment Reporting.

Recent accounting pronouncements

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the

ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The FASB has issued multiple updates to ASU 2016-13 as codified in Topic 326, including ASUs 2019-04, 2019-05, 2019-10, 2019-11, 2020-02, and 2020-03. These ASUs have provided for various minor technical corrections and improvements to the codification as well as other transition matters. Smaller reporting companies who file with the SEC and all other entities who do not file with the SEC are required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. While the Company is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating its current IT systems. The Company is currently assessing the impact that ASU 2016-13 will have on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820) - Changes to the Disclosure Requirements for Fair Value Measurement". ASU 2018-13 modifies the disclosure requirements on fair value measurements by requiring that Level 3 fair value disclosures include the range and weighted average of significant unobservable inputs used to develop those fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. Certain disclosure requirements in Topic 820 were also removed or modified. ASU 2018-13 was effective for the Company on January 1, 2020. The adoption of ASU 2018-13 did not have a material impact on the Company's consolidated financial statements.

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

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

In January 2020, the FASB issued ASU 2020-01, "Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) – Clarifying the Interactions between Topic 321, Topic 323, and Topic 815." The ASU is based on a consensus of the Emerging Issues Task Force and is expected to increase comparability in accounting for these transactions. ASU 2020-01 amends ASU 2016-01, which made targeted improvements to accounting for financial instruments, including providing an entity the ability to measure certain equity securities without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Among other topics, the amendments in ASU 2020-01 clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting. For public business entities, the amendments in the ASU are effective for fiscal years beginning after December 31, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2020-01 to have a material impact on its consolidated financial statements.

In March 2020, the FASB issued ASU 2020-04, “Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. Subsequently, in January 2021, the FASB issued ASU 2021-01 “Reference Rate Reform (Topic 848): Scope.” This ASU clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. The ASU also amends the expedients and exceptions in Topic 848 to capture the incremental consequences of the scope clarification and to tailor the existing guidance to derivative instruments affected by the discounting transition. An entity may elect to apply ASU No. 2021-01 on contract modifications that change the interest rate used for margining, discounting, or contract price alignment retrospectively as of any date from the beginning of the interim period that includes March 12, 2020, or prospectively to new modifications from any date within the interim period that includes or is subsequent to January 7, 2021, up to the date that financial statements are available to be issued. An entity may elect to apply ASU No. 2021-01 to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020, and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020. The Company has a team to assess ASU 2020-04 and its impact on the Company’s transition away from LIBOR for its loan and other financial instruments.

In March 2020 (Revised in April 2020), various regulatory agencies, including the Federal Reserve and the FDIC, (“the agencies”) issued an interagency statement on loan modifications and reporting for financial institutions working with customers affected by COVID-19. The interagency statement was effective immediately and impacted accounting for loan modifications. Under ASC 310-40, “Receivables – Troubled Debt Restructurings by Creditors,” a restructuring of debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies confirmed with the staff of the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented. In August 2020, a joint statement on additional loan modifications was issued. Among other things, the Interagency Statement addresses accounting and regulatory reporting considerations for loan modifications, including those accounted for under Section 4013 of the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act. The CARES Act was signed into law on March 27, 2020 to help support individuals and businesses through loans, grants, tax changes and other types of relief. The most significant impacts of the Act related to accounting for loan modifications and establishment of the Paycheck Protection Program (“PPP”). On December 21, 2020, the Consolidated Appropriates Act of 2021 (“CAA”) was passed. The CAA extends or modifies many of the relief programs first created by the CARES Act, including the PPP and treatment of certain loan modifications related to the COVID-19 pandemic. As of December 31 2020, the Company had a total of \$3,259,000 in loans past due greater than 30 days all of which were rehabilitated student loans which have a 98% guarantee by the DOE of principal and interest. For more financial data and other information about loan deferrals refer to section, “Response to COVID-19” under Item 2 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations”. This interagency guidance is expected to have an impact on the Company’s financial statements; however, this impact cannot be quantified at this time.

In August 2020, the FASB issued ASU 2020-06 “Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity.” The ASU simplifies accounting for convertible instruments by removing major separation models required under current GAAP.

Consequently, more convertible debt instruments will be reported as a single liability instrument and more convertible preferred stock as a single equity instrument with no separate accounting for embedded conversion features. The ASU removes certain settlement conditions that are required for equity contracts to qualify for the derivative scope exception, which will permit more equity contracts to qualify for it. The ASU also simplifies the diluted earnings per share calculation in certain areas. In addition, the amendment updates the disclosure requirements for convertible instruments to increase the information transparency. For public business entities, excluding smaller reporting companies, the amendments in the ASU are effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. For all other entities, including the Company, the standard will be effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2020-06 to have a material impact on its consolidated financial statements.

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

Note 2. Investment Securities Available for Sale

The amortized cost and fair value of investment securities available for sale as of December 31, 2020 and 2019 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2020				
U.S. Government agency obligations	\$ 8,048	\$ 94	\$ -	\$ 8,142
Mortgage-backed securities	23,412	645	(51)	24,006
Subordinated debt	8,795	37	(136)	8,696
	<u>\$ 40,255</u>	<u>\$ 776</u>	<u>\$ (187)</u>	<u>\$ 40,844</u>
December 31, 2019				
U.S. Government agency obligations	\$ 14,797	\$ 57	\$ (9)	\$ 14,845
Mortgage-backed securities	25,124	204	(26)	25,302
Subordinated debt	6,779	91	(80)	6,790
	<u>\$ 46,700</u>	<u>\$ 352</u>	<u>\$ (115)</u>	<u>\$ 46,937</u>

At December 31, 2020 and December 31, 2019, the Company had no investment securities pledged to secure borrowings from the Federal Home Loan Bank of Atlanta (“FHLB”).

Gross realized gains and losses pertaining to available for sale securities are detailed as follows for the years ended December 31, 2020 and 2019 (in thousands):

	December 31,	
	2020	2019
Gross realized gains	\$ 54	\$ 101
Gross realized losses	(42)	-
	<u>\$ 12</u>	<u>\$ 101</u>

The Company sold approximately \$8,000,000 and \$6,500,000 in 2020 and 2019, respectively, of investment securities available for sale at a gain of \$12,000 in 2020 and \$101,000 in 2019. The sales of these securities, which had fixed interest rates, allowed the Company to decrease its exposure to upward movement in interest rates that would result in unrealized losses being recognized in shareholders' equity.

Investment securities available for sale that had an unrealized loss position at December 31, 2020 and December 31, 2019 are detailed below (in thousands):

	Securities in a loss position for less than 12 Months		Securities in a loss position for more than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2020						
Mortgage-backed securities	5,475	(51)	-	-	5,475	(51)
Subordinated debt	1,747	(11)	2,807	(125)	4,554	(136)
	<u>\$ 7,222</u>	<u>\$ (62)</u>	<u>\$ 2,807</u>	<u>\$ (125)</u>	<u>\$ 10,029</u>	<u>\$ (187)</u>
December 31, 2019						
U.S. Government agency obligations	\$ 2,001	\$ (1)	\$ 5,368	\$ (8)	\$ 7,369	\$ (9)
Mortgage-backed securities	2,747	(26)	-	-	2,747	(26)
Subordinated debt	759	(6)	940	(74)	1,699	(80)
	<u>\$ 5,507</u>	<u>\$ (33)</u>	<u>\$ 6,308</u>	<u>\$ (82)</u>	<u>\$ 11,815</u>	<u>\$ (115)</u>

As of December 31, 2020, there were \$2.8 million, or five issues, of individual available for sale securities that had been in a continuous loss position for more than 12 months. These securities had an unrealized loss of \$125,000 and consisted of Subordinated debt.

As of December 31, 2019, there were \$6.3 million, or 10 issues, of individual available for sale securities that had been in a continuous loss position for more than 12 months. These securities had an unrealized loss of \$82,000 and consisted of U.S. Government agency obligations, and subordinated debt.

All of the unrealized losses are attributable to increases in interest rates and not to credit deterioration. Currently, the Company believes that it is probable that the Company will be able to collect all amounts due according to the contractual terms of the investments. Because the declines in fair value are attributable to changes in interest rates and not to credit quality, and because it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other than temporarily impaired at December 31, 2020.

The amortized cost and estimated fair value of investment securities available for sale as of December 31, 2020, by contractual maturity, are as follows (in thousands):

	Amortized	
	Cost	Fair Value
Less than one year	\$ 6,110	\$ 6,145
One to five years	310	315
Five to ten years	10,524	10,473
More than ten years	23,311	23,911
Total	<u>\$ 40,255</u>	<u>\$ 40,844</u>

Note 3. Loans

Loans classified by type as of December 31, 2020 and 2019 are as follows (dollars in thousands):

	December 31, 2020		December 31, 2019	
	Amount	%	Amount	%
Construction and land development				
Residential	\$ 8,103	1.44%	\$ 7,887	1.84%
Commercial	21,466	3.82%	24,063	5.60%
	<u>29,569</u>	<u>5.26%</u>	<u>31,950</u>	<u>7.44%</u>
Commercial real estate				
Owner occupied	99,784	17.79%	98,353	22.91%
Non-owner occupied	121,184	21.60%	116,508	27.14%
Multifamily	9,889	1.75%	13,332	3.10%
Farmland	367	0.07%	156	0.04%
	<u>231,224</u>	<u>41.21%</u>	<u>228,349</u>	<u>53.19%</u>
Consumer real estate				
Home equity lines	18,394	3.28%	21,509	5.01%
Secured by 1-4 family residential,				
First deed of trust	57,089	10.18%	55,856	13.01%
Second deed of trust	11,097	1.98%	10,411	2.43%
	<u>86,580</u>	<u>15.44%</u>	<u>87,776</u>	<u>20.45%</u>
Commercial and industrial loans				
(except those secured by real estate)	181,088	32.28%	45,074	10.50%
Guaranteed student loans	29,657	5.29%	33,525	7.81%
Consumer and other	2,885	0.52%	2,621	0.61%
	<u>561,003</u>	<u>100.0%</u>	<u>429,295</u>	<u>100.0%</u>
Deferred fees and costs, net	(2,048)		764	
Less: allowance for loan losses	(3,970)		(3,186)	
	<u>\$ 554,985</u>		<u>\$ 426,873</u>	

The Bank has a purchased portfolio of rehabilitated student loans guaranteed by the DOE. The guarantee covers approximately 98% of principal and accrued interest. The loans are serviced by a third-party servicer that specializes in handling the special needs of the DOE student loan programs.

The Bank originated \$185,137,000 in loans under the SBA's Paycheck Protection Program ("PPP") as of December 31, 2020. These loans have provided essential funds to approximately 1,500 businesses and nonprofits and protected more than 20,000 jobs in our community. The Bank is participating in the second round of PPP funding approved by Congress and signed into law by the President of the United States of America on December 27, 2020. The processing fees earned on the PPP loans will help to support the Bank's loan deferral program and potential credit losses associated with the COVID-19 pandemic. Below is a breakdown of PPP loans by loan size as of December 31, 2020 (dollars in thousands):

Loan Size	# of Loans	\$ of Loans
< \$350,000	1,172	\$ 72,526
\$350,000 - \$2 million	57	41,046
> \$2 million	6	23,102
Total	<u>1,235</u>	<u>\$ 136,674</u>

Loans pledged as collateral with the FHLB as part of their lending arrangements with the Company totaled \$65,587,000 and \$49,736,000 as of December 31, 2020 and 2019, respectively.

