

&F Financial Center

&F Bank
Focused on You

&F Bank
Focused on You

Peoples Community Bank Two great Bank Families...
Becoming your Community Bank!

&F Bank
Focused on You

COMING SOON **&F Bank** IN 2020...
Focused on You

MEMBER FDIC | EQUAL HOUSING LENDER

Opening Summer 2020!





C&F Financial Corporation is a one-bank holding company providing a full range of banking services to individuals and businesses through its subsidiaries.



C&F Bank (Citizens and Farmers Bank) offers quality banking services to individuals and businesses through 30 retail branches located in Virginia.



C&F Mortgage Corporation originates and sells residential mortgages throughout Virginia, West Virginia, Maryland, North Carolina and South Carolina. Through its subsidiary, C&F Mortgage also provides residential appraisal services.



C&F Finance Company specializes in new and used indirect auto, marine, and recreational vehicle lending in select areas of the following states: Alabama, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Minnesota, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, Virginia and West Virginia.

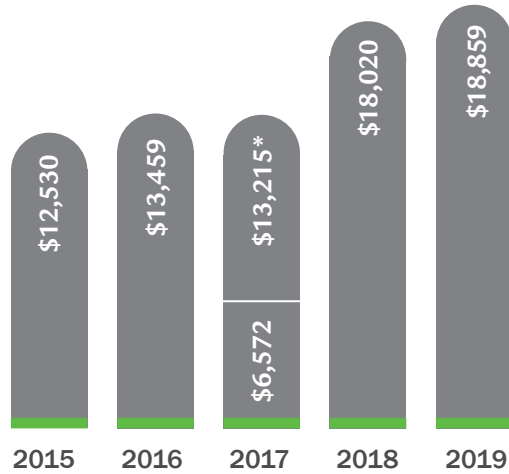


C&F Wealth Management Corporation provides a full range of securities brokerage, life and health insurance, and investment services to individuals and businesses through C&F Bank's 30 retail branch locations.

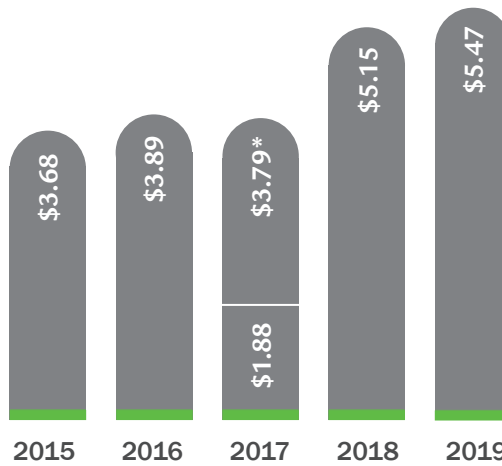


Financial Performance

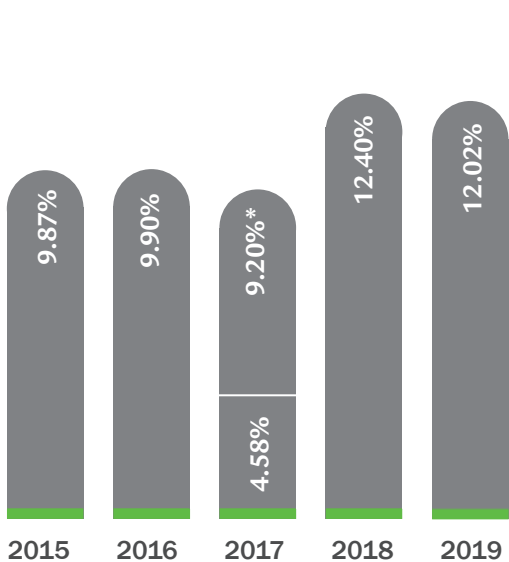
Net Income (in thousands)



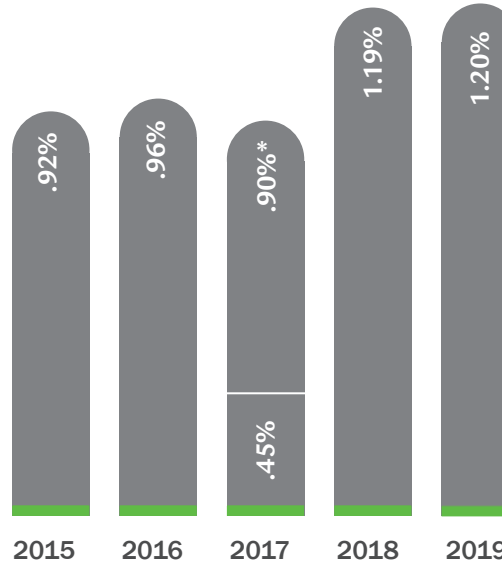
Earnings Per Share (assuming dilution)



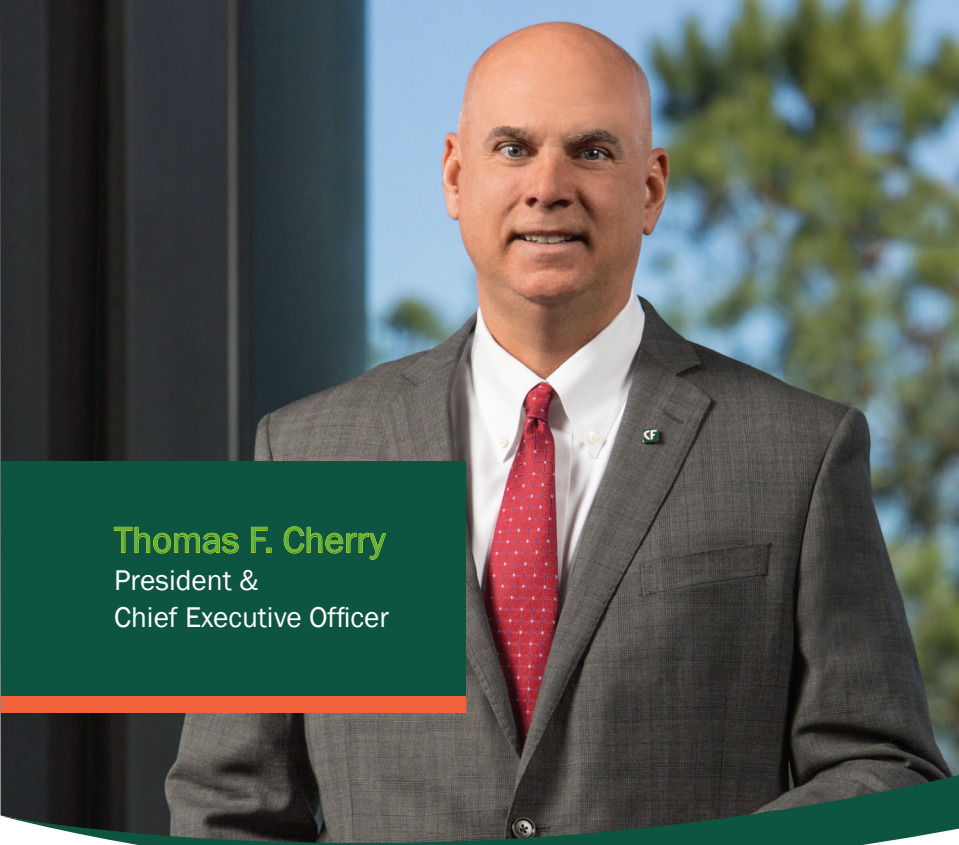
Return on Average Equity



Return on Average Assets



*The figures presented above include non-U.S. GAAP financial measures that reflect certain adjustments to performance measures for the year ended December 31, 2017. Refer to Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Use of Certain Non-U.S. GAAP Financial Measures" included in the accompanying Form 10-K for the fiscal year ended December 31, 2019 for additional information regarding the derivation of these measures.



Letter to Our Shareholders

Thomas F. Cherry
President &
Chief Executive Officer

It is our pleasure to present C&F Financial Corporation's ("C&F") 2019 annual report. Our 2019 net income of \$18.9 million set a new record, higher than our 2018 record of \$18.0 million. This represents \$5.47 per share for 2019 compared to \$5.15 per share in 2018. For 2019, our return on average equity was 12.02% and our return on average assets was 1.20%. We also increased our quarterly dividend to \$.38 per share in the fourth quarter of 2019. Total assets exceeded \$1.6 billion and loans increased to just under \$1.1 billion while deposits grew to just under \$1.3 billion at the end of 2019. Our capital increased to \$165 million, which is critical to our safety and soundness and ability to invest in our future. These results for 2019 include approximately \$650 thousand in costs (net of tax) associated with the merger of Peoples Bankshares, Inc. into C&F.

We are very excited about the merger of Peoples Bankshares, Inc., the parent of Peoples Community Bank (Peoples), into C&F, which was announced in August 2019 and closed on January 1, 2020. Peoples is headquartered in Montross, Virginia and has been in business since 1913, now offering five retail branches that serve the communities of Dahlgren, Fredericksburg, King George, Montross, and Warsaw on the Northern Neck of Virginia. At the time of purchase, Peoples had \$192 million in total assets and \$172 million in deposits. These branches are expected to convert to C&F Bank products, systems, and signage in the second quarter of 2020, making our combined footprint 30 locations across Eastern and Central Virginia.

This merger represents a unique opportunity to offer Peoples customers the product breadth and conveniences of a larger institution that is firmly committed to local communities. It also positions us to grow future profitability by leveraging capital investments we have already made and continuing to invest in customer service initiatives, employee education, and our infrastructure. This affirms our commitment to independent community banking principles for the benefit of our customers, employees, and shareholders alike. The combination of C&F Bank and Peoples will also enhance the products and services, locations, and ATMs available to all our customers while improving our opportunity to achieve strategic objectives such as increased loan growth and access to new markets.

While we are very excited about the opportunities this merger will present to C&F, our diversified business strategy continues to serve us well. Each of our primary business segments continues to deliver on their respective strategic priorities to increase profitability, including growing loans and deposits at C&F

Bank, increasing loan production at C&F Mortgage, continuing to improve asset quality, while also growing loans at C&F Finance, and growing assets under management at C&F Wealth Management.

C&F Bank reported net income of \$9.9 million for the year ended December 31, 2019, compared to net income of \$10.6 million for the same period in 2018. The decrease in earnings is largely a result of personnel costs associated with increasing our commercial lending staff, costs associated with continued investments in technology and infrastructure to support growth, and expenses associated with the Peoples merger. Our continued focus on commercial lending produced meaningful growth of 6.1 percent in average loans outstanding. Meanwhile, our asset quality metrics reflect continued commitment to risk management. Furthermore, our branch teams, commercial relationship managers, and treasury solutions representatives have worked together to increase total average deposits by 3.8 percent and particularly low-cost deposits as evidenced by our growth of 6.4 percent in average non-interest-bearing deposits. These efforts are important to the profitability of the Bank as deposits are the most cost-effective method to fund loan growth. In addition, low-cost, non-term deposits are a significant source of fee income.

Loan growth will further drive earnings growth, which is why we continue to invest in high caliber seasoned commercial lending talent in priority markets such as Hampton Roads, Charlottesville, and Richmond. We believe this investment in commercial lenders will result in an increase in loans outstanding in 2020 and years to come.

C&F Mortgage reported net income of \$3.8 million for the year ended December 31, 2019, compared to net income of \$1.9 million for the same period in 2018. A favorable interest rate environment and sustained economic expansion led to higher loan production and fee income for this segment. Loan originations were \$944 million for the year ended 2019, compared to \$699 million for 2018. Loan production for 2019 was the highest reported by the mortgage banking segment for any year since 2009, when home sales were supported by a federal income tax credit for first-time homebuyers.

As we have mentioned in the past, success in the mortgage business is highly driven by long-term retention of quality loan officers. We have consistently placed a high degree of focus on this objective and will continue to do so in 2020, as well as actively recruiting quality, experienced loan officers and developing new loan officers through our loan officer school.

C&F Mortgage introduced Lender Solutions in 2017, a service that generates fee income by providing certain mortgage origination functions to smaller financial institutions at a price that is more cost effective than if these companies performed the functions themselves. We continued to grow this service in 2019 and are excited about its prospects in 2020.

C&F Finance reported net income of \$6.9 million for the year ended December 31, 2019, compared to net income of \$6.7 million for the same period in 2018. C&F Finance generated growth in non-prime auto lending despite a competitive market. Positive developments include remotely leveraging current representatives to service dealers in markets where we had vacancies, which helped to increase the number of producing dealers. Credit quality has consistently improved since we made changes to our underwriting standards in 2016. As a result, we have experienced a sustained decline in annual charge offs (as a percentage of average assets), decreasing to 3.05 percent for 2019 from 4.14 percent for 2018, the lowest level of annual charge offs since 2012. We also increased our auto lending presence in new states, taking the total number of states served to nineteen.

C&F Finance also continued to grow its marine and recreational vehicle loan portfolio in 2019. It is important to note that we remained committed to the highest credit quality by only purchasing prime contracts in this segment. While pricing for these loans is lower than the non-prime automotive business, lower loan

losses are anticipated due to the higher credit quality of borrowers. C&F Finance entered the powersports financing market in 2019 using these same underwriting principles for prime borrowers. Another good year is expected as we further grow and diversify our portfolio through various product offerings in 2020.

C&F Wealth Management continues its transition from a transaction-based fee business model to one more focused on total assets under management and associated advisory fees. We believe this approach is better for both our customers and the long-term profitability of C&F Wealth Management, as we have seen increases in net income over the past three years. We continue to deepen relationships and collaborate with other C&F lines of business, which resulted in more business throughout the company. As in our other subsidiaries, C&F Wealth Management will continue recruiting and developing top talent in addition to leveraging technology to better assist our customers.

We have maintained for many years that the diversified nature of C&F's lines of business is a competitive advantage. To unify these business lines, we took steps in 2019 to create a consistent brand appearance to support our goals of increased brand recognition, growth in market share, and awareness of our Company's full financial services capabilities. We partnered with a branding firm to research, design, and produce a more consistent appearance and tone across all subsidiaries with digital, print, and advertising materials. For example, each of our subsidiaries is now represented by digital outlets, including websites and social media, that leverage the same "look and feel." We believe investments in a consistent brand appearance will increase our recognition as a full-service financial corporation in the markets we serve and lead to more business opportunities.

Similarly, when we collaborate across lines of businesses, we provide customers with a unique financial experience that sets us apart from other bank competitors and creates the opportunity to earn a greater share of our customers' financial wallet. In 2019, we achieved this type of collaboration in locations where we co-located representatives from different lines of business using our financial center concept. This concept combines our commercial, mortgage, wealth, and retail teams in one open and collaborative space. C&F financial centers put the customer at the center of our focus by providing a convenient, innovative, and all-inclusive experience to meet their financial needs. Examples include locations in the New Town district of Williamsburg, which houses representatives from commercial banking, mortgage banking, and wealth management; our Alverser facility in Richmond, which houses representatives from retail banking, commercial banking, mortgage banking and wealth management; the Charlottesville Mall facility which combines commercial and retail banking; and the 14th Street retail banking branch into which we consolidated our wealth management office. We already see higher referrals and production across the board in each of these locations, in addition to stronger team synergies working for the benefit of our customers. We will open two new financial centers later this year, one in downtown Richmond at the corner of 10th and Byrd Street and the other at the Shops at Stonefield on Route 29 in Charlottesville.

Serving evolving customer preferences at our retail branch locations remains a top priority. For several years we've shared that customer demand for retail bank branches is not going away, however the services customers expect at a branch continue to evolve. Previously, bank branches were most frequently visited by customers to conduct traditional banking transactions, whereas they are now highly interested in visiting one for financial education and consultation. In response, we are working with an architectural firm to develop and implement a master plan for branches, prioritizing design and appearance opportunities in each of our markets, including those acquired with the Peoples merger.

Digital commerce throughout the economy continued to accelerate in 2019 and our experience with C&F customers is no different. We saw a 20 percent annual growth in the number of personal mobile-banking users over each of the past three years. Additionally, a significant and growing number of our

customers are “mobile-only” meaning they have navigated away from traditional online banking to only using their mobile devices for transactions and information. We believe this increase is also due to our continued focus on increasing our mobile capabilities. For example, in 2019, we became one of the first banks in Virginia to offer Zelle®, a nationally recognized peer-to-peer payment service. Over the ten months Zelle has been offered, the number of customer transactions rose to nearly 3,000 per month. Other mobile services are growing fast as well, including mobile wallet purchase transactions, which more than doubled last year. Most notably, the check deposit function on our personal and business mobile apps has increased so significantly that it is now technically our second busiest “branch.”

These facts present strong reasons for us to stay ahead of the pace by investing in both our personal and business online/mobile services to retain and grow customer relationships. For example, last year we enhanced our online/mobile deposit account opening capabilities and added new automatic text alerts for potential debit card fraud activity. Looking ahead to 2020, we plan to make it possible to enroll in Bill Pay and view eStatements via the mobile app.

Growing, strengthening, and leveraging our workforce remains a top priority in 2020. We continue to face familiar challenges, most notably low unemployment and increasing competition for top talent. We are evolving our talent strategy to meet these challenges with programs that leverage our infrastructure and technology in ways that promote cross-company collaboration, consistency, and teamwork. As we expand our geographical footprint and add new financial centers, meeting the expectations of high-caliber talent regarding increased work-life balance, flexibility, and collaboration is a high priority. We know that it is our people who bring our products and services to life, so we will continue placing a strong focus on employee education, communication, and professional development programs. We believe that the investments we have made in leadership, skill-based, and professional development programs will allow our team members more opportunities to grow and expand their careers throughout the company and support our efforts to retain top talent.

We are also evaluating and enhancing our employee benefits programs to give us a competitive advantage in recruiting and retaining top talent. For example, we are now among the few community banks that offer a student loan paydown program, which will help our employees lower student loan debt faster by paying up to \$10,000 of principal over six years. We will also partner this year with Thomas Nelson Community College (TNCC) to offer team members an opportunity to build critical skills and earn college credit through an onsite Financial Accounting class taught by TNCC college professors. C&F has always been committed to investing in its employees and will continue to do so by offering affordable benefits, career development, and support to build their skills and knowledge for years to come.

Succession planning for our Board of Directors is also a critical component of our overall talent planning strategy. Accordingly, our Board of Directors appointed D. Anthony (Tony) Peay to serve as a director of the Corporation and the Bank in November 2019 and George R. Sisson III to serve as a director of the Corporation and the Bank effective February 2020. Tony is a retired CPA and community banker with over 36 years of experience in the industry; his extensive experience in finance and community banking, as well as his knowledge of the Richmond and Northern Neck markets, will be extremely valuable to our organization. George served as a director of Peoples Bankshares for over 30 years, most recently as Chairman of the Board. George owned and operated an insurance agency in Montross, Virginia which has served the Northern Neck region for the past 40 years. We look forward to both Tony’s and George’s insight as new board members.

C&F has consistently maintained that a strong community benefits everyone – our customers, employees, and shareholders. C&F Gives Back, our company-wide program promoting volunteerism to

create positive impacts in the communities where we live and serve, had a great 2019. We are proud to say that C&F employees gave nearly 3,000 volunteer hours to schools and other non-profit entities dedicated to serving our communities. Perhaps the greatest new example of our commitment is the addition of sixteen annual paid volunteer hours we now give each C&F employee to volunteer at an entity of their choice. We are proud of our teammates who generously give their time and support and we look forward to combining our efforts with Peoples teammates to make a similar impact on the Northern Neck as well.

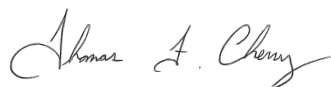
While we are excited about 2020, the year will not be without challenges. Most notably:

- **Margin compression due to low interest rates.** The banking industry is currently in one of the toughest environments possible to make money with historically low rates and a flat yield curve, meaning there is little difference between short-term and long-term rates. The Federal Open Market Committee (FOMC) projected two to three 25 basis point increases in interest rates for 2019; instead, an equal but opposite change in rates had occurred as rates declined 75 basis points over the course of the year. As a result, rates on our earning assets fell while deposit costs remained steady leading to margin compression. We will employ certain financial strategies to mitigate the effect of this margin compression, starting with growing quality loans and low-cost deposits.
- **Successful conversion of Peoples branches.** Although “conversion” is one word, it involves completing a series of tasks effectively to succeed. We learned many lessons from our successful merger with Central Virginia Bank (CVB) in 2013. For example, we know that merger success rests squarely on the compatibility of cultures in each bank and the relationships we build with new employees, communities, and customers. Like C&F, Peoples values outstanding customer service, community involvement, and helping customers achieve financial success. We are confident that we will achieve the same success with our new friends and colleagues from Peoples as we did with CVB.
- **Fraud prevention and cybercrime.** Companies and customers face growing threats with cyber-security as fraudsters become savvier in their methods. We continue to implement both internal and customer-facing systems that mitigate these criminal activities, however the challenge is significant and accelerating exponentially.

Our overall outlook for 2020 and beyond is very positive, despite facing similar headwinds in past years that include an inevitable economic downturn, asset deterioration, and regulatory expansion. Our optimism is driven by the customers, shareholders, and employees who make C&F a strong, stable, strategic, and growing financial institution now and well into the future.

Lastly, we would like to acknowledge the extraordinary contributions of our longtime Board member, friend and mentor, Barry Chernack, who passed away in November 2019. Barry was a member of the Board of Directors since 2002 and chair of the Audit Committee. Prior to joining our Board, he was a managing partner of PricewaterhouseCoopers LLP (PwC)'s southern Virginia practice. He provided significant contributions that affected our company throughout his tenure on our Board. It was an honor and a privilege to have Barry's guidance and support and we hope you will join us in remembering him with gratitude.

Thank you once again for your loyal support of our company.



Thomas F. Cherry, President & CEO



Larry G. Dillon, Executive Chairman



C&F Board of Directors: (seated l-r): James T. Napier, Elizabeth R. Kelley, Thomas F. Cherry, Larry G. Dillon, Audrey D. Holmes, Julie R. Agnew (standing l-r): D. Anthony Peay, J. P. Causey Jr., James H. Hudson III, Bryan E. McKernon, Paul C. Robinson, C. Elis Olsson,

Directors

C&F Financial Corporation and C&F Bank Board of Directors

Julie R. Agnew, Ph.D.*+

Associate Professor of Finance & Economics
Mason School of Business
The College of William & Mary

J.P. Causey Jr.*+

Attorney-at-Law
J.P. Causey Jr., Attorney-at-Law

Thomas F. Cherry*+

President & Chief Executive Officer
C&F Financial Corporation
C&F Bank

Larry G. Dillon*+

Executive Chairman
C&F Financial Corporation
C&F Bank

Audrey D. Holmes*+

Attorney-at-Law
Audrey D. Holmes, Attorney-at-Law

James H. Hudson III*+

Attorney-at-Law
Hudson Law, PLC

Elizabeth R. Kelley*+

Managing Director
Blue Heron Management, LLC

Bryan E. McKernon+

President & Chief Executive Officer
C&F Mortgage Corporation

James T. Napier*+

President
Napier Realtors, ERA

C. Elis Olsson*+

Director of Operations
Martinair, Inc.

D. Anthony Peay*+

Retired, Executive Bank Officer

Paul C. Robinson*+

Owner & President
Francisco, Robinson & Associates, Realtors

George R. Sisson III*+

Former Chairman
Peoples Bankshares, Incorporated

* C&F Financial Corporation Board Member
+ C&F Bank Board Member

Corporate Counsel

Hudson Law, PLC
West Point, Virginia

Independent Public Accountants

Yount, Hyde & Barbour, PC
Richmond, Virginia

C&F Bank Richmond Advisory Board

David H. Downs

Director of The Kornblau Institute
Virginia Commonwealth University

S. Craig Lane

President
Lane & Hamner, PC

Michael A. O'Malley

Financial Advisor
Hallberg & O'Malley Financial Group

Meade A. Spotts

President
Spotts Fain, PC

Scott E. Strickler

Treasurer
Robins Insurance Agency, Inc.

Adrienne P. Whitaker

Business Development Executive
Greater Richmond ARC



Officers & Locations

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West Point, Virginia 23181
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Thomas F. Cherry*
President & Chief Executive Officer

Larry G. Dillon*
Executive Chairman

Rodney W. Overby*
Executive Vice President &
Chief Information Officer

John A. Seaman III
Executive Vice President,
Chief Credit Officer

Deborah H. Hall
Senior Vice President,
Director of Credit Administration

Ellen M. Kurek
Senior Vice President,
Director of Credit Services

Jason E. Long*
Senior Vice President,
Chief Financial Officer

Robert K. Bailey III
Senior Banking Executive

Zirkle Blakey, III
Senior Banking Executive

Herbert E. Marth Jr.
Senior Banking Executive

Christopher A. Spillare
Senior Vice President, Treasurer

Matthew H. Steilberg
Senior Vice President,
Director of Retail Banking

Maria R. Sullivan
Senior Vice President,
Chief Human Resources Officer

Sandra S. Fryer
First Vice President,
Application Support Manager

Donna M. Haviland
First Vice President,
Director of Internal Audit

Anita M. Hazelwood
First Vice President, Treasury Consultant

Maureen B. Medlin
First Vice President, Director of Marketing

Deborah R. Nichols
First Vice President, Director of Compliance

Mary B. Randolph
First Vice President, Director of Loan
Documentation & Administration

Helga H. Ridenhour
First Vice President, Director of Operations

Teresa S. Weaver
First Vice President, Retail Market Leader

Christi L. Burge
Vice President, Compliance

Leslie A. Campbell
Vice President, Credit Administration

Joyce L. Coates
Vice President, Operations

Vernon A. Dennis
Vice President, Facilities Manager

Matthew P. Dolci
Vice President, Controller

Terrence C. Gates
Vice President, Appraisal Review

Taryn R. Haden
Vice President, Retail Market Leader

Taylor E. Johnson
Vice President, Commercial Underwriter

Dollie M. Kelly
Vice President, Quality Assurance
Manager & Security Officer

Kevin E. Kelly
Vice President, Special Assets

Donna A. Mathews
Vice President, Construction Lending

Mary L. Moniz
Vice President, Treasury Consultant

Lori H. Nein
Vice President, Branch Operations Support

Jonathan R. Olson
Vice President, Information Technology

Kelly T. Parsons
Vice President, Business Lending

Willis R. Parsons III
Vice President, Credit Administration

Randall L. Phelps
Vice President, Retail Market Leader

Deborah B. Randolph
Vice President, Compliance

John M. Randolph, Jr.
Vice President, Financial Planning
& Analysis Manager

Christopher J. Robb
Vice President, Commercial Underwriter

Stephen N. Schuman
Vice President, Loan Servicing Manager

Heather E. Snow
Vice President, Compliance

Tiffany S. Stewart
Vice President, Talent Acquisition

Theresa A. Trimmer
Vice President, Product Manager

Bobbie T. Washington
Vice President, Treasury Solutions

*Officers of C&F Financial Corporation



Officers & Locations

C&F Bank Branches

CARTERSVILLE, VIRGINIA

Bryony T. Gills
Assistant Vice President,
Branch Manager

CHARLOTTESVILLE, VIRGINIA

Patrick B. Lowry
Assistant Vice President,
Branch Manager

CHESTER, VIRGINIA

Jacob L. Smith
Assistant Vice President,
Branch Manager

CUMBERLAND, VIRGINIA

Deborah B. Henshaw
Assistant Vice President,
Branch Manager

DAHLGREN, VIRGINIA

KING GEORGE, VIRGINIA
StephanieAnn M. Burch
Vice President, Branch Manager

FREDERICKSBURG, VIRGINIA

Jennifer M. Books
Assistant Vice President,
Branch Manager

HAMPTON, VIRGINIA

Jordan K. McCrum
Assistant Vice President,
Branch Manager

MECHANICSVILLE, VIRGINIA

Mary S. Long
Assistant Vice President,
Branch Manager

MIDDLESEX, VIRGINIA

Elizabeth B. Faudree
Vice President, Branch Manager

MIDLOTHIAN, VIRGINIA

Alverser
Jane H. Wagner
Assistant Vice President,
Branch Manager

Brandermill

Maurice V. Dixon
Assistant Vice President,
Branch Manager

Midlothian

Jennifer L. Willner
Assistant Vice President,
Branch Manager

MONTROSS, VIRGINIA

Jennifer M. Dixon
Assistant Vice President,
Branch Manager

NEWPORT NEWS, VIRGINIA

City Center
Eric D. Floyd
Assistant Vice President,
Branch Manager

NORGE, VIRGINIA

Rebecca L. Hardin
Assistant Vice President,
Branch Manager

POWHATAN, VIRGINIA

Sherelle M. Anderson
Vice President, Branch Manager

PROVIDENCE FORGE, VIRGINIA

Penelope L. Wynn
Vice President, Branch Manager

QUINTON, VIRGINIA

David W. Renner
Assistant Vice President,
Branch Manager

RICHMOND, VIRGINIA

Patterson Avenue

Varina

Jamal I. Hasan
Assistant Vice President,
Branch Manager

Wellesley

Terrance L. Rogers
Assistant Vice President,
Branch Manager

West Broad

Bina Y. Doshi
Vice President, Branch Manager

SANDSTON, VIRGINIA

Natalee H. Bolton
Assistant Vice President,
Branch Manager

WARSAW, VIRGINIA

Rebecca C. Hubert
Assistant Vice President,
Branch Manager

WEST POINT, VIRGINIA

14th Street
Main Street
Bethany K. Bajsert
Assistant Vice President,
Branch Manager

WILLIAMSBURG, VIRGINIA

Jamestown Road
Trittie A. Mountcastle
Assistant Vice President,
Branch Manager

Longhill Road

Beth M. Hodges
Assistant Vice President,
Branch Manager

YORKTOWN, VIRGINIA

Kiln Creek
Dorsey R. Jackson
Assistant Vice President,
Branch Manager

C&F Commercial Banking Administrative Offices

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Mark J. Eggleston

Regional President, Southeast Virginia

Bradford T. Bonney

Vice President,
Commerical Relationship Manager

Jeffrey D. James

Assistant Vice President,
Business Banking Team Manager

CHARLOTTESVILLE

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William V. Krebs Jr.

Regional President, Central Virginia

Amanda L. Litchfield

Senior Commercial Executive

Scott C. Waskey

Senior Commercial Executive

NORTHERN NECK

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804.493.8031

William E. Ware

Senior Executive, Northern Neck



C&F Financial Center

Two C&F Financial Centers are scheduled to open in 2020.

RICHMOND

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David A. Howard
Senior Commercial Real Estate Executive

Philip B. Hager
Richmond Senior Executive

Mary F. Landon
First Vice President,
Senior Underwriter

Tracy E. Pendleton
First Vice President,
Relationship Manager

Walter M. Cart Jr.
Vice President, Relationship Manager

Michael D. Gasiorowski
Vice President, Relationship Manager

Robert M. Huff
Vice President, Regional Portfolio Manager

Matthew J. Ohlschlager
Vice President,
Relationship Manager

SOUTHSIDE HAMPTON ROADS

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Keith E. Gillespie
Senior Executive,
Southside Hampton Roads

C&F Wealth Management

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William C. Morrison, ChFC
President, Investment Officer

MIDLOTHIAN, VIRGINIA

Douglas L. Hartz
First Vice President, Investment Officer

POWHATAN, VIRGINIA

Mary Ellen Twigg
Assistant Vice President,
Investment Officer

WEST POINT, VIRGINIA

Douglas L. Cash Jr.
First Vice President, Investment Officer

WILLIAMSBURG, VIRGINIA

Jacqueline D. Howard
Assistant Vice President,
Investment Officer

C&F Mortgage Corporation Administrative Office

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Bryan E. McKernon
President & Chief Executive Officer

Mark A. Fox
Executive Vice President,
Chief Operating Officer

Donna G. Jarratt

Senior Vice President,
Chief of Branch Administration

Kevin A. McCann

Senior Vice President,
Chief Financial Officer

Michael J. Mazzola

Senior Vice President, Branch &
Loan Officer Training Manager

Timothy A. Back

Vice President,
Secondary Marketing Manager

Tracy L. Bishop

Vice President, Human Resources Manager

Madeline M. Witty

Vice President, Chief Compliance Officer

Georgia G. Parise

Vice President, Underwriting
& Risk Management

Julia A. Reynolds

Vice President, Project Manager

Michael J. Vogelbach

Vice President, Manager of
Information Systems



Officers & Locations

C&F Mortgage Corporation Offices

CHARLOTTESVILLE, VIRGINIA

William E. Hamrick
Vice President, Branch Manager

CHESAPEAKE, VIRGINIA

FREDERICKSBURG, VIRGINIA

Timothy J. Murphy
Vice President, Branch Manager

FISHERSVILLE, VIRGINIA

Vickie J. Painter
Vice President, Branch Manager

HARRISONBURG, VIRGINIA

Thomas M. McGloon
Branch Manager

LYNCHBURG, VIRGINIA

MIDLOTHIAN, VIRGINIA

Donald R. Jordan
Vice President, Branch Manager

Phillip T. Coon

Vice President, Branch Manager

Daniel J. Murphy

Vice President, Branch Manager

Melissa K. Bass

Production Manager

Jeffrey B. Baldwin

Branch Manager

Perry G. Shelton

Branch Manager

GLEN ALLEN, VIRGINIA

Page C. Yonce

Vice President, Branch Manager

J. Stokeley Fulton Jr.

Vice President, Branch Manager

WAYNESBORO, VIRGINIA

KAREN T. FRANK

Branch Manager

WILLIAMSBURG, VIRGINIA

Matthew D. Sydnor

Branch Manager

YORKTOWN, VIRGINIA

Mary. L. Rebholz

Branch Manager

MOYOCK, NORTH CAROLINA

Raymond A. Gunter

Branch Manager

O. Chaytor Midgett

Branch Manager

GASTONIA, NORTH CAROLINA

Nancy W. Poteat

Vice President, Branch Manager

ANNAPOLIS, MARYLAND

William J. Regan

Vice President, Branch Manager

WALDORF, MARYLAND

Timothy J. Murphy

Vice President, Branch Manager

FORT MILL, SOUTH CAROLINA

R.W. Edmondson III

Vice President, Branch Manager

KEYSER, WEST VIRGINIA

Karen R. Pfeil

Branch Manager

C&F SELECT, LLC

Jonathan M. Norris

President

CERTIFIED APPRAISALS, LLC

H. Daniel Salomonsky

Vice President, Appraisal Manager

C&F Finance Company Administrative Office

1313 East Main Street, Suite 400
Richmond, Virginia 23219
804.236.9601

S. Dustin Crone

President & Chief Executive Officer

Michael K. Wilson

Executive Vice President,
Chief Operating Officer

C. Shawn Moore

Executive Vice President,
Chief Credit Officer

Thomas W. Young

Senior Vice President, Operations

Kevin F. Jones Jr.

First Vice President,
Director of Originations

Charles A. Lamont Jr.