The following is a summary of loans directly or indirectly with executive officers or directors of the Company for the years ended December 31, 2020 and 2019 (in thousands):

	2020	2019
Beginning balance	\$ 5,323	\$ 5,201
Additions	11,228	8,751
Effect of changes in composition of related parties	(287)	-
Reductions	(11,592)	(8,629)
Ending balance	<u>\$ 4,672</u>	<u>\$ 5,323</u>

Executive officers and directors also had unused credit lines totaling \$1,507,000 and \$2,806,000 at December 31, 2020 and 2019, respectively. Based on management's evaluation all loans and credit lines to executive officers and directors were made in the ordinary course of business at the Company's normal credit terms, including interest rate and collateralization prevailing at the time for comparable transactions with other persons.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following table provides information on nonaccrual loans segregated by type at the dates indicated (dollars in thousands):

	December 31, 2020	December 31, 2019
Commercial real estate		
Non-owner occupied	\$ 303	\$ 497
	<u>303</u>	<u>497</u>
Consumer real estate		
Home equity lines	300	300
Secured by 1-4 family residential		
First deed of trust	630	842
Second deed of trust	317	63
	<u>1,247</u>	<u>1,205</u>
Commercial and industrial loans (except those secured by real estate)	<u>27</u>	<u>166</u>
Total loans	<u>\$ 1,577</u>	<u>\$ 1,868</u>

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

- Risk rated 1 to 4 loans are considered of sufficient quality to preclude an adverse rating. These assets generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral;
- Risk rated 5 loans are defined as having potential weaknesses that deserve management's close attention;

- Risk rated 6 loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any; and
- Risk rated 7 loans have all the weaknesses inherent in substandard loans, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following tables provide information on the risk rating of loans at the dates indicated (in thousands):

	Risk Rated 1-4	Risk Rated 5	Risk Rated 6	Risk Rated 7	Total Loans
December 31, 2020					
Construction and land development					
Residential	\$ 8,103	\$ -	\$ -	\$ -	\$ 8,103
Commercial	21,370	96	-	-	21,466
	29,473	96	-	-	29,569
Commercial real estate					
Owner occupied	88,066	9,405	2,313	-	99,784
Non-owner occupied	116,161	4,244	779	-	121,184
Multifamily	9,889	-	-	-	9,889
Farmland	367	-	-	-	367
	214,483	13,649	3,092	-	231,224
Consumer real estate					
Home equity lines	17,298	796	300	-	18,394
Secured by 1-4 family residential					
First deed of trust	53,731	2,212	1,146	-	57,089
Second deed of trust	9,425	1,236	436	-	11,097
	80,454	4,244	1,882	-	86,580
Commercial and industrial loans (except those secured by real estate)					
	178,217	2,602	269	-	181,088
Guaranteed student loans	29,657	-	-	-	29,657
Consumer and other	2,844	41	-	-	2,885
Total loans	\$ 536,336	\$ 20,632	\$ 5,243	\$ -	\$ 561,003
December 31, 2019					
Construction and land development					
Residential	\$ 7,887	\$ -	\$ -	\$ -	\$ 7,887
Commercial	23,758	-	305	-	24,063
	31,645	-	305	-	31,950
Commercial real estate					
Owner occupied	90,146	8,072	135	-	98,353
Non-owner occupied	115,781	230	497	-	116,508
Multifamily	13,186	146	-	-	13,332
Farmland	71	85	-	-	156
	219,184	8,533	632	-	228,349
Consumer real estate					
Home equity lines	20,486	723	300	-	21,509
Secured by 1-4 family residential					
First deed of trust	53,200	1,660	996	-	55,856
Second deed of trust	10,130	167	114	-	10,411
	83,816	2,550	1,410	-	87,776
Commercial and industrial loans (except those secured by real estate)					
	41,837	2,891	346	-	45,074
Guaranteed student loans	33,525	-	-	-	33,525
Consumer and other	2,621	-	-	-	2,621
Total loans	\$ 412,628	\$ 13,974	\$ 2,693	\$ -	\$ 429,295

The following tables present the aging of the recorded investment in past due loans as of the dates indicated (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
December 31, 2020							
Construction and land development							
Residential	\$ -	\$ -	\$ -	\$ -	\$ 8,103	\$ 8,103	\$ -
Commercial	-	-	-	-	21,466	21,466	-
	-	-	-	-	29,569	29,569	-
Commercial real estate							
Owner occupied	86	-	-	86	99,698	99,784	-
Non-owner occupied	-	-	-	-	121,184	121,184	-
Multifamily	-	-	-	-	9,889	9,889	-
Farmland	-	-	-	-	367	367	-
	86	-	-	86	231,138	231,224	-
Consumer real estate							
Home equity lines	-	-	-	-	18,394	18,394	-
Secured by 1-4 family residential							
First deed of trust	133	-	-	133	56,956	57,089	-
Second deed of trust	-	57	-	57	11,040	11,097	-
	133	57	-	190	86,390	86,580	-
Commercial and industrial loans (except those secured by real estate)							
Guaranteed student loans	25	-	-	25	181,063	181,088	-
Consumer and other	1,428	1,009	2,193	4,630	25,027	29,657	2,193
	1	-	-	1	2,884	2,885	-
Total loans	\$ 1,673	\$ 1,066	\$ 2,193	\$ 4,932	\$ 556,071	\$ 561,003	\$ 2,193
December 31, 2019							
Construction and land development							
Residential	\$ -	\$ -	\$ -	\$ -	\$ 7,887	\$ 7,887	\$ -
Commercial	-	-	-	-	24,063	24,063	-
	-	-	-	-	31,950	31,950	-
Commercial real estate							
Owner occupied	701	-	-	701	97,652	98,353	-
Non-owner occupied	-	-	-	-	116,508	116,508	-
Multifamily	-	-	-	-	13,332	13,332	-
Farmland	-	-	-	-	156	156	-
	701	-	-	701	227,648	228,349	-
Consumer real estate							
Home equity lines	52	-	-	52	21,457	21,509	-
Secured by 1-4 family residential							
First deed of trust	290	-	-	290	55,566	55,856	-
Second deed of trust	133	-	-	133	10,278	10,411	-
	475	-	-	475	87,301	87,776	-
Commercial and industrial loans (except those secured by real estate)							
Guaranteed student loans	773	-	-	773	44,301	45,074	-
Consumer and other	1,694	1,309	2,567	5,570	27,955	33,525	2,567
	4	-	-	4	2,617	2,621	-
Total loans	\$ 3,647	\$ 1,309	\$ 2,567	\$ 7,523	\$ 421,772	\$ 429,295	\$ 2,567

Loans greater than 90 days past due consist of student loans that are guaranteed by the DOE which covers approximately 98% of the principal and interest. Accordingly, these loans will not be placed on nonaccrual status and are not considered to be impaired.

Loans are considered impaired when, based on current information and events it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Loans evaluated individually for impairment include nonperforming loans, such as loans on nonaccrual, loans past due by 90 days or more, TDRs and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific

reserve is established for the amount of impairment. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible. Impaired loans are set forth in the following table as of the dates indicated (in thousands):

	December 31, 2020			December 31, 2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded						
Construction and land development						
Commercial	\$ -	\$ -	\$ -	\$ 337	\$ 337	\$ -
	-	-	-	337	337	-
Commercial real estate						
Owner occupied	2,780	2,795	-	2,089	2,104	-
Non-owner occupied	1,991	1,991	-	2,304	2,304	-
	4,771	4,786	-	4,393	4,408	-
Consumer real estate						
Home equity lines	300	300	-	300	300	-
Secured by 1-4 family residential						
First deed of trust	1,937	1,940	-	1,752	1,774	-
Second deed of trust	699	992	-	752	960	-
	2,936	3,232	-	2,804	3,034	-
Commercial and industrial loans						
(except those secured by real estate)	141	141	-	211	373	-
	7,848	8,159	-	7,745	8,152	-
With an allowance recorded						
Commercial real estate						
Owner occupied	1,125	1,125	9	1,414	1,414	15
	1,125	1,125	9	1,414	1,414	15
Consumer real estate						
Secured by 1-4 family residential						
First deed of trust	74	74	8	78	78	9
	74	74	8	78	78	9
Commercial and industrial loans						
(except those secured by real estate)	-	-	-	135	334	135
	1,199	1,199	17	1,627	1,826	159
Total						
Construction and land development						
Commercial	-	-	-	337	337	-
	-	-	-	337	337	-
Commercial real estate						
Owner occupied	3,905	3,920	9	3,503	3,518	15
Non-owner occupied	1,991	1,991	-	2,304	2,304	-
	5,896	5,911	9	5,807	5,822	15
Consumer real estate						
Home equity lines	300	300	-	300	300	-
Secured by 1-4 family residential,						
First deed of trust	2,011	2,014	8	1,830	1,852	9
Second deed of trust	699	992	-	752	960	-
	3,010	3,306	8	2,882	3,112	9
Commercial and industrial loans						
(except those secured by real estate)	141	141	-	346	707	135
	\$ 9,047	\$ 9,358	\$ 17	\$ 9,372	\$ 9,978	\$ 159

The following is a summary of average recorded investment in impaired loans with and without valuation allowance and interest income recognized on those loans for periods indicated (in thousands):

	December 31,			
	2020		2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Construction and land development				
Residential	\$ -	\$ -	\$ 81	\$ -
Commercial	221	-	329	-
	221	-	410	-
Commercial real estate				
Owner occupied	3,189	124	2,695	143
Non-owner occupied	1,980	89	2,434	128
	5,169	213	5,129	271
Consumer real estate				
Home equity lines				
Secured by 1-4 family residential	300	23	318	19
First deed of trust	2,069	66	2,280	76
Second deed of trust	802	46	810	40
	3,171	135	3,408	135
Commercial and industrial loans (except those secured by real estate)				
	151	1	626	17
	8,712	349	9,573	423
With an allowance recorded				
Commercial real estate				
Owner occupied	913	32	1,432	43
	913	32	1,432	43
Consumer real estate				
Secured by 1-4 family residential				
First deed of trust	76	4	166	6
Second deed of trust	26	-	-	-
	102	4	166	6
Commercial and industrial loans (except those secured by real estate)				
	129	-	225	1
Consumer and other	-	-	6	-
	1,144	36	1,829	50
Total				
Construction and land development				
Residential	-	-	81	-
Commercial	221	-	329	-
	221	-	410	-
Commercial real estate				
Owner occupied	4,102	156	4,127	186
Non-owner occupied	1,980	89	2,434	128
	6,082	213	6,561	314
Consumer real estate				
Home equity lines				
Secured by 1-4 family residential,	300	23	318	19
First deed of trust	2,145	70	2,446	82
Second deed of trust	828	46	810	40
	3,273	135	3,574	141
Commercial and industrial loans (except those secured by real estate)				
	280	1	851	18
Consumer and other	-	-	6	-
	\$ 9,856	\$ 385	\$ 11,402	\$ 473

As of December 31, 2020 and 2019, the Company had impaired loans of \$1,577,000 and \$1,868,000, respectively, which were on nonaccrual status. These loans had no valuation allowances as of December 31, 2020 and \$135,000 as of December 31, 2019. Cumulative interest income that would have been recorded had nonaccrual loans been performing would have been \$84,000 and \$136,000 for 2020 and 2019, respectively.