Vice President of Sales

Daniel H. Mullins

Vice President, Operations

Oneida C. Wood

Assistant Vice President,
Director of Human Resources

Sabrina K. Carroll

Director of Loan Servicing

Serving the following states:

ALABAMA	FLORIDA
GEORGIA	ILLINOIS
INDIANA	IOWA
KANSAS	KENTUCKY
MARYLAND	MINNESOTA
MISSOURI	NEW JERSEY
NORTH CAROLINA	OHIO
PENNSYLVANIA	TENNESSEE
TEXAS	VIRGINIA
WEST VIRGINIA	

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

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2019

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 000-23423

C&F FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Virginia
(State or other jurisdiction of incorporation or organization)

54-1680165
(I.R.S. Employer Identification No.)

802 Main Street
West Point, VA 23181
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (804) 843-2360

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$1.00 par value per share	CFFI	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
NONE

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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, a 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	<input type="checkbox"/>	Accelerated Filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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 is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of common stock held by non-affiliates of the registrant as of June 28, 2019, the last business day of the registrant's second fiscal quarter, was \$176,733,130.

There were 3,657,564 shares of common stock, \$1.00 par value per share, outstanding as of March 2, 2020.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held April 21, 2020 are incorporated by reference in Part III of this report.

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Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Corporation's expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute "forward-looking statements" as defined by federal securities laws and may include, but are not limited to: statements regarding expected future financial performance; expected impacts of the Corporation's acquisition (the Merger) of Peoples Bankshares, Incorporated (Peoples), including the expected levels of merger related expenses to be incurred by the Corporation and the potential impact of the Merger on the Corporation's and C&F Bank's liquidity and capital levels; strategic business initiatives and the anticipated effects thereof, including personnel additions and the expansion of the indirect lending program to include marine and recreational vehicles; technology initiatives; liquidity and capital levels; net interest margin compression and the Corporation's ability to manage net interest margin; the effect of future market and industry trends, including competitive trends in the non-prime consumer finance markets, the Corporation's and each business segment's loan portfolio, and business prospects related to each segment's loan portfolio, including future lending and growth in loans outstanding; asset quality and adequacy of the allowance for loan losses and the level of future charge-offs; trends regarding the provision for loan losses, net loan charge-offs, levels of nonperforming assets and troubled debt restructurings (TDRs); expenses associated with nonperforming assets; the utilization of scorecard models and the performance of loans purchased using those models; the effects of future interest rate levels and fluctuations; the amount and timing of accretion income associated with the fair value accounting adjustments recorded in connection with the 2013 acquisition of Central Virginia Bankshares, Inc. (CVBK) and its banking subsidiary Central Virginia Bank (CVB); adequacy of the allowance for indemnification losses; levels of noninterest income and expense; interest rates and yields including possible future interest rate changes; the deposit portfolio including trends in deposit maturities and rates; interest rate sensitivity; market risk; regulatory developments; monetary policy implemented by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) including changes to the Federal Funds rate; capital requirements; growth strategy; hedging strategy; and, financial and other goals. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

- the ability of the Corporation and the Bank to realize the anticipated benefits of the Merger, including the ability to successfully integrate Peoples' systems and processes into the Corporation's systems and processes
- expected revenue synergies and cost savings from the Merger that may not be fully realized or realized within the expected time frame
- revenues following the Merger that may be lower than expected
- customer and employee relationships and business operations as a result of disruptions caused by the Merger
- interest rates, such as changes or volatility in the Federal Funds rate, yields on U.S. Treasury securities or mortgage rates
- general business conditions, as well as conditions within the financial markets
- general economic conditions, including unemployment levels and slowdowns in economic growth
- the legislative/regulatory climate, regulatory initiatives with respect to financial institutions, including the Consumer Financial Protection Bureau (the CFPB) and the regulatory and enforcement activities of the CFPB, the application of the Basel III capital standards to C&F Bank, the effect of the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (the Act) and changes in the effect of the Act due to issuance of interpretive regulatory guidance or enactment of corrective or supplemental legislation
- monetary and fiscal policies of the U.S. Government, including policies of the U.S. Department of the Treasury and the Federal Reserve Board, and the effect of these policies on interest rates and business in our markets

- the value of securities held in the Corporation’s investment portfolios
- demand for loan products and the impact of changes in demand on loan growth
- the quality or composition of the loan portfolios and the value of the collateral securing those loans
- the commercial and residential real estate markets
- the inventory level and pricing of used automobiles, including sales prices of repossessed vehicles
- the level of net charge-offs on loans and the adequacy of our allowance for loan losses
- deposit flows
- demand in the secondary residential mortgage loan markets
- the level of indemnification losses related to mortgage loans sold
- the strength of the Corporation’s counterparties and the economy in general
- competition from both banks and non-banks, including competition in the non-prime automobile finance markets
- demand for financial services in the Corporation’s market area
- the Corporation's branch and market expansions, technology initiatives and other strategic initiatives
- cyber threats, attacks or events
- reliance on third parties for key services
- C&F Bank’s product offerings
- accounting principles, policies and guidelines and elections made by the Corporation thereunder

These risks and uncertainties, and the risks discussed in more detail in Item 1A. “Risk Factors,” should be considered in evaluating the forward-looking statements contained herein. Forward-looking statements are inherently uncertain. Forward-looking statements are based on management’s beliefs, assumptions and expectations as of the date of this report regarding future events or performance, taking into account all information currently available, and are applicable only as of the date of this report. Forward-looking statements generally can be identified by the use of words such as “believe,” “expect,” “anticipate,” “estimate,” “plan,” “may,” “will,” “intend,” “should,” “could,” or similar expressions. There can be no assurance that the underlying beliefs, assumptions or expectations will be proven to be accurate. We caution readers not to place undue reliance on those forward-looking statements. Actual results may differ materially from historical results or those expressed in or implied by such forward-looking statements. We undertake no obligation to update or revise any forward-looking statement to reflect events or circumstances arising after the date on which the statement was made, except as otherwise required by law.

PART I

ITEM 1. BUSINESS

General

C&F Financial Corporation (the Corporation) is a bank holding company that was incorporated in March 1994 under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of Citizens and Farmers Bank (the Bank or C&F Bank), which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. C&F Bank originally opened for business under the name Farmers and Mechanics Bank on January 22, 1927. C&F Bank has the following five wholly-owned subsidiaries, all incorporated under the laws of the Commonwealth of Virginia:

- C&F Mortgage Corporation
- C&F Finance Company
- C&F Wealth Management Corporation
- C&F Insurance Services, Inc.
- CVB Title Services, Inc.

The Corporation operates in a decentralized manner in three principal business segments: (1) retail banking through C&F Bank, (2) mortgage banking through C&F Mortgage Corporation (C&F Mortgage) and (3) consumer finance through C&F Finance Company (C&F Finance). For detailed information about the financial condition and results of operations of these segments, see “Note 19: Business Segments” in Item 8. “Financial Statements and Supplementary Data” in this report. C&F Wealth Management Corporation, organized in April 1995, is a full-service brokerage firm offering a comprehensive range of wealth management services and insurance products through third-party service providers. C&F Insurance Services, Inc. was organized in July 1999 for the primary purpose of owning an equity interest in an independent insurance agency that operates in Virginia and North Carolina. CVB Title Services, Inc. was organized for the primary purpose of owning an equity interest in a full service title and settlement agency. The financial position and operating results of C&F Wealth Management Corporation, C&F Insurance Services, Inc. and CVB Title Services, Inc. are not significant to the Corporation as a whole.

The Corporation also owns three non-operating subsidiaries, C&F Financial Statutory Trust II (Trust II) formed in December 2007, C&F Financial Statutory Trust I (Trust I) formed in July 2005, and Central Virginia Bankshares Statutory Trust I (CVBK Trust I) formed in December 2003. These trusts were formed for the purpose of issuing \$10.0 million each for Trust II and Trust I and \$5.0 million for CVBK Trust I of trust preferred capital securities in private placements to institutional investors. All three trusts are unconsolidated subsidiaries of the Corporation. The principal assets of these trusts are \$10.3 million each for Trust II and Trust I and \$5.2 million for CVBK Trust I of the Corporation’s junior subordinated debt securities (such securities of the Corporation referred to herein as “trust preferred capital notes”) that are reported as liabilities in the consolidated balance sheet of the Corporation.

Retail Banking

We provide retail banking services through C&F Bank. C&F Bank provides retail banking services at its main office in West Point, Virginia, and 29 Virginia branches (including five branches that were acquired on January 1, 2020 as part of the acquisition of Peoples) located one each in Cartersville, Charlottesville, Chester, Cumberland, Fredericksburg, Hampton, Mechanicsville, Montross, Newport News, Norge, Powhatan, Providence Forge, Quinton, Saluda, Sandston, Warsaw, West Point and Yorktown, two each in King George and Williamsburg, three in Midlothian and four in Richmond. These branches provide a wide range of banking services to individuals and businesses. These services include various types of checking and savings deposit accounts, as well as business, real estate, development,

mortgage, home equity and installment loans. The Bank also offers ATMs, internet and mobile banking, peer-to-peer payment capabilities and debit and credit cards, as well as safe deposit box rentals, notary public, electronic transfer and other customary bank services to its customers. Revenues from retail banking operations consist primarily of interest earned on loans and investment securities and fees earned on deposit accounts and debit card interchange. Retail banking revenues and operations are not materially affected by seasonal factors; however, public deposits tend to increase with tax collections primarily in the fourth quarter of each year and decline with spending thereafter. At December 31, 2019, assets of the retail banking segment totaled \$1.5 billion. For the year ended December 31, 2019, net income for this segment totaled \$9.9 million.

On January 1, 2020, the Corporation completed the acquisition of Peoples and its banking subsidiary Peoples Community Bank. Peoples Community Bank conducted its business through its main office in Montross, Virginia, and four branch offices located one each in Fredericksburg and Warsaw, and two in King George. Peoples Community Bank was initially established on June 17, 1913 under the name “The Peoples Bank of Montross, Virginia.” Upon completion of the transaction, Peoples was merged with and into the Corporation and Peoples Community Bank was merged with and into C&F Bank.

Mortgage Banking

We conduct mortgage banking activities through C&F Mortgage, which was organized in September 1995, and its 51%-owned subsidiary, C&F Select LLC, which was organized in January 2019. C&F Mortgage provides mortgage loan origination services through 12 locations in Virginia, two in Maryland, two in North Carolina, one in South Carolina, and one in West Virginia. The Virginia offices are located one each in Charlottesville, Chesapeake, Fishersville, Fredericksburg, Glen Allen, Harrisonburg, Lynchburg, Newport News, Waynesboro, and Williamsburg and two in Midlothian. The Maryland offices are located in Annapolis and Waldorf. The North Carolina offices are located in Gastonia and Moyock. The South Carolina office is located in Fort Mill. The West Virginia office is located in Keyser. C&F Select LLC provides mortgage loan origination services through two locations in Richmond, Virginia. The mortgage banking segment offers a wide variety of residential mortgage loans, which are originated for sale generally to the following investors: PennyMac Corporation; Wells Fargo Home Mortgage; SunTrust Mortgage, Inc.; the Virginia Housing Development Authority (VHDA); AmeriHome Mortgage Company, LLC; and Freedom Mortgage Corporation. The mortgage banking segment does not securitize loans. C&F Bank may also purchase mortgage loans from the mortgage banking segment. The mortgage banking segment originates conventional mortgage loans, mortgage loans insured by the Federal Housing Administration (the FHA), and mortgage loans guaranteed by the United States Department of Agriculture (the USDA) and the Veterans Administration (the VA). A majority of the conventional loans are conforming loans that qualify for purchase by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). The remainder of the conventional loans are non-conforming in that they do not meet Fannie Mae or Freddie Mac guidelines, but are eligible for sale to various other investors. The mortgage banking segment also has a division, Lender Solutions, that provides certain mortgage loan origination functions to third parties and a subsidiary, Certified Appraisals LLC, which provides ancillary mortgage loan production services to third parties for residential appraisals. Revenues from mortgage banking operations consist principally of gains on sales of loans to investors in the secondary mortgage market, loan origination fee income and interest earned on mortgage loans held for sale. Revenues and income from mortgage banking, which are driven primarily by the origination and sale of mortgage loans, are subject to seasonal factors, including the volume of home sales in the residential real estate market, which typically rises during spring and summer months and declines during fall and winter months. However, seasonal trends may be disrupted by cyclical and other economic factors that affect the residential real estate market. At December 31, 2019, assets of the mortgage banking segment totaled \$102.5 million. For the year ended December 31, 2019, net income for this segment totaled \$3.8 million.

Consumer Finance

We conduct consumer finance activities through C&F Finance. C&F Finance is a regional finance company purchasing automobile, marine and recreational vehicle (RV) loans throughout Virginia and in portions of Alabama, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Minnesota, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Texas and West Virginia through its offices in Richmond and Hampton, Virginia. C&F

Finance is an indirect lender that primarily provides automobile financing through lending programs that are designed to serve customers in the “non-prime” market who have limited access to traditional automobile financing. C&F Finance generally purchases automobile retail installment sales contracts from manufacturer-franchised dealerships with used-car operations and through selected independent dealerships. C&F Finance selects these dealers based on the types of vehicles sold. Specifically, C&F Finance prefers to finance later model, low mileage used vehicles because the initial depreciation on new vehicles is extremely high. The typical borrowers on the automobile retail installment sales contracts purchased have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, C&F Finance typically charges interest at higher rates than those charged by traditional financing sources. In addition, because C&F Finance provides financing in a relatively high-risk market, it expects to experience a higher level of credit losses than traditional automobile financing sources. Beginning in 2016 with C&F Finance’s implementation of a scorecard model for purchasing loan contracts, the credit worthiness of borrowers at origination has improved for automobile loans purchased by C&F Finance and both the interest rates charged and level of credit losses experienced have decreased. In addition to non-prime automobile financing, beginning in the first quarter of 2018, C&F Finance expanded its lending portfolio to include marine and RV loan contracts in the prime sector. These contracts are also purchased on an indirect basis through a referral program administered by a third party. Because these contracts are for prime loans made to individuals with higher credit scores, they are priced at rates substantially lower than the non-prime automobile portfolio. Revenues from consumer finance operations consist principally of interest earned on automobile, marine and RV loans. While the consumer finance segment’s loans outstanding and interest income are not materially affected by seasonal factors, delinquencies on automobile loans are generally highest in the period from November through January, related in part to seasonal trends affecting borrowers, including consumer spending. At December 31, 2019, assets of the consumer finance segment totaled \$314.4 million. For the year ended December 31, 2019, net income for this segment totaled \$6.9 million.

Employees

At December 31, 2019, we employed 643 full-time equivalent employees. We consider relations with our employees to be excellent.

Competition

Retail Banking

In the Bank’s market area, we compete with large national and regional financial institutions, savings associations and other independent community banks, as well as credit unions, mutual funds, brokerage firms, insurance companies and other lending and deposit platforms offered by non-bank financial technology firms. Increased competition has come from out-of-state banks through their acquisition of Virginia-based banks and interstate branching, and expansion of community and regional banks into our service areas.

The banking business in Virginia, and specifically in the Bank’s primary service areas between Hampton Roads and Charlottesville, and in the Northern Neck region of Virginia, is highly competitive for both loans and deposits, and is dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have are their ability to finance wide-ranging advertising campaigns, to maximize efficiencies through economies of scale and, by virtue of their greater total capitalization, to have substantially higher lending limits than the Bank.

Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution, affect competition for deposits and loans. We compete by emphasizing customer service, establishing long-term customer relationships, building customer loyalty and providing traditional and digital products and services to address the specific needs of our customers. We target individual customers, small-to-medium size business customers and acquisition, development and construction loan customers in our markets.

No material part of the Bank’s business is dependent upon a single or a few customers, and the loss of any single customer would not have a materially adverse effect upon the Bank’s business.

Mortgage Banking

C&F Mortgage competes with large national and regional banks, credit unions, smaller regional mortgage lenders, small local broker operations and internet lending platforms. Due to the increased regulatory and compliance burden, the industry has seen a consolidation in the number of competitors in the marketplace. The agency guidelines for sales of mortgages in the secondary market business continue to be stringent.

The competitive factors faced by C&F Mortgage continue to evolve because of regulatory reforms and initiatives, including but not limited to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). While C&F Mortgage has kept pace with all aspects of the regulations issued pursuant to the Dodd-Frank Act and by the CFPB, other such legislative and regulatory initiatives in the future have the potential to affect the operations of C&F Mortgage. Given the far-reaching effect of the Dodd-Frank Act and CFPB regulations on mortgage finance, compliance with the requirements of the Dodd-Frank Act and CFPB regulations has required and may continue to require substantial changes to mortgage lending systems and processes and other implementation efforts.

To operate profitably in this competitive and regulatory environment, mortgage companies must have a high level of operational and risk management skills and be able to attract and retain top mortgage origination talent. C&F Mortgage competes by attracting the top people in sales and operations in the industry, expanding into new markets that offer strategic growth opportunities, providing an infrastructure that manages regulatory changes efficiently and effectively, utilizing technology to improve efficiency and consistency in its operations and to mitigate compliance risk, offering products that are competitive in both loan parameters and pricing, and providing consistently high quality customer service.

No material part of C&F Mortgage's business is dependent upon a single customer and the loss of any single customer would not have a materially adverse effect upon C&F Mortgage's business. C&F Mortgage, like all residential mortgage lenders, would be affected by the inability of Fannie Mae, Freddie Mac, the FHA or the VA to purchase or guarantee loans. Although C&F Mortgage sells loans to various third-party investors, the ability of these aggregators to purchase or guarantee loans would be limited if these government-sponsored entities cease to exist or materially limit their purchases or guarantees of mortgage loans or suffer deteriorations in their financial condition.

Consumer Finance

The non-prime automobile finance business is highly competitive. The automobile finance market is highly fragmented and is served by a variety of financial entities, including the captive finance affiliates of major automotive manufacturers, banks, savings associations, credit unions and independent finance companies. Many of these competitors have substantially greater financial resources and lower costs of funds than our finance subsidiary. In addition, competitors often provide financing on terms that are more favorable to automobile purchasers or dealers than the terms C&F Finance offers. Many of these competitors also have long-standing relationships with automobile dealerships and may offer dealerships or their customers other forms of financing, including dealer floor plan financing and leasing, which we do not.

Over the past several years, a number of financial institutions and other lenders have increased focus on operations in the non-prime automobile finance markets resulting in intensified competition for loans and qualified personnel. In addition, certain competitors in the industry have (i) relaxed underwriting standards resulting in higher delinquencies and charge-offs for the industry and (ii) used loan pricing strategies resulting in lower loan yields. To continue to operate profitably, lenders must have a high level of operational and risk management skills and access to competitive costs of funds.

Providers of automobile financing traditionally have competed on the basis of interest rates charged, the quality of credit accepted, the flexibility of loan terms offered and the quality of service provided to dealers and customers. To establish C&F Finance as one of the principal financing sources for the dealers it serves, we compete predominantly by providing a high level of dealer service, building strong dealer relationships, offering flexible loan terms and quickly funding loans purchased from dealers.

No material part of C&F Finance's business is dependent upon any single dealer relationship, and the loss of any single dealer relationship would not have a materially adverse effect upon C&F Finance's business.

Regulation and Supervision

General

Bank holding companies, banks and their affiliates are extensively regulated under both federal and state law. The following summary briefly describes significant provisions of currently applicable federal and state laws and certain regulations and the potential impact of such provisions. This summary is not complete, and we refer you to the particular statutory or regulatory provisions or proposals for more information. Because regulation of financial institutions changes regularly and is the subject of constant legislative and regulatory debate, we cannot forecast how federal and state regulation and supervision of financial institutions may change in the future and affect the Corporation's and the Bank's operations.

Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other events led to the adoption of numerous laws and regulations that apply to, and focus on, financial institutions. The most significant of these laws is the Dodd-Frank Act, which was enacted on July 21, 2010 and, in part, was intended to implement significant structural reforms to the financial services industry.

The Dodd-Frank Act implemented far-reaching changes across the financial regulatory landscape, including changes that have significantly affected the business of all bank holding companies and banks, including the Corporation and the Bank. Some of the rules that have been proposed and, in some cases, adopted to comply with the Dodd-Frank Act's mandates are discussed further below. In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the EGRRCPA) was enacted to reduce the regulatory burden on certain banking organizations, including community banks, by modifying or eliminating certain federal regulatory requirements. While the EGRRCPA maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than \$10 billion as well as for larger banks with assets above \$50 billion. In addition, the EGRRCPA included regulatory relief for community banks regarding regulatory examination cycles, call reports, application of the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, qualified mortgages, and risk weights for certain high-risk commercial real estate loans. However, federal banking regulators retain broad discretion to impose additional regulatory requirements on banking organizations based on safety and soundness and U.S. financial system stability considerations.

The Corporation continues to experience ongoing regulatory reform. These regulatory changes could have a significant effect on how the Corporation conducts its business. The specific implications of the Dodd-Frank Act, the EGRRCPA, and other potential regulatory reforms cannot yet be fully predicted and will depend to a large extent on the specific regulations that are to be adopted in the future. Certain aspects of the Dodd-Frank Act and the EGRRCPA are discussed in more detail below.

Regulation of the Corporation

As a bank holding company, the Corporation is subject to the Bank Holding Company Act of 1956 (the BHCA) and regulation and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Pursuant to the BHCA the Federal Reserve Board has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve Board has reasonable grounds to believe that continuation of such activity or ownership constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company. The Federal Reserve Board and the Federal Deposit Insurance Corporation (the FDIC) have adopted guidelines and released interpretative materials that establish operational and managerial standards to promote the safe and sound operation of banks and bank holding

companies. These standards relate to the institution's key operating functions, including but not limited to capital management, internal controls, internal audit systems, information systems, data and cybersecurity, loan documentation, credit underwriting, interest rate exposure and risk management, vendor management, executive management and its compensation, corporate governance, asset growth, asset quality, earnings, liquidity and risk management.

The BHCA generally limits the activities of a bank holding company and its subsidiaries to that of banking, managing or controlling banks, or any other activity that is closely related to banking or to managing or controlling banks, and permits interstate banking acquisitions subject to certain conditions, including national and state concentration limits. The Federal Reserve Board has jurisdiction under the BHCA to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. A bank holding company must be "well capitalized" and "well managed" to engage in an interstate bank acquisition or merger, and banks may branch across state lines provided that the law of the state in which the branch is to be located would permit establishment of the branch if the bank were a state bank chartered by such state. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates, as further discussed below.

Each of the Bank's depository accounts is insured by the FDIC against loss to the depositor to the maximum extent permitted by applicable law, and federal law and regulatory policy impose a number of obligations and restrictions on the Corporation and the Bank to reduce potential loss exposure to depositors and to the FDIC Deposit Insurance Fund (DIF). For example, pursuant to the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company must commit resources to support its subsidiary depository institutions, which is referred to as serving as a "source of strength." In addition, insured depository institutions under common control must reimburse the FDIC for any loss suffered or reasonably anticipated by the DIF as a result of the default of a commonly controlled insured depository institution. The FDIC may decline to enforce the provisions if it determines that a waiver is in the best interest of the DIF. An FDIC claim for damages is superior to claims of stockholders of an insured depository institution or its holding company but is subordinate to claims of depositors, secured creditors and holders of subordinated debt, other than affiliates, of the commonly controlled insured depository institution.

The Federal Deposit Insurance Act (the FDIA) provides that amounts received from the liquidation or other resolution of any insured depository institution must be distributed, after payment of secured claims, to pay the deposit liabilities of the institution before payment of any other general creditor or stockholder of that institution – including that institution's parent holding company. This provision would give depositors a preference over general and subordinated creditors and stockholders if a receiver is appointed to distribute the assets of a bank.

The Corporation also is subject to regulation and supervision by the Virginia State Corporation Commission. The Corporation also must file annual, quarterly and other periodic reports with, and comply with other regulations of, the Securities and Exchange Commission (the SEC).

Capital Requirements

Basel III Capital Framework. The Federal Reserve Board and the FDIC have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the Basel III Final Rules) that apply to banking institutions they supervise. For the purposes of these capital rules, (i) common equity tier 1 capital (CET1) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stocks and trust preferred securities; and (iii) Tier 2 capital consists of other capital instruments, principally qualifying subordinated debt and preferred stock, and limited amounts of an institution's allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, importantly including applying higher risk weightings to certain commercial real estate loans.

The Basel III Final Rules and minimum capital ratios required to be maintained by banks were effective January 1, 2015. The Basel III Final Rules also include a requirement that banks maintain additional capital (the "capital conservation

buffer”), which was phased in beginning January 1, 2016 and was fully phased in effective January 1, 2019. The Basel III Final Rules and fully phased in capital conservation buffer require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5 percent, plus a 2.5 percent capital conservation buffer (which is added to the minimum CET1 ratio, effectively resulting in a required ratio of CET1 to risk-weighted assets of at least 7 percent), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0 percent, plus the capital conservation buffer (effectively resulting in a required Tier 1 capital ratio of 8.5 percent), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0 percent, plus the capital conservation buffer (effectively resulting in a required total capital ratio of 10.5 percent) and (iv) a minimum leverage ratio of 4 percent, calculated as the ratio of Tier 1 capital to average total assets, subject to certain adjustments and limitations.

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income, and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10 percent of CET1 or all such categories in the aggregate exceed 15 percent of CET1.

The Basel III Final Rules permanently include in Tier 1 capital trust preferred securities issued prior to May 19, 2010 by bank holding companies with less than \$15 billion in total assets, subject to a limit of 25 percent of Tier 1 capital. The Corporation expects that its trust preferred securities will be included in the Corporation’s Tier 1 capital until their maturity.

Community Bank Leverage Ratio. As a result of the EGRRCPA, the federal banking agencies were required to develop a Community Bank Leverage Ratio (the ratio of a bank’s tangible equity capital to average total consolidated assets) for banking organizations with assets of less than \$10 billion, such as the Bank. On October 29, 2019, the federal banking agencies issued a final rule that implements the Community Bank Leverage Ratio Framework (the CBLRF). To qualify for the CBLRF, a bank must have less than \$10 billion in total consolidated assets, limited amounts of off-balance sheet exposures and trading assets and liabilities, and a leverage ratio greater than 9 percent. A bank that elects the CBLRF and has a leverage ratio greater than 9 percent will be considered to be in compliance with Basel III capital requirements and exempt from the complex Basel III calculations and will also be deemed “well capitalized” under Prompt Corrective Action regulations, discussed below. A bank that falls out of compliance with the CBLRF will have a two-quarter grace period to come back into full compliance, provided its leverage ratio remains above 8 percent (a bank will be deemed “well capitalized” during the grace period). The CBLRF will be available for banking organizations to use as of March 31, 2020 (with the flexibility for banking organizations to subsequently opt into or out of the CBLRF, as applicable).

Small Bank Holding Company. The EGRRCPA also expanded the category of bank holding companies that may rely on the Federal Reserve Board’s Small Bank Holding Company Policy Statement by raising the maximum amount of assets a qualifying bank holding company may have from \$1 billion to \$3 billion. In addition to meeting the asset threshold, a bank holding company must not engage in significant nonbanking activities, not conduct significant off-balance sheet activities, and not have a material amount of debt or equity securities outstanding and registered with the SEC (subject to certain exceptions). The Federal Reserve Board may, in its discretion, exclude any bank holding company from the application of the Small Bank Holding Company Policy Statement if such action is warranted for supervisory purposes.

In August 2018, the Federal Reserve Board issued an interim final rule to apply the Small Bank Holding Company Policy Statement to bank holding companies with consolidated total assets of less than \$3 billion. The policy statement, which, among other things, exempts certain bank holding companies from minimum consolidated regulatory capital ratios that apply to other bank holding companies. As a result of the interim final rule, which was effective August 30, 2018, the Corporation expects that it will be treated as a small bank holding company and will not be subject to regulatory capital requirements. The comment period on the interim final rule closed on October 29, 2018 and, to date, the Federal Reserve Board has not issued a final rule to replace the interim final rule. The Bank remains subject to the regulatory capital requirements described above.

Limits on Dividends

The Corporation is a legal entity that is separate and distinct from the Bank. A significant portion of the revenues of the Corporation result from dividends paid to it by the Bank. Both the Corporation and C&F Bank are subject to laws and regulations that limit the payment of dividends, including limits on the sources of dividends and requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, Federal Reserve Board supervisory guidance indicates that the Federal Reserve Board may have safety and soundness concerns if a bank holding company pays dividends that exceed earnings for the period in which the dividend is being paid. Further, the FDIA prohibits insured depository institutions such as C&F Bank from making capital distributions, including paying dividends, if, after making such distribution, the institution would become undercapitalized as defined in the statute. We do not expect that any of these laws, regulations or policies will materially affect the ability of the Corporation or C&F Bank to pay dividends.

Insurance of Accounts, Assessments and Regulation by the FDIC

The Bank's deposits are insured by the DIF of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. The basic limit on FDIC deposit insurance coverage is \$250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations as an insured institution, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

Deposit Insurance Assessments. The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target "designated reserve ratio" (described in more detail below) of 2 percent for the DIF and, in lieu of dividends, provides for a lower assessment rate schedule when the reserve ratio reaches 2 percent and 2.5 percent. An institution's assessment rate is based on a statistical analysis of financial ratios that estimates the likelihood of failure over a three-year period, which considers the institution's weighted average CAMELS component rating, and is subject to further adjustments including those related to levels of unsecured debt and brokered deposits (not applicable to banks with less than \$10 billion in assets). At December 31, 2019, total base assessment rates for institutions that have been insured for at least five years range from 1.5 to 30 basis points applying to banks with less than \$10 billion in assets.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the "designated reserve ratio." The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis. As of December 31, 2019, the designated reserve ratio was 2.00 percent and the minimum designated reserve ratio was 1.35 percent.

At September 30, 2019, the reserve ratio was 1.41 percent. Banks with less than \$10 billion in total consolidated assets are eligible for credits to offset the portion of their assessments that helped to raise the reserve ratio to 1.35 percent. The FDIC automatically applies these credits to reduce an eligible bank's regular DIF assessment up to the entire amount of the assessment. The FDIC will remit any such remaining credits in a lump sum to the appropriate bank following application to the bank's regular DIF assessment for four quarterly assessment periods. The Bank was awarded credits of \$365,000, of which \$207,000 was used to offset its DIF assessment in the third and fourth quarters of 2019. The Corporation expects that the remainder of the credits will be utilized to offset the Bank's DIF assessment during 2020.

Regulation of the Bank and Other Subsidiaries

The Bank is subject to supervision, regulation and examination by the Virginia State Corporation Commission Bureau of Financial Institutions (VBFI) and its primary federal regulator, the FDIC. The various laws and regulations issued and administered by the regulatory agencies (including the CFPB) affect corporate practices, such as the payment of dividends, the incurrence of debt and the acquisition of financial institutions and other companies, and affect business practices and operations, such as the payment of interest on deposits, the charging of interest on loans, the types of business conducted, the products and terms offered to customers and the location of offices. Prior approval of the applicable primary federal regulator and the VBFI is required for a Virginia chartered bank or bank holding company to merge with another bank or bank holding company, or purchase the assets or assume the deposits of another bank or bank holding company, or acquire control of another bank or bank holding company. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory agencies will consider, among other things, the competitive effect and public benefits of the transactions, the financial condition, managerial resources, capital position and any asset concentrations (including commercial real estate loan concentrations) of the constituent organizations and the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act (CRA) and fair housing initiatives, the data security and cybersecurity infrastructure of the constituent organizations and the combined organization, the applicant's risk management programs and processes, and the applicant's compliance with and the effectiveness of the subject organizations in combating money laundering activities and complying with Bank Secrecy Act requirements.

Certain Transactions by Insured Banks with their Affiliates. There are statutory restrictions related to the extent bank holding companies and their non-bank subsidiaries may borrow, obtain credit from or otherwise engage in "covered transactions" with their insured depository institution (i.e., banking) subsidiaries. In general, an "affiliate" of a bank includes the bank's parent holding company and any subsidiary thereof. However, an "affiliate" does not generally include the bank's operating subsidiaries. A bank (and its subsidiaries) may not lend money to, or engage in other covered transactions with, its non-bank affiliates if the aggregate amount of covered transactions outstanding involving the bank, plus the proposed transaction, exceeds the following limits: (a) in the case of any one such affiliate, the aggregate amount of covered transactions of the bank and its subsidiaries cannot exceed 10 percent of the bank's capital stock and surplus; and (b) in the case of all affiliates, the aggregate amount of covered transactions of the bank and its subsidiaries cannot exceed 20 percent of the bank's capital stock and surplus. "Covered transactions" are defined to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliate that creates a credit exposure to such affiliate, or a derivatives transaction with an affiliate that creates a credit exposure to such affiliate. Certain covered transactions are also subject to collateral security requirements.

Covered transactions as well as other types of transactions between a bank and a bank holding company must be on market terms, which means that the transaction must be conducted on terms and under circumstances that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with or involving nonaffiliates or, in the absence of comparable transactions, that in good faith would be offered to or would apply to nonaffiliates. Moreover, certain amendments to the BHCA provide that, to further competition, a bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

Community Reinvestment Act. 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 are assessed based on specified factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility. In 2017, the Bank received a "Satisfactory" CRA rating.

Federal Home Loan Bank of Atlanta. The Bank is a member of the Federal Home Loan Bank (FHLB) of Atlanta, which is one of 12 regional FHLBs that provide funding to their members for making housing loans as well as for

affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each FHLB makes loans to members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, the Bank must purchase and maintain stock in the FHLB. At December 31, 2019, the Bank owned \$3.3 million of FHLB stock.

Consumer Protection. The CFPB is the federal regulatory agency that is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than \$10 billion of assets and, to a lesser extent, smaller institutions. The CFPB supervises and regulates providers of consumer financial products and services, and has rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth-in-Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA)).

Because the Corporation and the Bank are smaller institutions (i.e., with assets of \$10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Corporation by the Federal Reserve Board and to the Bank by the FDIC. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's principal regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and banks, could influence how the Federal Reserve Board and FDIC apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise effect of the CFPB's consumer protection activities on the Corporation and the Bank cannot be determined with certainty.

Mortgage Banking Regulation. In connection with making mortgage loans, the Bank and C&F Mortgage are subject to rules and regulations that, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers, in some cases restrict certain loan features and fix maximum interest rates and fees, 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. The Bank's mortgage origination activities are subject to the Equal Credit Opportunity Act (ECOA), TILA, Home Mortgage Disclosure Act, RESPA, and Home Ownership Equity Protection Act, and the regulations promulgated under these acts, among other additional state and federal laws, regulations and rules.

The Bank's mortgage origination activities are also subject to Regulation Z, which implements TILA. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined as mortgage loans without negative amortization, interest-only payments, balloon payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3 percent of the total loan amount. Under the EGRRCPA, most residential mortgage loans originated and held in portfolio by a bank with less than \$10 billion in assets will be designated as "qualified mortgages." Higher-priced qualified mortgages (e.g., sub-prime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Corporation's mortgage banking segment predominately originates mortgage loans that comply with Regulation Z's "qualified mortgage" rules.

In addition to certain regulations applicable to the Bank's mortgage origination activities, C&F Mortgage is subject to the rules and regulations of, and examination by, the Department of Housing and Urban Development (HUD), the FHA, the USDA, the VA and state regulatory authorities with respect to originating, processing 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.

Consumer Financing Regulation. C&F Finance also is regulated by the VBFI and the states and jurisdictions in which it operates, and its lending operations are subject to numerous federal regulations over which the CFPB has

rulemaking authority and regarding which enforcement authority is shared by the Federal Reserve Board, the FDIC, the Department of Justice and the Federal Trade Commission. The VBFI regulates and enforces laws relating to consumer lenders and sales finance agencies such as C&F Finance. Such rules and regulations generally provide for licensing of sales finance agencies; limitations on amounts, duration and charges, including interest rates, for various categories of loans; requirements as to the form and content of finance contracts and other documentation; and restrictions on collection practices and creditors' rights.

Certain federal regulatory agencies, and in particular, the CFPB, the Federal Trade Commission, and the Federal Reserve Board, have recently become more active in investigating the products, services and operations of banks and other finance companies engaged in auto finance activities. These investigations have extended to banks that engage in indirect automobile lending. As of January 1, 2020, the Corporation and C&F Finance were not subject to supervision by the CFPB.

Brokered Deposits. Section 29 of the FDIA and FDIC regulations generally limit the ability of any bank to accept, renew or roll over any brokered deposit unless it is "well capitalized" or, with the FDIC's approval, "adequately capitalized." However, as a result of the EGRRCPA, the FDIC undertook a comprehensive review of its regulatory approach to brokered deposits, including reciprocal deposits, and interest rate caps applicable to banks that are less than "well capitalized." On December 12, 2019, the FDIC issued a notice of proposed rulemaking to modernize its brokered deposit regulations. At this time, it is difficult to predict what changes, if any, to the brokered deposit regulations will actually be implemented or the effect of such changes on the Corporation.

Other Regulations

Prompt Corrective Action. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the 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 which is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities. As of December 31, 2019, the Bank was considered "well capitalized."

Incentive Compensation. The Federal Reserve Board, the Office of the Comptroller of the Currency (OCC) and the FDIC have issued regulatory guidance (the Incentive Compensation Guidance) intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Corporation, that are not "large, complex banking organizations." The findings will be included in reports of examination, and deficiencies will be incorporated into the organization's supervisory ratings. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In 2016, the SEC and the federal banking agencies proposed rules that prohibit covered financial institutions (including bank holding companies and banks) from establishing or maintaining incentive-based compensation arrangements that encourage inappropriate risk taking by providing covered persons (consisting of senior executive officers and significant risk takers, as defined in the rules) with excessive compensation, fees or benefits that could lead to material financial loss to the financial institution. The proposed rules outline factors to be considered when analyzing whether compensation is excessive and whether an incentive-based compensation arrangement encourages inappropriate risks that could lead to material loss to the covered financial institution, and establishes minimum requirements that incentive-based compensation arrangements must meet to be considered to not encourage inappropriate risks and to appropriately balance risk and reward. The proposed rules also impose additional corporate governance requirements on the boards of directors of covered financial institutions and impose additional record-keeping requirements. The comment period for these proposed rules has closed and a final rule has not yet been published.

Confidentiality and Required Disclosures of Customer Information. The Corporation is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure. Certain exceptions may apply to the requirement to deliver an annual privacy notice based on how a financial institution limits sharing of nonpublic personal information and whether the institution's disclosure practices or policies have changed in certain ways since the last privacy notice that was delivered.

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

Although these laws and programs impose compliance costs and create privacy obligations and, in some cases, reporting obligations, and compliance with all of the laws, programs, and privacy and reporting obligations may require significant resources of the Corporation and the Bank, these laws and programs do not materially affect the Bank's products, services or other business activities.

Cybersecurity. The federal banking agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution's board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking agencies expect financial institutions to establish lines of defense and ensure that their risk management processes also address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack. If the Corporation or the Bank fails to meet the expectations set forth in this regulatory guidance, the Corporation or the Bank could be subject to various regulatory actions and any remediation efforts may require significant resources of the Corporation or the Bank. In addition, all federal and state bank regulatory agencies continue to increase focus on cybersecurity programs and risks as part of regular supervisory exams.

In October 2016, the federal banking agencies issued proposed rules on enhanced cybersecurity risk-management and resilience standards that would apply to very large financial institutions and to services provided by third parties to these institutions. The comment period for these proposed rules has closed and a final rule has not been published. Although the proposed rules would apply only to bank holding companies and banks with \$50 billion or more in total consolidated assets, these rules could influence the federal banking agencies' expectations and supervisory requirements for information security standards and cybersecurity programs of smaller financial institutions, such as the Corporation and the Bank.

Stress Testing. The federal banking agencies have implemented stress testing requirements for certain large or risky financial institutions, including bank holding companies and state-chartered banks. Although these requirements do not apply to the Company and the Bank, the federal banking agencies emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential effect of adverse market conditions or outcomes on the

organization's financial condition. Based on existing regulatory guidance, the Corporation and the Bank will be expected to consider the institution's interest rate risk management, commercial real estate loan concentrations and other credit-related information, and funding and liquidity management during this analysis of adverse market conditions or outcomes.

Volcker Rule. The Dodd-Frank Act prohibits bank holding companies and their subsidiary banks from engaging in proprietary trading except in limited circumstances, and places limits on ownership of equity investments in private equity and hedge funds (the Volcker Rule). The EGRRCPA, and final rules adopted to implement the EGRRCPA, exempt all banks with less than \$10 billion in assets (including their holding companies and affiliates) from the Volcker Rule, provided that the institution has total trading assets and liabilities of five percent or less of total assets, subject to certain limited exceptions. The Corporation believes that its financial condition and its operations are not affected by the Volcker Rule, amendments thereto, or its implementing regulations.

Call Reports and Examination Cycle. All institutions, regardless of size, submit a quarterly call report that includes data used by federal banking agencies to monitor the condition, performance, and risk profile of individual institutions and the industry as a whole. The EGRRCPA contained provisions expanding the number of regulated institutions eligible to use streamlined call report forms. In June 2019, consistent with the provisions of the EGRRCPA, the federal banking agencies issued a final rule to permit insured depository institutions with total assets of less than \$5 billion that do not engage in certain complex or international activities to file the most streamlined version of the quarterly call report.

In December 2018, consistent with the provisions of the EGRRCPA, the federal banking agencies jointly adopted final rules that permit banks with up to \$3 billion in total assets, that received a composite CAMELS rating of "1" or "2," and that meet certain other criteria (including not having undergone any change in control during the previous 12-month period, and not being subject to a formal enforcement proceeding or order), to qualify for an 18-month on-site examination cycle.

Future Regulation

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Corporation in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Corporation cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Corporation. A change in statutes, regulations or regulatory policies applicable to the Corporation or any of its subsidiaries could have a material effect on the business of the Corporation.

Available Information

The Corporation's SEC filings are filed electronically and are available to the public over the Internet at the SEC's website at <http://www.sec.gov>. The Corporation's SEC filings also are available through our website at <http://www.cffc.com> under "Investor Relations/Financial Documents/SEC Filings" as of the day they are filed with the SEC. Copies of documents also can be obtained free of charge by writing to the Corporation's secretary at P.O. Box 391, West Point, VA 23181 or by calling 804-843-2360.

ITEM 1A. RISK FACTORS

Risks Related to the Corporation's Operations

We are subject to interest rate risk and fluctuations in interest rates may negatively affect our financial performance.

Our profitability depends in substantial part on our net interest margin, which is the difference between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits and borrowings divided by total interest-earning assets. Changes in interest rates will affect our net interest margin in diverse ways, including the pricing of loans and deposits, the levels of prepayments and asset quality. We are unable to predict actual fluctuations of market interest rates because many factors influencing interest rates, including changes in economic conditions, are beyond our control. We believe that our current interest rate exposure is manageable and does not indicate any significant exposure to interest rate changes. During 2019, the Federal Open Market Committee (FOMC) announced three rate cuts for the federal funds rate, which is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight, and in December 2019 the FOMC announced the federal funds rate would remain unchanged at 1.50 to 1.75 percent. Financial markets expect the FOMC to announce further decreases in the federal funds rate during 2020. Longer-term market interest rates, including yields on U.S. treasury bonds, have also remained low. Therefore, we are expecting continued pressure on our net interest margin due to intense competition for loans and deposits from both local and national financial institutions and the possible effect of lower interest rates on interest income. In addition, a significant portion of C&F Finance's funding is indexed to short-term interest rates and reprices as short-term interest rates change. An upward movement in interest rates may result in an unfavorable pricing disparity between C&F Finance's fixed rate loan portfolio and its adjustable-rate borrowings. Continued pressure on our net interest margin could adversely affect our results of operations.

Our business is subject to various lending and other economic risks that could adversely affect our results of operations and financial condition.

Deterioration in economic conditions could adversely affect our business. Our business is directly affected by general economic and market conditions; broad trends in industry and finance; legislative and regulatory changes; changes in governmental monetary and fiscal policies; and inflation, all of which are beyond our control. A deterioration in economic conditions, in particular a prolonged economic slowdown within our geographic region or a broader disruption in the economy, possibly as a result of a pandemic or other widespread public health emergency, could result in the following consequences, any of which could hurt our business materially: an increase in loan delinquencies; an increase in problem assets and foreclosures; a decline in demand for our products and services; and a deterioration in the value of collateral for loans made by our various business segments.

Adverse changes in economic conditions in our market areas or adverse conditions in an industry on which a local market in which we do business is dependent could adversely affect our results of operations and financial condition.

We provide full service banking and other financial services between Hampton Roads and Charlottesville, and in the Northern Neck region of Virginia. Our loan and deposit activities are directly affected by, and our financial success depends on, economic conditions within these markets, as well as conditions in the industries on which those markets are economically dependent. A deterioration in local economic conditions or in the condition of an industry on which a local market depends, such as the U.S. military and related defense contractors and industries, could adversely affect such factors as unemployment rates, business formations and expansions and housing market conditions. Adverse developments in any of these factors could result in among other things, a decline in loan demand, a reduction in the number of creditworthy borrowers seeking loans, an increase in delinquencies, defaults and foreclosures, an increase in classified and nonaccrual loans, a decrease in the value of loan collateral, and a decline in the financial condition of borrowers and guarantors, any of which could adversely affect our financial condition or business.

Our risk management framework may not be effective in mitigating risk and loss.

We maintain an enterprise risk management program that is designed to identify, quantify, monitor, report and control the risks we face. These risks include, but are not limited to, interest rate, credit, liquidity, operational, reputation, legal, compliance, economic and litigation risk. Although we assess our risk management program on an ongoing basis and make identified improvements to it, we can give no assurance that this approach and risk management framework (including related controls) will effectively mitigate the risks listed above or limit losses that we may incur. If our risk management program has flaws or gaps, or if our risk management controls do not function effectively, our results of operations, financial condition or business may be adversely affected.

Our level of credit risk is higher due to the concentration of our loan portfolio in commercial loans and in consumer finance loans.

At December 31, 2019, 44.9 percent of our loan portfolio consisted of commercial, financial and agricultural loans, which include loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity and residential loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans and to borrowers in similar lines of business, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans.

At December 31, 2019, 25.9 percent of our loan portfolio consisted of consumer finance loans that provide automobile financing for customers in the non-prime market. During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses may increase in this portfolio. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed vehicles or delay the timing of these sales. Because we focus on non-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on these loans are higher than those experienced in the general automobile finance industry and could be dramatically affected by a general economic downturn. In addition, our servicing costs may increase without a corresponding increase in our finance charge income. While we manage the higher risk inherent in loans made to non-prime borrowers through our underwriting criteria for installment sales contracts we purchase and collection methods, we cannot guarantee that these criteria or methods will ultimately provide adequate protection against these risks.

Competition from other financial institutions and financial intermediaries may adversely affect our profitability.

We face substantial competition in originating loans and in attracting deposits. Our competition in originating loans and attracting deposits comes principally from other banks, mortgage banking companies, consumer finance companies, savings associations, credit unions, brokerage firms, insurance companies and other institutional lenders and purchasers of loans. 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 clients. These institutions may be able to offer the same loan products and services that we offer at more competitive rates and prices. Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could adversely affect our profitability.

Weakness in the secondary residential mortgage loan markets will adversely affect income from our mortgage company.

One of the components of our strategic plan is to generate significant noninterest income from C&F Mortgage, which originates a variety of residential loan products for sale into the secondary market. Interest rates, housing inventory, housing demand, cash buyers, new mortgage lending regulations and other market conditions have a direct effect on loan originations across the industry.

In addition, deterioration in economic conditions may also cause borrowers to default on their mortgages. This may result in potential repurchase or indemnification liability for C&F Mortgage on residential mortgage loans originated and sold into the secondary market in the event of claims by investors of borrower misrepresentation, fraud, early-payment

default, or underwriting error, as investors attempt to minimize their losses. We cannot be assured that a prolonged period of payment defaults and foreclosures will not result in an increase in requests for repurchases or indemnifications. We attempt to maintain an appropriate allowance for indemnification losses. Although we believe our allowance for indemnification losses is adequate, this estimate is inherently subjective and indemnification losses depend on future events that are often not within our control. Therefore, we can give no assurance that established reserves will be adequate in the future. Additional provision for indemnification losses would have an adverse effect on the Corporation's net income.

Our home lending profitability could be significantly reduced if we are not able to originate and sell a high volume of mortgage loans.

The existence of an active secondary market is a critical component of C&F Mortgage's ability to generate income from the sale of loans to investors. Active secondary markets for residential mortgages depend upon the continuation of programs currently offered by government-sponsored enterprises (GSEs) (such as Fannie Mae and Freddie Mac), the FHA, the VA, the USDA, and state bond programs, which account for a substantial portion of the secondary market in residential mortgage loans. Because the largest participants in the secondary market are GSEs whose activities are governed by federal law, any future changes in laws that significantly affect the activity of the GSEs could adversely affect our mortgage company's operations. Further, in September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the U.S. government. Although to date, the conservatorship has not had a significant or adverse effect on our operations, it is unclear whether further changes or reforms would adversely affect our operations. Although we sell loans to various third-party investors, the ability of these aggregators to purchase loans would be limited if the GSEs cease to exist or materially limit their purchases of mortgage loans.

An increase in interest rates may reduce our mortgage revenues, which would negatively affect our noninterest income.

Our mortgage banking segment provides a significant portion of our noninterest income. We generate gains on sales of mortgage loans primarily from sales of mortgage loans that we originate. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors. This would result in a decrease in noninterest income. In addition, our results of operations are affected by the amount of noninterest expenses (including for personnel and systems infrastructure) associated with mortgage banking activities. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in mortgage loan origination activity.

If our allowance for loan losses becomes inadequate, our results of operations may be adversely affected.

Making loans is an essential element of our business. The risk of nonpayment is affected by a number of factors, including but not limited to: the duration of the credit; credit risks of a particular customer; changes in economic and industry conditions; and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans may not be repaid. We attempt to maintain an appropriate allowance for loan losses to provide for losses in our loan portfolio. Because any estimate of loan losses is necessarily subjective and the accuracy of any estimate depends on the outcome of future events that are not within our control, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional provision for loan losses will be required, which would have an adverse effect on the Corporation's net income. Although we believe our allowance for loan losses is adequate to absorb losses that are inherent in our loan portfolio, we cannot predict the timing or severity of such losses nor give any assurance that our allowance will be adequate in the future.

The Financial Accounting Standards Board (FASB) has issued a new accounting standard that will be effective for the Corporation for the fiscal year beginning January 1, 2023. This standard, Accounting Standards Codification (ASC) Topic 326, "Financial Instruments—Credit Losses" (ASC 326) will require the Corporation to record an allowance for credit losses that represents expected credit losses over the lifetime of all loans in its portfolio. This represents a change from the current method of providing for an allowance for loan losses that have been incurred. We have not yet determined the impact that ASC 326 will have on our consolidated financial statements and regulatory capital. While the adoption of ASC 326 will not

affect ultimate loan performance or cash flows of the Corporation from making loans, the period in which expected credit losses affect net income of the Corporation may not be similar to the recognition of loan losses under current accounting guidance. If recognition of the allowance for credit losses results in a reduction of the regulatory capital of C&F Bank, the initial reduction in regulatory capital will be phased in over three years under regulatory guidance. If the reduction in regulatory capital of C&F Bank is significant, it may adversely impact the future ability of the Corporation to pay dividends to shareholders.

Our real estate lending business can result in increased costs associated with Other Real Estate Owned (OREO).

Because we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we are exposed to the risks inherent in the ownership of real estate. The amount that we may realize after a default is dependent upon factors outside of our control, including, but not limited to, general or local economic conditions, environmental cleanup liability, neighborhood values, interest rates, real estate tax rates, operating expenses of the mortgaged properties, and supply of and demand for properties. Certain expenditures associated with the ownership of income-producing real estate, principally real estate taxes and maintenance costs, may adversely affect the net cash flows generated by the real estate. Therefore, the cost of operating income-producing real property may exceed the rental income earned from such property, and we may have to advance funds in order to protect our investment or we may be required to dispose of the real property at a loss.

Acquisition of assets and assumption of liabilities may expose us to intangible asset risk, which could affect our result of operations and financial condition.

In connection with accounting for prior acquisitions, we recorded assets acquired and liabilities assumed at their fair value, which resulted in the recognition of certain intangible assets, including goodwill. Adverse conditions in our business climate, including a significant decline in future operating cash flows, a significant change in our stock price or market capitalization, or a deviation from our expected growth rate and performance, may significantly affect the fair value of any goodwill and may trigger impairment losses, which could be materially adverse to our results of operations and financial condition.

We rely substantially on deposits obtained from customers in our target markets to provide liquidity and support growth.

Our business strategies are based on access to funding from local customer deposits. Deposit levels may be affected by a number of factors, including interest rates paid by competitors, general interest rate levels, returns available to customers on alternative investments and general economic conditions. If our deposit levels fall, we could lose a relatively low cost source of funding and our interest expense would likely increase as we obtain alternative funding to replace lost deposits. If local customer deposits are not sufficient to fund our normal operations and growth, we will look to outside sources, such as borrowings from the FHLB, which is a secured funding source. Our ability to access borrowings from the FHLB will be dependent upon whether and the extent to which we can provide collateral to secure FHLB borrowings. We may also look to federal funds purchased and brokered deposits, although the use of brokered deposits may be limited or discouraged by our banking regulators. We may also seek to raise funds through the issuance of shares of our common stock, or other equity or equity-related securities, or debt securities including subordinated notes as additional sources of liquidity. If we are unable to access funding sufficient to support our business operations and growth strategies or are only able to access such funding on unattractive terms, we may not be able to implement our business strategies which may negatively affect our financial performance.

We are subject to security and operational risks, including cybersecurity risks and cyber attacks, relating to our use of technology that could damage our reputation and our business.

In the ordinary course of business, the Corporation collects and stores 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 the Corporation's business strategy. The Corporation has invested in information security technologies and continually reviews processes and practices that are designed to protect its networks, computers and data from damage or unauthorized access. Despite these security

measures, the Corporation's computer systems and infrastructure may be vulnerable to attacks by hackers or may be breached due to employee error, malfeasance or other disruptions. Security breaches, including cyber incidents, identity theft and hacking events, have been experienced by several of the world's largest financial institutions that utilize sophisticated security tools to prevent such breaches, incidents and events. Any security breach that we experience could result in legal claims, regulatory penalties, disruption in operation, remediation expenses, costs associated with customer notification and credit monitoring services, increased insurance premiums, loss of customers and business partners and damage to the Corporation's reputation. We rely on customary security systems and procedures to provide the security and authentication necessary to effect secure collection, transmission and storage of sensitive data. These systems and procedures include but are not limited to (i) regular penetration testing of our network, (ii) regular employee training programs on sound security practices and awareness of security threats, (iii) deployment of tools to monitor our network including intrusion prevention and detection systems, electronic mail spam filters, anti-virus, anti-malware, anti-ransomware, resource logging and patch management, (iv) multifactor authentication for customers using treasury management tools and employees who access our network from outside of our premises, and (v) enforcement of security policies and procedures for the additions and maintenance of user access and rights to resources. However, because the techniques used to obtain unauthorized access, or to disable or degrade systems change frequently and are often not recognized until launched against a target, the Corporation may be unable to anticipate these techniques or to implement adequate protective measures.

While most of our core data processing is conducted internally, certain key applications are outsourced to third party providers. If our third party providers encounter difficulties or if we have difficulty in communicating with such third parties, it will significantly affect our ability to adequately process and account for customer transactions, which would significantly affect our business operations and reputation. Additionally, in recent years banking regulators have focused on the responsibilities of financial institutions to supervise vendors and other third-party service providers. We may have to dedicate significant resources to manage risks and regulatory burdens presented by our relationship with vendors and third-party service providers, including our data processing and cybersecurity service providers.

Business counterparties, over which the Corporation may have limited or no control, may experience disruptions that could adversely affect the Corporation.

Multiple major U.S. retailers and a major consumer credit reporting agency have experienced data systems incursions in recent years reportedly resulting in the thefts of credit and debit card information, online account information, and other personal and financial data of hundreds of millions of individuals. Retailer incursions may affect debit cards issued and deposit accounts maintained by many banks, including C&F Bank. Although the Corporation is not aware of any instance in which the Corporation's or the Bank's systems have been breached in a retailer incursion, these events can cause the Bank to reissue a significant number of cards and take other costly steps to avoid significant theft loss to the Bank and its customers. In some cases, the Bank may be required to reimburse customers for the losses they incur. Credit reporting agency intrusions affect the Bank's customers and can require these customers and the Bank to increase account monitoring and take remedial action to prevent unauthorized account activity or access. Other possible points of intrusion or disruption outside the Corporation's and the Bank's control include internet service providers, electronic mail portal providers, social media portals, distant-server (or "cloud") service providers, electronic data security providers, telecommunications companies and smart phone manufacturers.

Consumers may increasingly decide not to use banks to complete their financial transactions, which could have a material adverse impact on our financial condition and operations.

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills 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. 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 business is technology dependent and an inability to invest in technological improvements may adversely affect results of operations and financial condition.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services, which may require substantial capital expenditures to modify or adapt existing products and services. In addition to enhancing customer service, the effective use of technology increases efficiency and results in reduced costs, although a financial institution's initial investment in a technology product or service may represent a significant incremental cost. Our future success will depend in part upon our ability to create synergies in our operations through the use of technology and to facilitate the ability of customers to engage in financial transactions in a manner that enhances the customer experience. We cannot assure that technological improvements will increase operational efficiency or that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers, which may cause the Corporation to lose market share or incur additional expense.

Changes in accounting standards and management's selection of accounting methods, including assumptions and estimates, could materially affect our financial statements.

From time to time, the SEC and FASB change the financial accounting and reporting standards that govern the preparation of the Corporation's financial statements. These changes can be hard to predict and can materially affect how the Corporation records and reports its financial condition and results of operations. In some cases, the Corporation could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings. In addition, management is required to use certain assumptions and estimates in preparing our financial statements, including determining the fair value of certain assets and liabilities, among other items. If the assumptions or estimates are incorrect, the Corporation may experience unexpected material consequences.

We rely heavily on our management team and the unexpected loss of key officers may adversely affect our operations.

We believe that our growth and future success will depend in large part on the skills of our executive officers. We also depend upon the experience of the officers of our subsidiaries and on their relationships with the communities they serve. The loss of the services of one or more of these officers could disrupt our operations and impair our ability to implement our business strategy, which could adversely affect our business, financial condition and results of operations.

The success of our business strategies depends on our ability to identify and recruit individuals with experience and relationships in our primary markets.

The successful implementation of our business strategy will require us to continue to attract, hire, motivate and retain skilled personnel to develop new customer relationships as well as new financial products and services. The market for qualified management personnel is competitive, which has contributed to salary and employee benefit costs that have risen and are expected to continue to rise, which may have an adverse effect on the Corporation's net income. 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, and we may not be able to effectively integrate these individuals into our operations. Our inability to identify, recruit and retain talented personnel to manage our operations effectively and in a timely manner could limit our growth, which could materially adversely affect our business.

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

We believe that a critical contributor to our success has been our corporate culture, which focuses on building personal relationships with our customers. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively affect our future success.

Risks Related to the Regulation of the Corporation

Compliance with laws, regulations and supervisory guidance, both new and existing, may adversely affect our business, financial condition and results of operations.

We are subject to numerous laws, regulations and supervision from both federal and state agencies. Failure to comply with these laws and regulations could result in financial, structural and operational penalties, including receivership. In addition, establishing systems and processes to achieve compliance with these laws and regulations may increase our costs and/or limit our ability to pursue certain business opportunities.

Laws and regulations, and any interpretations and applications with respect thereto, generally are intended to benefit consumers, borrowers and depositors, but not stockholders. The legislative and regulatory environment is beyond our control, may change rapidly and unpredictably and may negatively influence our revenues, costs, earnings, and capital levels. Our success depends on our ability to maintain compliance with both existing and new laws and regulations.

Future legislation, regulation and government policy could affect the banking industry as a whole, including the Corporation's business and results of operations, in ways that are difficult to predict. In addition, the Corporation's results of operations could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

The CFPB may increase our regulatory compliance burden and could affect the consumer financial products and services that we offer.

Among the Dodd-Frank Act's significant regulatory changes, it created a new financial consumer protection agency, the CFPB. The CFPB is reshaping the consumer financial laws through rulemaking and enforcement of the Dodd-Frank Act's prohibitions against unfair, deceptive and abusive consumer finance products or practices, which are directly affecting the business operations of financial institutions offering consumer financial products or services, including the Corporation. This agency's broad rulemaking authority includes identifying practices or acts that are unfair, deceptive or abusive in connection with any consumer financial transaction, financial product or service. Although the CFPB has jurisdiction over banks with \$10 billion or greater in assets, rules, regulations and policies issued by the CFPB may also apply to the Corporation or its subsidiaries by virtue of the adoption of such policies and best practices by the Federal Reserve and the FDIC. Further, the CFPB may include its own examiners in regulatory examinations by the Corporation's primary regulators. The total costs, limitations and restrictions related to the CFPB may produce significant, material effects on our business, financial condition and results of operations.

Our earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies.

The policies of the Federal Reserve affect us significantly. The Federal Reserve regulates the supply of money and credit in the United States. Its policies directly and indirectly influence the rate of interest earned on loans and paid on borrowings and interest-bearing deposits and can also affect the value of financial instruments we hold. Those policies determine to a significant extent our cost of funds for lending and investing. Changes in those policies are beyond our control and are difficult to predict. Federal Reserve policies can also affect our borrowers, potentially increasing the risk that they may fail to repay their loans. For example, a tightening of the money supply by the Federal Reserve could reduce the demand for a borrower's products and services. This could adversely affect the borrower's earnings and ability to repay a loan, which could have a material adverse effect on our financial condition and results of operations.

Risks Related to the Corporation's Common Stock

Our common stock price may be volatile, which could result in losses to our investors.

Our common stock price has been volatile in the past, and several factors could cause the price to fluctuate in the future. These factors include, but are not limited to, actual or anticipated variations in earnings, changes in analysts' recommendations or projections with regard to our common stock or the markets and businesses in which we operate,

operations and stock performance of other companies deemed to be our peers, and reports of trends and concerns and other issues related to the financial services industry. Fluctuations in our common stock price may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices.

Future sales of our common stock by shareholders or the perception that those sales could occur may cause our common stock price to decline.

Although our common stock is listed for trading on NASDAQ Global Select Market, the trading volume in our common stock may be lower than that of other larger financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the potential for lower relative trading volume in our common stock, significant sales of the common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of these sales or perceptions.

Future issuances of our common stock could adversely affect the market price of our common stock and could be dilutive.

We may issue additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, shares of our common stock. Issuances of a substantial number of shares of our common stock, or the expectation that such issuances might occur, including in connection with acquisitions, could materially adversely affect the market price of the shares of our common stock and could be dilutive to shareholders. Any decision we make to issue common stock in the future will depend on market conditions and other factors, and we cannot predict or estimate the amount, timing, or nature of possible future issuances of our common stock. Accordingly, our shareholders bear the risk that future issuances of our securities will reduce the market price of the common stock and dilute their stock holdings in the Corporation.

The Corporation relies on dividends from the Bank for substantially all of its revenue.

The Corporation is a bank holding company that conducts substantially all of its operations through the Bank and the Bank's subsidiaries. As a result, the Corporation relies on dividends from the Bank for substantially all of its revenues. There are various regulatory restrictions on the ability of the Bank to pay dividends or make other payments to the Corporation, and the Corporation's right to participate in a distribution of assets upon the Bank's liquidation or reorganization is subject to the prior claims of the Bank's creditors. If the Bank is unable to pay dividends to the Corporation, the Corporation may not be able to service its outstanding borrowings and other debt, pay its other obligations or pay a cash dividend to the holders of the Corporation's common stock, and the Corporation's business, financial condition and results of operations may be materially adversely affected. Further, although the Corporation has historically paid cash dividends to holders of its common stock, holders of common stock are not entitled to receive dividends and regulatory or economic factors may cause the Corporation's Board of Directors to consider, among other actions, the reduction of dividends paid on the Corporation's common stock even if the Bank continues to pay dividends to the Corporation.

Risks Related to the Acquisition of Peoples

Combining Peoples into the Corporation may be more difficult, costly or time-consuming than we expect.

The success of the Merger will depend, in part, on the Corporation's ability to realize the anticipated benefits and cost savings from combining the business of Peoples into the business of the Corporation without materially disrupting the existing customer relationships of Peoples or the Corporation. If the Corporation is not able to achieve these objectives, the anticipated benefits and cost savings of the Merger may not be realized fully, or at all, or may take longer to realize than expected.

The success of the Merger will depend, in part, on the Corporation's ability to successfully combine the businesses of the Corporation and Peoples. To realize these anticipated benefits, the Corporation will integrate Peoples's business into its own. The integration process in the Merger could result in the disruption of ongoing business, inconsistencies in standards, controls, procedures, and policies that affect adversely the Corporation's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the Merger. If the Corporation experiences difficulties with the integration process, the anticipated benefits of the Merger may not be realized, fully or at all, or may take longer to realize than expected. As with any merger of financial institutions, there also may be disruptions that cause the Corporation to lose customers or cause customers to withdraw their deposits from C&F Bank, or other unintended consequences that could have a material adverse effect on the Corporation's results of operations or financial condition after the Merger. These integration matters could have an adverse effect on the Corporation for an indeterminate period after consummation of the Merger.

The Corporation may not be able to effectively integrate the operations of Peoples Community Bank into C&F Bank.

The future operating performance of the Corporation and C&F Bank will depend, in part, on the success of the merger of Peoples Community Bank with and into C&F Bank. The success of the subsidiary bank merger will, in turn, depend on a number of factors, including the Corporation's ability to (i) integrate the operations and branches of Peoples Community Bank and C&F Bank, (ii) retain the deposits and customers of Peoples Community Bank and C&F Bank, (iii) control the incremental increase in noninterest expense arising from the Merger in a manner that enables the combined bank to improve its overall operating efficiencies, and (iv) retain and integrate the appropriate personnel of Peoples Community Bank into the operations of C&F Bank, and reduce overlapping bank personnel. The integration of Peoples Community Bank and C&F Bank will require the dedication of the time and resources of the C&F Bank's management and may temporarily distract management's attention from the day-to-day business of C&F Bank. If C&F Bank is unable to successfully integrate Peoples Community Bank, C&F Bank may not be able to realize expected operating efficiencies and eliminate redundant costs.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Corporation has no unresolved comments from the SEC staff.

ITEM 2. PROPERTIES

The following describes the location and general character of the principal offices and other materially important physical properties of the Corporation.

The main office of C&F Bank is located in West Point, Virginia and the operations center, which includes the offices of the retail banking segment's loan, deposit and administrative functions, is located in Toano, Virginia. C&F Bank owns both buildings which comprise approximately 100,000 square feet in total. Additionally, the retail banking segment operates 29 branch offices and 3 regional commercial lending offices in Virginia, of which it owns 26 branch offices and leases 3 branch offices and 3 lending offices. Four branches owned by C&F Bank and one branch leased by C&F Bank are former branches of Peoples Community Bank and were acquired on January 1, 2020 as part of the acquisition of Peoples.

The mortgage banking segment's main administrative office and a loan production office are located in Midlothian, Virginia, in a building owned by C&F Bank that also houses a branch of C&F Bank. In addition, the mortgage banking segment has 19 loan production offices, of which 2 in Virginia are located in C&F Bank branches, 17 are leased from nonaffiliates, including: 11 in Virginia, 2 in Maryland, 2 in North Carolina, 1 in South Carolina and 1 in West Virginia.

C&F Finance's headquarters and its loan and administrative functions and staff are located in Richmond, Virginia, in offices that are leased.

All of the Corporation's properties are in good operating condition and are adequate for the Corporation's present and anticipated future needs.

ITEM 3. LEGAL PROCEEDINGS

The Corporation and its subsidiaries may be involved in certain litigation matters arising in the ordinary course of business. Although the ultimate outcome of these matters cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, we believe, based on current knowledge, that the resolution of any such matters arising in the ordinary course of business will not have a material adverse effect on the Corporation.

ITEM 4. MINE SAFETY DISCLOSURES

None.

INFORMATION ABOUT OUR EXECUTIVE OFFICERS

Name (Age) Present Position	Business Experience During Past Five Years
Thomas F. Cherry (51) President and Chief Executive Officer	Chief Executive Officer of the Corporation and C&F Bank since 2019; President of the Corporation and C&F Bank since 2014; Director of the Corporation and C&F Bank since 2015; Secretary of the Corporation and C&F Bank from 2002 to 2018; Chief Financial Officer of the Corporation and C&F Bank from 2004 to 2016; Executive Vice President and Chief Financial Officer of CVBK and CVB from September 2013 through March 2014
Larry G. Dillon (67) Executive Chairman	Chairman of the Board of Directors of the Corporation and C&F Bank since 1989; Chief Executive Officer of the Corporation and C&F Bank from 1989 to 2018; President of the Corporation and C&F Bank from 1989 to 2014; Chairman, President and Chief Executive Officer of CVBK and CVB from September 2013 through March 2014
Jason E. Long (40) Senior Vice President, Chief Financial Officer and Secretary	Senior Vice President and Chief Financial Officer of the Corporation and C&F Bank since 2016; Secretary of the Corporation and C&F Bank since 2019; First Vice President of C&F Bank from 2014 to 2016; Various positions, most recently Principal from April 2013 through September 2014, at the accounting firm of Yount, Hyde & Barbour, P.C. since 2002, focusing on the financial services industry
Bryan E. McKernon (63) President and Chief Executive Officer, C&F Mortgage	President and Chief Executive Officer of C&F Mortgage since 1995; Director of C&F Bank since 1998
S. Dustin Crone (51) President and Chief Executive Officer, C&F Finance	Chief Executive Officer of C&F Finance since 2020; President of C&F Finance since 2010
John A. Seaman, III (62). Executive Vice President and Chief Credit Officer, C&F Bank	Executive Vice President and Chief Credit Officer of C&F Bank since 2011 and of CVB from September 2013 through March 2014

PART II

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

The Corporation's common stock is listed for trading on the NASDAQ Global Select Market of the NASDAQ Stock Market under the symbol "CFFI." As of March 2, 2020, there were approximately 3,000 shareholders of record. As of that date, the closing price of our common stock on the NASDAQ Global Select Stock Market was \$48.45.