Included in impaired loans are loans classified as TDRs. A modification of a loan's terms constitutes a TDR if the creditor grants a concession to the borrower for economic or legal reasons related to the borrower's financial difficulties that it would not otherwise consider. For loans classified as impaired TDRs, the Company further evaluates the loans as performing or nonaccrual. To restore a nonaccrual loan that has been formally restructured in a TDR to accrual status, we perform a current, well documented credit analysis supporting a return to accrual status based on the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the TDR must remain in nonaccrual status. The analysis considers the borrower's sustained historical repayment performance for a reasonable period to the return-to-accrual date, but may take into account payments made for a reasonable period prior to the restructuring if the payments are consistent with the modified terms. A sustained period of repayment performance generally would be a minimum of six months and would involve payments in the form of cash or cash equivalents.

An accruing loan that is modified in a TDR can remain in accrual status if, based on a current well-documented credit analysis, collection of principal and interest in accordance with the modified terms is reasonably assured, and the borrower has demonstrated sustained historical repayment performance for a reasonable period before modification. The following is a summary of performing and nonaccrual TDRs and the related specific valuation allowance by portfolio segment as of December 31, 2020 and 2019 (dollars in thousands).

	Total	Performing	Nonaccrual	Specific Valuation Allowance
December 31, 2020				
Commercial real estate				
Owner occupied	\$ 3,396	\$ 3,396	\$ -	\$ -
Non-owner occupied	1,991	1,688	303	-
	<u>5,387</u>	<u>5,084</u>	<u>303</u>	<u>-</u>
Consumer real estate				
Secured by 1-4 family residential				
First deeds of trust	1,460	910	550	9
Second deeds of trust	617	556	61	8
	<u>2,077</u>	<u>1,466</u>	<u>611</u>	<u>17</u>
Commercial and industrial loans (except those secured by real estate)	27	-	27	-
	<u>\$ 7,491</u>	<u>\$ 6,550</u>	<u>\$ 941</u>	<u>\$ 17</u>
Number of loans	34	27	7	2

	Total	Performing	Nonaccrual	Specific Valuation Allowance
December 31, 2019				
Commercial real estate				
Owner occupied	\$ 3,502	\$ 3,502	\$ -	\$ 15
Non-owner occupied	2,304	1,807	497	-
	5,806	5,309	497	15
Consumer real estate				
Secured by 1-4 family residential				
First deeds of trust	1,641	881	760	9
Second deeds of trust	752	689	63	-
	2,393	1,570	823	9
Commercial and industrial loans (except those secured by real estate)	211	180	31	-
	\$ 8,410	\$ 7,059	\$ 1,351	\$ 24
Number of loans	38	29	9	3

The following table provides information about TDRs identified during the indicated periods (dollars in thousands).

	December 31, 2020			December 31, 2019		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial real estate						
Non-owner occupied	1	\$ 311	\$ 311	1	\$ 515	\$ 515
	1	\$ 311	\$ 311	1	\$ 515	\$ 515

There were no defaults on TDRs that were modified as TDRs during the twelve month periods ended December 31, 2020 and 2019.

The CARES Act, as amended by the CAA, permits financial institutions to suspend requirements under GAAP for loan modifications to borrowers affected by COVID-19 that would otherwise be characterized as TDRs and suspend any determination related thereto if (i) the loan modification is made between March 1, 2020 and the earlier of January 1, 2022 or 60 days after the end of the COVID-19 emergency declaration and (ii) the applicable loan was not more than 30 days past due as of December 31, 2019. In addition, federal bank regulatory authorities have issued guidance to encourage financial institutions to make loan modifications for borrowers affected by COVID-19 and have assured financial institutions that they will neither receive supervisory criticism for such prudent loan modifications, nor be required by examiners to automatically categorize COVID-19-related loan modifications as TDRs. As of December 31, 2020, the Company had approximately \$38.0 million in loans still under their modified terms. The Company's modification program primarily included payment deferrals and interest only modifications.

Note 4. Allowance for Loan Losses

Activity in the allowance for loan losses was as follows for the periods indicated (in thousands):

	Beginning Balance	Provision for (Recovery of) Loan Losses	Charge-offs	Recoveries	Ending Balance
Year Ended December 31, 2020					
Construction and land development					
Residential	\$ 48	\$ 141	\$ -	\$ 25	\$ 214
Commercial	137	148	-	-	285
	185	289	-	25	499
Commercial real estate					
Owner occupied	671	376	-	-	1,047
Non-owner occupied	831	590	-	-	1,421
Multifamily	85	(38)	-	-	47
Farmland	2	-	-	-	2
	1,589	928	-	-	2,517
Consumer real estate					
Home equity lines	271	(247)	-	-	24
Secured by 1-4 family residential					
First deed of trust	343	(190)	-	13	166
Second deed of trust	64	45	(85)	55	79
	678	(392)	(85)	68	269
Commercial and industrial loans (except those secured by real estate)					
Student loans	572	(58)	(135)	29	408
Consumer and other	108	27	(48)	-	87
Unallocated	30	26	(24)	4	36
	24	130	-	-	154
	\$ 3,186	\$ 950	\$ (292)	\$ 126	\$ 3,970
Year Ended December 31, 2019					
Construction and land development					
Residential	\$ 42	\$ (1)	\$ -	\$ 7	\$ 48
Commercial	220	(85)	-	2	137
	262	(86)	-	9	185
Commercial real estate					
Owner occupied	673	(2)	-	-	671
Non-owner occupied	673	158	-	-	831
Multifamily	87	(2)	-	-	85
Farmland	2	-	-	-	2
	1,435	154	-	-	1,589
Consumer real estate					
Home equity lines	244	50	(35)	12	271
Secured by 1-4 family residential					
First deed of trust	385	(56)	-	14	343
Second deed of trust	51	(56)	-	69	64
	680	(62)	(35)	95	678
Commercial and industrial loans (except those secured by real estate)					
Student loans	308	239	(64)	89	572
Consumer and other	121	80	(93)	-	108
Unallocated	34	(3)	(26)	25	30
	211	(187)	-	-	24
	\$ 3,051	\$ 135	\$ (218)	\$ 218	\$ 3,186

The amount of the loan loss provision (recovery) is determined by an evaluation of the level of loans outstanding, the level of nonperforming loans, historical loan loss experience, delinquency trends, underlying collateral values, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions. Loans originated under PPP are not considered in the evaluation of the allowance for loan losses because these loans carry a 100% guarantee from the SBA; however, if the collectability on the guarantee on a loan is at risk that loan will be included in the evaluation of the allowance for loan losses.

The level of the allowance reflects changes in the size of the portfolio or in any of its components as well as management's continuing evaluation of industry concentrations, specific credit risk, loan loss experience, current loan portfolio quality, and present economic, political and regulatory conditions. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgement, should be charged off. While management utilizes its best judgement and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company recorded a provision for loan losses of \$950,000 for the year ended December 31, 2020. The provision for loan losses was driven primarily by an increase in the qualitative factors as a result of the continued economic uncertainty surrounding COVID-19. The increase in the qualitative factors due to COVID-19 were a result of deterioration in local economic factors such as the higher levels of unemployment and the increased credit risk due to loan payment deferrals under the CARES Act. The Company believes the current level of allowance for loan loss reserves are adequate to cover incurred losses. However, the full economic impact of the COVID-19 pandemic is currently unknown and the Company must continue to monitor our loan portfolio for loss indicators which may require further provisions for loan losses. The Company recorded a provision for loan losses of \$135,000 for the year ended December 31, 2019 because of an increase in the specific reserves associated with a relationship evaluated individually for impairment.

The allowance for loan losses at each of the periods presented includes an amount that could not be identified to individual types of loans referred to as the unallocated portion of the allowance. We recognize the inherent imprecision in estimates of losses due to various uncertainties and the variability related to the factors used in calculation of the allowance. The allowance for loan losses included an unallocated portion of approximately \$154,000 and \$24,000 at December 31, 2020 and December 31, 2019, respectively.

Loans were evaluated for impairment as follows for the periods indicated (in thousands):

	Recorded Investment in Loans					
	Allowance			Loans		
	Ending Balance	Individually	Collectively	Ending Balance	Individually	Collectively
Year Ended December 31, 2020						
Construction and land development						
Residential	\$ 214	\$ -	\$ 214	\$ 8,103	\$ -	\$ 8,103
Commercial	285	-	285	21,466	-	21,466
	499	-	499	29,569	-	29,569
Commercial real estate						
Owner occupied	1,047	9	1,038	99,784	3,905	95,879
Non-owner occupied	1,421	-	1,421	121,184	1,991	119,193
Multifamily	47	-	47	9,889	-	9,889
Farmland	2	-	2	367	-	367
	2,517	9	2,508	231,224	5,896	225,328
Consumer real estate						
Home equity lines	24	-	24	18,394	300	18,094
Secured by 1-4 family residential						
First deed of trust	166	8	158	57,089	2,011	55,078
Second deed of trust	79	-	79	11,097	699	10,398
	269	8	261	86,580	3,010	83,570
Commercial and industrial loans (except those secured by real estate)						
	408	-	408	181,088	141	180,947
Student loans	87	-	87	29,657	-	29,657
Consumer and other	190	-	190	2,885	-	2,885
	\$ 3,970	\$ 17	\$ 3,953	\$ 561,003	\$ 9,047	\$ 551,956
Year Ended December 31, 2019						
Construction and land development						
Residential	\$ 48	\$ -	\$ 48	\$ 7,887	\$ -	\$ 7,887
Commercial	137	-	137	24,063	337	23,726
	185	-	185	31,950	337	31,613
Commercial real estate						
Owner occupied	671	15	656	98,353	3,503	94,850
Non-owner occupied	831	-	831	116,508	2,304	114,204
Multifamily	85	-	85	13,332	-	13,332
Farmland	2	-	2	156	-	156
	1,589	15	1,574	228,349	5,807	222,542
Consumer real estate						
Home equity lines	271	-	271	21,509	300	21,209
Secured by 1-4 family residential						
First deed of trust	343	9	334	55,856	1,830	54,026
Second deed of trust	64	-	64	10,411	752	9,659
	678	9	669	87,776	2,882	84,894
Commercial and industrial loans (except those secured by real estate)						
	572	135	437	45,074	346	44,728
Student loans	108	-	108	33,525	-	33,525
Consumer and other	54	-	54	2,621	-	2,621
	\$ 3,186	\$ 159	\$ 3,027	\$ 429,295	\$ 9,372	\$ 419,923

Note 5. Premises and Equipment

The following is a summary of premises and equipment as of December 31, 2020 and 2019 (in thousands):

	2020		2019	
Land	\$	4,352	\$	4,352
Buildings and improvements		10,796		10,601
Furniture, fixtures and equipment		7,614		7,479
Total premises and equipment		22,762		22,432
Less: Accumulated depreciation and amortization		(10,983)		(10,396)
Premises and equipment, net	\$	11,779	\$	12,036

Depreciation and amortization of premises and equipment for 2020 and 2019 amounted to \$586,000 and \$644,000, respectively.