Payment of dividends is at the discretion of the Corporation's Board of Directors and is subject to various federal and state regulatory limitations. For further information regarding payment of dividends refer to Item 1. "Business," under the heading "Limits on Dividends."

Issuer Purchases of Equity Securities

The Corporation's Board of Directors authorized programs to repurchase the Corporation's common stock in May 2014 (which was subsequently reauthorized, most recently in April 2018), for repurchases of up to \$5.0 million of the Corporation's common stock through May 31, 2019, and in May 2019 for repurchases of up to \$5.0 million of the Corporation's common stock from June 1, 2019 through May 31, 2020. Repurchases under either program could be made through privately-negotiated transactions, or open-market transactions, including pursuant to a trading plan in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the Exchange Act) and/or Rule 10b-18 of the Exchange Act. Under the repurchase program last reauthorized in April 2018, the Corporation made aggregate common stock repurchases of \$3.8 million between November 2018 and May 2019. As of December 31, 2019, the Corporation has made aggregate common stock repurchases of \$1.7 million under the repurchase program authorized in May 2019.

The following table summarizes repurchases of the Corporation's common stock that occurred during the three months ended December 31, 2019.

<i>(Dollars in thousands, except for per share amounts)</i>	Total Number of Shares Purchased ¹	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2019 - October 31, 2019	407	\$ 51.20	—	\$ 3,299
November 1, 2019 - November 30, 2019 ..	—	\$ —	—	\$ 3,299
December 1, 2019 - December 31, 2019 . . .	4,161	\$ 56.86	—	\$ 3,299
Total	<u>4,568</u>	<u>\$ 56.36</u>	<u>—</u>	

¹ During the three months ended December 31, 2019, 4,568 shares were withheld upon the vesting of restricted shares granted to employees of the Corporation and its subsidiaries in order to satisfy tax withholding obligations.

ITEM 6. SELECTED FINANCIAL DATA

Five Year Financial Summary

<i>(Dollars in thousands, except per share amounts)</i>	2019	2018	2017	2016	2015
Financial Condition:					
Total assets ¹	\$ 1,657,432	\$ 1,521,411	\$ 1,509,056	\$ 1,451,992	\$ 1,405,076
Securities, available for sale	189,733	214,910	218,976	210,026	219,476
Loans held for sale	90,500	41,895	55,384	52,027	44,000
Loans (net of allowance for loan losses)	1,082,318	1,028,097	992,062	962,674	865,892
Total deposits	1,291,250	1,181,661	1,171,429	1,119,921	1,073,633
Total equity	165,279	151,958	141,702	139,214	131,059
Results of Operations:					
Interest income	\$ 95,010	\$ 92,548	\$ 89,593	\$ 89,439	\$ 87,049
Interest expense	14,556	11,027	9,601	8,968	8,694
Net interest income	80,454	81,521	79,992	80,471	78,355
Provision for loan losses	8,515	11,006	16,435	18,040	15,512
Net interest income after provision for loan losses	71,939	70,515	63,557	62,431	62,843
Noninterest income	32,012	25,758	27,232	26,047	21,220
Noninterest expenses	80,019	73,732	72,823	70,560	66,680
Income before taxes	23,932	22,541	17,966	17,918	17,383
Income tax expense ²	5,082	4,521	11,394	4,459	4,853
Net income ²	\$ 18,850	\$ 18,020	\$ 6,572	\$ 13,459	\$ 12,530
Share Data:					
Earnings per share—basic ²	\$ 5.47	\$ 5.15	\$ 1.89	\$ 3.90	\$ 3.68
Earnings per share—assuming dilution ²	5.47	5.15	1.88	3.89	3.68
Dividends per share	1.49	1.41	1.33	1.29	1.22
Weighted average number of shares—basic	3,450,745	3,501,221	3,486,510	3,454,282	3,401,426
Weighted average number of shares—assuming dilution	3,450,745	3,501,221	3,486,589	3,455,883	3,401,834
Significant Ratios:					
Net interest margin	5.52 %	5.80 %	5.99 %	6.30 %	6.35 %
Return on average assets ²	1.20	1.19	0.45	0.96	0.92
Return on average equity ²	12.02	12.40	4.58	9.90	9.87
Dividend payout ratio ²	27.24	27.38	70.37	33.08	33.20
Average equity to average assets	10.02	9.63	9.82	9.65	9.29
Asset Quality:					
Allowance for loan losses (ALL)					
Retail banking	\$ 10,482	\$ 10,426	\$ 10,775	\$ 11,115	\$ 11,017
Mortgage banking	598	598	598	598	598
Consumer finance	21,793	22,999	24,353	25,353	23,954
Ratio of ALL to total loans					
Retail banking ³	1.32 %	1.37 %	1.48 %	1.63 %	1.86 %
Mortgage banking	12.88	17.19	18.22	18.26	17.12
Consumer finance	6.96	7.77	8.34	8.33	8.21

¹ On January 1, 2019, the Corporation adopted Accounting Standards Update 2016-02, “Leases (Topic 842)” on a modified restrospective basis, which resulted in recognition of a lease liability of approximately \$3.14 million and a corresponding right-of-use asset. Periods prior to January 1, 2019 have not been restated.

² In connection with the reduction in the federal corporate income tax rate as a result of the enactment of the Tax Cuts and Jobs Act of 2017, the Corporation recognized a one-time remeasurement of its federal net deferred tax asset in 2017, which resulted in additional income tax expense and a decrease in net income of \$6.6 million.

³ The ratio of the allowance for loan losses to total loans is computed excluding purchased credit impaired loans.

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

The following discussion supplements and provides information about the major components of the results of operations, financial condition, liquidity and capital resources of the Corporation. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements.

OVERVIEW

Our primary financial goals are to maximize the Corporation's earnings and to deploy capital in profitable growth initiatives that will enhance long-term shareholder value. We track three primary financial performance measures in order to assess the level of success in achieving these goals: (1) return on average assets (ROA), (2) return on average equity (ROE), and (3) growth in earnings. In addition to these financial performance measures, we track the performance of the Corporation's three principal business segments: retail banking, mortgage banking, and consumer finance. We also actively manage our capital through growth, dividends and share repurchases, while considering the need to maintain a strong capital position.

Financial Performance Highlights

Net income for the Corporation was \$18.9 million in 2019, or \$5.47 per share assuming dilution, compared to \$18.0 million in 2018, or \$5.15 per share assuming dilution, and \$6.6 million in 2017, or \$1.88 per share assuming dilution. The Corporation's ROE and ROA were 12.02 percent and 1.20 percent, respectively, for 2019, compared to 12.40 percent and 1.19 percent, respectively, for 2018 and 4.58 percent and 0.45 percent, respectively, for 2017.

Excluding the effects of certain nonrecurring items discussed below, adjusted net income was \$19.5 million in 2019, or \$5.66 per share assuming dilution, compared to \$18.0 million in 2018, or \$5.15 per share assuming dilution, and \$13.2 million in 2017, or \$3.79 per share assuming dilution. Adjusted ROE and ROA, which exclude the effects of certain nonrecurring items discussed below, were 12.44 percent and 1.25 percent, respectively, for 2019, compared to 12.40 percent and 1.19 percent, respectively, for 2018 and 9.20 percent and 0.90 percent, respectively, for 2017.

Net income for 2019 included merger related expenses of \$709,000 (\$653,000 after income taxes) incurred in connection with the Corporation's acquisition of Peoples Bankshares, Incorporated (Peoples), which was completed on January 1, 2020. Net income for 2017 included the effect of the Tax Cuts and Jobs Act (the Tax Act), which was signed into law on December 22, 2017. As a result of the permanent reduction in the federal corporate income tax rate, the Corporation recorded a one-time remeasurement adjustment to its net federal deferred tax asset of \$6.6 million, which was recognized in income tax expense. Merger related expenses and the effects of the tax acts are nonrecurring adjustments and do not reflect the ongoing performance of the Corporation, and are excluded from adjusted net income, adjusted earnings per share, adjusted ROE and adjusted ROA.

Refer to "Use of Certain Non-GAAP Financial Measures," below, for a reconciliation of adjusted net income, adjusted earnings per share, adjusted ROE and adjusted ROA, which are non-GAAP financial measures, to the most directly comparable financial measures calculated in accordance with U.S. GAAP.

Net income for 2019 increased 4.6 percent and adjusted net income increased 8.2 percent compared to 2018. The increase in net income was attributable in part to growth in average loans at the retail banking segment of 6.1 percent, growth in loan production volume at the mortgage banking segment of 35.2 percent, and a decrease in net charge-offs as a percentage of average loans outstanding at the consumer finance segment to 3.05 percent for 2019, compared to 4.14 percent in 2018.

2020 Outlook

Management believes the Corporation's financial performance in 2020 will be affected by (1) lower accretion income related to the fair value accounting adjustments in the Corporation's acquisition of CVBK in 2013, (2) expenses related to the acquisition of Peoples and the integration of its systems and processes, (3) an uncertain interest rate environment, which may affect volume in the mortgage banking industry and contribute to net interest margin compression, (4) an increase in average loans outstanding at the retail banking segment, which will have a favorable effect on interest income, and (5) continued decline in the average yield of the non-prime automobile loan portfolio at the consumer finance segment as seasoned loans that have higher interest rates than the average yield of the portfolio are replaced with new purchases of lower-yielding, higher-quality loans. The following additional factors could influence the Corporation's financial performance in 2020:

- **Retail Banking:** Growth in higher-yielding earning assets, specifically loans, will continue to be our primary focus at the Bank during 2020. We expanded our lending capabilities in 2019 by adding new talent to our commercial lending team in the Richmond, Charlottesville, and Hampton Roads markets, and our acquisition of Peoples adds to our earning assets as well as gives us access to new markets where we hope to pursue additional loan production. Our growing lending team and continued economic strength in our markets, particularly in real estate development and construction, has led us to expect continued growth in our loan portfolio during 2020. However, it will be challenging to maintain the retail banking segment's net interest margin at its current level, as interest income from purchased credit impaired (PCI) loans in 2019 that resulted primarily from repayments of certain credits is unlikely to be realized at the same level in 2020. Additionally, the cost of interest-bearing deposits may be slower to respond to decreases in interest rates than yields on loans, which may result in net interest margin compression. While the acquisition of Peoples may result in accretion of fair value accounting adjustments recognized in interest income, this is not expected to have a meaningful impact on net income of the retail banking segment in 2020. We expect an increase in occupancy expense in 2020 related to new facilities, including two new branch office locations. Also in 2020, we expect to continue to focus on our digital strategy, because online and mobile access are quickly becoming the primary means of banking for many businesses and individuals, and we believe our digital strategy commitment is critical to remaining competitive within the financial services industry.
- **Mortgage Banking:** C&F Mortgage generates significant noninterest income from the origination and sale of residential loan products into the secondary market. In 2019, an environment of economic expansion and low interest rates contributed to significant growth in refinance and home purchase mortgage loan production at the mortgage banking segment. Loan production and revenue in 2020 are highly uncertain and will depend on economic conditions and market factors beyond our control, including interest rates, housing inventory and loan demand. In addition, during 2020, C&F Mortgage anticipates it will continue to (1) compete to retain and attract qualified loan officers, (2) incur costs associated with updating and enhancing our compliance management system and processes for originating residential loans to mitigate compliance and regulatory risks, as well as improving the quality of our loan origination process and (3) utilize technology to its fullest capability in order to realize efficiencies overall in our mortgage banking processes and to create opportunities for revenue generation.
- **Consumer Finance:** C&F Finance provides automobile financing through programs that are designed to serve customers in the non-prime sector and marine and RV financing for borrowers in the prime sector. As has been the case for the last several years, competition in the non-prime automobile loan business remains aggressive, resulting in lower interest rates and in many cases, less restrictive underwriting standards by several of our competitors. We expect organic loan growth to continue to be challenging in 2020. However, C&F Finance's scorecard model for purchasing automobile loan contracts, which was implemented in 2016 and results in the purchase of loans with higher credit metrics, as well as our expansion into marine and RV loans, are expected to result in charge-offs at C&F Finance remaining at a level lower than that experienced prior to 2018. We believe it will be challenging to maintain the consumer finance segment's net interest margin at its current level as the expansion of our loan portfolio into marine and RV loans will reduce average yields on loans and competition in the market for non-prime automobile loans may cause yields to continue to decline, which may

be partially offset by lower costs of borrowing if short-term interest rates remain low. Through growth in loans outstanding, particularly in the non-prime automobile portfolio, and improving credit quality, we aim to mitigate the effects of net interest margin compression in 2020. We also expect to continue investing in technology at C&F Finance in order to capture more business, improve efficiencies, and manage the rigorous regulatory burdens and evolving compliance issues in the indirect lending industry.

Principal Business Segments

An overview of the financial results for each of the Corporation's principal segments is presented below. A more detailed discussion is included in the section "Results of Operations."

Retail Banking: The retail banking segment reported net income of \$9.9 million for the year ended December 31, 2019, compared to net income of \$10.6 million for the year ended December 31, 2018. Retail banking segment net income for the year ended December 31, 2019 included merger related expenses of \$236,000 (\$196,000 after income taxes).

For the year and quarter ended December 31, 2019, compared to the same periods in 2018, retail banking segment net income decreased primarily as a result of (1) higher operating expenses associated with C&F Bank adding new talent to its commercial lending team in the Richmond and Charlottesville markets and investing in technology infrastructure to support continued growth, as well as higher cost of providing employee health benefits, (2) higher average rates on interest-bearing deposit accounts, (3) lower interest income on certain purchased loans, as discussed below and (4) merger related expenses, which were partially offset by (1) higher average loans outstanding, which contributed to higher interest income, (2) higher interchange income, (3) proceeds from bank-owned life insurance and (4) lower expense associated with the FDIC insurance assessment as a result of credits available to banks with less than \$10 billion in total assets.

The recognition of interest income on purchased credit impaired (PCI) loans is based on management's expectation of future payments of principal and interest. Certain PCI loans have paid off earlier than expected during 2019 and 2018, affecting the recognition of interest income as repayments occur. Interest income recognized on PCI loans was \$3.4 million and \$3.7 million for the years ended December 31, 2019 and 2018, respectively.

Average loans increased \$44.5 million or 6.1 percent for the year ended December 31, 2019, compared to the same period in 2018, primarily due to growth in the commercial business lending and acquisition and development segments of the loan portfolio. C&F Bank's total nonperforming assets were \$2.6 million at December 31, 2019, compared to \$1.7 million at December 31, 2018. Nonperforming assets included \$1.5 million in nonaccrual loans at December 31, 2019 and 2018, and included \$1.1 million in other real estate owned at December 31, 2019, compared to \$246,000 at December 31, 2018. The increase in nonperforming assets since December 31, 2018 was due primarily to the balance of land and buildings of C&F Bank's Bellgrade branch in Midlothian, Virginia, which were reclassified into other real estate owned when the Bellgrade branch was consolidated into a nearby branch during 2019. Nonaccrual loans were comprised primarily of residential mortgages and equity lines at December 31, 2019 and 2018.

Mortgage Banking: The mortgage banking segment reported net income of \$3.8 million for the year ended December 31, 2019, compared to net income of \$1.9 million for the year ended December 31, 2018.

The increase in net income of the mortgage banking segment for the year ended December 31, 2019 compared to the same period in 2018 was due primarily to higher gains on sales of loans, resulting from higher loan production, which was partially offset by higher compensation expense related to higher loan volume. Mortgage loan originations for the mortgage banking segment were \$944.1 million and \$699.0 million for the years ended December 31, 2019 and 2018, respectively. Loan production for the year ended December 31, 2019 was the highest reported by the mortgage banking segment for any calendar year since 2009, when home sales were supported by a federal income tax credit for first-time home buyers. Lower interest rates on mortgage loans have contributed to an increase in volume in the broader mortgage industry in 2019 compared to 2018. Mortgage loan originations during the the year ended December 31, 2019 for refinancings and home purchases were \$224.9 million and \$719.2 million, respectively, compared to \$76.9 million and \$566.2 million, respectively, during the year ended December 31, 2018.

Consumer Finance: The consumer finance segment reported net income of \$6.9 million for the year ended December 31, 2019, compared to net income of \$6.7 million for the year ended December 31, 2018.

The increase in net income of the consumer finance segment for the year ended December 31, 2019 compared to the year ended December 31, 2018 was due primarily to a decline in the provision for loan losses of \$2.8 million as a result of lower charge-offs and improving credit quality of the portfolio, partially offset by (1) lower loan yields, (2) higher interest expense on variable-rate borrowings resulting from higher loans outstanding (which are financed by borrowings) and higher short-term interest rates during 2019 compared to 2018 and (3) higher cost of providing employee health benefits. The average yield on loans was lower for 2019 compared to 2018 due to continued competition in the non-prime automobile loan business and the consumer finance segment pursuing growth in higher quality, lower yielding loans, which include prime marine and recreational vehicle (RV) loans.

The net charge-off ratio for 2019 was 3.05 percent of average total loans, which represents a decrease from 4.14 percent for 2018 and is lower than any year since 2012. The decline reflects a lower number of charge-offs during 2019 as a result of C&F Finance Company's purchasing automobile loan contracts with higher credit metrics beginning in 2016. At December 31, 2019, total delinquent loans as a percentage of total loans was 4.17 percent, compared to 4.76 percent at December 31, 2018. The allowance for loan losses was \$21.8 million, or 6.96 percent of total loans at December 31, 2019, compared to \$23.0 million, or 7.77 percent of total loans at December 31, 2018. The decrease in the level of the allowance for loan losses as a percentage of total loans was primarily due to lower net charge-offs on non-prime automobile loans. At December 31, 2019, compared to December 31, 2018, the higher composition within the consumer finance segment's loan portfolio of prime marine and RV loans accounted for approximately 16 basis points of the 81 basis points decrease in the ratio of the allowance for loan losses to total loans.

Other: The remaining components included in the consolidated results of operations of the Corporation are comprised primarily of net losses associated with holding company expenses of the Corporation, partially offset by the net income of C&F Wealth Management. These components reported aggregate net losses of \$1.7 million and \$1.2 million for the years ended December 31, 2019 and 2018, respectively. The higher net loss during 2019, compared to 2018, was primarily due to merger related expenses.

Acquisition of Peoples Bankshares, Incorporated: On January 1, 2020, the Corporation completed the acquisition of Peoples and its banking subsidiary, Peoples Community Bank for an aggregate purchase price of \$22.2 million of cash and stock. With the addition of Peoples, the Corporation would have had approximately \$1.8 billion in assets, \$1.3 billion in total gross loans outstanding and \$1.5 billion in total deposits on a combined basis at December 31, 2019. The former Peoples Community Bank branches will continue to operate as Peoples Community Bank, a division of C&F Bank, until the systems conversion is expected to be completed in April 2020. For the year ended December 31, 2019, the Corporation recorded merger related expenses of \$709,000 (\$653,000 after income taxes) in connection with its acquisition of Peoples, of which \$236,000 (\$196,000 after income taxes) was allocated to the retail banking segment and the remainder was recorded as a holding company expense. The Corporation estimates that it will incur aggregate after-tax merger related costs of approximately \$1.9 million, with the remaining \$1.2 million expected to be recorded in the first half of 2020.

Capital Management and Dividends

Total equity was \$165.3 million at December 31, 2019, compared to \$152.0 million at December 31, 2018. Capital growth resulted primarily from earnings for the year ended December 31, 2018, offset in part by dividends and share repurchases during the year.

The Corporation's Board of Directors continued its policy of paying dividends in 2019. For the year ended December 31, 2019, the Corporation declared dividends of \$1.49 per share. Annual dividends per share increased 5.7 percent over dividends of \$1.41 per share declared in 2018, resulting from one increase in the quarterly dividend during 2019. The Board of Directors of the Corporation continually reviews the amount of cash dividends per share and the resulting dividend payout ratio in light of changes in economic conditions, current and future capital levels and requirements and expected future earnings.

In May 2019, the Corporation's Board of Directors authorized a program, effective June 1, 2019, to repurchase up to \$5.0 million of the Corporation's common stock (the Repurchase Program) through May 31, 2020. As of December 31, 2019, the Corporation has made aggregate common stock repurchases of \$1.7 million under the Repurchase Program. At December 31, 2019, the book value per share of the Corporation's common stock was \$48.07, and tangible book value per share was \$43.61, compared to \$43.45 and \$39.00, respectively, at December 31, 2018.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires us to make estimates and assumptions. Those accounting policies with the greatest uncertainty and that require management's most difficult, subjective or complex judgments affecting the application of these policies, and the greatest likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are described below.

Allowance for Loan Losses: We establish the allowance for loan losses through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. Our judgment in determining the level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs for relevant periods of time, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower's ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available.

Impairment of Loans: We consider a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. We measure impairment on a loan-by-loan basis based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment in the loan. All TDRs are also considered impaired loans and are evaluated individually. A TDR occurs when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. For more information see the section titled "Asset Quality" within Item 7.

Loans Acquired in a Business Combination: Acquired loans are classified as either (i) purchased credit-impaired (PCI) loans or (ii) purchased performing loans and are recorded at fair value on the date of acquisition.

PCI loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments. When determining fair value, PCI loans are aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the "nonaccretable difference." Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the "accretable yield" and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

On a quarterly basis, we evaluate our estimate of cash flows expected to be collected on PCI loans. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan, or pool(s) of loans.

Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

PCI loans are not classified as nonperforming by the Corporation at the time they are acquired, regardless of whether they had been classified as nonperforming by the previous holder of such loans, and they will not be classified as nonperforming so long as, at quarterly re-estimation periods, we believe we will fully collect the new carrying value of the pools of loans.

The Corporation accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required for any deterioration in these loans in future periods.

Goodwill: The Corporation's goodwill was recognized in connection with past business combinations and is reported at the retail banking segment and the consumer finance segment. The Corporation reviews the carrying value of goodwill at least annually or more frequently if certain impairment indicators exist. In testing goodwill for impairment, the Corporation may first consider qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we conclude that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then no further testing is required and the goodwill of the reporting unit is not impaired. If the Corporation elects to bypass the qualitative assessment or if we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the fair value of the reporting unit is compared with its carrying value to determine whether an impairment exists. In the fourth quarter of 2019 and 2018, the Corporation evaluated goodwill for impairment at the retail banking segment and the consumer finance segment and concluded that no impairment existed based on an assessment of qualitative factors.

Income Taxes: Determining the Corporation's effective tax rate requires judgment. The Corporation's net deferred tax asset is determined annually based on temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, there may be transactions and calculations for which the ultimate tax outcomes are uncertain and the Corporation's tax returns are subject to audit by various tax authorities. Although we believe that estimates related to income taxes are reasonable, no assurance can be given that the final tax outcome will not be materially different than that which is reflected in the consolidated financial statements.

For further information concerning accounting policies, refer to Item 8. "Financial Statements and Supplementary Data" under the heading "Note 1: Summary of Significant Accounting Policies."

RESULTS OF OPERATIONS

NET INTEREST INCOME

The following table shows the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for each of the years ended December 31, 2019, 2018 and 2017. Loans include loans held for sale. Loans placed on a nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Accretion and amortization of fair value purchase adjustments are included in the computation of yields on loans and investments and on the cost of borrowings acquired in connection with the purchase of CVB. The CVB accretion contributed approximately 29 basis points to the yield on loans and 23 basis points to both the yield on interest earning assets and net interest margin for the year ended December 31, 2019, compared to approximately 28 basis points to the yield on loans and 21 basis points to both the yield on interest earning assets and net interest margin for the year ended December 31, 2018, and approximately 14 basis points to the yield on loans and 11 basis points to both the yield on interest earning assets and the net interest margin for the year ended

December 31, 2017. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid) using the federal corporate income tax rate of 21 percent for the years ended December 31, 2019 and 2018 and 34 percent for the year ended December 31, 2017.

TABLE 1: Average Balances, Income and Expense, Yields and Rates

<i>(Dollars in thousands)</i>	2019			2018			2017		
	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate
Assets									
Securities:									
Taxable	\$ 131,778	\$ 3,202	2.43 %	\$ 138,053	\$ 3,197	2.32 %	\$ 115,392	\$ 2,517	2.18 %
Tax-exempt	71,531	2,671	3.73	86,436	3,451	3.99	98,526	4,868	4.94
Total securities	203,309	5,873	2.89	224,489	6,648	2.96	213,918	7,385	3.45
Total loans	1,154,645	87,561	7.58	1,074,834	84,554	7.87	1,043,418	82,789	7.93
Interest-bearing deposits in other banks	110,638	2,179	1.97	118,176	2,097	1.77	107,629	1,128	1.05
Total earning assets	1,468,592	95,613	6.51	1,417,499	93,299	6.58	1,364,965	91,302	6.69
Allowance for loan losses	(33,733)			(35,409)			(36,101)		
Total non-earning assets	130,569			126,814			134,275		
Total assets	<u>\$ 1,565,428</u>			<u>\$ 1,508,904</u>			<u>\$ 1,463,139</u>		
Liabilities and Equity									
Interest-bearing deposits:									
Interest-bearing demand deposits	\$ 218,394	1,168	0.53	\$ 221,750	799	0.36	\$ 215,627	482	0.22
Money market deposit accounts	199,840	1,020	0.51	215,662	699	0.32	221,279	606	0.27
Savings accounts	120,644	110	0.09	116,896	103	0.09	109,789	87	0.08
Certificates of deposit, \$100 or more	207,931	3,876	1.86	172,616	2,206	1.28	163,100	1,839	1.13
Other certificates of deposit	184,613	2,920	1.58	177,279	1,879	1.06	181,746	1,734	0.95
Total interest-bearing deposits	931,422	9,094	0.98	904,203	5,686	0.63	891,541	4,748	0.53
Borrowings	160,327	5,462	3.41	165,290	5,341	3.23	165,662	4,853	2.93
Total interest-bearing liabilities	1,091,749	14,556	1.33	1,069,493	11,027	1.03	1,057,203	9,601	0.91
Noninterest-bearing demand deposits	283,505			266,415			236,937		
Other liabilities	33,364			27,678			25,353		
Total liabilities	1,408,618			1,363,586			1,319,493		
Equity	156,810			145,318			143,646		
Total liabilities and equity	<u>\$ 1,565,428</u>			<u>\$ 1,508,904</u>			<u>\$ 1,463,139</u>		
Net interest income		<u>\$ 81,057</u>			<u>\$ 82,272</u>			<u>\$ 81,701</u>	
Interest rate spread			<u>5.18 %</u>			<u>5.55 %</u>			<u>5.78 %</u>
Interest expense to average earning assets			<u>0.99 %</u>			<u>0.78 %</u>			<u>0.70 %</u>
Net interest margin			<u>5.52 %</u>			<u>5.80 %</u>			<u>5.99 %</u>

Interest income and expense are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table shows the direct causes of the year-to-year changes in the components of net interest income on a taxable-equivalent basis. The Corporation calculates the rate and volume variances using a formula prescribed by the SEC. Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the absolute dollar amounts of each.

TABLE 2: Rate-Volume Recap

<i>(Dollars in thousands)</i>	2019 from 2018			2018 from 2017		
	Increase (Decrease) Due to		Total Increase (Decrease)	Increase (Decrease) Due to		Total Increase (Decrease)
	Rate	Volume		Rate	Volume	
Interest income:						
Loans	\$ (3,169)	\$ 6,176	\$ 3,007	\$ (646)	\$ 2,411	\$ 1,765
Securities:						
Taxable	151	(146)	5	168	512	680
Tax-exempt	(214)	(566)	(780)	(865)	(552)	(1,417)
Interest-bearing deposits in other banks	223	(141)	82	848	121	969
Total interest income	<u>(3,009)</u>	<u>5,323</u>	<u>2,314</u>	<u>(495)</u>	<u>2,492</u>	<u>1,997</u>
Interest expense:						
Interest-bearing deposits:						
Interest-bearing demand deposits	381	(12)	369	304	13	317
Money market deposit accounts	376	(55)	321	108	(15)	93
Savings accounts	—	7	7	10	6	16
Certificates of deposit, \$100 or more.	1,150	520	1,670	255	112	367
Other certificates of deposit	960	81	1,041	189	(44)	145
Total interest-bearing deposits	<u>2,867</u>	<u>541</u>	<u>3,408</u>	<u>866</u>	<u>72</u>	<u>938</u>
Borrowings	287	(166)	121	499	(11)	488
Total interest expense	<u>3,154</u>	<u>375</u>	<u>3,529</u>	<u>1,365</u>	<u>61</u>	<u>1,426</u>
Change in net interest income	<u>\$ (6,163)</u>	<u>\$ 4,948</u>	<u>\$ (1,215)</u>	<u>\$ (1,860)</u>	<u>\$ 2,431</u>	<u>\$ 571</u>

Net interest income, on a taxable-equivalent basis, for 2019 decreased to \$81.1 million, compared to \$82.3 million for 2018, primarily as a result of lower net interest margin, partially offset by growth in average earning assets. Net interest margin decreased 28 basis points to 5.52 percent, compared to 5.80 percent for 2018, and average earning assets grew \$51.1 million, or 3.6 percent, in 2019 compared to 2018. The net interest margin decline resulted from a 30 basis point increase in the cost of interest-bearing liabilities coupled with a seven basis point decline in the yield on interest-earning assets for the year ended December 31, 2019, compared to the year ended December 31, 2018. The increase in the cost of interest-bearing liabilities was a result of higher costs of deposits and borrowings. The decline in yield on interest-earning assets was primarily attributable to a decrease in the yields on the loan and investment securities portfolios for 2019 compared to 2018, partially offset by an increase in the yield on interest-earning deposits in other banks.

Average loans, which includes both loans held for investment and loans held for sale, increased \$79.8 million to \$1.2 billion for the year ended December 31, 2019, compared to 2018. Average loans held for investment of the retail banking segment increased \$44.5 million, or 6.1 percent, for the year ended December 31, 2019, compared to 2018, primarily due to growth in the commercial business lending and land acquisition and development segments of the loan portfolio during 2019, which was partially attributable to C&F Bank expanding its commercial lending team. Average loans held for investment at the consumer finance segment increased \$10.9 million, or 3.7 percent, for 2019 compared to 2018 as a result of the continued expansion of the consumer finance segment's purchases of marine and RV loan contracts and growth in automobile loans outstanding. Average loans held for sale increased \$24.3 million, or 59.9 percent for 2019, compared to 2018, due to higher loan production.

The overall yield on loans decreased 29 basis points to 7.58 percent for 2019, compared to 2018, due primarily to higher growth in loans at the retail banking and mortgage banking segments than the consumer finance segment, a decrease in the average yield on loans at the consumer finance segment, and lower interest income on PCI loans at the retail banking segment, partially offset by higher yields on loans at the retail banking segment. Higher loan growth at the retail banking and mortgage banking segments than the consumer finance segment resulted in a decrease in the overall yield on loans, as loan yields are higher on average at the consumer finance segment. Lower average yields on loans at the consumer finance segment were due primarily to continued competition in the non-prime automobile loan business and to the consumer finance segment's pursuing growth in higher quality, lower yielding loans, which include prime marine and RV loans. The higher average yield on loans at the retail banking segment in 2019 compared to 2018 was primarily a result of higher yields on home equity lines of credit and construction loans.

Average securities available for sale decreased \$21.2 million for 2019, compared to 2018, primarily due to higher calls and maturities of obligations of states and political subdivisions and lower purchases during the year ended 2019.

The average yield on the securities portfolio on a taxable-equivalent basis decreased seven basis points for 2019, compared to 2018.

Average interest-bearing deposits in other banks, consisting primarily of excess cash reserves maintained at the Federal Reserve Bank, decreased \$7.5 million during 2019, compared to 2018. The decrease during 2019 resulted from growth in average loans outpacing growth in average deposits. The average yield on these overnight funds increased 20 basis points for 2019, compared to 2018, as the Federal Reserve Bank increased the interest rate on excess cash reserve balances from 1.50 percent in December 2017 to 2.40 percent by the end of the second quarter of 2019. The Federal Reserve Bank then decreased the interest rate on excess cash reserve balances to 1.55 percent by the end of 2019.

Average money market, savings and interest-bearing demand deposits decreased \$15.4 million for 2019, compared to 2018, and average time deposits increased \$42.6 million for 2019, compared to 2018, as interest rates offered on time deposits rose, attracting deposit customers. The increase in the average cost of interest-bearing deposits for 2019 compared to 2018 was 35 basis points, due to increases in interest rates on time deposits, interest-bearing demand deposits, and money market deposits driven by changes in market interest rates.

Average borrowings decreased \$5.0 million for 2019, compared to 2018. The decrease resulted from maturities during 2018 of a \$5.0 million repurchase agreement with a third-party correspondent bank and a \$2.5 million advance from the FHLB. The average cost of borrowings increased 18 basis points during 2019, compared to 2018, because of increases in short-term interest rates, to which variable-rate borrowing at the consumer finance segment is indexed. At December 31, 2019, the current cost of these variable rate borrowings was lower than any period since the first quarter of 2018 as a result of decreases in short-term interest rates during 2019.

The Corporation believes that it may be challenging to maintain net interest margin at its current level based on the effects of (1) the current interest rate environment, which has at times included an inverted yield curve and historically low interest rates, (2) possible lower average yields on consumer finance segment loans as seasoned loans that have higher interest rates than the average yield of the portfolio are replaced with lower-yielding higher-quality loans (including marine and RV loans), (3) lower accretion of purchase discounts on PCI loans from the acquisition of CVBK, which is included in yields on loans, (4) lower loan production, and therefore lower average loans held for sale, at the mortgage banking segment following historically high levels during 2019 and (5) the acquisition of Peoples, which has historically had a lower net interest margin than the Corporation. The Corporation expects to be able to mitigate the effects of these factors with future loan growth at the retail banking segment and the consumer finance segment.

Discussion of net interest income for the year ended December 31, 2017 has been omitted as such discussion was provided in Part II, Item 7. "Management's Discussion and Analysis," under the heading "Net Interest Income" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on February 26, 2019.

NONINTEREST INCOME

TABLE 3: Noninterest Income

	Year Ended December 31, 2019				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
<i>(Dollars in thousands)</i>					
Gains on sales of loans	\$ —	\$ 10,603	\$ —	\$ —	\$ 10,603
Mortgage banking fee income	—	4,700	—	—	4,700
Interchange income	4,203	—	—	—	4,203
Service charges on deposit accounts	3,923	—	—	—	3,923
Wealth management services income, net	—	—	—	2,029	2,029
Other service charges and fees	1,492	—	4	—	1,496
Income from bank-owned life insurance	607	—	104	—	711
Net gains on calls of available for sale securities	10	—	—	—	10
Other income	1,157	403	457	2,320	4,337
Total noninterest income	<u>\$ 11,392</u>	<u>\$ 15,706</u>	<u>\$ 565</u>	<u>\$ 4,349</u>	<u>\$ 32,012</u>
	Year Ended December 31, 2018				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
<i>(Dollars in thousands)</i>					
Gains on sales of loans	\$ —	\$ 7,841	\$ —	\$ —	\$ 7,841
Mortgage banking fee income	—	3,686	—	—	3,686
Interchange income	3,882	—	—	—	3,882
Service charges on deposit accounts	4,213	—	—	—	4,213
Wealth management services income, net	—	—	—	1,860	1,860
Other service charges and fees	1,379	—	7	—	1,386
Income from bank-owned life insurance	320	—	104	—	424
Net gains on calls of available for sale securities	10	—	—	—	10
Other income	1,225	329	627	275	2,456
Total noninterest income	<u>\$ 11,029</u>	<u>\$ 11,856</u>	<u>\$ 738</u>	<u>\$ 2,135</u>	<u>\$ 25,758</u>
	Year Ended December 31, 2017				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
<i>(Dollars in thousands)</i>					
Gains on sales of loans	\$ —	\$ 8,553	\$ —	\$ —	\$ 8,553
Mortgage banking fee income	—	3,885	—	—	3,885
Interchange income	3,476	—	—	—	3,476
Service charges on deposit accounts	4,458	—	—	—	4,458
Wealth management services income, net	—	—	—	1,619	1,619
Other service charges and fees	1,336	—	7	—	1,343
Income from bank-owned life insurance	328	—	105	—	433
Net gains on calls of available for sale securities	10	—	—	—	10
Other income	893	210	766	1,586	3,455
Total noninterest income	<u>\$ 10,501</u>	<u>\$ 12,648</u>	<u>\$ 878</u>	<u>\$ 3,205</u>	<u>\$ 27,232</u>

Total noninterest income increased \$6.3 million, or 24.3 percent, for the year ended December 31, 2019, compared to the year ended December 31, 2018. The increase in noninterest income was due primarily to (1) an increase in gains on sales of loans and mortgage banking fee income, which consists of fees related to loan originations, at the mortgage banking segment as a result of higher mortgage loan production, as lower mortgage loan interest rates contributed to an increase in volume in the broader mortgage industry, (2) an increase in debit card interchange income at the retail banking segment, (3) an increase in income from bank-owned life insurance at the retail banking segment resulting from proceeds on one policy received in 2019, (4) an increase in income, included in “Other income,” related to interest rate swaps offered to commercial loan customers at the retail banking segment and (5) net unrealized gains of \$2.1 million in 2019 at the

Corporation related to the its nonqualified deferred compensation plan compared to no such gain in 2018. These increases were partially offset by decreased service charges on deposit accounts at the retail banking segment resulting from fewer overdraft fees charged and lower income at the retail banking segment related to the Bank’s cash balance pension plan, which is included in “Other income”.

Discussion of noninterest income for the year ended December 31, 2017 has been omitted as such discussion was provided in Part II, Item 7. “Management’s Discussion and Analysis,” under the heading “Noninterest Income” in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on February 26, 2019.

NONINTEREST EXPENSE

TABLE 4: Noninterest Expense

<i>(Dollars in thousands)</i>	Year Ended December 31, 2019				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 28,231	\$ 5,965	\$ 8,668	\$ 4,337	\$ 47,201
Occupancy expense	5,739	2,246	685	73	8,743
Other expenses:					
Data processing	6,694	54	1,303	76	8,127
Professional fees	1,904	175	583	603	3,265
Other expenses	5,996	3,238	2,963	486	12,683
Total other expenses	14,594	3,467	4,849	1,165	24,075
Total noninterest expense	\$ 48,564	\$ 11,678	\$ 14,202	\$ 5,575	\$ 80,019

<i>(Dollars in thousands)</i>	Year Ended December 31, 2018				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 26,632	\$ 5,298	\$ 8,542	\$ 1,531	\$ 42,003
Occupancy expense	5,483	1,980	782	63	8,308
Other expenses:					
Data processing	6,097	54	1,263	38	7,452
Professional fees	2,138	122	643	141	3,044
Other expenses	6,165	2,916	2,826	1,018	12,925
Total other expenses	14,400	3,092	4,732	1,197	23,421
Total noninterest expense	\$ 46,515	\$ 10,370	\$ 14,056	\$ 2,791	\$ 73,732

<i>(Dollars in thousands)</i>	Year Ended December 31, 2017				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 25,132	\$ 5,945	\$ 9,272	\$ 3,248	\$ 43,597
Occupancy expense	4,671	1,957	1,035	67	7,730
Other expenses:					
Data processing	5,343	53	1,256	35	6,687
Professional fees	1,739	88	486	103	2,416
Other expenses	6,198	3,087	2,644	464	12,393
Total other expenses	13,280	3,228	4,386	602	21,496
Total noninterest expense	\$ 43,083	\$ 11,130	\$ 14,693	\$ 3,917	\$ 72,823

Total noninterest expense increased \$6.3 million, or 8.5 percent, for the year ended December 31, 2019, compared to the year ended December 31, 2018. The increase in noninterest expenses was due primarily to (1) an increase in salaries and employee benefits expense (a) at the retail banking segment associated with C&F Bank adding new talent to its commercial lending team in the Richmond and Charlottesville markets and higher cost of providing employee health benefits, (b) at the mortgage banking segment resulting from higher mortgage loan production and (c) at the Corporation related to its nonqualified deferred compensation plan, (2) merger related expenses associated with the acquisition of Peoples at the retail banking segment and the Corporation and (3) higher data processing and occupancy expenses at the retail banking segment associated with C&F Bank's investing in technology infrastructure to support continued growth. Partially offsetting these increases was (1) a decrease in the FDIC insurance assessment expense, included in "Other expenses," at the retail banking segment, as a result of credits available to banks with less than \$10 billion in total assets and (2) lower professional fees in 2019 at the retail banking segment related to improving compliance processes.

Merger related expenses for the year ended December 31, 2019 included \$236,000 at the retail banking segment, of which \$173,000 was professional fees expense and \$50,000 was data processing expense, and \$473,000 at the Corporation, of which \$441,000 was professional fees expense.

Compensation expense related to the Corporation's nonqualified deferred compensation plan is recorded based in part on changes in the fair value of assets held in trust for the plan, which are allocated to participants. As a result of unrealized gains related to the nonqualified plan, additional compensation expense of \$2.1 million was recorded in 2019 compared to a reduction of compensation expense of \$610,000 in 2018, and was offset by gains recorded in noninterest income, as discussed above.

Discussion of noninterest expense for the year ended December 31, 2017 has been omitted as such discussion was provided in Part II, Item 7. "Management's Discussion and Analysis," under the heading "Noninterest Expense" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on February 26, 2019.

INCOME TAXES

Income tax expense on 2019 earnings was \$5.1 million, resulting in an effective tax rate of 21.2 percent, compared with \$4.5 million, or 20.1 percent, in 2018 and \$11.4 million, or 63.4 percent, in 2017. The effective tax rate for the year ended December 31, 2019 includes the effect of merger related expenses, a portion of which were nondeductible. Discussion of income taxes for the year ended December 31, 2017 has been omitted as such discussion was provided in Part II, Item 7. "Management's Discussion and Analysis," under the heading "Income Taxes" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on February 26, 2019.

ASSET QUALITY

Allowance and Provision for Loan Losses

Allowance for Loan Losses Methodology – Retail Banking and Mortgage Banking. We conduct an analysis of the collectibility of the loan portfolio on a regular basis. This analysis does not apply to PCI loans, loans carried at fair value, loans held for sale or off-balance sheet credit exposure (e.g., unfunded loan commitments and standby letters of credit). We use this analysis to assess the sufficiency of the allowance for loan losses and to determine the necessary provision for loan losses.

The analysis, at a minimum, considers the following factors:

- Changes in lending policies and procedures, including underwriting, collection, charge-off and recovery;
- Changes in international, national, regional and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;
- Changes in the nature and volume of the portfolio and in the terms of loans;

- Changes in the experience, ability and depth of lending management and other relevant staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans and the volume and severity of adversely classified or graded loans;
- Changes in the quality of our loan review system;
- Changes in the value of the underlying collateral for collateral-dependent loans;
- The existence and effect of any concentrations of credit and changes in the level of such concentrations;
- The effect of other external factors, such as competition;
- Historical trends of actual loan losses based on volume and types of loans; and
- Significant one-time transactions affecting the allowance for loan losses.

In conjunction with the factors described above, we consider the following risk elements that are inherent in the loan portfolio as part of the analysis:

- Real estate residential mortgage loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.
- Real estate construction 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, financial and agricultural 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. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.
- Equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.
- Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

The review process generally begins with loan officers or management identifying problem loans to be reviewed on an individual basis for impairment. This review of individual loans is limited to those loans that have indications of probable loss or that may result in significant losses to the Corporation, while all other loans, which may include delinquent loans and loans classified as special mention or substandard, are evaluated as a group, as discussed below. In addition, all TDRs are considered impaired loans and are individually evaluated. We consider a loan impaired when it is probable that we will be unable to collect all interest and principal payments as scheduled in the loan agreement. A loan is not considered impaired during a period of delay in payment if the ultimate collectibility of all amounts due is expected. If a loan is considered impaired, impairment is measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. A valuation allowance is established for an impaired loan to the extent that this measure of the impaired loan is less than the recorded investment in the loan. When a loan is determined to be impaired, we follow a consistent process to measure that impairment in our loan portfolio. For collateral dependent loans we obtain an updated appraisal if we do not have a current one on file. Appraisals are performed by independent third party appraisers with relevant industry experience. We may make adjustments to the appraised value based on recent sales of similar properties or general market

conditions when appropriate. We also estimate costs to sell collateral in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan.

The remaining non-impaired loans are grouped by loan type (e.g., commercial real estate, commercial, residential mortgage, consumer). We assign each loan type an allowance factor based on the historical loss rate for that type of loan and an evaluation of the qualitative factors mentioned above to determine a general allowance. We assign classified loans (i.e., special mention, substandard, doubtful, loss) a higher allowance factor than non-classified loans within a particular loan type based on our concerns regarding collectibility. Our allowance factors increase with the severity of classification. Allowance factors used for unclassified loans are based on our analysis of charge-off history for relevant periods of time which can vary depending on economic conditions, and our judgment based on the overall analysis of the lending environment including the general economic conditions. Our analysis of charge-off history also considers economic cycles and the trends during those cycles. The allowance for loan losses is the aggregate of specific allowances and the general allowance for each portfolio type.

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

- Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.
- Special mention loans have a specific, identified weakness in the borrower's operations and in the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history may be characterized by late payments. The Corporation's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.
- Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet the Corporation's definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.
- Substandard nonaccrual loans have the same characteristics as substandard loans; however, they have a nonaccrual classification because it is probable that the Corporation will not be able to collect all amounts due.
- Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high.
- Loss rated loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

Allowance for Loan Losses Methodology - PCI Loans - As previously described, on a quarterly basis we evaluate our estimate of cash flows expected to be collected on PCI loans. These evaluations require the continued assessment of key assumptions and estimates similar to the initial estimate of fair value, such as the effect of collateral value changes, changing loss severities, estimated and experienced prepayment speeds and other relevant factors. Subsequent decreases to the expected cash flows to be collected on a PCI loan will generally result in a provision for loan losses resulting in an

increase to the allowance for loan losses. For a more detailed description, see “Critical Accounting Policies” in this Item 7.

Allowance for Loan Losses Methodology – Consumer Finance. The consumer finance segment’s loans consist of non-prime automobile loans and prime marine and RV loans. These loans carry risks associated with (1) the continued credit-worthiness of borrowers and (2) the value of rapidly-depreciating collateral. These loans do not lend themselves to a classification process because of the short duration of time between default, repossession and charge-off. Therefore, the loan loss allowance review process generally focuses on an analysis of charge-off history for relevant periods of time, which can vary depending on economic conditions. Further consideration is given to the following factors:

- An overall analysis of the lending environment;
- Changes in the volume and severity of past due loans;
- Changes in the value of the underlying collateral;
- Changes in lending policies and procedures, including underwriting, collection and recovery;
- Changes in the composition of the portfolio; and
- The effect of external factors, such as competition.

Loans are segregated between performing and nonperforming loans. Performing loans are those that have made timely payments in accordance with the terms of the loan agreement and that are not past due 90 days or more. Nonperforming loans are those that do not accrue interest and are greater than 90 days past due.

In accordance with its policies and guidelines and consistent with industry practices, C&F Finance, at times, offers payment deferrals to non-prime automobile borrowers, whereby the borrower is allowed to move up to two payments within a twelve-month rolling period to the end of the loan. A fee will be collected for extensions only in states that permit it. An account for which all delinquent payments are deferred is classified as current at the time the deferment is granted and therefore is not included as a delinquent account. Thereafter, such an account is aged based on the timely payment of future installments in the same manner as any other account. We evaluate the results of this deferment strategy based upon the amount of cash installments that are collected on accounts after they have been deferred versus the extent to which the collateral underlying the deferred accounts has depreciated over the same period of time. Based on this evaluation, we believe that payment deferrals granted according to our policies and guidelines are an effective portfolio management technique and result in higher ultimate cash collections. Payment deferrals may affect the ultimate timing of when an account is charged off. Increased use of deferrals may result in a lengthening of the loss confirmation period, which would increase expectations of credit losses inherent in the portfolio and therefore increase the allowance for loan losses and related provision for loan losses. The average amounts deferred on a monthly basis, as a percentage of average non-prime automobile loans outstanding, was 1.90 percent in 2019, 2.30 percent in 2018 and 2.57 percent in 2017.

The allowance for loan losses represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. The provision for loan losses increases the allowance, and loans charged off, net of recoveries, reduce the allowance. The following table presents the Corporation's loan loss experience for the periods indicated:

TABLE 5: Allowance for Loan Losses

<i>(Dollars in thousands)</i>	Year Ended December 31,				
	2019	2018	2017	2016	2015
Balance, beginning of period	\$ 34,023	\$ 35,726	\$ 37,066	\$ 35,569	\$ 35,606
Provision for loan losses:					
Retail Banking	360	100	200	—	—
Mortgage Banking	—	—	—	—	45
Consumer Finance	8,155	10,906	16,235	18,040	15,467
Total provision for loan losses	8,515	11,006	16,435	18,040	15,512
Loans charged off:					
Real estate—residential mortgage	(46)	(42)	(179)	(82)	(144)
Commercial, financial and agricultural ¹	(29)	(409)	(349)	(87)	(21)
Equity lines	(138)	—	(42)	(57)	(19)
Consumer	(349)	(344)	(301)	(281)	(317)
Consumer finance	(13,991)	(16,477)	(21,525)	(20,663)	(19,816)
Total loans charged off	(14,553)	(17,272)	(22,396)	(21,170)	(20,317)
Recoveries of loans previously charged off:					
Real estate—residential mortgage	26	57	118	163	257
Commercial, financial and agricultural ¹	4	59	21	206	31
Equity lines	—	—	2	—	1
Consumer	228	230	189	236	268
Consumer finance	4,630	4,217	4,291	4,022	4,211
Total recoveries	4,888	4,563	4,621	4,627	4,768
Net loans charged off	(9,665)	(12,709)	(17,775)	(16,543)	(15,549)
Balance, end of period	\$ 32,873	\$ 34,023	\$ 35,726	\$ 37,066	\$ 35,569
Ratio of net charge-offs (recoveries) to average total loans outstanding during period for Retail Banking	0.04 %	0.06 %	0.08 %	(0.02)%	(0.01)%
Ratio of net charge-offs to average total loans outstanding during period for Consumer Finance	3.05 %	4.14 %	5.82 %	5.55 %	5.50 %

¹ Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

For further information regarding the adequacy of our allowance for loan losses, refer to "Nonperforming Assets" within this Item 7.

The allocation of the allowance for loan losses at December 31 for the years indicated and the ratio of corresponding outstanding loan balances to total loans are as follows:

TABLE 6: Allocation of Allowance for Loan Losses

<i>(Dollars in thousands)</i>	December 31,				
	2019	2018	2017	2016	2015
Allocation of allowance for loan losses:					
Real estate—residential mortgage	\$ 2,080	\$ 2,246	\$ 2,371	\$ 2,559	\$ 2,471
Real estate—construction ¹	681	727	605	816	94
Commercial, financial and agricultural ²	7,121	6,688	7,478	7,393	7,755
Equity lines	733	1,106	688	685	1,052
Consumer	465	257	231	261	243
Consumer finance	<u>21,793</u>	<u>22,999</u>	<u>24,353</u>	<u>25,352</u>	<u>23,954</u>
Total allowance for loan losses	<u>\$ 32,873</u>	<u>\$ 34,023</u>	<u>\$ 35,726</u>	<u>\$ 37,066</u>	<u>\$ 35,569</u>
Ratio of loans to total period-end loans:					
Real estate—residential mortgage	16 %	17 %	19 %	19 %	21 %
Real estate—construction ¹	5	5	4	6	1
Commercial, financial and agricultural ²	45	43	43	39	39
Equity lines	5	5	5	5	6
Consumer	1	2	1	1	1
Consumer finance	<u>28</u>	<u>28</u>	<u>28</u>	<u>30</u>	<u>32</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

¹ Includes the Corporation's real estate construction lending and consumer real estate lot lending.

² Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Loans by credit quality indicators as of December 31, 2019 were as follows:

TABLE 7A: Credit Quality Indicators

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total ¹
Real estate – residential mortgage	\$ 177,049	\$ 1,839	\$ 881	\$ 1,526	\$ 181,295
Real estate – construction ²	54,246	—	—	—	54,246
Commercial, financial and agricultural ³	487,374	13,357	70	11	500,812
Equity lines	51,662	181	11	229	52,083
Consumer	13,632	6	—	118	13,756
	<u>\$ 783,963</u>	<u>\$ 15,383</u>	<u>\$ 962</u>	<u>\$ 1,884</u>	<u>\$ 802,192</u>

<i>(Dollars in thousands)</i>	Performing	Non- Performing	Total
Consumer finance	<u>\$ 312,388</u>	<u>\$ 611</u>	<u>\$ 312,999</u>

¹ At December 31, 2019, the Corporation did not have any loans classified as Doubtful or Loss.

² Includes the Corporation's real estate construction lending and consumer real estate lot lending.

³ Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Loans by credit quality indicators as of December 31, 2018 were as follows:

TABLE 7B: Credit Quality Indicators

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total ¹
Real estate – residential mortgage	\$ 180,232	\$ 2,832	\$ 1,243	\$ 594	\$ 184,901
Real estate – construction ²	54,461	—	—	—	54,461
Commercial, financial and agricultural ³	440,832	14,625	454	24	455,935
Equity lines	54,289	389	99	883	55,660
Consumer	14,998	5	6	—	15,009
	<u>\$ 744,812</u>	<u>\$ 17,851</u>	<u>\$ 1,802</u>	<u>\$ 1,501</u>	<u>\$ 765,966</u>

<i>(Dollars in thousands)</i>	Performing	Non- Performing	Total
Consumer finance	<u>\$ 295,442</u>	<u>\$ 712</u>	<u>\$ 296,154</u>

¹ At December 31, 2018, the Corporation did not have any loans classified as Doubtful or Loss.

² Includes the Corporation’s real estate construction lending and consumer real estate lot lending.

³ Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

The retail banking segment allowance for loan losses as a percentage of total loans, excluding PCI loans, declined to 1.32 percent at December 31, 2019, compared to 1.37 percent at December 31, 2018, because of a decrease in the allowance related to impaired loans and overall improved credit quality. We believe that the current level of the allowance for loan losses at the retail banking segment is adequate to absorb probable losses inherent in the loan portfolio, based on the relevant history of charge-offs and recoveries, current economic conditions, overall portfolio quality and review of specific criticized loans. If loan concentrations within the retail banking segment’s loan portfolio result in higher credit risk or if economic conditions deteriorate in future periods, a higher level of nonperforming loans may be experienced, which may then require a higher provision for loan losses.

The consumer finance segment’s allowance for loan losses decreased by \$1.2 million to \$21.8 million at December 31, 2019 from \$23.0 million at December 31, 2018, and its provision for loan losses decreased \$2.8 million for the year ended December 31, 2019, as compared to 2018. The decrease in the allowance and the lower provision resulted primarily from C&F Finance purchasing automobile loan contracts with higher credit metrics beginning in 2016, which has led to an overall improvement in the credit quality of the portfolio and lower charge-offs. Delinquent loans as a percentage of total loans decreased to 4.17 percent at December 31, 2019 from 4.76 percent at December 31, 2018 and the net charge-off ratio for 2019 decreased to 3.05 percent from 4.14 percent for 2018. The allowance for loan losses as a percentage of loans decreased to 6.96 percent at December 31, 2019, compared to 7.77 percent at December 31, 2018, primarily as a result of lower net charge-offs on non-prime automobile loans. Management expects the marine and RV loan contracts purchased by the consumer finance segment beginning in the first quarter of 2018, which are contracts for prime loans made to borrowers with higher credit scores, to require both a lower provision for loan losses and allowance for loan losses than the consumer finance segment’s non-prime automobile loans, contributing to a decrease in the overall level of the consumer finance segment’s allowance for loan losses as a percentage of total loans. At December 31, 2019, compared to December 31, 2018, the higher composition within the consumer finance segment’s loan portfolio of marine and RV loans accounted for 16 basis points of the 81 basis points decrease in this ratio.

As previously described, the consumer finance segment, at times, offers payment deferrals to non-prime automobile borrowers as a management technique to achieve higher ultimate cash collections on select loan accounts. Payment deferrals may affect the ultimate timing of when an account is charged off. A significant reliance on deferrals as a means of managing collections may result in a lengthening of the loss confirmation period, which would increase expectations of credit losses inherent in the portfolio. The average amounts deferred on a monthly basis, as a percentage of average non-prime automobile loans outstanding was 1.90 percent in 2019, 2.30 percent in 2018 and 2.57 percent in 2017.

Because C&F Finance primarily focuses on non-prime borrowers, the anticipated rates of delinquencies, defaults, repossessions and losses on the consumer finance loans are higher than those experienced in the general automobile finance industry and could be more dramatically affected by a general economic downturn. These periods also may be accompanied by decreased consumer demand for used automobiles and declining values of automobiles securing outstanding loans, which weakens collateral coverage and increases the amount of a loss in the event of default. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed automobiles or delay the timing of these sales. While we manage the higher risk inherent in loans made to non-prime borrowers through the underwriting criteria, portfolio management and collection methods employed by C&F Finance, we cannot guarantee that these criteria or methods will afford adequate protection against these risks. However, we believe that the current allowance for loan losses is adequate to absorb probable losses on existing consumer finance segment loans that may become uncollectible. If factors influencing the consumer finance segment result in higher net charge-off ratios in future periods, the consumer finance segment may need to increase the level of its allowance for loan losses through additional provisions for loan losses, which could negatively affect future earnings of the consumer finance segment.

Nonperforming Assets

A loan's past due status is based on the contractual due date of the most delinquent payment due. Loans are generally placed on nonaccrual status when the collection of principal or interest is 90 days or more past due, or earlier, if collection is uncertain based on an evaluation of the net realizable value of the collateral and the financial strength of the borrower. Loans greater than 90 days past due may remain on accrual status if management determines it has adequate collateral to cover the principal and interest. For those loans that are carried on nonaccrual status, payments are first applied to principal outstanding. A loan may be returned to accrual status if the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms of the loan and there is reasonable assurance the borrower will continue to make payments as agreed. These policies are applied consistently across our loan portfolio.

Assets acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of like properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. We may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations indicate a further deterioration in market conditions. Revenue and expenses from operations and changes in the property valuations are included in net expenses from foreclosed assets and improvements are capitalized.

At the consumer finance segment, the repossession process is generally initiated after a loan becomes more than 60 days delinquent. Borrowers have an opportunity to redeem their repossessed vehicles by paying all outstanding balances, including finance charges and fees. Vehicles that are not redeemed within the prescribed waiting period before C&F Finance has the legal right to sell the repossessed vehicle then become available-for-sale at the end of that period and are reclassified from loans to other assets and are recorded initially at fair value less estimated costs to sell. The difference between the carrying amount of each loan and the fair value of the vehicle (i.e. the deficiency) is charged against the allowance for loan losses. Accounts still in process of collection or for which the Corporation does not have the legal right to sell continue to be classified as loans until such legal authority is obtained. After the vehicles have been sold in third-party auctions, we credit the proceeds from the sale of the vehicles, and any other recoveries, to the carrying value of the repossessed vehicles. C&F Finance pursues collection of deficiencies, as allowed by state law, when it deems such action to be appropriate.

Table 8 summarizes nonperforming assets at December 31 of each of the past five years.

TABLE 8: Nonperforming Assets

Retail Banking Segment

<i>(Dollars in thousands)</i>	2019	2018	2017	2016	2015
Loans, excluding purchased loans	\$ 770,423	\$ 723,778	\$ 686,605	\$ 629,523	\$ 525,283
Purchased performing loans ¹	26,422	36,874	42,793	53,329	67,022
Purchased credit impaired loans ¹	705	1,835	3,103	9,256	13,908
Total loans	\$ 797,550	\$ 762,487	\$ 732,501	\$ 692,108	\$ 606,213
Nonaccrual loans ²	\$ 1,512	\$ 1,464	\$ 5,272	\$ 4,235	\$ 6,157
OREO ³	1,103	246	168	195	942
Total nonperforming assets	\$ 2,615	\$ 1,710	\$ 5,440	\$ 4,430	\$ 7,099
Accruing loans past due for 90 days or more	\$ 109	\$ 324	\$ 306	\$ 6	\$ 761
Troubled debt-restructurings (TDRs) ²	\$ 4,353	\$ 5,451	\$ 10,896	\$ 5,825	\$ 5,344
Allowance for loan losses (ALL)	\$ 10,482	\$ 10,426	\$ 10,775	\$ 11,115	\$ 11,017
Nonperforming assets to total loans and OREO	0.33 %	0.22 %	0.74 %	0.64 %	1.17 %
ALL to total loans, excluding purchased credit impaired loans	1.32	1.37	1.48	1.63	1.86
ALL to total nonaccrual loans	693.25	712.16	204.38	262.46	178.93
Net charge-offs (recoveries) to average total loans	0.04	0.06	0.08	(0.02)	(0.01)

- ¹ Acquired loans are tracked in two separate categories – “purchased performing” and “purchased credit impaired.” The remaining discount for the purchased performing loans was \$1.4 million at December 31, 2019, \$1.9 million at December 31, 2018, \$2.3 million at December 31, 2017, \$2.9 million at December 31, 2016 and \$4.0 million at December 31, 2015. The remaining discount for the purchased credit impaired loans was \$5.6 million at December 31, 2019, \$7.9 million at December 31, 2018, \$9.8 million at December 31, 2017, \$10.5 million at December 31, 2016 and \$11.8 million at December 31, 2015.
- ² Nonaccrual loans include nonaccrual TDRs of \$254,000 at December 31, 2019, \$166,000 at December 31, 2018, \$3.9 million at December 31, 2017, \$2.0 million at December 31, 2016 and \$2.5 million at December 31, 2015.
- ³ OREO includes \$835,000 at December 31, 2019 related to the land and buildings of the Bellgrade branch, which was consolidated into a nearby branch in the third quarter of 2019.

Mortgage Banking Segment

<i>(Dollars in thousands)</i>	2019	2018	2017	2016	2015
Nonaccrual loans	\$ 372	\$ 37	\$ 39	\$ 41	\$ —
Total loans	\$ 4,642	\$ 3,479	\$ 3,283	\$ 3,275	\$ 3,493
Allowance for loan losses	\$ 598	\$ 598	\$ 598	\$ 598	\$ 598
Nonaccrual loans to total loans	8.01 %	1.06 %	1.19 %	1.25 %	— %
Allowance for loan losses to total loans	12.88	17.19	18.22	18.26	17.12

Consumer Finance Segment

<i>(Dollars in thousands)</i>	2019	2018	2017	2016	2015
Nonaccrual loans	\$ 611	\$ 712	\$ 764	\$ 1,215	\$ 1,321
Accruing loans past due for 90 days or more	\$ —	\$ —	\$ —	\$ —	\$ —
Repossessed assets	\$ 410	\$ 371	\$ 250	\$ 580	\$ 392
Total loans	\$ 312,999	\$ 296,154	\$ 292,004	\$ 304,357	\$ 293,480
Allowance for loan losses	\$ 21,793	\$ 22,999	\$ 24,353	\$ 25,353	\$ 23,954
Nonaccrual loans to total loans	0.20 %	0.24 %	0.26 %	0.40 %	0.28 %
Allowance for loan losses to total loans	6.96	7.77	8.34	8.33	8.21
Net charge-offs to average total loans	3.05	4.14	5.82	5.55	5.50

Table 9 presents the changes in the OREO balance for 2019 and 2018.

TABLE 9: OREO Changes

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2019	2018
Balance at the beginning of year, gross	\$ 303	\$ 225
Additions	1,401	98
Sales proceeds	(521)	(18)
Gain (loss) on disposition	8	(2)
Balance at the end of year, gross	1,191	303
Less valuation allowance	(88)	(57)
Balance at the end of year, net	\$ 1,103	\$ 246

Nonperforming assets of the retail banking segment totaled \$2.6 million at December 31, 2019, compared to \$1.7 million at December 31, 2018. Nonperforming assets included \$1.5 million in nonaccrual loans at December 31, 2019 and 2018, and included \$1.1 million in other real estate owned at December 31, 2019, compared to \$246,000 at December 31, 2018. The increase in nonperforming assets since December 31, 2018 was due primarily to the balance of land and buildings of C&F Bank's Bellgrade branch in Midlothian, Virginia, which were reclassified into other real estate owned when the Bellgrade branch was consolidated into a nearby branch during 2019. Nonaccrual loans were comprised primarily of residential mortgages and equity lines at December 31, 2019 and 2018.

Nonaccrual loans at the consumer finance segment decreased to \$611,000 at December 31, 2019 from \$712,000 at December 31, 2018. As noted above, the allowance for loan losses at the consumer finance segment decreased from \$23.0 million at December 31, 2018 to \$21.8 million at December 31, 2019, and the ratio of the allowance for loan losses to total consumer finance loans was 6.96 percent as of December 31, 2019, compared to 7.77 percent at December 31, 2018. Nonaccrual consumer finance loans remain low relative to the allowance for loan losses and the total consumer finance loan portfolio because the consumer finance segment generally initiates repossession of loan collateral once a loan becomes more than 60 days delinquent. Repossessed vehicles of the consumer finance segment are classified as other assets and consist only of vehicles the Corporation has the legal right to sell. Prior to the reclassification from loans to repossessed vehicles, the difference between the carrying amount of each loan and the fair value of each vehicle (i.e. the deficiency) is charged against the allowance for loan losses. At December 31, 2019, repossessed vehicles at fair value less estimated costs to sell included in other assets totaled \$410,000, compared to \$371,000 at December 31, 2018.

If interest on nonaccrual loans had been recognized, we would have recorded additional gross interest income of \$165,000 for 2019, \$325,000 for 2018, and \$462,000 for 2017. Interest received on nonaccrual loans was \$69,000 for 2019, \$384,000 in 2018, \$89,000 in 2017.

As discussed above, we measure impaired loans either based on 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. We maintain a

valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment in the loan. TDRs occur when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. These concessions typically are made for loss mitigation purposes and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs are considered impaired loans.

Impaired loans, which included TDRs of \$4.4 million, and the related allowance at December 31, 2019, were as follows:

TABLE 10A: Impaired Loans

<i>(Dollars in thousands)</i>	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$ 3,891	\$ 2,192	\$ 1,479	\$ 72	\$ 3,506	\$ 155
Commercial, financial and agricultural:						
Commercial real estate lending	1,459	4	1,447	77	1,581	82
Equity lines.	31	31	—	—	32	2
Consumer	130	—	121	118	123	—
Total	<u>\$ 5,511</u>	<u>\$ 2,227</u>	<u>\$ 3,047</u>	<u>\$ 267</u>	<u>\$ 5,242</u>	<u>\$ 239</u>

Impaired loans, which included TDRs of \$5.5 million, and the related allowance at December 31, 2018, were as follows:

TABLE 10B: Impaired Loans

<i>(Dollars in thousands)</i>	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$ 3,057	\$ 1,288	\$ 1,677	\$ 92	\$ 3,056	\$ 142
Commercial, financial and agricultural:						
Commercial real estate lending	2,468	1,498	927	10	2,653	132
Commercial business lending.	33	25	—	—	26	—
Equity lines.	365	31	326	326	359	2
Consumer	5	—	5	—	5	—
Total	<u>\$ 5,928</u>	<u>\$ 2,842</u>	<u>\$ 2,935</u>	<u>\$ 428</u>	<u>\$ 6,099</u>	<u>\$ 276</u>

TDRs at December 31, 2019 and 2018 were as follows:

TABLE 11: Troubled Debt Restructurings

<i>(Dollars in thousands)</i>	December 31, 2019	December 31, 2018
Accruing TDRs	\$ 4,099	\$ 5,285
Nonaccrual TDRs ¹	254	166
Total TDRs ²	<u>\$ 4,353</u>	<u>\$ 5,451</u>

¹ Included in nonaccrual loans in Table 8: Nonperforming Assets.

² Included in impaired loans in Tables 10A and 10B: Impaired Loans.

While TDRs are considered impaired loans, not all TDRs are on nonaccrual status. If a loan was on nonaccrual status at the time of the TDR modification, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on the Corporation's policy for returning loans to accrual status. If a loan was accruing prior to being modified as a TDR and if management concludes that the borrower is able to make such modified payments, and there are no other factors or circumstances that would cause management to conclude otherwise, the TDR will remain on an accruing status.

FINANCIAL CONDITION

SUMMARY

A financial institution's primary sources of revenue are generated by its earning assets and sales of financial assets, while its major expenses are produced by the funding of those assets with interest-bearing liabilities, provisions for loan losses and compensation to employees. Effective management of these sources and uses of funds is essential in attaining a financial institution's maximum profitability while maintaining an acceptable level of risk.

At December 31, 2019, the Corporation had total assets of \$1.66 billion compared to \$1.52 billion at December 31, 2018. The significant components of the Corporation's Consolidated Balance Sheets are discussed below.

LOAN PORTFOLIO

General

Through the retail banking segment, we engage in a wide range of lending activities, which include the origination, primarily in the retail banking segment's market area, of (1) one-to-four family and multi-family residential mortgage loans, (2) commercial real estate loans, (3) construction loans, (4) land acquisition and development loans, (5) consumer loans and (6) commercial business loans. We engage in non-prime automobile, and marine and RV lending through the consumer finance segment and in residential mortgage lending through the mortgage banking segment with substantially all of the loans originated through the mortgage banking segment sold to third-party investors. At December 31, 2019, the Corporation's loans held for investment in all categories, net of the allowance for loan losses, totaled \$1.08 billion and loans held for sale had a fair value of \$90.50 million.

Tables 12 and 13 present information pertaining to the composition of loans held for investment and the maturity/repricing of certain loans held for investment.