Note 6. Investment in Bank Owned Life Insurance

The Bank is owner and designated beneficiary on life insurance policies in the aggregate face amount of \$13,730,000 covering certain of its directors and executive officers. The earnings from these policies are used to offset expenses related to retirement plans. The cash surrender value of these policies at December 31, 2020 and 2019 was approximately \$7,806,000 and \$7,612,000, respectively.

Note 7. Deposits

Deposits as of December 31, 2020 and 2019 were as follows (dollars in thousands):

	December 31, 2020		December 31, 2019	
	Amount	%	Amount	%
Demand accounts	\$ 222,305	37.8%	\$ 131,228	29.6%
Interest checking accounts	70,342	11.9%	48,427	10.9%
Money market accounts	152,726	26.0%	99,955	22.6%
Savings accounts	38,083	6.5%	26,396	6.0%
Time deposits of \$250,000 and over	16,014	2.7%	22,327	5.0%
Other time deposits	88,912	15.1%	114,875	25.9%
Total	\$ 588,382	100.0%	\$ 443,208	100.0%

The following are the scheduled maturities of time deposits as of December 31, 2020 (in thousands):

Year Ending December 31,	Less Than \$250,000	Greater Than or Equal to \$250,000	Total
2021	\$ 64,064	\$ 11,349	\$ 75,413
2022	15,583	4,403	19,986
2023	5,786	262	6,048
2024	1,338	-	1,338
2025	2,141	-	2,141
Total	\$ 88,912	\$ 16,014	\$ 104,926

Deposits held at the Company by related parties, which include officers, directors, greater than 5% shareholders and companies in which directors of the board have a significant ownership interest, approximated \$14,159,000 and \$15,067,000 at December 31, 2020 and 2019, respectively.

Note 8. Borrowings

The Company uses both short-term and long-term borrowings to supplement deposits when they are available at a lower overall cost to the Company or they can be invested at a positive rate of return.

As a member of the Federal Home Loan Bank of Atlanta, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances from the FHLB. The Company held \$484,000 in FHLB stock at December 31, 2020 and \$1,694,000 at December 31, 2019, which is held at cost. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. FHLB borrowings are secured by the pledge of commercial loans and 1-4 family residential loans. The Company had no outstanding FHLB advances at December 31, 2020. The Company prepaid all of its outstanding FHLB advances during year ended December 31, 2020, which resulted in the recognition of \$696,000 in in prepayment fees. The Company had FHLB advances of \$29,000,000 at December 31, 2019 maturing through 2023.

Through the Federal Reserve Bank, the Company can borrow funds through the Payment Protection Program Liquidity Fund (“PPPLF”) which are secured by the Company’s PPP loans. As of December 31, 2020, the Company had \$41.5 million in outstanding advances under the PPPLF. The Company’s available borrowing capacity under the PPPLF as of December 31, 2020 was \$95.2 million.

The Company had advances from the FHLB for the periods indicated that consisted of the following (dollars in thousands):

Year Ended December 31, 2019			
Type	Maturity Date	Interest Rate	Advance Amount
Variable	June 29, 2020	1.780%	\$ 8,000
Fixed Rate	June 28, 2021	2.854%	3,000
Fixed Rate	July 6, 2020	2.770%	5,000
Fixed Rate	September 27, 2021	3.102%	2,000
Fixed Rate	September 25, 2023	3.212%	2,000
Fixed Rate	November 15, 2021	3.149%	6,500
Fixed Rate	December 11, 2023	3.289%	2,500
			\$ 29,000

The Company uses federal funds purchased and repurchase agreements for short-term borrowing needs. Securities sold under agreements to repurchase are classified as borrowings and generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. There were no borrowings against the lines at December 31, 2020. The carrying value of these short term borrowing agreements was \$5,317,000 at December 31, 2019.

The Company’s unused lines of credit for future borrowings total approximately \$93.1 million at December 31, 2020, which consists of \$50.3 million available from the FHLB, \$10 million on revolving bank line of credit, \$7.8 million under secured federal funds agreements with third party financial institutions, \$25 million in repurchase lines of credit with third party financial institutions. Additional loans and securities

are available that can be pledged as collateral for future borrowings from the Federal Reserve Bank of Richmond or the FHLB above the current lendable collateral value.

Information related to borrowings as of December 31, 2020 and 2019 is as follows (dollars in thousands):

	<u>Year Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Balance outstanding at end of year		
Maximum outstanding during the year		
Federal Funds Purchased	\$ 4,559	\$ 6,594
FHLB advances	51,000	31,000
PPPLF	45,120	-
Balance outstanding at end of year		
Federal Funds Purchased	-	5,317
FHLB advances	-	29,000
PPPLF	41,529	-
Average amount outstanding during the year		
Federal Funds Purchased	91	456
FHLB advances	27,785	22,693
PPPLF	28,857	-
Average interest rate during the year		
Federal Funds Purchased	1.65%	2.32%
FHLB advances	2.17%	3.05%
PPPLF	0.35%	0.00%
Average interest rate at end of year		
Federal Funds Purchased	0.00%	2.54%
FHLB advances	0.00%	2.69%
PPPLF	0.35%	0.00%

Note 9. Income Taxes

The following summarizes the tax effects of temporary differences that comprise deferred tax assets and liabilities at December 31, 2020 and 2019 (in thousands):

	<u>2020</u>	<u>2019</u>
Deferred tax assets		
Net operating loss carryforward	\$ 217	\$ 2,995
Capital loss carryforward	25	25
State net operating loss carryforward	-	97
AMT credit	-	11
Allowance for loan losses	834	669
Deferred Cost, net of fees	430	-
Interest on nonaccrual loans	18	29
Expenses and writedowns related to foreclosed property	66	97
Stock compensation	34	10
Employee benefits	794	792
Pension expense	3	8
Depreciation	31	134
Other, net	29	11
Total deferred tax assets	<u>2,481</u>	<u>4,878</u>
Deferred tax liabilities		

Unrealized gain on available for sale securities	124	50
	<u>124</u>	<u>50</u>
Total deferred tax liabilities		
	<u>124</u>	<u>50</u>
Net deferred tax asset	<u>\$ 2,357</u>	<u>\$ 4,828</u>

The net deferred tax asset is included in other assets on the consolidated balance sheet. ASC Topic 740, *Income Taxes*, requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard. Management considers both positive and negative evidence and analyzes changes in near-term market conditions as well as other factors which may impact future operating results. In making such judgments, significant weight is given to evidence that can be objectively verified. The deferred tax assets are analyzed quarterly for changes affecting realization.

In assessing the Company’s ability to realize its net deferred tax asset, management considers whether it is more likely than not that some portion or all of the net deferred tax asset will or will not be realized. The Company’s ultimate realization of the net deferred tax asset is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers the nature and amount of historical and projected future taxable income, the scheduled reversal of deferred tax assets and liabilities, and available tax planning strategies in making this assessment. The amount of net deferred taxes recognized could be impacted by changes to any of these variables.

Each quarter, the Company weighs both the positive and negative information with respect to realization of the net deferred tax asset and analyzes its position as to whether or not a valuation allowance is required.

Given the consistent earnings and stable asset quality, the Company’s analysis concluded that, it is more likely than not that the Company will generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset.

The net operating losses available to offset future taxable income amounted to \$1,031,000 at December 31, 2020 and will begin expiring in 2028.

The income tax expense charged to operations for the years ended December 31, 2020 and 2019 consists of the following (in thousands):

	2020	2019
Current tax expense (benefit)	\$ 92	\$ (33)
Deferred tax expense	<u>2,393</u>	<u>1,197</u>
Provision for income taxes	<u>\$ 2,485</u>	<u>\$ 1,164</u>

A reconciliation of income taxes computed at the federal statutory income tax rate to total income taxes is as follows for the years ended December 31, 2020 and 2019 (in thousands):

	2020	2019
Net income before income taxes	<u>\$ 11,039</u>	<u>\$ 5,641</u>
Computed "expected" tax expense	\$ 2,318	\$ 1,185
State taxes, net of fed	201	15
Cash surrender value of life insurance	(41)	(37)
Other	<u>7</u>	<u>1</u>

Provision for income taxes	<u>\$ 2,485</u>	<u>\$ 1,164</u>
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Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded franchise tax expense, within other operating expense, of approximately \$439,000 and \$385,000 for the years ended December 31, 2020 and 2019, respectively. With few exceptions, the Company is no longer subject to U.S. Federal, State, or local income tax examinations by tax authorities for years prior to 2017.

Note 10. Earnings per Share

The following table presents the basic and diluted earnings per share computations (in thousands except per share data):

	2020	2019
Numerator		
Net income - basic and diluted	\$ 8,554	\$ 4,477
Denominator		
Weighted average shares outstanding - basic	1,459	1,445
Dilutive effect of common stock options	-	-
Weighted average shares outstanding - diluted	1,459	1,445
Earnings per share – basic	\$ 5.86	\$ 3.10
Earnings per share – diluted	\$ 5.86	\$ 3.10

Applicable guidance requires that outstanding, unvested share-based payment awards that contain voting rights and rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Accordingly, the weighted average number of shares of the Company's common stock used in the calculation of basic and diluted net income per common share includes unvested shares of the Company's outstanding restricted common stock.

The vesting of 6,573 and 4,155 restricted stock units outstanding as of December 31, 2020 and 2019, respectively, are dependent upon meeting certain performance criteria. As of December 31, 2020 and December 31, 2019, it was indeterminable whether these non-vested restricted stock units will vest and as such those shares are excluded from common shares issued and outstanding at each date and are not included in the computation of earnings per share for any period presented.

Outstanding options and warrants to purchase common stock were considered in the computation of diluted earnings per share for the periods presented. Stock options for 592 and 555 shares were not included in computing diluted earnings per share at December 31, 2020 and 2019, respectively, because their effects were anti-dilutive.

Note 11. Lease Commitments

The following tables present information about the Company's leases (dollars in thousands):

	For the years ended December 31,	
	2020	2019
Lease liabilities	\$ 930	\$ 1,027
Right-of-use assets	\$ 916	\$ 1,015
Weighted average remaining lease term	5.05 years	4.29 years
Weighted average discount rate	2.39%	2.98%
	For the years ended December 31,	
	2020	2019
Lease cost		
Operating lease cost	\$ 427	\$ 427
Total lease cost	\$ 427	\$ 427

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities is as follows (dollars in thousands):

	As of December 31, 2020	
Lease payments due		
Twelve months ending December 31, 2021	\$	337
Twelve months ending December 31, 2022		181
Twelve months ending December 31, 2023		106
Twelve months ending December 31, 2024		111
Twelve months ending December 31, 2025		102
Thereafter		154
Total undiscounted cash flows	\$	991
Discount		61
Lease liabilities	\$	930

Cash paid for amounts included in the measurement of lease liabilities for the year ended December 31, 2020 and 2019 was \$378,000 and \$415,000, respectively. The Company recognized lease expense of \$427,000 for each of the years ended December 31, 2020 and 2019.

Note 12. Commitments and Contingencies

Off-balance-sheet risk – The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the financial statements. The contract amounts of these instruments reflect the extent of involvement that the Company has in particular classes of instruments.