TABLE 12: Summary of Loans Held for Investment

<i>(Dollars in thousands)</i>	December 31,				
	2019	2018	2017	2016	2015
Real estate—residential mortgage	\$ 181,295	\$ 184,901	\$ 184,863	\$ 188,264	\$ 186,763
Real estate—construction ¹	54,246	54,461	44,782	55,732	7,759
Commercial, financial, and agricultural ²	500,812	455,935	437,884	390,388	356,062
Equity lines	52,083	55,660	55,237	52,600	50,111
Consumer	13,756	15,009	13,018	8,399	9,011
Consumer finance	312,999	296,154	292,004	304,357	291,755
Total loans	1,115,191	1,062,120	1,027,788	999,740	901,461
Less allowance for loan losses	(32,873)	(34,023)	(35,726)	(37,066)	(35,569)
Total loans, net	\$ 1,082,318	\$ 1,028,097	\$ 992,062	\$ 962,674	\$ 865,892

¹ Includes the Corporation's real estate construction lending and consumer real estate lot lending.

² Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

TABLE 13: Maturity/Repricing Schedule of Loans Held for Investment

<i>(Dollars in thousands)</i>	December 31, 2019	
	Commercial, Financial, and Agricultural	Real Estate Construction
Variable Rate:		
Within 1 year	\$ 37,938	\$ 25,053
1 to 5 years	129,110	3,475
After 5 years	125,830	535
Fixed Rate:		
Within 1 year	\$ 101,703	\$ 20,042
1 to 5 years	45,668	5,106
After 5 years	60,563	35

The increase in total loans from December 31, 2018 to December 31, 2019 was primarily due to (1) commercial loan growth at the retail banking segment resulting from additions of experienced lenders to our commercial lending team and (2) consumer finance loan growth as a result of growth in automobile loans and continued expansion of purchases of marine and RV loan contracts.

Total loans at December 31, 2019 and 2018 included loans purchased in connection with the Corporation's acquisition of CVB on October 1, 2013. These loans were recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses. On the date of acquisition, the Corporation acquired PCI loans with a fair value of \$35.3 million and purchased performing loans with a fair value of \$111.8 million. The following tables present the outstanding principal balance and the carrying amount of purchased loans that are included in the Corporation's Consolidated Balance Sheets at December 31, 2019 and 2018.

TABLE 14: PCI and Purchased Performing Loans

<i>(Dollars in thousands)</i>	December 31, 2019		
	Purchased Credit Impaired	Purchased Performing	Total
Outstanding principal balance	<u>\$ 6,262</u>	<u>\$ 27,839</u>	<u>\$ 34,101</u>
Carrying amount			
Real estate – residential mortgage	\$ 107	\$ 7,035	\$ 7,142
Commercial, financial and agricultural	563	11,338	11,901
Equity lines	35	8,046	8,081
Consumer	—	3	3
Total acquired loans	<u>\$ 705</u>	<u>\$ 26,422</u>	<u>\$ 27,127</u>

	December 31, 2018		
	Purchased Credit Impaired	Purchased Performing	Total
<i>(Dollars in thousands)</i>			
Outstanding principal balance	\$ 9,734	\$ 38,768	\$ 48,502
Carrying amount			
Real estate – residential mortgage.	\$ 284	\$ 8,823	\$ 9,107
Commercial, financial and agricultural.	1,461	18,982	20,443
Equity lines	90	9,063	9,153
Consumer	—	6	6
Total acquired loans	<u>\$ 1,835</u>	<u>\$ 36,874</u>	<u>\$ 38,709</u>

For a description of the Corporation’s accounting for purchased performing and PCI loans, see “Critical Accounting Policies” in this Item 7.

Credit Policy

The Corporation’s credit policy establishes minimum requirements and provides for appropriate limitations on overall concentration of credit within the Corporation. The policy provides guidance in general credit policies, underwriting policies and risk management, credit approval, and administrative and problem asset management policies. The overall goal of the Corporation’s credit policy is to ensure that loan growth is accompanied by acceptable asset quality with uniform and consistently applied approval, administration, and documentation practices and standards.

Residential Mortgage Lending – Held for Sale

The mortgage banking segment’s guidelines for underwriting conventional conforming loans comply with the underwriting criteria established by Fannie Mae, Freddie Mac and/or the applicable third party investor. The guidelines for non-conforming conventional loans are based on the requirements of private investors and information provided by third-party investors. The guidelines used by C&F Mortgage to originate FHA-insured, USDA-guaranteed and VA-guaranteed loans comply with the criteria established by HUD, the USDA, the VA and/or the applicable third party investor. The conventional loans that C&F Mortgage originates that have loan-to-value ratios greater than 80 percent at origination are generally insured by private mortgage insurance.

Residential Mortgage Lending – Held for Investment

The retail banking segment originates residential mortgage loans secured by first and second liens on properties located in its primary market area in the Hampton to Charlottesville corridor in Virginia. The Bank offers various types of residential first mortgage loans in addition to traditional long-term, fixed-rate loans. The majority of such loans include 10, 15 and 30 year amortizing mortgage loans with fixed rates of interest and fixed-rate mortgage loans with terms of 20, 25 and 30 years but subject to call after five years at the Bank’s option. Second mortgage loans are offered with fixed and adjustable rates. Second mortgage loans are granted for a fixed period of time, usually between 5 and 20 years. Call option provisions are included in the loan documents for some longer-term, fixed-rate second mortgage loans, and these provisions allow the Bank to make interest rate adjustments for such loans.

Loans associated with residential mortgage lending are included in the real estate—residential mortgage category in Table 12: Summary of Loans Held for Investment.

Construction Lending

The retail banking segment has a real estate construction lending program. We make loans primarily for the construction of one-to-four family residences and, to a lesser extent, multi-family dwellings. The Bank also makes

construction loans for office and warehouse facilities and other nonresidential projects, generally limited to borrowers that present other business opportunities for the retail banking segment.

The amounts, interest rates and terms for construction loans vary, depending upon market conditions, the size and complexity of the project, and the financial strength of the borrower and any guarantors of the loan. The term for a typical construction loan ranges from 9 months to 15 months for the construction of an individual residence and from 15 months to a maximum of 3 years for larger residential or commercial projects. We do not typically amortize construction loans, and the borrower pays interest monthly on the outstanding principal balance of the loan. The Bank offers fixed and variable interest rates on construction loans. We do not generally finance the construction of commercial real estate projects built on a speculative basis. For residential builder loans, we limit the number of models and/or speculative units allowed depending on market conditions, the builder's financial strength and track record and other factors. Generally, the maximum loan-to-value ratio for one-to-four family residential construction loans is 80 percent of the property's fair market value, or 85 percent of the property's fair market value if the property will be the borrower's primary residence. The fair market value of a project is determined on the basis of an appraisal of the project conducted by an appraiser approved by the Bank. For larger projects where unit absorption or leasing is a concern, we may also obtain a feasibility study or other acceptable information from the borrower or other sources about the likely disposition of the property following the completion of construction.

Construction loans for nonresidential projects and multi-unit residential projects are generally larger and involve a greater degree of risk to the Bank than residential mortgage loans. We attempt to minimize such risks (1) by making construction loans in accordance with our underwriting standards and to established customers in our primary market area and (2) by monitoring the quality, progress and cost of construction. Generally, our maximum loan-to-value ratio for non-residential projects and multi-unit residential projects is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis.

Loans associated with construction lending are included in the real estate—construction category in Table 12: Summary of Loans Held for Investment.

Consumer Lot Lending

The retail banking segment's consumer lot loans are made to individuals for the purpose of acquiring an unimproved building site for the construction of a residence that generally will be occupied by the borrower. Consumer lot loans are made only to individual borrowers, and each borrower generally must certify his or her intention to build and occupy a single-family residence on the lot. These loans typically have a maximum term of either three or five years with a balloon payment of the entire balance of the loan being due in full at the end of the initial term. The interest rate for these loans is fixed or variable at a rate that is slightly higher than prevailing rates for one-to-four family residential mortgage loans. We do not believe consumer lot loans bear as much risk as land acquisition and development loans because such loans are not made for the construction of residences for immediate resale, are not made to developers and builders, and are not concentrated in any one subdivision or community.

Loans associated with consumer lot lending are included in the real estate—construction category in Table 12: Summary of Loans Held for Investment.

Commercial Real Estate Lending

The retail banking segment's commercial real estate loans are primarily secured by the value of real property. The proceeds of commercial real estate loans are generally used by the borrower to finance or refinance the cost of acquiring and/or improving a commercial property. The properties that typically secure these loans are office and warehouse facilities, hotels, apartment complexes, retail facilities, restaurants and other commercial properties. Present policy authorizes commercial real estate loans to borrowers who will occupy or use the financed property in connection with their normal business operations. We also will consider making commercial real estate loans secured by non-owner-occupied properties under the following two conditions: (1) the borrower is in strong financial condition and presents a substantial

business opportunity for the Corporation and (2) the borrower has substantially pre-leased the property to high-caliber tenants.

Our commercial real estate loans are usually amortized over a period of time ranging from 15 years to 30 years and usually have a term to maturity ranging from 5 years to 15 years. These loans normally have provisions for interest rate adjustments after the loan is three to five years old. The maximum loan-to-value ratio for a commercial real estate loan is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis. Most commercial real estate loans are further secured by one or more unconditional personal guarantees.

In recent years, we have structured a portion of our commercial real estate loans as mini-permanent loans. The amortization period, term and interest rates for these loans vary based on borrower preferences and our assessment of the loan and the degree of risk involved. If the borrower prefers a fixed rate of interest, we usually offer a loan with a fixed rate of interest for a term of 3 to 10 years with an amortization period of up to 30 years. The remaining balance of the loan is due and payable in a single balloon payment at the end of the initial term. We believe these loan terms provide some protection from changes in the borrower's business and income as well as changes in general economic conditions. In the case of fixed-rate commercial real estate loans, shorter maturities also provide an opportunity to adjust the interest rate on this type of interest-earning asset in accordance with our asset and liability management strategies. Certain commercial customers qualify for participation in an interest rate swap program. This program provides flexible pricing structures for our larger borrowers who wish to pay a fixed rate of interest, while preserving a floating rate for the Bank, which protects C&F Bank from exposure to rising interest rates.

Loans secured by commercial real estate are generally larger and involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate are usually dependent on successful operation or management of the properties securing such loans, repayment of such loans is subject to changes in both general and local economic conditions and the borrower's business and income. As a result, events beyond our control, such as a downturn in the local economy, could adversely affect the performance of the commercial real estate loan portfolio. We seek to minimize these risks by lending to established customers and generally restricting our commercial real estate loans to our primary market area. Emphasis is placed on the income producing characteristics and quality of the collateral.

Loans associated with commercial real estate lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Land Acquisition and Development Lending

The retail banking segment makes land acquisition and development loans to builders and developers for the purpose of acquiring unimproved land to be developed for residential building sites, residential housing subdivisions, multi-family dwellings and a variety of commercial uses. Our policy is to make land acquisition loans to borrowers for the purpose of acquiring developed lots for single-family, townhouse or condominium construction. We will make both land acquisition and development loans to residential builders, experienced developers and others in strong financial condition to provide additional construction and mortgage lending opportunities for the Bank.

We underwrite and process land acquisition and development loans in much the same manner as commercial construction loans and commercial real estate loans. For land acquisition and development loans, we use lower loan-to-value ratios, which are a maximum of 65 percent for raw land, 75 percent for land development and improved lots and 80 percent of the discounted appraised value of the property as determined in accordance with the appraisal policies for developed lots for single-family or townhouse construction. We can waive the maximum loan-to-value ratio for particularly strong borrowers on an exception basis. The term of land acquisition and development loans ranges from a maximum of two years for loans relating to the acquisition of unimproved land to, generally, a maximum of three years for other types of projects. All land acquisition and development loans generally are further secured by one or more unconditional personal guarantees. Because these loans are usually larger in amount and involve more risk than consumer lot loans, we carefully evaluate the borrower's assumptions and projections about market conditions and absorption rates

in the community in which the property is located and the borrower's ability to carry the loan if the borrower's assumptions prove inaccurate.

Loans associated with land acquisition and development lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Builder Line Lending

The retail banking segment offers builder lines of credit to residential home builders to support their land and lot inventory needs. A construction loan facility for a builder will typically have an expiration of 12 months or less. Each loan that is made under the master loan facility will have a stated maturity that allows time for the residential unit to be constructed and sold to a homebuyer under prevailing market conditions. Specific terms vary based on the purpose of the loan (e.g., lot inventory, spec or non pre-sold units, pre-sold units) and previous sales activity to new homebuyers in the particular development. Repayment relies upon the successful performance of the underlying residential real estate project. This type of lending carries a higher level of risk related to residential real estate market conditions, a functioning first and secondary market in which to sell residential properties, and the borrower's ability to manage inventory and run projects. We manage this risk by lending to experienced builders and by using specific underwriting policies and procedures for these types of loans.

Loans associated with builder line lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Commercial Business Lending

The retail banking segment's commercial business loan products include revolving lines of credit to provide working capital, term loans to finance the purchase of vehicles and equipment, letters of credit to guarantee payment and performance, and other commercial loans. In general, these credit facilities carry the unconditional guaranty of the owners and/or stockholders.

Revolving and operating lines of credit are typically secured by all current assets of the borrower, provide for the acceleration of repayment upon any event of default, are monitored monthly or quarterly to ensure compliance with loan covenants, and are re-underwritten or renewed annually. Interest rates generally will float at a spread tied to the Bank's prime lending rate. Term loans are generally advanced for the purchase of, and are secured by, vehicles and equipment and are normally fully amortized over a term of two to five years, on either a fixed or floating rate basis.

Loans associated with commercial business lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Equity Line Lending

The retail banking segment offers its customers home equity lines of credit that enable customers to borrow funds secured by the equity in their homes. Currently, home equity lines of credit are offered with adjustable rates of interest that are generally priced at a spread to the prime lending rate. Home equity lines of credit are made on an open-end, revolving basis. Home equity loans generally do not present as much risk to the Bank as other types of consumer loans. These loans must satisfy our underwriting criteria, including loan-to-value and credit score guidelines.

Loans associated with equity line lending are included in the equity lines category in Table 12: Summary of Loans Held for Investment.

Consumer Lending

The retail banking segment offers a variety of consumer loans, including automobile, personal secured and unsecured, and loans secured by savings accounts or certificates of deposit. The shorter terms and generally higher interest

rates on consumer loans help the Bank maintain a profitable spread between its average loan yield and its cost of funds. Consumer loans secured by collateral other than a personal residence generally involve more credit risk than residential mortgage loans because of the type and nature of the collateral or, in certain cases, the absence of collateral. However, we believe the higher yields generally earned on such loans compensate for the increased credit risk associated with such loans. These loans must satisfy our underwriting criteria, including loan-to-value, debt ratio and credit score guidelines.

Loans associated with consumer lending are included in the consumer category in Table 12: Summary of Loans Held for Investment.

Consumer Finance

The consumer finance segment has an extensive automobile dealer network through which it purchases installment contracts throughout its markets. Credit approval is centralized in two locations, which along with the application processing system, ensures that contract purchase decisions comply with C&F Finance's underwriting policies and procedures.

Finance contract application packages completed by prospective borrowers are submitted by the automobile dealers electronically through a third-party online automotive sales and finance platform to C&F Finance's automated origination and application system, which processes the credit bureau report, generates all relevant loan calculations and displays the requested contract structure. C&F Finance personnel with credit authority review the transaction and determine whether to approve or deny the purchase of the contract. The purchase decision is based primarily on the applicant's credit history with emphasis on prior auto loan history, current employment status, income, collateral type and mileage, and the loan-to-value ratio. In 2016, C&F Finance implemented a scorecard model that improved underwriting and pricing efficiencies.

The consumer finance segment's underwriting and collateral guidelines form the basis for the purchase decision. Exceptions to credit policies and authorities must be approved by a designated credit officer. C&F Finance's typical automobile customers have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, we expect C&F Finance to sustain a higher level of credit losses in the automobile portfolio than traditional financing sources. However, C&F Finance generally purchases these contracts with interest at higher rates than those charged by traditional financing sources. These higher rates should more than offset the increase in the provision for loan losses for this segment of the Corporation's loan portfolio.

In addition to purchasing automobile contracts through a dealer network, C&F Finance began purchasing marine and RV contracts, also on an indirect basis, through a third party provider in 2018. While the approval process is generally the same as the automobile approval process described above, borrowers on marine and RV contracts purchased by C&F Finance have not had prior credit issues and these contracts are considered prime. The rates charged on these loans are significantly less than the automobile portfolio with a much lower expected level of credit losses.

Loans associated with indirect automobile and marine and recreational vehicle financing are included in the consumer finance category in Table 12: Summary of Loans Held for Investment.

SECURITIES

The investment portfolio plays a primary role in the management of the Corporation's interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, increases in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At December 31, 2019 and 2018, all securities in the Corporation's investment portfolio were classified as available for sale.

Table 15 sets forth the composition of the Corporation's securities available for sale in dollar amounts at fair value and as a percentage of the Corporation's total securities available for sale at the dates indicated.

TABLE 15: Securities Available for Sale

<i>(Dollars in thousands)</i>	December 31, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
U.S. government agencies and corporations	\$ 21,440	11 %	\$ 17,473	8 %
Mortgage-backed securities	86,585	46	104,983	49
Obligations of states and political subdivisions	81,708	43	92,454	43
Total available for sale securities at fair value	<u>\$ 189,733</u>	<u>100 %</u>	<u>\$ 214,910</u>	<u>100 %</u>

The Corporation seeks to diversify its portfolio to minimize risk, including by purchasing (1) shorter-duration mortgage-backed securities to reduce interest rate risk and for cash flow and reinvestment opportunities and (2) securities issued by states and political subdivisions due to the tax benefits and the higher tax-adjusted yield obtained from these securities. All of the Corporation's mortgage-backed securities are direct issues of United States government agencies or government-sponsored enterprises. At December 31, 2019, all of the Corporation's obligations of states and political subdivisions that were in a net unrealized loss position were rated "A" or better by Standard & Poor's or Moody's Investors Service.

Table 16 presents additional information pertaining to the composition of the securities portfolio at amortized cost, by the earlier of contractual maturity or expected maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

TABLE 16: Maturity of Securities

<i>(Dollars in thousands)</i>	December 31, 2019	
	Amortized Cost	Weighted Average Yield ¹
U.S. government agencies and corporations:		
Maturing within 1 year	\$ 5,373	2.19 %
Maturing after 1 year, but within 5 years	9,083	2.06
Maturing after 5 years, but within 10 years	6,998	2.31
Total U.S. government agencies and corporations	<u>21,454</u>	<u>2.17</u>
Mortgage-backed securities:		
Maturing within 1 year	485	2.71
Maturing after 1 year, but within 5 years	83,911	2.32
Maturing after 5 years, but within 10 years	—	—
Maturing after 10 years	1,253	3.22
Total mortgage-backed securities	<u>85,649</u>	<u>2.33</u>
States and municipals: ¹		
Maturing within 1 year	27,793	2.95
Maturing after 1 year, but within 5 years	42,976	2.44
Maturing after 5 years, but within 10 years	8,214	3.64
Maturing after 10 years	1,673	4.52
Total states and municipals	<u>80,656</u>	<u>2.78</u>
Total securities:		
Maturing within 1 year	33,651	2.83
Maturing after 1 year, but within 5 years	135,970	2.34
Maturing after 5 years, but within 10 years	15,212	3.03
Maturing after 10 years	2,926	3.96
Total securities	<u>\$ 187,759</u>	<u>2.51 %</u>

¹ Yields on tax-exempt securities have been computed on a taxable-equivalent basis using the federal corporate income tax rate of 21 percent.

DEPOSITS

The Corporation's predominant source of funds is depository accounts, which are comprised of demand deposits, savings and money market accounts, and time deposits. The Corporation's deposits are principally provided by individuals and businesses located within the communities served.

Deposits totaled \$1.29 billion at December 31, 2019, compared to \$1.18 billion at December 31, 2018. This increase primarily consisted of a \$75.5 million increase in time deposits, a \$25.6 million increase in non-interest bearing demand deposits and a \$8.5 million increase in savings, money market and interest-bearing demand deposits.

The Corporation had \$2.0 million in brokered money market deposits outstanding at December 31, 2019, compared to \$2.4 million in brokered money market deposits at December 31, 2018. The source of these brokered deposits is uninvested cash balances held in third-party brokerage sweep accounts. The Corporation uses brokered deposits as a means of diversifying liquidity sources, as opposed to a long-term deposit gathering strategy.

Table 17 presents the average deposit balances and average rates paid for the years 2019, 2018 and 2017.

TABLE 17: Average Deposits and Rates Paid

	Year Ended December 31,					
	2019		2018		2017	
<i>(Dollars in thousands)</i>	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits	\$ 283,505		\$ 266,415		\$ 236,937	
Interest-bearing transaction accounts	218,394	0.53 %	221,750	0.36 %	215,627	0.22 %
Money market deposit accounts	199,840	0.51	215,662	0.32	221,279	0.27
Savings accounts	120,644	0.09	116,896	0.09	109,789	0.08
Certificates of deposit, \$100 thousand or more	207,931	1.86	172,616	1.28	163,100	1.13
Other certificates of deposit	184,613	1.58	177,279	1.06	181,746	0.95
Total interest-bearing deposits	931,422	0.98 %	904,203	0.63 %	891,541	0.53 %
Total deposits	\$ 1,214,927		\$ 1,170,618		\$ 1,128,478	

Table 18 details maturities of certificates of deposit with balances of \$100,000 or more at December 31, 2019.

TABLE 18: Maturities of Certificates of Deposit with Balances of \$100,000 or More

<i>(Dollars in thousands)</i>	December 31, 2019
3 months or less	\$ 95,915
3-6 months	54,722
6-12 months	121,491
Over 12 months	149,928
Total	\$ 422,056

BORROWINGS

In addition to deposits, the Corporation utilizes short-term and long-term borrowings as sources of funds. Short-term borrowings from the Federal Reserve Bank and the FHLB may be used to fund the Corporation's day-to-day operations. Short-term borrowings also include securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the day sold, as well as overnight unsecured fed funds lines with correspondent banks. Long-term borrowings consist of advances from the FHLB and advances under a non-recourse revolving bank line of credit. All FHLB advances are secured by a blanket floating lien on all of C&F Bank's qualifying closed-end and revolving open-end loans secured by 1-4 family residential properties, including loans held for

sale. All Federal Reserve Bank advances are secured by loan-specific liens on certain qualifying loans of C&F Bank that are not otherwise pledged. The bank line of credit is non-recourse and is secured by loans at C&F Finance.

Trust I, Trust II and CVBK Trust I are wholly-owned non-operating subsidiaries of the Corporation, formed for the purpose of issuing trust preferred capital securities. Collectively, these trusts have issued \$25.0 million of trust preferred capital securities to institutional investors through private placements and \$775,000 in common equity that is held by the Corporation. Trust preferred capital securities of \$5.0 million issued by CVBK Trust I, \$10.0 million issued by Trust I, and \$10.0 million issued by Trust II mature in 2033, 2035 and 2037, respectively, and are redeemable at the Corporation's option. The principal assets of CVBK Trust I, Trust I and Trust II are trust preferred capital notes of the Corporation of \$5.2 million, \$10.3 million and \$10.3 million, respectively, which have like maturities and like interest rates to the trust preferred capital securities. The interest payments by the Corporation on the notes will be used by the trusts to pay the quarterly distributions on the trust preferred capital securities.

For further information concerning the Corporation's borrowings, refer to Item 8. "Financial Statements and Supplementary Data" under the heading "Note 10: Borrowings."

OFF-BALANCE-SHEET ARRANGEMENTS

To meet the financing needs of customers, the Corporation is a party, in the normal course of business, to financial instruments with off-balance-sheet risk. These financial instruments include commitments to extend credit, commitments to sell loans and standby letters of credit. These instruments involve elements of credit and interest rate risk in addition to the amount on the balance sheet. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of these instruments. We use the same credit policies in making these commitments and conditional obligations as we do for on-balance-sheet instruments. We obtain collateral based on our credit assessment of the customer in each circumstance.

Loan commitments are agreements to extend credit to a customer provided that there are no violations of the terms of the contract prior to funding. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The total amount of unused loan commitments at the Bank was \$256.2 million at December 31, 2019, and \$244.2 million at December 31, 2018, which does not include IRLCs at C&F Mortgage, as discussed below.

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 contract amount of standby letters of credit was \$16.6 million at December 31, 2019 and \$19.3 million at December 31, 2018.

The mortgage banking segment enters into IRLCs with customers to originate loans for which the interest rates are determined (or "locked") prior to funding. The mortgage banking segment is exposed to interest rate risk through fixed-rate IRLCs and mortgage loans from the time that interest rates are locked until the loans are sold in the secondary market. The mortgage banking segment manages interest rate risk arising from these fixed-rate IRLCs and mortgage loans by either (1) entering into forward sales contracts with investors at the time that interest rates are locked for loans to be delivered on a best efforts basis or (2) entering into forward sales contracts for unspecified mortgage backed securities (TBA securities) until it can enter into forward sales contracts with investors for loans to be delivered on a mandatory basis. IRLCs, forward sales of loans and forward sales of TBA securities are derivative financial instruments.

At December 31, 2019, the mortgage banking segment had \$63.4 million of IRLCs and \$65.8 million of unpaid principal on mortgage loans held for sale for which it managed interest rate risk using best-efforts forward sales contracts for \$129.1 million in mortgage loans. Also at December 31, 2019, the mortgage banking segment had \$11.7 million of IRLCs and \$22.0 of unpaid principal on mortgage loans held for sale for which it managed interest rate risk using forward sales of \$24.0 million of TBA securities and mandatory-delivery forward sales contracts for \$6.7 million in mortgage loans. At December 31, 2018, C&F Mortgage had best-efforts forward sales contracts for all of its IRLCs and mortgage loans held for sale.

The mortgage banking segment sells substantially all of the residential mortgage loans it originates to third-party investors. As is customary in the industry, the agreements with these investors require the mortgage banking segment to extend representations and warranties with respect to program compliance, borrower misrepresentation, fraud, and early payment performance. Under the agreements, the investors are entitled to make loss claims and repurchase requests of the mortgage banking segment for loans that contain covered deficiencies. The mortgage banking segment has obtained early payment default recourse waivers for a significant portion of its business. Recourse periods for early payment default for the remaining investors vary from 90 days up to one year. Recourse periods for borrower misrepresentation or fraud, or underwriting error do not have a stated time limit. The mortgage banking segment maintains an allowance for indemnifications that represents management's estimate of losses that are probable of arising under these recourse provisions. As performance data for loans that have been sold is not made available to the mortgage banking segment by the investors, the evaluation of potential losses is inherently subjective. A schedule of expected losses on loans with claims or indemnifications is maintained to ensure the reserve is adequate to cover estimated losses. Payments made under these recourse provisions were \$66,000 in 2019. There were no payments made in 2018 and 2017.

Risks also arise from the possible inability of investors to meet the terms of their contracts. The mortgage banking segment has procedures in place to evaluate the credit risk of investors and does not expect any counterparty to fail to meet its obligations.

The Corporation uses derivatives to manage exposure to interest rate risk through the use of interest rate swaps. Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date with no exchange of underlying principal amounts.

The Corporation has interest rate swaps that qualify and are designated as cash flow hedges. The Corporation's cash flow hedges effectively modify the Corporation's exposure to interest rate risk by converting variable rates of interest on \$25.0 million of the Corporation's trust preferred capital notes to fixed rates of interest for periods that end between June 2024 and June 2029. The cash flow hedges' total notional amount is \$25.0 million. At December 31, 2019, the cash flow hedges had a fair value of \$145,000, which is recorded in other liabilities. The net gain/loss on the cash flow hedges is recognized as a component of other comprehensive income and reclassified into earnings in the same period(s) during which the hedged transactions affect earnings.

The Corporation also enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Corporation simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net effect of these interest rate swaps and the related loans is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. At December 31, 2019, the total notional amount of the interest rate swaps related to these loans was \$148.5 million, and the interest rate swaps had a net fair value of zero, with \$2.5 million recognized in other assets and \$2.5 million recognized in other liabilities. These swaps are not designated as hedging instruments; therefore, changes in fair value are recorded in other noninterest expense.

LIQUIDITY

The objective of the Corporation's liquidity management is to ensure the continuous availability of funds to satisfy the credit needs of our customers and the demands of our depositors, creditors and investors. Stable core deposits and a strong capital position are the components of a solid foundation for the Corporation's liquidity position. Additional sources of liquidity available to the Corporation include cash flows from operations, loan payments and payoffs, deposit growth,

maturities, calls and sales of securities, the issuance of brokered certificates of deposit and the capacity to borrow additional funds.

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks, federal funds sold and nonpledged securities available for sale, totaled \$227.7 million at December 31, 2019, compared to \$220.1 million at December 31, 2018. The Corporation's funding sources, including capacity, amount outstanding and amount available at December 31, 2019 are presented in Table 19.

TABLE 19: Funding Sources

<i>(Dollars in thousands)</i>	December 31, 2019		
	Capacity	Outstanding	Available
Unsecured federal funds agreements	\$ 95,000	\$ —	\$ 95,000
Repurchase lines of credit	50,000	—	50,000
Borrowings from FHLB	204,148	44,500	159,648
Borrowings from Federal Reserve Bank	18,447	—	18,447
Revolving bank line of credit	120,000	75,029	44,971
Total	<u>\$ 487,595</u>	<u>\$ 119,529</u>	<u>\$ 368,066</u>

We have no reason to believe these arrangements will not be renewed at maturity. Additional loans and securities are available that can be pledged as collateral for future borrowings from the Federal Reserve Bank or the FHLB above the current lendable collateral value. Our ability to maintain sufficient liquidity may be affected by numerous factors, including economic conditions nationally and in our markets. Depending on our liquidity levels, our capital position, conditions in the capital markets, our business operations and initiatives, and other factors, we may from time to time consider the issuance of debt, equity or other securities or other possible capital market transactions, the proceeds of which could provide additional liquidity for our operations.

Time deposits of \$100,000 or more, maturing in less than a year, totaled \$272.1 million at December 31, 2019; time deposits of \$100,000 or more, maturing in more than one year, totaled \$149.9 million.

The Corporation's contractual obligations and scheduled payment amounts due at various intervals over the next five years and beyond as of December 31, 2019 are presented in Table 20.

Table 20: Contractual Obligations

<i>(Dollars in thousands)</i>	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Bank line of credit	\$ 75,029	\$ —	\$ 75,029	\$ —	\$ —
FHLB advances ¹	44,500	7,500	7,500	12,500	17,000
Trust preferred capital notes	25,281	—	—	—	25,281
Operating leases	2,936	1,385	1,198	232	121
Total ²	<u>\$ 147,746</u>	<u>\$ 8,885</u>	<u>\$ 83,727</u>	<u>\$ 12,732</u>	<u>\$ 42,402</u>

¹ FHLB advances include convertible advances of \$7.5 million, \$7.5 million, \$5.0 million, \$5.0 million, \$5.0 million and \$7.0 million maturing in 2022, 2023, 2024, 2025, 2026 and 2027, respectively. These advances have fixed rates of interest unless the FHLB exercises its option to convert the interest on these advances from fixed-rate to variable-rate (i.e., the conversion date). We can elect to repay the advances in whole or in part on their respective conversion dates and on any interest payment dates thereafter without the payment of a fee if the FHLB elects to convert the advances. However, we would incur a fee if we repay the advances (1) prior to their respective conversion dates, (2) if the FHLB does not convert the advance on the conversion date, or, (3) after notification of conversion, on any date other than the conversion date or any interest payment date thereafter. FHLB advances also include fixed rate hybrid advances of \$7.5 million maturing in 2020. These advances provide fixed-rate funding until the stated maturity date. We may add interest rate caps or floors at a future date, at which time the cost of the caps or floors will be added to the advance rate. For further information concerning the Corporation's FHLB borrowings, refer to Item 8, "Financial Statements and Supplementary Data," under the heading "Note 10: Borrowings."

² At December 31, 2019, there were no outstanding Federal Funds purchased or borrowings from the Federal Reserve Bank.

On January 1, 2020, the Corporation completed the acquisition of Peoples whereby Peoples shareholders received aggregate merger consideration of approximately \$10.6 million in cash and 210,052 shares of the Corporation's common stock. The Corporation estimates that it will incur additional aggregate after-tax merger related costs of approximately \$1.2 million in the first half of 2020.

As a result of the Corporation's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Corporation maintains overall liquidity sufficient to satisfy its operational requirements and contractual obligations.

CAPITAL RESOURCES

Total equity was \$165.3 million at year-end 2019, compared with \$152.0 million at year-end 2018. During 2019, the Corporation declared common stock dividends of \$1.49 per share, compared to \$1.41 per share declared in 2018 and \$1.33 per share declared in 2017.

The assessment of capital adequacy depends on such factors as asset quality, liquidity, earnings performance, and changing competitive conditions and economic forces. We regularly review the adequacy of the Corporation's and the Bank's capital. We maintain a structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses. While we will continue to look for opportunities to invest capital in profitable growth, share purchases are another tool that facilitates improving shareholder return, as measured by ROE and earnings per share.

Under the small bank holding company policy statement of the Federal Reserve Board, which applies to certain bank holding companies with consolidated total assets of less than \$3 billion, the Corporation is not subject to regulatory capital requirements. The disclosure below reflects the Corporation's consolidated capital as determined under regulations that apply to bank holding companies that are not small bank holding companies and minimum capital requirements that would apply to the Corporation if it were not a small bank holding company.

The Corporation's CET1 to total risk-weighted assets ratio was 11.7 percent and 11.9 percent at December 31, 2019 and 2018, respectively. The Corporation's Tier 1 capital to risk-weighted assets ratio was 13.6 percent and 14.0 percent at December 31, 2019 and 2018, respectively. The total capital to risk-weighted assets ratio was 14.9 percent at December 31, 2019, compared with 15.3 percent at December 31, 2018. The Tier 1 leverage ratio was 11.1 percent at

December 31, 2019, compared with 11.3 percent at December 31, 2018. These ratios include \$25.0 million of trust preferred capital securities in tier 1 capital of the Corporation. Additionally, all applicable regulatory capital ratios of C&F Bank were in excess of mandated minimum requirements at December 31, 2019 and 2018.

Under the Basel III Final Rule, the Bank must maintain a capital conservation buffer of additional total capital and CET1. The capital conservation buffer requirement was phased in from January 1, 2016 until January 1, 2019 in equal annual installments of 0.625 percent. Accordingly, at December 31, 2019, the Bank was required to maintain a capital conservation buffer of 2.5 percent and exceeded the total capital conservation buffer and the tier 1 capital conservation buffer by 355 basis points and 428 basis points, respectively. At December 31, 2018, the Bank was required to maintain a capital conservation buffer of 1.875 percent and exceeded the total capital conservation buffer and the tier 1 capital conservation buffer by 525 and 598 basis points, respectively.

The Corporation's capital resources may be affected by the Corporation's acquisition of Peoples, which was completed on January 1, 2020. Peoples shareholders received aggregate merger consideration of approximately \$10.6 million in cash and 210,052 shares of the Corporation's common stock. C&F Bank paid a dividend to the Corporation in the fourth quarter of 2019 to fund the cash portion of the purchase price and the Corporation's merger related expenses, which reduced the capital of the Bank. Furthermore, the acquisition of Peoples is expected to generate goodwill and other intangible assets that will be excluded from the regulatory capital of C&F Bank, which may result in a decrease in C&F Bank's regulatory capital ratios. Additionally, the Corporation expects to incur aggregate after-tax merger related expenses of approximately \$1.9 million after income taxes. For the year ended December 31, 2019, the Corporation recorded merger related expenses of \$709,000 (\$653,000 after income taxes). Of this amount, C&F Bank recorded merger related expenses of \$236,000 (\$196,000 after income taxes). The Corporation expects to incur the remaining \$1.2 million of after-tax merger related expenses in the first half of 2020. C&F Bank expects that it will remain well-capitalized following the completion of the Corporation's acquisition of Peoples.

The Corporation's capital resources may be affected by the Corporation's Repurchase Program, which was authorized by the Corporation's Board of Directors during the second quarter of 2019. Under the Repurchase Program the Corporation is authorized to purchase up to \$5.0 million of its common stock. Repurchases under the program may be made through privately-negotiated transactions or open-market transactions, and shares repurchased will be returned to the status of authorized and unissued shares of common stock. The timing, number and purchase price of shares repurchased under the program will be determined by management and the Board of Directors in their discretion and will depend on a number of factors, including the market price of the shares, general market and economic conditions, applicable legal requirements and other conditions. The Repurchase Program is authorized through May 31, 2020. As of December 31, 2019, \$3.3 million of the Corporation's common stock may be repurchased under the Corporation's Repurchase Program.

RECENT ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements affecting the Corporation are described in Item 8. "Financial Statements and Supplementary Data" under the heading "Note 1: Summary of Significant Accounting Policies-Recent Significant Accounting Pronouncements."

EFFECTS OF INFLATION AND CHANGING PRICES

The Corporation's financial statements included herein have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). U.S. GAAP presently requires the Corporation to measure financial position and operating results primarily in terms of historic 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 Corporation 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 Corporation, 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.

USE OF CERTAIN NON-GAAP FINANCIAL MEASURES

The accounting and reporting policies of the Corporation conform to U.S. GAAP and prevailing practices in the banking industry. However, certain non-GAAP measures are used by management to supplement the evaluation of the Corporation's performance. These include adjusted net income; adjusted earnings per share; adjusted ROE; and adjusted ROA, all of which are adjusted to exclude the one-time effects of (1) merger related expenses in connection with the acquisition of Peoples and (2) the remeasurement of deferred tax assets and liabilities in connection with the enactment of the Tax Cuts and Jobs Act on December 22, 2017; and tangible book value per share.

Management believes that the use of these non-GAAP measures provide meaningful information about operating performance by enhancing comparability with other financial periods and other financial institutions. The non-GAAP measures used by management enhance comparability by excluding the effects of items that do not reflect ongoing operating performance, including non-recurring gains or charges, and balances of intangible assets, including goodwill, that vary significantly between institutions. These non-GAAP financial measures should not be considered an alternative to U.S. GAAP-basis financial statements, and other bank holding companies may define or calculate these or similar measures differently.

A reconciliation of the non-GAAP financial measures used by the Corporation to evaluate and measure the Corporation's performance to the most directly comparable U.S. GAAP financial measures is presented below.

<i>(Dollars in thousands, except per share amounts)</i>	For The Year Ended		
	December 31,		
	2019	2018	2017
Adjusted Net Income and Earnings Per Share			
Net income, as reported	\$ 18,850	\$ 18,020	\$ 6,572
Merger related costs	709	-	-
Related income taxes	(56)	-	-
Net deferred tax asset remeasurement adjustment	-	-	6,643
Adjusted net income	\$ 19,503	\$ 18,020	\$ 13,215
Weighted average shares - assuming dilution	3,450,745	3,501,221	3,486,589
Weighted average shares - basic	3,450,745	3,501,221	3,486,510
Earnings per share - assuming dilution			
Earnings per share - assuming dilution, as reported	\$ 5.47	\$ 5.15	\$ 1.88
Adjusted earnings per share - assuming dilution	\$ 5.66	\$ 5.15	\$ 3.79
Earnings per share - basic			
Earnings per share - basic, as reported	\$ 5.47	\$ 5.15	\$ 1.89
Adjusted earnings per share - basic	\$ 5.66	\$ 5.15	\$ 3.79
Adjusted ROE			
Average total equity, as reported	\$ 156,810	\$ 145,318	\$ 143,646
ROE, as reported	12.02 %	12.40 %	4.58 %
Adjusted ROE	12.44 %	12.40 %	9.20 %
Adjusted ROA			
Average total assets, as reported	\$1,565,428	\$1,508,904	\$1,463,139
ROA, as reported	1.20 %	1.19 %	0.45 %
Adjusted ROA	1.25 %	1.19 %	0.90 %
Tangible Book Value Per Share			
Total equity	\$ 165,279	\$ 151,957	\$ 141,702
Less goodwill	14,425	14,425	14,425
Less other intangible assets	912	1,142	1,593
Tangible equity	\$ 149,942	\$ 136,390	\$ 125,684
Shares outstanding	3,438,126	3,497,122	3,495,845
Book value per share	\$ 48.07	\$ 43.45	\$ 40.53
Tangible book value per share	\$ 43.61	\$ 39.00	\$ 35.95

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Corporation's primary component of market risk is interest rate volatility. Fluctuations in interest rates will affect the amount of interest income and expense the Corporation receives or pays on a significant portion of its assets and liabilities and the market value of its interest-earning assets and interest-bearing liabilities, excluding those which have a very short term until maturity. The Corporation does not subject itself to foreign currency exchange rate risk or commodity price risk due to the current nature of its operations.

The primary objective of the Corporation's asset/liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent and appropriate. Thus the goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

The Corporation assumes interest rate risk in the normal course of operations. The fair values of most of the Corporation's financial instruments will change when interest rates change and that change may be either favorable or unfavorable to the Corporation. Management attempts to match maturities and repricing dates of assets and liabilities to the extent believed necessary to balance minimizing interest rate risk and increasing net interest income in current market conditions. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates, maturities and repricing dates of assets and liabilities and attempts to manage interest rate risk by adjusting terms of new loans, deposits and borrowings, by investing in securities with terms that manage the Corporation's overall interest rate risk, and in some cases by using derivative contracts to reduce the Corporation's overall exposure to changes in interest rates. The Corporation does not enter into interest rate-sensitive instruments for trading purposes.

We use simulation analysis to assess earnings at risk and economic value of equity (EVE) analysis to assess economic value at risk. These methods allow management to regularly monitor both the direction and magnitude of the Corporation's interest rate risk exposure. These modeling techniques involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of both assets and liabilities, prepayments on amortizing assets, other embedded options, non-maturity deposit sensitivity and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation's interest rate risk position over time.

Simulation analysis evaluates the potential effect of upward and downward changes in market interest rates on future net interest income. The analysis involves changing the interest rates used in determining net interest income over the next twelve months. The resulting percentage change in net interest income in various rate scenarios is an indication of the Corporation's shorter-term interest rate risk. The analysis utilizes a "static" balance sheet approach, which assumes changes in interest rates without any management response to change the composition of the balance sheet. The measurement date balance sheet composition is maintained over the simulation time period with maturing and repayment dollars being rolled back into like instruments for new terms at current market rates. Additional assumptions are applied to modify volumes and pricing under the various rate scenarios. These assumptions include loan prepayments, time deposit early withdrawals, the sensitivity of deposit repricing to changes in market rates, withdrawal behavior of non-maturing deposits, and other factors that management deems significant.

The simulation analysis results are presented in the table below. These results, based on a measurement date balance sheet as of December 31, 2019, indicate that the Corporation would expect net interest income to decrease over the next twelve months 8.83 percent assuming an immediate downward shift in market interest rates of 200 basis points (BP) and to increase 7.43 percent if rates shifted upward to the same degree.

One-Year Net Interest Income Simulation (dollars in thousands)

<u>Assumed Market Interest Rate Shift</u>	Hypothetical Change in Net Interest Income Over the Next Twelve Months as of December 31,			
	2019		2018	
	Dollars	Percentage	Dollars	Percentage
-200 BP shock	\$ (6,584)	(8.83)%	\$ (6,897)	(8.86)%
+200 BP shock	\$ 5,538	7.43 %	\$ 4,223	5.42 %

The EVE analysis provides information on the risk inherent in the balance sheet that might not be taken into account in the simulation analysis due to the shorter time horizon used in that analysis. The EVE of the balance sheet is defined as the discounted present value of expected asset cash flows minus the discounted present value of the expected liability cash flows. The analysis involves changing the interest rates used in determining the expected cash flows and in discounting the cash flows. The resulting percentage change in net present value in various rate scenarios is an indication of the longer term repricing risk and options embedded in the balance sheet.

The EVE analysis results are presented in the table below. These results as of December 31, 2019 indicate that the EVE would decrease 15.60 percent assuming an immediate downward shift in market interest rates of 200 BP and would increase 6.60 percent if rates shifted upward to the same degree.

Static EVE Change (dollars in thousands)

<u>Assumed Market Interest Rate Shift</u>	Hypothetical Change in EVE as of December 31,			
	2019		2018	
	Dollars	Percentage	Dollars	Percentage
-200 BP shock	\$ (36,038)	(15.60)%	\$ (45,371)	(17.04)%
+200 BP shock	\$ 15,256	6.60 %	\$ 21,237	7.98 %

In the simulation analysis above, net interest income increases over the next twelve months in the event of an immediate upward shift in interest rates, but declines in the event of an immediate downward shift in interest rates. In a rising rate environment, the Corporation’s assets would reprice quicker than the Corporation’s borrowings and deposits primarily due to the shorter maturity or repricing dates of its interest-bearing deposits in other banks and its loan portfolio. However, in a falling rate environment the simulation assumes that adjustable-rate assets will continue to reprice downward, subject to floors on certain loans, and fixed-rate assets with prepayment or callable options will reprice at lower rates while certain deposits cannot reprice any lower.

The EVE analysis above indicates an increase in the EVE in an immediate upward shift in interest rates, and a decrease in the EVE in an immediate downward shift in interest rates. The Corporation’s assets would reprice quicker over time than the Corporation’s borrowings and deposits due to the shorter maturity or repricing dates of its interest-bearing deposits in other banks and its loan portfolio as compared to time deposits and borrowings and the longer average life of non-maturing deposits, such as interest checking and money market accounts.

The Corporation uses interest rate swaps to manage select exposures to interest rate risk. Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date with no exchange of underlying principal amounts. The Corporation has interest rate swaps that

qualify as cash flow hedges. The cash flow hedges effectively modify the Corporation's exposure to interest rate risk associated with the Corporation's trust preferred capital notes by converting variable rates of interest on the trust preferred capital notes to fixed rates of interest for periods ending between June 2024 and June 2029. Also, as part of the Corporation's overall strategy for maximizing net interest income while managing interest rate risk, the Corporation enters into interest rate swaps in connection with originating loans to certain commercial borrowers as a means to offer a fixed-rate instrument to the borrower while effectively retaining a variable-rate instrument.

The mortgage banking segment enters into IRLCs with customers to originate loans for which the interest rates are determined prior to funding. The mortgage banking segment then mitigates interest rate risk on these IRLCs and loans held for sale by (1) entering into forward sales contracts with investors at the time that interest rates are locked for loans to be delivered on a best efforts basis or (2) entering into forward sales contracts for unspecified mortgage backed securities (TBA securities) until it can enter into forward sales contracts with investors for loans to be delivered on a mandatory basis. IRLCs, forward sales of loans and forward sales of TBA securities are derivative financial instruments.

We believe that our current interest rate exposure is manageable and does not indicate any significant exposure to interest rate changes.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**C&F FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2019	2018
<i>(Dollars in thousands, except per share amounts)</i>		
Assets		
Cash and due from banks	\$ 21,148	\$ 14,138
Interest-bearing deposits in other banks	144,285	100,875
Total cash and cash equivalents	165,433	115,013
Securities—available for sale at fair value, amortized cost of \$187,759 and \$216,650, respectively	189,733	214,910
Loans held for sale, at fair value	90,500	41,895
Loans, net of allowance for loan losses of \$32,873 and \$34,023, respectively	1,082,318	1,028,097
Restricted stock, at cost	3,257	3,247
Corporate premises and equipment, net	35,261	37,100
Other real estate owned, net of valuation allowance of \$88 and \$57, respectively	1,103	246
Accrued interest receivable	6,776	7,436
Goodwill	14,425	14,425
Other intangible assets, net	912	1,142
Bank-owned life insurance	16,044	16,065
Net deferred tax asset	11,219	12,193
Other assets	40,451	29,642
Total assets	\$ 1,657,432	\$ 1,521,411
Liabilities		
Deposits		
Noninterest-bearing demand deposits	\$ 296,985	\$ 271,360
Savings and interest-bearing demand deposits	572,209	563,741
Time deposits	422,056	346,560
Total deposits	1,291,250	1,181,661
Short-term borrowings	16,360	14,917
Long-term borrowings	119,529	119,529
Trust preferred capital notes	25,281	25,245
Accrued interest payable	1,291	920
Other liabilities	38,442	27,181
Total liabilities	1,492,153	1,369,453
Commitments and contingent liabilities (Note 17)		
Equity		
Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,438,126 and 3,497,122 shares issued and outstanding, respectively, includes 142,020 and 139,455 of unvested shares, respectively)	3,296	3,358
Additional paid-in capital	9,503	12,752
Retained earnings	154,248	140,520
Accumulated other comprehensive loss, net	(2,249)	(4,672)
Equity attributable to C&F Financial Corporation	164,798	151,958
Noncontrolling interest	481	—
Total equity	165,279	151,958
Total liabilities and equity	\$ 1,657,432	\$ 1,521,411

See notes to consolidated financial statements.

C&F FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2019	2018	2017
<i>(Dollars in thousands, except per share amounts)</i>			
Interest income			
Interest and fees on loans	\$ 87,519	\$ 84,529	\$ 82,734
Interest on interest-bearing deposits and federal funds sold	2,179	2,097	1,128
Interest and dividends on securities			
U.S. government agencies and corporations	427	361	340
Mortgage-backed securities	2,210	2,314	1,773
Tax-exempt obligations of states and political subdivisions	2,110	2,725	3,214
Taxable obligations of states and political subdivisions	358	319	242
Other	207	203	162
Total interest income	<u>95,010</u>	<u>92,548</u>	<u>89,593</u>
Interest expense			
Savings and interest-bearing deposits	2,298	1,601	1,175
Time deposits	6,796	4,085	3,573
Borrowings	4,327	4,189	3,702
Trust preferred capital notes	1,135	1,152	1,151
Total interest expense	<u>14,556</u>	<u>11,027</u>	<u>9,601</u>
Net interest income	<u>80,454</u>	<u>81,521</u>	<u>79,992</u>
Provision for loan losses	8,515	11,006	16,435
Net interest income after provision for loan losses	<u>71,939</u>	<u>70,515</u>	<u>63,557</u>
Noninterest income			
Gains on sales of loans	10,603	7,841	8,553
Mortgage banking fee income	4,700	3,686	3,885
Interchange income	4,203	3,882	3,476
Service charges on deposit accounts	3,923	4,213	4,458
Wealth management services income, net	2,029	1,860	1,619
Other service charges and fees	1,496	1,386	1,343
Net gains on maturities and calls of available for sale securities	10	10	10
Other	5,048	2,880	3,888
Total noninterest income	<u>32,012</u>	<u>25,758</u>	<u>27,232</u>
Noninterest expenses			
Salaries and employee benefits	47,201	42,003	43,597
Occupancy	8,743	8,308	7,730
Other	24,075	23,421	21,496
Total noninterest expenses	<u>80,019</u>	<u>73,732</u>	<u>72,823</u>
Income before income taxes	<u>23,932</u>	<u>22,541</u>	<u>17,966</u>
Income tax expense	5,082	4,521	11,394
Net income	<u>18,850</u>	<u>18,020</u>	<u>\$ 6,572</u>
Less net income (loss) attributable to noncontrolling interest	<u>(9)</u>	<u>—</u>	<u>—</u>
Net income attributable to C&F Financial Corporation	<u>\$ 18,859</u>	<u>\$ 18,020</u>	<u>\$ 6,572</u>
Net income per share - basic	<u>\$ 5.47</u>	<u>\$ 5.15</u>	<u>\$ 1.89</u>
Net income per share - assuming dilution	<u>\$ 5.47</u>	<u>\$ 5.15</u>	<u>\$ 1.88</u>

See notes to consolidated financial statements.

C&F FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Net income.....	\$ 18,850	\$ 18,020	\$ 6,572
Other comprehensive income (loss):			
Defined benefit plan:			
Net actuarial (losses) gains arising during the period	(409)	(1,155)	148
Related income tax effects	86	242	(51)
Reclassification of recognized net actuarial losses into net income ¹	187	125	154
Related income tax effects	(38)	(26)	(54)
Amortization of prior service credit into net income ¹	(68)	(62)	(61)
Related income tax effects	14	13	21
Defined benefit plan, net of tax	(228)	(863)	157
Cash flow hedges:			
Unrealized holding (losses) gains arising during the period	(325)	123	223
Related income tax effects	84	(32)	(88)
Amortization of hedging gains into net income ²	(56)	—	—
Related income tax effects	14	—	—
Cash flow hedges, net of tax	(283)	91	135
Securities available for sale:			
Unrealized holding gains (losses) arising during the period	3,724	(2,538)	(1,315)
Related income tax effects	(782)	533	460
Reclassification of net realized gains into net income ³	(10)	(10)	(10)
Related income tax effects	2	2	4
Securities available for sale, net of tax	2,934	(2,013)	(861)
Other comprehensive income (loss), net of tax	2,423	(2,785)	(569)
Comprehensive income	21,273	15,235	6,003
Less comprehensive income (loss) attributable to noncontrolling interest	(9)	—	—
Comprehensive income attributable to C&F Financial Corporation	\$ 21,282	\$ 15,235	\$ 6,003

¹ These items are included in the computation of net periodic benefit cost and are included in “Noninterest income-Other” on the Consolidated Statements of Income. See “Note 13: Employee Benefit Plans,” for additional information.

² These items are included in “Interest expense – Trust preferred capital notes” on the Consolidated Statements of Income.

³ These items are included in “Net gains on maturities and calls of available for sale securities” on the Consolidated Statements of Income.

See notes to consolidated financial statements.

C&F FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY

	Attributable to C&F Financial Corporation				Noncontrolling Interest	Total Equity
	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)		
<i>(Dollars in thousands, except per share amounts)</i>						
Balance December 31, 2016	\$ 3,331	\$ 11,705	\$ 125,162	\$ (984)	—	\$ 139,214
Comprehensive income:						
Net income	—	—	6,572	—	—	6,572
Other comprehensive loss	—	—	—	(569)	—	(569)
Reclassification of certain tax effects ¹	—	—	334	(334)	—	—
Stock options exercised	2	82	—	—	—	84
Share-based compensation	—	1,451	—	—	—	1,451
Restricted stock vested	32	(32)	—	—	—	—
Common stock issued	3	144	—	—	—	147
Common stock purchased	(10)	(550)	—	—	—	(560)
Cash dividends declared (\$1.33 per share)	—	—	(4,637)	—	—	(4,637)
Balance December 31, 2017	<u>3,358</u>	<u>12,800</u>	<u>127,431</u>	<u>(1,887)</u>	—	<u>141,702</u>
Comprehensive income:						
Net income	—	—	18,020	—	—	18,020
Other comprehensive loss	—	—	—	(2,785)	—	(2,785)
Share-based compensation	—	1,345	—	—	—	1,345
Restricted stock vested	26	(26)	—	—	—	—
Common stock issued	3	141	—	—	—	144
Common stock purchased	(29)	(1,508)	—	—	—	(1,537)
Cash dividends declared (\$1.41 per share)	—	—	(4,931)	—	—	(4,931)
Balance December 31, 2018	<u>3,358</u>	<u>12,752</u>	<u>140,520</u>	<u>(4,672)</u>	—	<u>151,958</u>
Comprehensive income:						
Net income (loss)	—	—	18,859	—	(9)	18,850
Other comprehensive income	—	—	—	2,423	—	2,423
Issuance of noncontrolling interest	—	—	—	—	490	490
Share-based compensation	—	1,466	—	—	—	1,466
Restricted stock vested	32	(32)	—	—	—	—
Common stock issued	3	137	—	—	—	140
Common stock purchased	(97)	(4,820)	—	—	—	(4,917)
Cash dividends declared (\$1.49 per share)	—	—	(5,131)	—	—	(5,131)
Balance December 31, 2019	<u>\$ 3,296</u>	<u>\$ 9,503</u>	<u>\$ 154,248</u>	<u>\$ (2,249)</u>	<u>\$ 481</u>	<u>\$ 165,279</u>

¹ Reclassification relates to the adoption of ASU 2018-02 in the year ended December 31, 2017 for stranded tax effects related to the reduction in the enacted federal corporate income tax rate.

See notes to consolidated financial statements.

C&F FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Operating activities:			
Net income	\$ 18,850	\$ 18,020	\$ 6,572
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Depreciation	3,636	3,220	2,771
Deferred income taxes	354	632	9,405
Provision for loan losses	8,515	11,006	16,435
Share-based compensation	1,466	1,345	1,451
Pension expense	649	403	627
Pension contribution	—	(3,000)	(1,500)
Accretion of certain acquisition-related discounts, net	(2,871)	(3,034)	(1,706)
Amortization of intangible assets	230	451	676
Net realized gains on maturities and calls of securities available for sale	(10)	(10)	(10)
Accretion of discounts and amortization of premiums on securities, net	1,534	1,783	1,676
Income from bank-owned life insurance	(711)	(424)	(433)
Proceeds from sales of loans held for sale	903,968	720,250	750,110
Origination of loans held for sale	(941,001)	(699,028)	(744,780)
Gains on sales of loans held for sale	(10,603)	(7,841)	(8,553)
Other (gains) and losses, net	(18)	(150)	131
Change in other assets and liabilities:			
Accrued interest receivable	660	153	(328)
Other assets	137	3,936	(3,807)
Accrued interest payable	371	82	135
Other liabilities	(320)	(672)	(3,097)
Net cash (used in) provided by operating activities	(15,164)	47,122	25,775
Investing activities:			
Proceeds from bank-owned life insurance	785	—	—
Proceeds from maturities and calls of securities available for sale and payments on mortgage-backed securities	75,583	51,067	41,520
Purchases of securities available for sale	(48,216)	(51,322)	(53,461)
Repayments on loans held for investment by non-bank affiliates	123,140	117,014	117,018
Purchases of loans held for investment by non-bank affiliates	(149,377)	(133,484)	(121,644)
Net increase in retail banking loans held for investment	(31,886)	(27,720)	(39,659)
Proceeds from sales of other real estate owned	521	18	245
Purchases of corporate premises and equipment	(2,706)	(3,374)	(4,180)
Changes in collateral posted with other financial institutions, net	(2,490)	—	—
Other investing activities, net	(1,283)	278	249
Net cash used in investing activities	(35,929)	(47,523)	(59,912)
Financing activities:			
Net increase in demand and savings deposits	34,093	11,625	47,970
Net increase (decrease) in time deposits	75,496	(1,393)	3,538
Net increase (decrease) in short-term borrowings	1,444	(5,705)	3,257
Proceeds from long-term borrowings	7,000	—	—
Repayments of long-term borrowings	(7,000)	(2,500)	—
Repurchases of common stock	(4,385)	(1,105)	—
Cash dividends paid	(5,131)	(4,931)	(4,637)
Other financing activities, net	(4)	—	231
Net cash provided by (used in) financing activities	101,513	(4,009)	50,359
Net increase (decrease) in cash and cash equivalents	50,420	(4,410)	16,222
Cash and cash equivalents at beginning of period	115,013	119,423	103,201
Cash and cash equivalents at end of period	\$ 165,433	\$ 115,013	\$ 119,423
Supplemental cash flow disclosures:			
Interest paid	\$ 14,150	\$ 10,909	\$ 9,430
Income taxes paid	2,296	821	5,133
Supplemental disclosure of noncash investing and financing activities:			
Value of shares withheld at vesting for employee taxes	\$ 532	\$ 432	\$ 560
Transfers from loans to other real estate owned	496	98	208
Transfers from corporate premises and equipment to other real estate owned	835	—	—
Liabilities assumed to acquire right of use assets under operating leases	1,137	—	—
Issuance of noncontrolling interest	490	—	—

See notes to consolidated financial statements.

C&F FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts of C&F Financial Corporation (the Corporation), its direct wholly-owned subsidiary, Citizens and Farmers Bank (the Bank or C&F Bank), and indirect subsidiaries that are wholly-owned or controlled. Subsidiaries that are less than wholly owned are fully consolidated if they are controlled by the Corporation or one of its subsidiaries, and the portion of any subsidiary not owned by the Corporation is reported as noncontrolling interest. All significant intercompany accounts and transactions have been eliminated in consolidation. In addition, the Corporation owns all of the common stock of C&F Financial Statutory Trust I, C&F Financial Statutory Trust II, and Central Virginia Bankshares Statutory Trust I, all of which are unconsolidated subsidiaries. The subordinated debt owed to these trusts is reported as liabilities of the Corporation. The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and to predominant practices within the banking industry.

Nature of Operations: The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia.

C&F Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Wealth Management Corporation (C&F Wealth Management), C&F Insurance Services, Inc., and CVB Title Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan production services for residential appraisals. C&F Mortgage owns a 51 percent interest in C&F Select LLC, which was organized in January 2019 and is also engaged in the business of originating and selling residential mortgages. C&F Finance, acquired in September 2002, is a finance company purchasing automobile, marine and recreational vehicle (RV) loans through indirect lending programs. C&F Wealth Management, organized in April 1995, is a full-service brokerage firm offering a comprehensive range of wealth management services and insurance products through third-party service providers. C&F Insurance Services, Inc., was organized in July 1999, for the primary purpose of owning an equity interest in an independent insurance agency that operates in Virginia and North Carolina. CVB Title Services, Inc. was organized for the primary purpose of owning an equity interest in a full service title and settlement agency. Business segment data is presented in Note 19.

Basis of Presentation: The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, impairment of loans and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made.

Reclassification: Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation. None of these reclassifications are considered material.

Significant Group Concentrations of Credit Risk: The Corporation invests in a variety of securities, principally obligations of U.S. government agencies and obligations of states and political subdivisions. At December 31, 2019, securities issued by the Commonwealth of Virginia and its political subdivisions comprised 12.8 percent of its state and political subdivision portfolio and securities issued by Norfolk, Virginia comprised 4.6 percent of its state and political subdivision portfolio. There are no concentrations of any state or issuer in the Corporation's portfolio of securities available for sale that exceed ten percent of stockholders' equity at December 31, 2019, and the Corporation does not have any other significant securities concentrations in any one industry or geographic region. Additional information about the Corporation's securities portfolio and investment activities is presented in Note 3.

States in which significant concentrations of the Corporation's lending activities exist include Virginia, Tennessee, Georgia and Ohio. At December 31, 2019, 44.9 percent of the Corporation's loan portfolio consisted of commercial, financial and agricultural loans, which include loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property. In addition, 25.9 percent of the Corporation's loan portfolio consisted of non-prime consumer finance loans to individuals, secured by automobiles. The Corporation does not have any significant loan concentrations to any one customer. Additional information about the Corporation's lending activities is presented in Note 4.

Business Combination: On October 1, 2013, the Corporation acquired Central Virginia Bankshares, Inc. (CVBK) and its wholly-owned subsidiary Central Virginia Bank (CVB). This acquisition was accounted for using the acquisition method of accounting, meaning the assets and liabilities of CVBK were recorded at their respective fair values as of October 1, 2013.

On January 1, 2020, the Corporation completed the acquisition of Peoples Bankshares, Incorporated (Peoples) and its banking subsidiary, Peoples Community Bank for an aggregate purchase price of \$22.2 million of cash and stock. Additional information about the acquisition is presented in Note 24.

Cash and Cash Equivalents: For purposes of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash, balances due from banks, interest-bearing deposits in banks and federal funds sold, all of which mature within 90 days. The Bank is required to maintain average balances on hand or with the Federal Reserve Bank (FRB). At December 31, 2019 and 2018, the minimum requirement was \$1.03 million and \$1.07 million, respectively.

Securities: Investments in debt securities are classified as either held to maturity, available for sale, or trading, based on management's intent. Currently all of the Corporation's investment securities are classified as available for sale. Available for sale debt securities are carried at estimated fair value with the corresponding unrealized gains and losses recognized in other comprehensive income. Gains or losses are recognized in net income on the trade date using the amortized cost of the specific security sold. Purchase premiums and discounts are recognized in interest income using the effective interest rate method over the period from purchase to maturity or, for callable securities, the earliest call date.

Impairment of debt securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) we intend to sell the security or (ii) it is more-likely-than-not that we will be required to sell the security before recovery of its amortized cost basis. If, however, the Corporation does not intend to sell the security and it is not more-likely-than-not that the Corporation will be required to sell the security before recovery, the Corporation must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. The Corporation regularly reviews unrealized losses in its investments in securities based on criteria including the extent to which market value is below amortized cost, the duration of that market decline, the financial health of and specific prospects for the issuer, the Corporation's best estimate of the present value of cash flows expected to be collected from debt securities, the Corporation's intention with regard to holding the security to maturity and the likelihood that the Corporation would be required to sell the security before recovery.

Loans Held for Sale: The Corporation has elected to use a fair value accounting option for loans originated for resale by C&F Mortgage. These loans are classified as loans held for sale (LHFS) and are measured at fair value in accordance with Accounting Standards Codification (ASC) Topic 820 - *Fair Value Measurement*, with changes in fair value reported in net income as a component of "Gains on sales of loans." Substantially all loans originated by C&F Mortgage are held for sale to outside investors.

Loans Acquired in a Business Combination: Loans acquired in a business combination, such as the Corporation's acquisition of CVB, are recorded at estimated fair value on the date of acquisition without the carryover of the related

allowance for loan losses. Purchased credit-impaired (PCI) loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments. When determining fair value, PCI loans were aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the “nonaccretable difference,” and is not recorded. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. On a quarterly basis, the Corporation evaluates its estimate of cash flows expected to be collected. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses, while subsequent increases in cash flows may result in a reversal of post-acquisition provision for loan losses, or a transfer from nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

The Corporation’s PCI loans currently consist of loans acquired in connection with the acquisition of CVB. PCI loans that were classified as nonperforming by CVB are no longer classified as nonperforming so long as, at quarterly re-estimation periods, we believe we will fully collect the new carrying value of the pools of loans.

Loans not designated PCI loans as of the acquisition date are designated purchased performing loans. The Corporation accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans’ contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required in future periods for any deterioration in these loans subsequent to the acquisition.

Originated Loans: The Corporation makes mortgage, commercial and consumer loans to customers. The Corporation’s recorded investment in loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally is reported at the unpaid principal balances adjusted for charges-offs, unearned discounts, any deferred fees or costs on originated loans, and the allowance for loan losses. Interest on loans is credited to operations based on the principal amount outstanding. Loan fees and origination costs are deferred and the net amount is amortized as an adjustment of the related loan’s yield using the level-yield method. The Corporation is amortizing these amounts over the contractual life of the related loans.

A loan’s past due status is based on the contractual due date of the most delinquent payment due. Loans are generally placed on nonaccrual status when the collection of principal or interest is 90 days or more past due, or earlier, if collection is uncertain based on an evaluation of the net realizable value of the collateral and the financial strength of the borrower. Loans greater than 90 days past due may remain on accrual status if management determines it has adequate collateral to cover the principal and interest. For those loans that are carried on nonaccrual status, payments are first applied to principal outstanding. A loan may be returned to accrual status if the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms of the loan and there is reasonable assurance the borrower will continue to make payments as agreed. These policies are applied consistently across our loan portfolio.

The Corporation considers a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. A loan is not considered impaired during a period of delay in payment if the ultimate collectibility of all amounts due is expected. Impairment is measured based on either 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. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

Troubled debt restructurings (TDRs) occur when the Corporation agrees to significantly modify the original terms of a loan due to the deterioration in the financial condition of the borrower. TDRs are considered impaired loans and are evaluated individually. Upon designation as a TDR, the Corporation evaluates the borrower's payment history, past due status and ability to make payments based on the revised terms of the loan. If a loan was accruing prior to being modified as a TDR and if the Corporation concludes that the borrower is able to make such payments, and there are no other factors or circumstances that would cause it to conclude otherwise, the loan will remain on an accruing status. If a loan was on nonaccrual status at the time of the TDR, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on the policy for returning loans to accrual status as noted above. As of December 31, 2019 and 2018, the Corporation had \$4.35 million and \$5.45 million, respectively, of loans classified as TDRs.

In the ordinary course of business, the Corporation has entered into commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the Consolidated Balance Sheets when they are funded.

Allowance for Loan Losses: The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance for loan losses for the difference between the carrying value of the loan and the estimated net realizable value or fair value of the collateral, if collateral dependent, when management believes that the collectibility of the principal is unlikely. 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 level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower's ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The evaluation also considers the following risk characteristics of each loan portfolio:

- Real estate residential mortgage loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.
- Real estate construction 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, financial and agricultural 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. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.
- Consumer and consumer finance loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles and marine and recreational vehicles (RVs)), 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.
- Equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

The allowance consists of specific and general components. The specific component relates to loans that are individually evaluated for impairment, and is established when the discounted cash flows (or collateral value or observable market price) of an impaired loan is lower than the carrying value of that loan. For collateral dependent loans, an updated appraisal will be ordered if a current one is not on file. Appraisals are performed by independent third-party appraisers with relevant industry experience. Adjustments to the appraised value may be made based on recent sales of similar properties or general market conditions when appropriate. The general component covers non-classified loans and those loans classified as substandard or special mention that are not individually evaluated for impairment. The general component is based on historical loss experience adjusted for qualitative factors, such as current economic conditions, including current home sales and foreclosures, unemployment rates and retail sales. Relative to non-classified loans, non-impaired classified loans are assigned a higher allowance factor which increases with the severity of classification. The characteristics of these loan ratings are as follows:

- Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.
- Special mention loans have a specific identified weakness in the borrower's operations and in the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history may be characterized by late payments. The Corporation's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.
- Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet the Corporation's definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.
- Substandard nonaccrual loans have the same characteristics as substandard loans; however, they have a nonaccrual classification because it is probable that the Corporation will not be able to collect all amounts due.
- Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high.
- Loss rated loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

On a quarterly basis the Corporation evaluates its estimate of cash flows to be collected on PCI loans. These evaluations require the continued assessment of key assumptions and estimates similar to the initial estimate of fair value as of the acquisition date, such as the effect of collateral value changes, changing loss severities, estimated and experienced prepayment speeds and other relevant factors. Subsequent decreases to the expected cash flows to be collected on a PCI loan will generally result in a provision for loan losses.

The consumer finance loans are segregated between performing and nonperforming loans. Performing loans are those that have made timely payments in accordance with the terms of the loan agreement and are not past due 90 days or more. Nonperforming loans are those that do not accrue interest and are greater than 90 days past due.