The Company’s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, and to potential credit loss associated with letters of credit issued, is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for loans and other such on-balance sheet instruments.

At December 31, 2020 and 2019, the Company had outstanding the following approximate off-balance-sheet financial instruments whose contract amounts represent credit risk (in thousands):

	December 31, 2020	December 31, 2019
Undisbursed credit lines	\$ 107,130	\$ 83,366
Commitments to extend or originate credit	38,910	15,722
Standby letters of credit	4,934	6,732
Total commitments to extend credit	\$ 150,974	\$ 105,820

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. Historically, any commitments expire without being drawn upon; therefore, the total commitment amounts shown in the above table are not necessarily indicative of future cash requirements. The Company evaluates each customer’s creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary by the Company upon extension of credit is based on management’s credit evaluation of the customer. Collateral held varies but

may include personal or income-producing commercial real estate, accounts receivable, inventory and equipment.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Concentrations of credit risk – Generally, the Company’s loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company’s market area. Although the Company is building a diversified loan portfolio, a substantial portion of its clients’ ability to honor contracts is reliant upon the economic stability of the Richmond, Virginia area, including the real estate markets in the area. The concentrations of credit by type of loan are set forth in Note 3. The distribution of commitments to extend credit approximates the distribution of loans outstanding.

Note 13. Shareholders’ Equity and Regulatory Matters

Preferred Stock

On May 1, 2009, as part of the Capital Purchase Program established by the U.S. Department of the Treasury (the “Treasury”) under the Emergency Economic Stabilization Act of 2008, the Company sold (i) 14,738 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value \$4.00 per share, having a liquidation preference of \$1,000 per share (the “preferred stock”) and (ii) a warrant (the “Warrant”) to purchase 499,029 shares of the Company’s common stock at an initial exercise price of \$4.43 per share, subject to certain anti-dilution and other adjustments, to the Treasury for an aggregate purchase price of \$14,738,000 in cash. During the first quarter of 2018, the Company used the proceeds from a subordinated note issuance to redeem the remaining 5,027 outstanding shares of preferred stock plus accrued dividends of \$56,554. The Warrant expired on May 1, 2019.

Accumulated Other Comprehensive Income

The following table presents the cumulative balances of the components of accumulated other comprehensive income, net of deferred taxes of \$114,000 and \$38,000 as of December 31, 2020 and 2019, respectively (in thousands):

	Year Ended December 31,	
	2020	2019
Net unrealized gains on securities	\$ 466	\$ 186
Net unrecognized losses on defined benefit plan	(36)	(44)
Total other comprehensive income	<u>\$ 430</u>	<u>\$ 142</u>

Regulatory Matters

The Company meets the eligibility criteria of a small bank holding company in accordance with the Board of Governors of the Federal Reserve System’s (the “Federal Reserve”) Small Bank Holding Company Policy Statement (the “SBHC Policy Statement”). On August 28, 2018, the Federal Reserve issued an interim final rule required by the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, which was signed into law on May 24, 2018 (the “EGRRCPA”), that expands the applicability of the SBHC Policy Statement to bank holding companies with total consolidated assets of less than \$3 billion (up from the prior \$1 billion threshold). Under the SBHC Policy Statement, qualifying bank holding companies, such as the Company, have additional flexibility in the amount of debt they can issue and are also exempt from the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act (the “Basel III Capital Rules”). The SBHC Policy Statement does not apply to the Bank and the Bank must comply with the Basel III Capital Rules.

The Bank is required to comply with the capital adequacy standards established by the Federal Deposit Insurance Corporation (“FDIC”). The FDIC has adopted rules to implement the Basel III Capital Rules. The Basel III Capital Rules establish minimum capital ratios and risk weightings that are applied to many classes of assets held by community banks, including applying higher risk weightings to certain commercial real estate loans.

The Basel III Capital Rules require banks to comply with the following minimum capital ratios: (1) a ratio of common equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7%); (2) a ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (effectively resulting in a minimum Tier 1 capital ratio of 8.5%); (3) a ratio of total capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (effectively resulting in a minimum total capital ratio of 10.5%); and (4) a leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter). The capital conservation buffer is designed to absorb losses during periods of economic stress and was fully phased in as at January 1, 2019. Banking organizations with a ratio of common equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall. As of December 31, 2020, the Bank exceeded the minimum ratios under the Basel III Capital Rules.

The Bank must also comply with the capital requirements set forth in the “prompt corrective action” regulations pursuant to Section 38 of the Federal Deposit Insurance Act of 1950. To be well capitalized under these regulations, a bank must have the following minimum capital ratios: (1) a common equity Tier 1 capital ratio of at least 6.5%; (2) a Tier 1 risk-based capital ratio of at least 8.0%; (3) a total risk-based capital ratio of at least 10.0%; and (4) a leverage ratio of at least 5.0%. As of December 31, 2020, the Bank exceeded the minimum ratios to be classified as well capitalized.

On September 17, 2019, the federal bank regulators issued a final rule required by the EGRRCPA that permits qualifying banks and bank holding companies that have less than \$10 billion of assets, like the Company and the Bank, to elect to be subject to a 9% leverage ratio that would be applied using less complex leverage calculations (commonly referred to as the community bank leverage ratio or “CBLR”). Under the rule, which became effective January 1, 2020, banks and bank holding companies that opt into the CBLR framework and maintain a CBLR of greater than 9% would not be subject to other risk-based and leverage capital requirements under the Basel III Capital Rules and would be deemed to have met the well capitalized ratio requirements under the “prompt corrective action” framework. In April 2020, as required by the Coronavirus Aid, Relief, and Economic Security Act, which was passed in response to the COVID-19 pandemic, federal bank regulators issued two interim final rules related to the CBLR framework. One interim final rule provides that, as of the second quarter of 2020, banking organizations with leverage ratios of 8% or greater (and that meet the other existing qualifying criteria) may elect to use the CBLR framework. It also establishes a two-quarter grace period for qualifying community banking organizations whose leverage ratios fall below the 8% CBLR requirement, so long as the banking organization maintains a leverage ratio of 7% or greater. The second interim final rule provides a transition from the temporary 8% CBLR requirement to a 9% CBLR requirement. It establishes a minimum CBLR of 8% for the second through fourth quarters of 2020, 8.5% for 2021, and 9% thereafter, and maintains a two-quarter grace period for qualifying community banking organizations whose leverage ratios fall no more than 100 basis points below the applicable CBLR requirement. The Bank elected not to opt into the CBLR framework as of December 31, 2020.

The capital amounts and ratios at December 31, 2020 and 2019 for the Bank are presented in the table below (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2020						
Total capital (to risk-weighted assets)						
Village Bank	\$ 65,723	14.20%	\$ 37,015	8.00%	\$ 46,269	10.00%
Tier 1 capital (to risk-weighted assets)						
Village Bank	61,753	13.35%	27,761	6.00%	37,015	8.00%
Leverage ratio (Tier 1 capital to average assets)						
Village Bank	61,753	9.28%	26,607	4.00%	33,259	5.00%
Common equity tier 1 (to risk-weighted assets)						
Village Bank	61,753	13.35%	20,821	4.50%	30,075	6.50%
December 31, 2019						
Total capital (to risk-weighted assets)						
Village Bank	\$ 54,653	12.56%	\$ 34,807	8.00%	\$ 43,508	10.00%
Tier 1 capital (to risk-weighted assets)						
Village Bank	52,867	12.15%	26,015	6.00%	34,807	8.00%
Leverage ratio (Tier 1 capital to average assets)						
Village Bank	52,867	9.69%	21,823	4.00%	27,278	5.00%
Common equity tier 1 (to risk-weighted assets)						
Village Bank	52,867	12.15%	19,579	4.50%	28,280	6.50%

Note 14. Stock Incentive Plans

In accordance with accounting standards, the Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost is recognized over the period during which an employee is required to provide service in exchange for the award rather than disclosed in the financial statements.

The following table summarizes options outstanding under the Company's stock incentive plans at the indicated dates:

	Year Ended December 31,							
	2020		2019					
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	734	\$ 25.63	\$ 9.76		734	\$ 25.63	\$ 9.76	
Granted	-	-	-		-	-	-	
Forfeited	-	-	-		-	-	-	
Exercised	-	-	-		-	-	-	
Options outstanding, end of period	734	\$ 25.63	\$ 9.76	\$ -	734	\$ 25.63	\$ 9.76	\$ -
Options exercisable, end of period	734				734			

The following table summarizes information about stock options outstanding at December 31, 2020:

Range of Exercise Prices	Outstanding			Exercisable	
	Number of Options	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$25.28-\$25.76	734	2.57	\$ 25.63	734	\$ 25.63
	734	2.57	25.63	734	25.63

During 2020, we granted certain officers time-based restricted shares of common stock and performance-based restricted stock units. The time-based restricted shares vest ratably over a three year period provided the officer is employed with the Company on the applicable vesting date. The performance-based units which have a two-year performance period that began on January 2, 2021, vest based on the Company's achievement of performance targets related to return on tangible common equity and the adversely classified items ratio over the performance period with possible payouts ranging from 0% to 150% of the target awards.

During 2019, we granted certain officers time-based restricted shares of common stock and performance-based restricted stock units. The time-based shares vest ratably over a three-year period provided that the officer is employed with the Company on the applicable vesting date. The performance-based units, which have a two-year performance period that began on January 2, 2020, vest based on the Company's achievement of performance targets related to return on tangible common equity and the adversely classified items ratio with possible payouts ranging from 0% to 150% of the target awards.

The total number of shares underlying non-vested restricted stock was 24,529 and 12,310 at December 31, 2020 and 2019, respectively. The fair value of the stock is based on the grant date of the award and the expense is recognized over the vesting period. Unamortized stock-based compensation related to non-vested share-based compensation arrangements granted under the stock incentive plan as of December 31, 2020 and 2019 was \$593,000 and \$364,000, respectively. The time based unrecognized compensation of

\$455,000 is expected to be recognized over a weighted average period of 2.28 years. During 2020 and 2019, there were forfeitures of 1,094 and 8,274 shares of restricted stock awards, respectively.

A summary of changes in the Company's non-vested restricted stock awards for the year follows:

	Shares	Weighted- Average Grant-Date Fair-Value	Aggregate Intrinsic Value
December 31, 2019	12,310	\$ 33.83	\$ 423,341
Granted	17,798	29.67	612,073
Vested	(4,731)	33.83	(162,699)
Forfeited	(1,094)	33.82	(37,623)
Other ⁽¹⁾	246	33.82	8,460
December 31, 2020	24,529	\$ 30.87	\$ 843,552

⁽¹⁾ Represents the incremental increase in shares that vested based on the restricted stock units vesting at the maximum potential value as opposed to the targeted value of the award.

Stock-based compensation expense was \$240,000 and \$413,000 for the years ended December 31, 2020 and 2019, respectively.

Note 15. Trust Preferred Securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, \$5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate was 2.38% and 4.06% at December 31, 2020 and 2019, respectively. The securities were redeemable at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. No amounts have been redeemed at December 31, 2020 and there are no plans to do so. The principal asset of the Trust is \$5.2 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, \$3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.4%) which adjusts and is also payable quarterly. The interest rate was 1.63% and 3.31% at December 31, 2020 and 2019, respectively. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. No amounts have been redeemed at December 31, 2020 and there are no plans to do so. The principal asset of the Trust is \$3.6 million of the Company's junior subordinated securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust's obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral

of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends. The Company is current on these interest payments.

Note 16. Subordinated Debt Offering

On March 21, 2018, the Company issued \$5,700,000 of fixed-to-floating rate subordinated notes due March 31, 2028 in a private placement. The Company received \$5,539,000 in net proceeds after deducting issuance costs. The subordinated notes accrue interest at a fixed rate of 6.50% for the first five years until March 31, 2023; thereafter, the subordinated notes will accrue interest at an annual floating rate equal to three-month LIBOR plus a spread of 3.73% until maturity or early redemption. The Company may redeem the subordinated notes in whole or in part, on or after March 31, 2023. The subordinated notes are unsecured and subordinated in right of payment to all of the Company's existing and future senior indebtedness, whether secured or unsecured, including claims of depositors and general creditors, and rank equally in right of payment with any unsecured, subordinated indebtedness that the Company may incur in the future. At December 31, 2020, the carrying value of the notes totaled \$5,628,000.

Note 17. Retirement Plans

401K Plan: The Bank provides a qualified 401K plan to all eligible employees which is administered through the Virginia Bankers Association Benefits Corporation. Employees are eligible to participate in the plan after three months of employment. Eligible employees may, subject to statutory limitations, contribute a portion of their salary to the plan through payroll deduction. Due to economic conditions at the time, the Bank ceased its matching program in 2009; however, beginning January 2013, the Bank reinstated the 401K match. The Bank provided a matching contribution of 100% of the first 1% the participant contributes, and then 50% of the next 5% of their salary, totaling a maximum 3.5%. Participants are always fully vested in their own contributions, and the Bank's matching contributions vest 100% after two years of service. Total contributions to the plan for the years ended December 31, 2020 and 2019 were \$420,000, and \$351,000, respectively.

Supplemental Executive Retirement Plan: The Bank established the Village Bank SERP on January 1, 2005 to provide supplemental retirement income to certain executive officers as designated by the Personnel Committee, later replaced by the Compensation Committee, and approved by the board of directors. The SERP is an unfunded employee pension plan under the provisions of the Employee Retirement Income Security Act of 1974. An eligible employee, once designated by the Committee and approved by the board of directors in writing to participate in the SERP, becomes a participant in the SERP 60 days following such approval (unless an earlier participation date is approved). The retirement benefit to be received by a participant is determined by the Committee and approved by the board of directors and is payable in equal monthly installments over the period specified in the SERP for each respective participant, commencing on the first day of the month following a participant's retirement or termination of employment, provided the participant has been employed by the Bank for a minimum of 10 years. The Compensation Committee, in its sole discretion, may choose to treat a participant who has experienced a termination of employment on or after attaining age 65 but prior to completing his service requirement as having completed his service requirement. During the second quarter of 2019, the ownership of the Company's largest shareholder exceeded 50% of the Company's outstanding common stock, which triggered change in control provisions included in the SERP. The SERP provides for the acceleration of the vesting of benefits in the event of a change in control, which resulted in the three executives participating in the plan becoming fully vested as of the date of the change in control. At December 31, 2020 and 2019, the Bank's liability under the SERP was \$2,524,000 and \$2,546,000, respectively, and expense for the years ended December 31, 2020 and 2019 was \$133,000 and \$513,000, respectively. The increase in other comprehensive income related to the minimum pension adjustment was \$9,000 net of tax for the years ended December 31, 2020 and 2019. The increase in cash surrender value of the bank owned life insurance related to the participants was \$194,000 and \$171,000 for the years ended December 31, 2020 and 2019, respectively.

Directors' Deferral Plan: The Bank established the Village Bank Outside Directors Deferral Plan (the "Directors Deferral Plan") on January 1, 2005 under which non-employee directors of the Bank have the opportunity to defer receipt of all or a portion of certain compensation until retirement or departure from the board of directors. Deferral of compensation under the Directors Deferral Plan is voluntary by non-employee directors and to participate in the plan a director must file a deferral election as provided in the plan. A director shall become an active participant with respect to a plan year (as defined in the plan) only if he is expected to have compensation during the plan year and he timely files a deferral election. A separate account is established for each participant in the plan and each account shall, in addition to compensation deferred at the election of the participant, be credited with interest on the balance of the account, the rate of such interest to be established by the board of directors in its sole discretion at the beginning of each plan year. For those directors electing to purchase stock, the obligation will only be settled by delivery of the fixed number of shares they purchased. At December 31, 2020 and 2019, the Bank's liability under the Directors Deferral Plan was \$524,000 and \$419,000, respectively, and expense for the years ended December 31, 2020 and 2019 was \$111,000 and \$109,000, respectively. In the first quarter of 2015 and the fourth quarter of 2013, certain directors elected to purchase common stock with funds from their deferred compensation accounts causing the December 31, 2015 and December 31, 2013 liability to be lower than the December 31, 2014 liability. A rabbi trust was established to hold the shares. At December 31, 2020 and 2019, the trust held 37,290 and 40,875 shares, respectively, of Company common stock totaling \$771,000 and \$856,000, respectively.

Note 18. Fair Value

The Company determines the fair value of its financial instruments based on the requirements established in ASC 820: *Fair Value Measurements*, which provides a framework for measuring fair value under GAAP and requires an entity to maximize the use of observable inputs when measuring fair value. ASC 820 defines fair value as the exit price, the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date under current market conditions.

ASC 820 establishes a hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair values hierarchy is as follows:

Level 1 Inputs — Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Inputs — Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Inputs — Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods to determine the fair value of each type of financial instrument:

Securities: Fair values for securities available-for-sale are obtained from an independent pricing service. The prices are not adjusted. The independent pricing service uses industry-standard models to price U.S. Government agency obligations and mortgage backed securities that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace (Levels 1 and 2). If the inputs used to provide the evaluation for certain

securities are unobservable and/or there is little, if any, market activity, then the security would fall to the lowest level of the hierarchy (Level 3).

Impaired loans: The Company does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is considered impaired and an allowance for loan losses is established. The Company measures impairment either based on the fair value of the loan using the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent, or using the present value of expected future cash flows discounted at the loan's effective interest rate, which is not a fair value measurement. The Company maintains a valuation allowance to the extent that this measure of the impaired loan is less than the recorded investment in the loan. When an impaired loan is measured at fair value based solely on observable market prices or a current appraisal without further adjustment for unobservable inputs, the Company records the impaired loan as a nonrecurring fair value measurement classified as Level 2. However, if based on management's review, additional discounts to observed market prices or appraisals are required or if observable inputs are not available, the Company records the impaired loan as a nonrecurring fair value measurement classified as Level 3. Impaired loans that are measured based on expected future cash flows discounted at the loan's effective interest rate rather than the market rate of interest, are not recorded at fair value and are therefore excluded from fair value disclosure requirements

Loans held for sale: During the first quarter of 2020, the Company elected to begin using fair value accounting for its entire portfolio of LHFS in accordance with ASC 820 - Fair Value Measurement and Disclosures. Fair value of the Company's LHFS is based on observable market prices for similar instruments traded in the secondary mortgage loan markets in which the Company conducts business. The Company's portfolio of LHFS is classified as Level 2. At December 31, 2019, these loans were carried at the lower of cost or estimated fair value on an aggregate basis as determined by outstanding commitments from investors. Gains and losses on the sale of loans are recorded within mortgage banking income, net on the Consolidated Statements of Income.

Derivative asset – IRLCs: Beginning with the first quarter of 2020, the Company recognizes IRLCs at fair value based on the price of the underlying loans obtained from an investor for loans that will be delivered on a best efforts basis while taking into consideration the probability that the rate lock commitments will close. All of the Company's IRLCs are classified as Level 2. The fair value of IRLC was considered immaterial at December 31, 2019.

Derivative asset/liability – forward sale commitments: During the first quarter of 2020, the Company elected to begin using fair value accounting for its forward sales commitments related to IRLCs and LHFS. Best efforts sale commitments are entered into for loans intended for sale in the secondary market at the time the borrower commitment is made. The best efforts commitments are valued using the committed price to the counter-party against the current market price of the IRLC or mortgage LHFS. All of the Company's forward sale commitments are classified as Level 2.

Other Real Estate Owned: OREO assets are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Subsequently, OREO assets are carried at fair value less estimated costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Assets held for sale: Assets held for sale were transferred from premises and equipment at the lower of cost less accumulated depreciation or fair value at the date of transfer. The Company periodically evaluates the value of assets held for sale and records an impairment charge for any subsequent declines in fair value less selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the assets held for sale as

nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the asset held for sale as nonrecurring Level 3.

Assets and liabilities measured at fair value under Topic 820 on a recurring and non-recurring basis are summarized below for the indicated dates (in thousands):

	Fair Value Measurement at December 31, 2020 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets – Recurring				
US Government Agencies	\$ 8,142	\$ -	\$ 8,142	\$ -
Mortgage-backed securities	24,006	-	24,006	-
Subordinated debt	8,696	-	8,446	250
Loans held for sale	34,421	-	34,421	-
IRLC	1,552	-	1,552	-
Financial Liabilities - Recurring				
Forward sales commitment	3,105	-	3,105	-
Financial Assets - Non-Recurring				
Other real estate owned	336	-	-	336
	Fair Value Measurement at December 31, 2019 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets - Recurring				
US Government Agencies	\$ 14,845	\$ -	\$ 14,845	\$ -
Mortgage-backed securities	25,302	-	25,302	-
Subordinated debt	6,790	-	6,540	250
Financial Assets - Non-Recurring				
Impaired loans	1,468	-	-	1,468
Assets held for sale	514	-	-	514
Other real estate owned	526	-	-	526

The following table presents qualitative information about Level 3 fair value measurements for financial instruments measured at fair value for the years ended December 31, 2020 and 2019 (dollars in thousands):

	December 31, 2020			Range (Weighted Average)
	Fair Value Estimate	Valuation Techniques	Unobservable Input	
Other real estate owned	\$ 336	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)

(1) Fair Value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not identifiable

(2) Internal valuations may be conducted to determine Fair Value for assets with nominal carrying balances

December 31, 2019

	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Impaired loans - real estate secured	\$ 1,468	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (10%)
Assets held for sale	\$ 514	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (15%)
Other real estate owned	\$ 526	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)

(1) Fair Value is generally determined through independent appraisals of the underlying collateral, which generally includes various level 3 inputs which are not identifiable

(2) Internal valuations may be conducted to determine Fair Value for assets with nominal carrying balances

FASB ASC 825, Financial Instruments, requires disclosure about fair value of financial instruments, including those financial assets and financial liabilities that are not required to be measured and reported at fair value on a recurring or nonrecurring basis. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company. In accordance with ASU 2016-01, the Company uses the exit price notion, rather than the entry price notion, in calculating the fair values of financial instruments not measured at fair value on a recurring basis.

The following tables reflect the carrying amounts and estimated fair values of the Company's financial instruments whether or not recognized on the Consolidated Balance Sheet at fair value.

	Level in Fair Value Hierarchy	December 31, 2020		December 31, 2019	
		Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<i>(In thousands)</i>					
Financial assets					
Cash	Level 1	\$ 12,709	\$ 12,709	\$ 19,967	\$ 19,967
Cash equivalents	Level 2	30,742	30,742	-	-
Investment securities available for sale	Level 1	1,193	1,193	-	-
Investment securities available for sale	Level 2	39,401	39,401	46,687	46,687
Investment securities available for sale	Level 3	250	250	250	250
Federal Home Loan Bank stock	Level 2	484	484	1,694	1,694
Loans held for sale	Level 2	34,421	34,421	12,722	12,722
Loans	Level 3	561,003	562,362	427,827	429,254
Impaired loans	Level 3	-	-	1,468	1,468
Assets held for sale	Level 3	-	-	514	514
Other real estate owned	Level 3	336	336	526	526
Bank owned life insurance	Level 3	7,806	7,806	7,612	7,612
Accrued interest receivable	Level 2	4,943	4,943	2,597	2,597
Interest rate lock commitments	Level 2	1,552	1,552	-	-
Financial liabilities					
Deposits	Level 2	588,382	589,017	443,208	443,645
FHLB borrowings	Level 2	-	-	29,000	29,285
Trust preferred securities	Level 2	8,764	9,697	8,764	9,812
Other borrowings	Level 2	47,157	47,157	10,912	10,912
Accrued interest payable	Level 2	194	194	221	221
Forward sales commitment	Level 2	3,105	3,105	-	-

Note 19. Segment Reporting

The Company has two reportable segments: traditional commercial banking and mortgage banking. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage LHFS, gains on sales of loans in the secondary mortgage market, and loan origination fee income.

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on the commercial banking segment's cost of funds. Additionally, the mortgage banking segment leases premises from the commercial banking segment. These transactions are eliminated in the consolidation process.

The following table presents segment information as of and for the years ended December 31, 2020 and 2019 (in thousands):

	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Year Ended December 31, 2020				
Revenues				
Interest income	\$ 25,404	\$ 581	\$ (159)	\$ 25,826
Gain on sale of loans	-	11,703	-	11,703
Other revenues	2,688	1,408	(242)	3,854
Total revenues	28,092	13,692	(401)	41,383
Expenses				
Provision for loan losses	950	-	-	950
Interest expense	4,433	159	(159)	4,433
Salaries and benefits	8,867	4,053	-	12,920
Commissions	-	3,312	-	3,312
Other expenses	7,784	1,187	(242)	8,729
Total operating expenses	22,034	8,711	(401)	30,344
Income before income taxes	6,058	4,981	-	11,039
Income tax expense	1,439	1,046	-	2,485
Net income	\$ 4,619	\$ 3,935	\$ -	\$ 8,554
Total assets	\$ 704,258	\$ 18,604	\$ (16,626)	\$ 706,236
	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Year Ended December 31, 2019				
Revenues				
Interest income	\$ 23,079	\$ 539	\$ (131)	\$ 23,487
Gain on sale of loans	-	6,205	-	6,205
Other revenues	3,044	754	(220)	3,578
Total revenues	26,123	7,498	(351)	33,270
Expenses				
Provision for loan losses	135	-	-	135
Interest expense	5,330	131	-(131)	5,330
Salaries and benefits	9,047	3,194	-	12,241
Commissions	-	1,875	-	1,875
Other expenses	7,209	1,059	(220)	8,048
Total operating expenses	21,721	6,259	(351)	27,629
Income before income taxes				
Income tax expense	4,402	1,239	-	5,641
Net income	904	260	-	1,164
Total assets	\$ 3,498	\$ 979	\$ -	\$ 4,477
	\$ 542,053	\$ 10,924	\$ (12,664)	\$ 540,313

Note 20. Parent Corporation Only Financial Statements

**Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Condensed Balance Sheet
(in thousands)**

	December 31, 2020	December 31, 2019
Assets		
Cash and due from banks	\$ 1,549	\$ 1,007
Investment in subsidiaries	62,183	53,768
Investment in special purpose subsidiary	264	264
Prepaid expenses and other assets	2,438	2,284
	<u>\$ 66,434</u>	<u>\$ 57,323</u>
Liabilities and Shareholders' Equity		
Liabilities		
Balance due to nonbank subsidiaries	\$ 8,764	\$ 8,764
Other borrowings	5,628	5,595
Accrued interest payable	46	47
Other liabilities	-	3
Total liabilities	<u>14,438</u>	<u>14,409</u>
Shareholders' equity		
Common stock	5,794	5,779
Additional paid-in capital	54,510	54,285
Accumulated deficit	(8,738)	(17,292)
Stock in directors rabbi trust	(771)	(856)
Directors deferred fees obligation	771	856
Accumulated other comprehensive income	430	142
Total stockholders' equity	<u>51,996</u>	<u>42,914</u>
	<u>\$ 66,434</u>	<u>\$ 57,323</u>

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Condensed Statements of Operations and Comprehensive Income
Years Ended December 31, 2020 and 2019
(in thousands)

	2020	2019
Income		
Interest income	\$ 4	\$ 3
Dividends received from subsidiaries	1,250	1,000
Total Income	1,254	1,003
Interest expense		
Interest on borrowed funds	631	775
Total interest expense	631	775
Net interest expense	623	228
Noninterest expense		
Supplies	30	30
Professional and outside services	39	61
Other	43	42
Total noninterest expense	112	133
Net loss before undistributed income (loss) of subsidiary	511	(905)
Undistributed income (loss) of subsidiary	7,888	4,192
Net income before income tax benefit	8,399	4,287
Income tax benefit	(155)	(190)
Net income	\$ 8,554	\$ 4,477
Total comprehensive income	\$ 8,842	\$ 5,368

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Condensed Statements of Cash Flows
Years Ended December 31, 2020 and 2019
(in thousands)

	2020	2019
Cash Flows from Operating Activities		
Net income	\$ 8,554	\$ 4,477
Adjustments to reconcile net income		
to net cash used in operating activities		
Amortization of debt issuance costs	33	32
Undistributed income of subsidiary	(9,138)	(5,192)
Net change in:		
Other assets	(154)	(190)
Interest Payable	-	-
Other liabilities	(3)	3
Net cash used in operating activities	(708)	(870)
Cash Flows from Investing Activities		
Dividend from subsidiary	1,250	1,000
Net cash provided by investing activities	1,250	1,000
Cash Flows from Financing Activities		
Net cash provided by financing activities	-	-
Net increase in cash	542	130
Cash, beginning of year	1,007	877
Cash, end of year	\$ 1,549	\$ 1,007

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that as of December 31, 2020, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and regulations and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Company's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Company or its subsidiaries to disclose material information otherwise required to be set forth in the Company's periodic reports.

Management's Report on Internal Control over Financial Reporting. Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance to the Company's management and board of directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2020. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework (2013)*. Based on our assessment, we believe that, as of December 31, 2020, the Company's internal control over financial reporting was effective based on those criteria.

Changes in Internal Control Over Financial Reporting. There has been no change in the Company's internal control over financial reporting during the fourth quarter of the fiscal year ended December 31, 2020 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required to be disclosed in this Item 10 is contained in the Company's Proxy Statement for the 2021 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required to be disclosed in this Item 11 is contained in the Company's Proxy Statement for the 2021 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information required to be disclosed in this Item 12 is contained in the Company's Proxy Statement for the 2021 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required to be disclosed in this Item 13 is contained in the Company's Proxy Statement for the 2021 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required to be disclosed in this Item 14 is contained in the Company's Proxy Statement for the 2021 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

The following consolidated financial statements and reports are included in Part II, Item 8, of this report on Form 10-K.

Reports of Independent Registered Public Accounting Firm (Yount, Hyde & Barbour, P.C.)

Consolidated Balance Sheets – December 31, 2020 and 2019

Consolidated Statements of Income – Years Ended December 31, 2020 and 2019

Consolidated Statements of Comprehensive Income – Years Ended

December 31, 2020 and 2019

Consolidated Statements of Shareholders' Equity – Years Ended December 31, 2020 and 2019

Consolidated Statements of Cash Flows – Years Ended December 31, 2020 and 2019

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

All schedules are omitted since they are not required, are not applicable, or the required information is shown in the consolidated financial statements or notes thereto.

(a)(3) Exhibits

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

<u>Exhibit Number</u>	<u>Description</u>
3.1	Articles of Incorporation of Village Bank and Trust Financial Corp., as amended (incorporated herein by reference to Exhibit 3.1 of the Quarterly Report on Form 10-Q for the period ended September 30, 2014, filed with the Securities and Exchange Commission on October 31, 2014).
3.2	Amended and Restated Bylaws of Village Bank and Trust Financial Corp. (incorporated herein by reference to Exhibit 3.2 of the Current Report on Form 8-K, filed with the Securities and Exchange Commission on March 26, 2020).
4.1	Specimen of Certificate for Village Bank and Trust Financial Corp. common stock (incorporated by reference to Exhibit 4.1 of the Form S-1 Registration Statement filed with the Securities and Exchange Commission on November 12, 2014 (SEC File No. 333-200147)).
4.2	Form of Subordinated Note (incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 21, 2018).
4.3	Description of Village Bank and Trust Financial Corp.'s Securities.
10.1	Employment Agreement, dated October 1, 2017, by and between Village Bank and Trust Financial Corp. and William G. Foster (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 4, 2017).*
10.2	Transition and Consulting Agreement, dated August 4, 2020, by and between Village Bank and Trust Financial Corp. and William G. Foster, Jr. (incorporated

by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on August 10, 2020).*

- 10.3 Employment Agreement, dated July 28, 2020, by and between Village Bank and Trust Financial Corp. and James E. Hendricks, Jr. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 31, 2020).*
- 10.4 Supplemental Executive Retirement Plan, dated December 30, 2020, by and between Village Bank and Trust Financial Corp. and James E. Hendricks, Jr. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 2, 2021). *
- 10.5 Employment Agreement, dated September 4, 2020, by and between Village Bank and Max C. Morehead, Jr. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on September 10, 2020).*
- 10.6 Amended and Restated Change of Control Agreement, dated March 24, 2020, by and between Village Bank and Trust Financial Corp. and Donald M. Kaloski, Jr. (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 26, 2020).*
- 10.7 Change of Control Agreement, dated August 24, 2020, by and between Village Bank and Christy F. Quesenbery (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on August 28, 2020).*
- 10.8 Incentive Plan, as amended June 18, 2014 (incorporated by reference to Exhibit 99.1 of the Form S-8 Registration Statement filed with the Securities and Exchange Commission on June 18, 2014 (SEC File No. 333-196893)).*
- 10.9 Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.5 of the Annual Report on Form 10-KSB for the year ended December 31, 2004).*
- 10.10 Form of Non-Employee Director Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.6 of the Annual Report on Form 10-KSB for the year ended December 31, 2004).*
- 10.11 Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan, as amended (incorporated by reference to Appendix A of the Proxy Statement for the Annual Meeting of Shareholders held on May 19, 2020, filed with the Securities and Exchange Commission on April 6, 2020).*
- 10.12 Form of Performance-Based Restricted Stock Unit Award Agreement under the Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 8, 2015).*
- 10.13 Form of Time-Based Restricted Stock Award Agreement under the Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 8, 2015).*

- 10.14 Village Bank and Trust Financial Corp. Deferred Compensation Plan (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on November 22, 2019).*
- 10.15 Outside Directors Deferral Plan, dated January 1, 2005 (incorporated by reference to Exhibit 10.9 of the Annual Report on Form 10-K for the year ended December 31, 2010).*
- 10.16 Supplemental Executive Retirement Plan, dated January 1, 2005 (incorporated by reference to Exhibit 10.10 of the Annual Report on Form 10-K for the year ended December 31, 2010).*
- 10.17 Form of Subordinated Note Purchase Agreement (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on March 21, 2018).
- 21 Subsidiaries of Village Bank and Trust Financial Corp.
- 23.1 Consent of Yount, Hyde & Barbour, P.C. Accounting Firm.
- 31.1 Section 302 Certification by Chief Executive Officer.
- 31.2 Section 302 Certification by Chief Financial Officer.
- 32 Section 906 Certification.
- 101 The following materials from the Village Bank and Trust Financial Corp. Annual Report on Form 10-K for the year ended December 31, 2020 formatted in eXtensible Business Reporting (XBRL) (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Shareholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Condensed Consolidated Financial Statements.

* Management contracts and compensatory plans and arrangements.

ITEM 16. FORM 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VILLAGE BANK AND TRUST FINANCIAL CORP.

Date: March 19, 2021

By: /s/ James E. Hendricks, Jr.
James E. Hendricks, Jr.
President and Chief Executive Officer

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ James E. Hendricks, Jr.</u> James E. Hendricks, Jr.	President, Chief Executive Officer and Director (Principal Executive Officer)	March 19, 2021
<u>/s/ Donald M. Kaloski, Jr.</u> Donald M. Kaloski, Jr.	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 19, 2021
<u>/s/ R.T. Avery, III</u> R.T. Avery, III	Director	March 19, 2021
<u>/s/ Craig D. Bell</u> Craig D. Bell	Director and Chairman of the Board	March 19, 2021
<u>/s/ Michael A. Katzen</u> Michael A. Katzen	Director	March 19, 2021
<u>/s/ George R. Whittemore</u> George R. Whittemore	Director	March 19, 2021
<u>/s/ Michael L. Toalson</u> Michael L. Toalson	Director	March 19, 2021
<u>/s/ Frank E Jenkins, Jr.</u> Frank E Jenkins, Jr.	Director	March 19, 2021
<u>/s/ Devon M. Henry</u> Devon M. Henry	Director	March 19, 2021
<u>/s/ Mary Margaret Kastelberg</u> Mary Margaret Kastelberg	Director	March 19, 2021

DESCRIPTION OF VILLAGE BANK AND TRUST FINANCIAL CORP.'S SECURITIES

As of December 31, 2020, the common stock of Village Bank and Trust Financial Corp. (the "Company") was the only class of its securities registered under Section 12 of the Securities Exchange Act of 1934. The following summary description of the material features of the Company's common stock does not purport to be complete and is subject to, and qualified in its entirety by reference to, the Company's articles of incorporation and bylaws, each as amended. For more information, refer to the Company's articles of incorporation and bylaws and any applicable provisions of relevant law, including the Virginia Stock Corporation Act and federal laws governing banks and bank holding companies.

General

The Company is authorized to issue 10,000,000 shares of common stock, par value \$4.00 per share. Each share of the Company's common stock has the same relative rights as, and is identical in all respects to, each other share of the Company's common stock. The Company's common stock is listed on the Nasdaq Capital Market under the symbol "VBFC." Computershare, Inc., 250 Royall Street, Canton, Massachusetts, is the transfer agent for the Company's common stock.

Voting Rights

Except as otherwise provided by law, each holder of the Company's common stock has one vote per share on all matters voted upon by shareholders. Directors are elected by a plurality of the votes cast and shareholders do not have the right to accumulate their votes in the election of directors.

Dividends

Holders of shares of the Company's common stock are entitled to receive dividends when and as declared by the Company's board of directors out of funds legally available therefor. The payment of distributions by the Company is subject to the restrictions of Virginia law applicable to the declaration of distributions by a corporation. A Virginia corporation generally may not authorize and make distributions if, after giving effect to the distribution, it would be unable to meet its debts as they become due in the usual course of business or if the corporation's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if it were dissolved at that time, to satisfy the preferential rights of shareholders whose rights are superior to the rights of those receiving the distribution. In addition, the payment of distributions to shareholders is subject to any prior rights of outstanding preferred stock.

As a bank holding company, the Company's ability to pay dividends is affected by the ability of Village Bank, the Company's bank subsidiary, to pay dividends to the Company. The ability of Village Bank to pay dividends is influenced by bank regulatory requirements and capital guidelines.

Liquidation Rights

In the event of the Company's liquidation, dissolution or winding up, the holders of shares of the Company's common stock are entitled to receive, in cash or in kind, the Company's assets available for distribution remaining after payment or provision for payment of the Company debts and liabilities and after satisfaction of all liquidation preferences applicable to any preferred stock.

Classes of Directors

The Company's board of directors is divided into three classes, apportioned as evenly as possible, with directors serving staggered three-year terms.

No Preemptive or Conversion Rights; Redemption and Assessment

Holders of shares of the Company's common stock do not have preemptive rights to purchase additional shares of common stock and have no conversion or redemption rights. The Company's common stock is not subject to redemption or any sinking fund and the outstanding shares are fully paid and nonassessable.

Preferred Stock

The Company's board of directors may, from time to time, without shareholder approval, issue shares of the Company's authorized, undesignated preferred stock, in one or more classes or series. In connection with any such issuance, the board of directors may by resolution determine the designation, voting rights, preferences as to dividends, in liquidation or otherwise, participation, redemption, sinking fund, conversion, dividend or other special rights or powers, and the limitations, qualifications and restrictions of such shares of preferred stock. The creation and issuance of any series of preferred stock, and the relative rights, designations and preferences of such series, if and when established, will depend upon, among other things, the future capital needs of the Company, then existing market conditions and other factors that, in the judgment of the Company's board, might warrant the issuance of preferred stock.

Anti-takeover Considerations

Certain provisions of the Company's articles of incorporation and bylaws may discourage attempts to acquire control of the Company. These provisions also may render the removal of one or all directors more difficult or deter or delay corporate changes of control that the Company's board of directors did not approve. These provisions include the following:

Classified Board of Directors. The Company's board of directors is divided into three classes of directors serving staggered three-year terms. As a result, approximately one-third of the board of directors will be elected at each annual meeting of shareholders. The classification of directors, together with the provision in the articles of incorporation that permits the remaining directors to fill any vacancies on the board of directors, will have the effect of making it more difficult for shareholders to change the composition of the board of directors. As a result, at least two annual meetings of shareholders may be required for the shareholders to change a majority of the directors, whether or not a change in the board of directors would be beneficial and whether or not a majority of shareholders believe that such a change would be desirable.

Authorized Preferred Stock. The Company's articles of incorporation authorize the board of directors, subject to applicable Virginia law and federal banking regulations, to authorize the issuance of preferred stock at such times, for such purposes and for such consideration as the board may deem advisable without further shareholder approval. The issuance of preferred stock under certain circumstances may have the effect of discouraging an attempt by a third party to acquire control of the Company by, for example, authorizing the issuance of a series of preferred stock with rights and preferences designed to impede the proposed transaction.

Supermajority Voting Provisions. The Company's articles of incorporation state that certain significant corporate actions must be approved by a majority of all the votes entitled to be cast on the action by each voting group entitled to vote at a meeting at which a quorum of the voting group is present, provided that the action has been approved and recommended by at least two-thirds of the directors in office at the time of such approval and recommendation. If the action is not so approved and recommended by two-thirds of the directors in office, then the action must be approved by the affirmative vote of 80% or more

of all of the votes entitled to be cast on such action by each voting group entitled to vote. These significant corporate actions include: adoption of amendments to the Company's articles of incorporation; adoption of plans of merger or share exchange; sales of all or substantially all of the Company's assets other than in the ordinary course of business; and adoption of plans of dissolution.

No Cumulative Voting. The Company's articles of incorporation do not provide for cumulative voting for any purpose. The absence of cumulative voting may afford anti-takeover protection by making it more difficult for the Company's shareholders to elect nominees opposed by the board of directors.

Shareholder Meetings. Pursuant to the Company's bylaws, special meetings of shareholders may be called only by the Company's president or board of directors. As a result, shareholders are not able to act on matters other than at annual shareholders' meetings unless they are able to persuade the president or a majority of the board of directors to call a special meeting.

Advance Notification Requirements. The Company's bylaws require a shareholder who desires to raise new business, or nominate a candidate for election to the board of directors, at an annual meeting of shareholders to provide advance notice of at least 60 days and not more than 90 days before the date of the scheduled annual meeting; provided that in the event that less than 70 days' notice or prior public disclosure of the date of the scheduled annual meeting is given or made, notice by a shareholder, to be timely, must be received not later than the close of business on the 10th day following the earlier of the date on which such notice of the meeting was mailed or the date public disclosure of the meeting was made. The bylaws require a shareholder who desires to raise new business to provide certain information to the Company concerning the nature of the new business, the shareholder and the shareholder's interest in the business matter. Similarly, a shareholder wishing to nominate any person for election as a director must provide the Company with certain information concerning the nominee and the proposing shareholder. Such requirements may discourage the Company's shareholders from submitting nominations and proposals.

Subsidiaries of Village Bank and Trust Financial Corp.

<u>Name of Subsidiary</u>	<u>State of Organization</u>
Village Bank	Virginia
Village Bank Mortgage Corporation (wholly-owned subsidiary of Village Bank)	Virginia
Village Insurance Agency, Inc. (wholly-owned subsidiary of Village Bank)	Virginia
Village Financial Services Corporation (wholly-owned subsidiary of Village Bank)	Virginia
Southern Community Financial Capital Trust I	Virginia
Village Financial Statutory Trust II	Virginia



CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements on Form S-8 (No. 333-205407, No. 333-196893, No. 333-192408 and No. 333-239454) and Form S-3 (No. 333-159594) of Village Bank and Trust Financial Corp. of our report dated March 19, 2021, relating to our audit of the consolidated financial statements included in the Annual Report on Form 10-K of Village Bank and Trust Financial Corp. and Subsidiary for the year ended December 31, 2020.

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

Richmond, Virginia
March 19, 2021

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, James E. Hendricks, Jr., certify that:

1. I have reviewed this Annual Report on Form 10-K of Village Bank and Trust Financial Corp. for the year ended December 31, 2020;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 19, 2021

By: /s/ James E. Hendricks, Jr.
 James E. Hendricks, Jr.
 President and
 Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Donald M. Kaloski, Jr., certify that:

1. I have reviewed this Annual Report on Form 10-K of Village Bank and Trust Financial Corp. for the year ended December 31, 2020;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 19, 2021

By: /s/ Donald M. Kaloski, Jr.
Donald M. Kaloski, Jr.
Executive Vice President and
Chief Financial Officer

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

In connection with the Annual Report of Village Bank and Trust Financial Corp. (the “Company”) on Form 10-K for the year ended December 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on their knowledge and belief:

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

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

/s/ James E. Hendricks, Jr.
James E. Hendricks, Jr.
President and Chief Executive Officer

March 19, 2021
Date

/s/ Donald M. Kaloski, Jr.
Donald M. Kaloski, Jr.
Executive Vice President and Chief Financial Officer

March 19, 2021
Date

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