Allowance for Indemnifications: The allowance for indemnifications is established through charges to earnings in the form of a provision for indemnifications, which is included in other noninterest expenses. A loss is charged against the

allowance for indemnifications when a purchaser of a loan (investor) sold by the mortgage banking segment incurs a validated indemnified loss due to borrower misrepresentation, fraud, early payment default or underwriting error.

The allowance represents an amount that, in management's judgment, will be adequate to absorb any losses that are probable of arising from valid indemnification requests for loans that have been sold by the mortgage banking segment. Management's judgment in determining the level of the allowance is based on the volume of loans sold, historical experience, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure. Physical possession of residential real estate securing consumer mortgage loans occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or similar legal agreement. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations indicate a further deterioration in market conditions. Revenue and expenses from operations and changes in the property valuations are included in other noninterest expenses and improvements are capitalized.

The Corporation records a gain/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 Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform the obligations under the contract and whether collectability of the transaction price is probable. In determining the gain/loss on the sale, the Corporation adjusts the transaction price and the related gain/loss on sale if a significant financing component is present.

Repossessed Assets: Repossessed assets primarily consist of vehicles repossessed by C&F Finance due to borrowers' payment defaults. The repossession process is generally initiated after a loan becomes more than 60 days delinquent. Most customers have an opportunity to redeem their repossessed vehicles by paying all outstanding balances, including finance charges and fees. Vehicles that are not redeemed within a prescribed waiting period following repossession are then reclassified from loans to repossessed assets available-for-sale (included in other assets) and recorded initially at fair value less estimated costs to sell. The difference between the carrying amount of each loan and the fair value of the vehicle (i.e., the deficiency) is charged against the allowance for loan losses. The waiting period is determined as the length of time after repossession that C&F Finance is prohibited to sell the vehicle under the laws of the state where the vehicle was repossessed. Accounts still in process of collection or for which the Corporation does not have the legal right to sell continue to be classified as loans until such legal authority is obtained. At December 31, 2019, repossessed vehicles at fair value less estimated costs to sell included in other assets totaled \$410,000, compared to \$371,000 at December 31, 2018.

Repossession expense includes the costs to repossess and sell vehicles. These costs include transportation, storage, rekeying, condition reports, legal fees, fees paid to repossession agents and auction fees. These costs are included in noninterest expenses.

Corporate Premises and Equipment: Land is carried at cost. Buildings and equipment are carried at cost less accumulated depreciation computed using a straight-line method over the estimated useful lives of the assets. Estimated useful lives range from ten to forty years for buildings and from three to ten years for equipment, furniture and fixtures. Maintenance and repairs are charged to expense as incurred and major improvements are capitalized. Upon sale or retirement of depreciable properties, the cost and related accumulated depreciation are netted against proceeds and any resulting gain or loss is included in income.

Goodwill: The Corporation's goodwill was recognized in connection with past business combinations and is reported at the retail banking segment and the consumer finance segment. The Corporation reviews the carrying value of goodwill at least annually or more frequently if certain impairment indicators exist. In testing goodwill for impairment, the Corporation

may first consider qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we conclude that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then no further testing is required and the goodwill of the reporting unit is not impaired. If the Corporation elects to bypass the qualitative assessment or if we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the fair value of the reporting unit is compared with its carrying amount to determine whether an impairment exists.

Other Intangible Assets: In connection with acquisition by C&F Wealth Management in 2016 of the assets of a registered investment advisor, the Corporation recorded \$1.40 million of amortizable intangible assets, which primarily relate to the value of the customer relationships. The Corporation is amortizing these intangible assets over the period of expected benefit, which ranges from five to nine years using a straight-line method. At December 31, 2019 and 2018, the remaining balance of these intangible assets were \$912,000 and \$1.07 million, respectively. The Corporation recognized a core deposit intangible asset in connection with its acquisition of CVBK in 2013, which was amortized over an estimated weighted average life of six years using the “sum of years digits” method. The core deposit intangible asset was fully amortized at December 31, 2019, and its remaining balance at December 31, 2018 was \$70,000.

Transfer of Financial Assets: Transfers of loans are accounted for as sales when control over the loans has been surrendered. Control over transferred loans is deemed to be surrendered when (1) the loans have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred loans and (3) the Corporation does not maintain effective control over the transferred loans through an agreement to repurchase them before their maturity.

Income Taxes: The Corporation determines deferred income tax assets and liabilities based on temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Income tax expense includes taxes on income or loss that is taxable in the period and changes during the period in deferred tax assets and liabilities.

C&F Bank invests in qualified affordable housing projects through housing equity funds, the purpose of which is to encourage investment in low-income residential property development in Virginia by providing a return on investment through federal income tax credits and other tax benefits on losses generated by the projects. C&F Bank recognizes its share of losses on these projects as a component of income tax expense.

The benefit of an uncertain tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination by the applicable taxing authority, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. Interest and penalties associated with unrecognized tax benefits are recognized as a component of income tax expense.

Retirement Plan: The Corporation recognizes the overfunded or underfunded status of its defined benefit pension plan as an asset or liability in its Consolidated Balance Sheets, measured as the difference between plan assets at fair value and the projected benefit obligation as of December 31. Net periodic pension cost or income is recorded each period based on actuarially determined amounts in accordance with GAAP and recognized in salaries and employment benefits and other noninterest income in the Consolidated Statements of Income. Actuarial determinations of net periodic pension cost or income are based on assumptions related to discount rates, rates of return on plan assets, employee compensation and mortality and interest crediting rates. Other changes in the overfunded or underfunded status of the pension plan are recorded in the year in which the changes occur through other comprehensive income.

Share-Based Compensation: Share-based compensation expense for grants of restricted shares is accounted for using the fair value of the Corporation’s common stock on the date the restricted shares are awarded. Compensation expense for

restricted shares is charged to income ratably over the required service period. Forfeitures reduce compensation expense for the periods in which forfeitures actually occur.

Earnings Per Share: The Corporation applies the two-class method of computing basic and diluted earnings per share (EPS), which allocates a portion of undistributed earnings to the Corporation's unvested restricted shares awarded to employees and non-employee directors. These restricted shares are participating securities which contain rights to nonforfeitable dividends prior to vesting. Accordingly, the weighted average number of shares outstanding used in the calculation of basic and diluted EPS includes both common shares and unvested restricted shares outstanding. EPS calculations are presented in Note 11.

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the Consolidated Balance Sheets. The Corporation's derivative financial instruments include (1) interest rate swaps that qualify and are designated as cash flow hedges on the Corporation's trust preferred capital notes, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate contracts arising from mortgage banking activities, including interest rate lock commitments (IRLCs) on mortgage loans and related forward sales of mortgage loans and mortgage backed securities. The gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period(s) during which the hedged transactions affect earnings. IRLCs, forward sales contracts and interest rate swaps with loan customers and dealer counterparties are not designated as hedging instruments, and therefore changes in the fair value of these instruments are reported as noninterest income or noninterest expense, as applicable. The Corporation's derivative financial instruments are described more fully in Note 20.

Leases: The Corporation recognizes a lease liability and a right-of-use asset in connection with leases in which it is a lessee, except for leases with a term of twelve months or less. A lease liability represents the Corporation's obligation to make future payments under lease contracts, and a right-of-use asset represents the Corporation's right to control the use of the underlying property during the lease term. Lease liabilities and right-of-use assets are recognized upon commencement of a lease and measured as the present value of lease payments over the lease term, discounted at the incremental borrowing rate of the lessee. The Corporation has elected not to separate lease and nonlease components within the same contract and instead to account for the entire contract as a lease.

Service Charges on Deposit Accounts. The Corporation earns fees from its deposit customers for overdraft and account maintenance services. Overdraft fees are recognized when the overdraft occurs. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation.

Other Service Charges and Fees. The Corporation earns fees from its customers for transaction-based services. Such services include ATM, stop payment and wire transfer fees at the retail banking segment and on-line payment processing fees at the consumer finance segment. In each case, these service charges and fees are recognized in income at the time or within the same period that the Corporation's performance obligation is satisfied.

Interchange Income. The Corporation earns interchange fees from debit and credit cardholder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services.

Wealth Management Services Income, Net. The Corporation earns revenue by providing wealth management services and health and life insurance products to its customers through third-party service providers. Fees that are transaction-based (e.g., execution of trades) are recognized on a monthly basis. Other fees and commissions are earned over time as services are provided and are generally assessed based on either account activity or the market value of assets under management at the end of each period. Fees and commissions collected from customers are reported net of related fees paid to the third-party service providers and presented in noninterest income.

Recent Significant Accounting Pronouncements:

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, “*Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*,” as part of its project on financial instruments. Subsequently, this ASU was amended when the FASB issued ASU 2018-19, “*Codification Improvements to Topic 326, Financial Instruments – Credit Losses*,” ASU 2019-04, “*Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*,” ASU 2019-05, “*Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*,” ASU 2019-10, “*Financial Instruments—Credit losses (Topic 326), Derivatives and hedging (Topic 815), and Leases (Topic 842)—Effective dates*” and ASU 2019-11, “*Codification Improvements to Topic 326, Financial Instruments—Credit Losses*” (collectively, ASC 326). ASC 326 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The new standard will be effective for the Corporation beginning on January 1, 2023. Early adoption of the new standard is permitted.

The amendments of ASC 326, upon adoption, will be applied on a modified retrospective basis, with the cumulative effect of adopting the new standard being recorded as an adjustment to opening retained earnings in the period of adoption. The Corporation has established a working group to prepare for and implement changes related to ASC 326 and has gathered historical loan loss data for purposes of evaluating appropriate portfolio segmentation and modeling methods under the standard. The Corporation has performed procedures to validate the historical loan loss data to ensure its suitability and reliability for purposes of developing an estimate of expected credit losses under ASC 326. The Corporation has engaged a vendor to assist in modeling expected lifetime losses under ASC 326, and is continuing to develop and refine an approach to estimating the allowance for credit losses. The adoption of ASC 326 will result in significant changes to the Corporation’s consolidated financial statements, which may include changes in the level of the allowance for credit losses that will be considered adequate, a reduction in total equity and regulatory capital of C&F Bank, differences in the timing of recognizing changes to the allowance for credit losses and expanded disclosures about the allowance for credit losses. The Corporation has not yet determined an estimate of the effect of these changes. The adoption of the standard will also result in significant changes in the Corporation’s internal control over financial reporting related to the allowance for credit losses.

In January 2017, the FASB issued ASU 2017-04, “*Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*,” which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for public business entities that are SEC filers for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-04 to have a material effect on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “*Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*.” These amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2018-13 to have a material effect on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, “*Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*.” These

amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Certain disclosure requirements have been deleted while the following disclosure requirements have been added: the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments also clarify the disclosure requirements regarding the projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets and the accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets. The amendments are effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2018-14 to have a material effect on its consolidated financial statements.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not currently expected to have a material effect on the Corporation's financial position, results of operations or cash flows.

NOTE 2: Adoption of New Accounting Standards

On January 1, 2019, the Corporation adopted ASU 2016-02, "Leases (Topic 842)" and related amendments (collectively, ASC 842), which resulted in recognition of a lease liability and right-of-use asset in connection with leases in which the Corporation is the lessee. Under ASC 842, lessor accounting is largely unchanged. The Corporation elected an optional transition method to apply ASC 842 as of the adoption date on a modified retrospective basis. Periods prior to January 1, 2019 have not been restated. Upon adoption, the Corporation recorded a lease liability of approximately \$3.14 million for its remaining payment obligations as of January 1, 2019 for leases in effect at that time, excluding leases with an original term of twelve months or less, and a corresponding right-of-use asset. All of the Corporation's existing leases upon adoption of ASC 842 were classified as operating leases based on the classification of each lease under previous U.S. GAAP; classification of these leases was not reconsidered upon adoption of ASC 842. Refer to Note 8 for further information about the Corporation's leases.

NOTE 3: Securities

The Corporation's debt securities, all of which are classified as available for sale, are summarized as follows:

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(Dollars in thousands)</i>				
U.S. government agencies and corporations	\$ 21,454	\$ 3	\$ (17)	\$ 21,440
Mortgage-backed securities	85,649	979	(43)	86,585
Obligations of states and political subdivisions	80,656	1,111	(59)	81,708
	<u>\$ 187,759</u>	<u>\$ 2,093</u>	<u>\$ (119)</u>	<u>\$ 189,733</u>
	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(Dollars in thousands)</i>				
U.S. government agencies and corporations	\$ 18,008	\$ 1	\$ (536)	\$ 17,473
Mortgage-backed securities	106,787	85	(1,889)	104,983
Obligations of states and political subdivisions	91,855	840	(241)	92,454
	<u>\$ 216,650</u>	<u>\$ 926</u>	<u>\$ (2,666)</u>	<u>\$ 214,910</u>

The amortized cost and estimated fair value of securities at December 31, 2019, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

<i>(Dollars in thousands)</i>	December 31, 2019	
	Amortized Cost	Fair Value
Due in one year or less	\$ 33,651	\$ 33,757
Due after one year through five years	135,970	137,446
Due after five years through ten years	15,212	15,342
Due after ten years	2,926	3,188
	<u>\$ 187,759</u>	<u>\$ 189,733</u>

The following table presents the gross realized gains and losses on and the proceeds from the maturities and calls of securities for the years ended December 31, 2019, 2018 and 2017. There were no sales of securities during the periods presented.

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Realized gains from maturities and calls of securities:			
Gross realized gains	\$ 10	\$ 10	\$ 10
Gross realized losses	—	—	—
Net realized gains	<u>\$ 10</u>	<u>\$ 10</u>	<u>\$ 10</u>
Proceeds from maturities, calls and paydowns of securities	<u>\$ 75,583</u>	<u>\$ 51,067</u>	<u>\$ 41,520</u>

The Corporation pledges securities primarily to secure public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$126.22 million and an aggregate fair value of \$127.47 million were pledged at December 31, 2019. Securities with an aggregate amortized cost of \$110.81 million and an aggregate fair value of \$109.83 million were pledged at December 31, 2018.

Securities in an unrealized loss position at December 31, 2019, by duration of the period of the unrealized loss, are shown below.

<i>(Dollars in thousands)</i>	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations . .	\$ 6,256	\$ 11	\$ 4,094	\$ 6	\$ 10,350	\$ 17
Mortgage-backed securities	4,099	7	10,166	36	14,265	43
Obligations of states and political subdivisions.	9,187	53	1,368	6	10,555	59
Total temporarily impaired securities	<u>\$ 19,542</u>	<u>\$ 71</u>	<u>\$ 15,628</u>	<u>\$ 48</u>	<u>\$ 35,170</u>	<u>\$ 119</u>

There were 61 debt securities totaling \$35.17 million of aggregate fair value considered temporarily impaired at December 31, 2019. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates, especially in debt securities purchased prior to 2018. The value of debt securities declines as interest rates rise, and interest rates were higher at December 31, 2019 than at the time these securities were purchased. The Corporation's mortgage-backed securities are entirely issued by either U.S. government agencies or U.S. government-sponsored enterprises. Collectively, these entities provide a guarantee, which is either explicitly or implicitly supported by the full faith and credit of the U.S. government, that investors in such mortgage-backed securities will receive timely principal and interest payments. At December 31, 2019, all of the Corporation's obligations of states and political subdivisions that were in a net unrealized loss position were rated "A" or better by Standard & Poor's or Moody's Investors Service. The Corporation considers all of its investments in debt securities at December 31, 2019 to meet regulatory credit

quality standards, meaning the securities have low risk of default by the obligor, and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at December 31, 2019 and no other-than-temporary impairment loss has been recognized in net income.

Securities in an unrealized loss position at December 31, 2018, by duration of the period of the unrealized loss, are shown below.

<i>(Dollars in thousands)</i>	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	\$ 997	\$ 1	\$ 15,725	\$ 535	\$ 16,722	\$ 536
Mortgage-backed securities	17,934	132	72,830	1,757	90,764	1,889
Obligations of states and political subdivisions	9,492	29	20,555	212	30,047	241
Total temporarily impaired securities	<u>\$ 28,423</u>	<u>\$ 162</u>	<u>\$ 109,110</u>	<u>\$ 2,504</u>	<u>\$ 137,533</u>	<u>\$ 2,666</u>

The Corporation’s investment in restricted stock totaled \$3.26 million at December 31, 2019 and consisted of Federal Home Loan Bank (FHLB) stock. Restricted stock is generally viewed as a long-term investment, which is carried at cost because there is no market for the stock other than the FHLBs. Therefore, when evaluating restricted stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing any temporary decline in value. The Corporation did not consider its investment in restricted stock to be other-than-temporarily impaired at December 31, 2019 and no impairment has been recognized.

NOTE 4: Loans

Major classifications of loans are summarized as follows:

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Real estate – residential mortgage	\$ 181,295	\$ 184,901
Real estate – construction ¹	54,246	54,461
Commercial, financial and agricultural ²	500,812	455,935
Equity lines	52,083	55,660
Consumer	13,756	15,009
Consumer finance	312,999	296,154
	<u>1,115,191</u>	<u>1,062,120</u>
Less allowance for loan losses	<u>(32,873)</u>	<u>(34,023)</u>
Loans, net	<u>\$ 1,082,318</u>	<u>\$ 1,028,097</u>

¹ Includes the Corporation’s real estate construction lending and consumer real estate lot lending.

² Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Consumer loans included \$449,000 and \$275,000 of demand deposit overdrafts at December 31, 2019 and 2018, respectively.

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of CVB on October 1, 2013 that were recorded at fair value at the acquisition date in the Consolidated Balance Sheets are as follows:

<i>(Dollars in thousands)</i>	December 31, 2019			December 31, 2018		
	Acquired Loans - Purchased Credit Impaired	Acquired Loans - Purchased Performing	Acquired Loans - Total	Acquired Loans - Purchased Credit Impaired	Acquired Loans - Purchased Performing	Acquired Loans - Total
Outstanding principal balance	\$ 6,262	\$ 27,839	\$ 34,101	\$ 9,734	\$ 38,768	\$ 48,502
Carrying amount						
Real estate – residential mortgage	\$ 107	\$ 7,035	\$ 7,142	\$ 284	\$ 8,823	\$ 9,107
Commercial, financial and agricultural ¹	563	11,338	11,901	1,461	18,982	20,443
Equity lines	35	8,046	8,081	90	9,063	9,153
Consumer	—	3	3	—	6	6
Total acquired loans	\$ 705	\$ 26,422	\$ 27,127	\$ 1,835	\$ 36,874	\$ 38,709

¹ Includes acquired loans classified by the Corporation as commercial real estate lending and commercial business lending.

The following table presents a summary of the change in the accretable yield of loans classified as PCI loans:

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2019	2018
Accretable yield, balance at beginning of period	\$ 5,987	\$ 7,304
Accretion	(3,360)	(3,737)
Reclassification of nonaccretable difference due to improvement in expected cash flows	1,587	2,191
Other changes, net.	507	229
Accretable yield, balance at end of period.	\$ 4,721	\$ 5,987

Loans on nonaccrual status at December 31, 2019 and 2018 were as follows:

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Real estate – residential mortgage	\$ 1,526	\$ 594
Commercial, financial and agricultural:		
Commercial business lending	11	24
Equity lines	229	883
Consumer	118	—
Consumer finance	611	712
Total loans on nonaccrual status	\$ 2,495	\$ 2,213

If interest income had been recognized on nonaccrual loans at their stated rates during the years ended December 31, 2019, 2018 and 2017, interest income would have increased by approximately \$165,000, \$325,000 and \$462,000, respectively.

The past due status of loans as of December 31, 2019 was as follows:

<i>(Dollars in thousands)</i>	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	PCI	Current ¹	Total Loans	90+ Days Past Due and Accruing
Real estate – residential mortgage	\$ 1,428	\$ 161	\$ 1,016	\$ 2,605	\$ 107	\$ 178,583	\$ 181,295	\$ —
Real estate – construction:								
Construction lending	—	—	—	—	—	40,943	40,943	—
Consumer lot lending	—	—	—	—	—	13,303	13,303	—
Commercial, financial and agricultural:								
Commercial real estate lending	—	—	—	—	563	325,991	326,554	—
Land acquisition and development lending	—	—	—	—	—	42,891	42,891	—
Builder line lending	—	—	—	—	—	26,373	26,373	—
Commercial business lending	73	18	—	91	—	104,903	104,994	—
Equity lines	229	56	223	508	35	51,540	52,083	109
Consumer	20	10	—	30	—	13,726	13,756	—
Consumer finance	11,034	1,420	611	13,065	—	299,934	312,999	—
Total	<u>\$ 12,784</u>	<u>\$ 1,665</u>	<u>\$ 1,850</u>	<u>\$ 16,299</u>	<u>\$ 705</u>	<u>\$ 1,098,187</u>	<u>\$ 1,115,191</u>	<u>\$ 109</u>

¹ For the purposes of the table above, “Current” includes loans that are 1-29 days past due.

The table above includes nonaccrual loans that are current of \$547,000, 30-59 days past due of \$197,000, 60-89 days past due of \$10,000 and 90+ days past due of \$1.74 million.

The past due status of loans as of December 31, 2018 was as follows:

<i>(Dollars in thousands)</i>	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	PCI	Current ¹	Total Loans	90+ Days Past Due and Accruing
Real estate – residential mortgage	\$ 1,221	\$ —	\$ 37	\$ 1,258	\$ 284	\$ 183,359	\$ 184,901	\$ 9
Real estate – construction:								
Construction lending	—	—	—	—	—	42,051	42,051	—
Consumer lot lending	—	—	—	—	—	12,410	12,410	—
Commercial, financial and agricultural:								
Commercial real estate lending	—	—	315	315	1,461	309,057	310,833	315
Land acquisition and development lending	—	—	—	—	—	43,404	43,404	—
Builder line lending	—	—	—	—	—	31,201	31,201	—
Commercial business lending	163	19	24	206	—	70,291	70,497	—
Equity lines	46	584	325	955	90	54,615	55,660	—
Consumer	31	—	—	31	—	14,978	15,009	—
Consumer finance	11,419	1,965	712	14,096	—	282,058	296,154	—
Total	<u>\$ 12,880</u>	<u>\$ 2,568</u>	<u>\$ 1,413</u>	<u>\$ 16,861</u>	<u>\$ 1,835</u>	<u>\$ 1,043,424</u>	<u>\$ 1,062,120</u>	<u>\$ 324</u>

¹ For the purposes of the table above, “Current” includes loans that are 1-29 days past due.

The table above includes nonaccrual loans that are current of \$458,000, 30-59 days past due of \$97,000, 60-89 days past due of \$560,000 and 90+ days past due of \$1.10 million.

Loan modifications that were classified as TDRs, and the recorded investment in those loans at the time of their modification, during the years ended December 31, 2019 and 2018 and 2017 were as follows:

<i>(Dollars in thousands)</i>	Year Ended December 31,					
	2019		2018		2017	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Real estate – residential mortgage	2	\$ 95	1	\$ 140	2	\$ 365
Commercial, financial and agricultural:						
Commercial real estate lending	—	—	—	—	7	6,800
Consumer	1	121	1	5	—	—
Total	<u>3</u>	<u>\$ 216</u>	<u>2</u>	<u>\$ 145</u>	<u>9</u>	<u>\$ 7,165</u>

One TDR during the year ended December 31, 2019, one during the year ended December 31, 2018 and nine during the year ended December 31, 2017 included modifications of the loan's interest rate. Two TDRs during the year ended December 31, 2019 and one during the year ended December 31, 2018 included modifications of the loan's payment structure. Three TDRs during the year ended December 31, 2017 included a modification of the term of the loan. There were no TDRs in the years ended December 31, 2019, 2018 or 2017 that included a reduction in principal as part of the loan's modification.

All TDRs are considered impaired loans and are individually evaluated in the determination of the allowance for loan losses. A TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due. The specific reserve associated with a TDR is reevaluated when a TDR payment default occurs. There were no TDR payment defaults during the years ended December 31, 2019 and 2018. During the year ended December 31, 2017, TDR payment defaults occurred on three loans totaling \$4.65 million that were part of a single commercial relationship and became more than 90 days past due.

Impaired loans, which included TDRs of \$4.35 million, and the related allowance at December 31, 2019 were as follows:

<i>(Dollars in thousands)</i>	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$ 3,891	\$ 2,192	\$ 1,479	\$ 72	\$ 3,506	\$ 155
Commercial, financial and agricultural:						
Commercial real estate lending	1,459	4	1,447	77	1,581	82
Equity lines	31	31	—	—	32	2
Consumer	130	—	121	118	123	—
Total	<u>\$ 5,511</u>	<u>\$ 2,227</u>	<u>\$ 3,047</u>	<u>\$ 267</u>	<u>\$ 5,242</u>	<u>\$ 239</u>

Impaired loans, which included TDRs of \$5.45 million, and the related allowance at December 31, 2018 were as follows:

<i>(Dollars in thousands)</i>	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$ 3,057	\$ 1,288	\$ 1,677	\$ 92	\$ 3,056	\$ 142
Commercial, financial and agricultural:						
Commercial real estate lending	2,468	1,498	927	10	2,653	132
Commercial business lending	33	25	—	—	26	—
Equity lines	365	31	326	326	359	2
Consumer	5	—	5	—	5	—
Total	<u>\$ 5,928</u>	<u>\$ 2,842</u>	<u>\$ 2,935</u>	<u>\$ 428</u>	<u>\$ 6,099</u>	<u>\$ 276</u>

NOTE 5: Allowance for Loan Losses

Changes in the allowance for loan losses for the years ended December 31, 2019, 2018 and 2017 were as follows:

<i>(Dollars in thousands)</i>	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Balance at December 31, 2016	\$ 2,559	\$ 816	\$ 7,393	\$ 685	\$ 261	\$ 25,352	\$ 37,066
Provision charged to operations	(127)	(211)	413	43	82	16,235	16,435
Loans charged off	(179)	—	(349)	(42)	(301)	(21,525)	(22,396)
Recoveries of loans previously charged off	118	—	21	2	189	4,291	4,621
Balance at December 31, 2017	2,371	605	7,478	688	231	24,353	35,726
Provision charged to operations	(140)	122	(440)	418	140	10,906	11,006
Loans charged off	(42)	—	(409)	—	(344)	(16,477)	(17,272)
Recoveries of loans previously charged off	57	—	59	—	230	4,217	4,563
Balance at December 31, 2018	2,246	727	6,688	1,106	257	22,999	34,023
Provision charged to operations	(146)	(46)	458	(235)	329	8,155	8,515
Loans charged off	(46)	—	(29)	(138)	(349)	(13,991)	(14,553)
Recoveries of loans previously charged off	26	—	4	—	228	4,630	4,888
Balance at December 31, 2019	\$ 2,080	\$ 681	\$ 7,121	\$ 733	\$ 465	\$ 21,793	\$ 32,873

The following table presents, as of December 31, 2019, the balance of the allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

<i>(Dollars in thousands)</i>	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 72	\$ —	\$ 77	\$ —	\$ 118	\$ —	\$ 267
Collectively evaluated for impairment	2,008	681	7,044	733	347	21,793	32,606
Acquired loans - PCI	—	—	—	—	—	—	—
Total allowance	\$ 2,080	\$ 681	\$ 7,121	\$ 733	\$ 465	\$ 21,793	\$ 32,873
Loans:							
Individually evaluated for impairment	\$ 3,671	\$ —	\$ 1,451	\$ 31	\$ 121	\$ —	\$ 5,274
Collectively evaluated for impairment	177,517	54,246	498,798	52,017	13,635	312,999	1,109,212
Acquired loans - PCI	107	—	563	35	—	—	705
Total loans	\$ 181,295	\$ 54,246	\$ 500,812	\$ 52,083	\$ 13,756	\$ 312,999	\$ 1,115,191

The following table presents, as of December 31, 2018, the balance of the allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

<i>(Dollars in thousands)</i>	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 92	\$ —	\$ 10	\$ 326	\$ —	\$ —	\$ 428
Collectively evaluated for impairment	2,154	727	6,678	780	257	22,999	33,595
Acquired loans - PCI	—	—	—	—	—	—	—
Total allowance	\$ 2,246	\$ 727	\$ 6,688	\$ 1,106	\$ 257	\$ 22,999	\$ 34,023
Loans:							
Individually evaluated for impairment	\$ 2,965	\$ —	\$ 2,450	\$ 357	\$ 5	\$ —	\$ 5,777
Collectively evaluated for impairment	181,652	54,461	452,024	55,213	15,004	296,154	1,054,508
Acquired loans - PCI	284	—	1,461	90	—	—	1,835
Total loans	\$ 184,901	\$ 54,461	\$ 455,935	\$ 55,660	\$ 15,009	\$ 296,154	\$ 1,062,120

Loans by credit quality indicators as of December 31, 2019 were as follows:

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total ¹
Real estate – residential mortgage	\$ 177,049	\$ 1,839	\$ 881	\$ 1,526	\$ 181,295
Real estate – construction:					
Construction lending	40,943	—	—	—	40,943
Consumer lot lending	13,303	—	—	—	13,303
Commercial, financial and agricultural:					
Commercial real estate lending	323,218	3,266	70	—	326,554
Land acquisition and development lending	33,870	9,021	—	—	42,891
Builder line lending	25,995	378	—	—	26,373
Commercial business lending	104,291	692	—	11	104,994
Equity lines	51,662	181	11	229	52,083
Consumer	13,632	6	—	118	13,756
	<u>\$ 783,963</u>	<u>\$ 15,383</u>	<u>\$ 962</u>	<u>\$ 1,884</u>	<u>\$ 802,192</u>

¹ At December 31, 2019, the Corporation did not have any loans classified as Doubtful or Loss.

<i>(Dollars in thousands)</i>	Performing	Non- Performing	Total
Consumer finance	<u>\$ 312,388</u>	<u>\$ 611</u>	<u>\$ 312,999</u>

Loans by credit quality indicators as of December 31, 2018 were as follows:

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total ¹
Real estate – residential mortgage	\$ 180,232	\$ 2,832	\$ 1,243	\$ 594	\$ 184,901
Real estate – construction:					
Construction lending	42,051	—	—	—	42,051
Consumer lot lending	12,410	—	—	—	12,410
Commercial, financial and agricultural:					
Commercial real estate lending	306,578	3,801	454	—	310,833
Land acquisition and development lending	33,156	10,248	—	—	43,404
Builder line lending	31,201	—	—	—	31,201
Commercial business lending	69,897	576	—	24	70,497
Equity lines	54,289	389	99	883	55,660
Consumer	14,998	5	6	—	15,009
	<u>\$ 744,812</u>	<u>\$ 17,851</u>	<u>\$ 1,802</u>	<u>\$ 1,501</u>	<u>\$ 765,966</u>

¹ At December 31, 2018, the Corporation did not have any loans classified as Doubtful or Loss.

<i>(Dollars in thousands)</i>	Performing	Non- Performing	Total
Consumer finance	<u>\$ 295,442</u>	<u>\$ 712</u>	<u>\$ 296,154</u>

NOTE 6: OREO

At December 31, 2019 and 2018, the carrying amount of OREO was \$1.10 million and \$246,000, respectively. At December 31, 2019, OREO was primarily comprised of a property in Midlothian, Virginia previously used by the Bank as its Bellgrade branch, which was consolidated into a nearby branch in 2019. OREO is otherwise comprised of residential

properties and non-residential properties associated with commercial relationships, and are located primarily in Virginia. Changes in the balance for OREO are as follows:

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2019	2018
Balance at the beginning of year, gross	\$ 303	\$ 225
Additions	1,401	98
Sales proceeds	(521)	(18)
Gain (loss) on disposition	8	(2)
Balance at the end of year, gross	1,191	303
Less valuation allowance	(88)	(57)
Balance at the end of year, net	<u>\$ 1,103</u>	<u>\$ 246</u>

Changes in the allowance for OREO losses are as follows:

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Balance at the beginning of year	\$ 57	\$ 57	\$ 86
Provision for losses	31	—	—
Charge-offs, net	—	—	(29)
Balance at the end of year	<u>\$ 88</u>	<u>\$ 57</u>	<u>\$ 57</u>

Other net noninterest expense applicable to OREO, excluding the provision for losses and gain or loss on disposition, was \$34,000, \$26,000 and \$72,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

NOTE 7: Corporate Premises and Equipment

Major classifications of corporate premises and equipment are summarized as follows:

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Land	7,806	\$ 8,300
Buildings	35,933	36,284
Equipment, furniture and fixtures	18,285	17,392
	62,024	61,976
Less accumulated depreciation	(26,763)	(24,876)
	<u>\$ 35,261</u>	<u>\$ 37,100</u>

NOTE 8: Leases

The Corporation's leases comprise primarily leases of real estate and office equipment in which the Corporation is the lessee, and all of which are classified as operating leases. Lease cost for the year ended December 31, 2019 is as follows:

<i>(Dollars in thousands)</i>	Year Ended December 31, 2019
Operating lease cost	\$ 1,681
Short-term lease cost	128
Variable lease cost	43
Total lease cost	<u>\$ 1,852</u>

Variable lease payments primarily represent payments for common area maintenance related to real estate leases and taxes and fees related to equipment leases.

Cash paid for amounts included in the measurement of lease liabilities during the year ended December 31, 2019 was \$1.72 million. As of December 31, 2019, the weighted average remaining lease term and discount rate for the Corporation's leases were 3.0 years and 3.2 percent, respectively. Right-of-use assets and lease liabilities of \$2.78 million and \$2.81 million were included in other assets and other liabilities, respectively, as of December 31, 2019. During the year ended December 31, 2019, the Corporation obtained right-of-use assets in exchange for lease liabilities of \$1.14 million.

The Corporation adopted ASC 842 effective January 1, 2019. Prior to January 1, 2019, the Corporation measured lease expense in accordance with ASC Topic 840. During the years ended December 31, 2018 and 2017, the Corporation recognized lease expense of \$1.68 million and \$1.77 million, respectively.

Certain of the Corporation's leases contain options to extend the lease term beyond the initial term. Options to extend the lease term are recognized as part of the Corporation's lease liabilities and right-of-use assets at the commencement of a lease to the extent the Corporation is reasonably certain to exercise such options.

Maturities of the Corporation's lease liabilities are as follows:

<i>(Dollars in thousands)</i>	<u>December 31, 2019</u>
2020	\$ 1,385
2021	906
2022	292
2023	128
2024	104
Thereafter	<u>121</u>
Total	2,936
Imputed interest	<u>(123)</u>
Lease liabilities	<u>\$ 2,813</u>

The table above excludes payments of \$7.92 million related to two lease agreements that have been executed where the Corporation has not obtained control of the real estate properties under lease as of December 31, 2019 and has therefore not recognized a lease liability or right-of-use asset.

NOTE 9: Time Deposits

Time deposits are summarized as follows:

<i>(Dollars in thousands)</i>	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
Certificates of deposit, over \$250	\$ 109,310	\$ 72,880
Other time deposits	312,746	273,680
	<u>\$ 422,056</u>	<u>\$ 346,560</u>

Remaining maturities on time deposits are as follows:

<i>(Dollars in thousands)</i>	<u>December 31, 2019</u>	
2020	\$	259,430
2021		93,857
2022		31,399
2023		13,033
2024		14,612
Thereafter		9,725
	\$	422,056

NOTE 10: Borrowings

The table below presents selected information on short-term borrowings:

<i>(Dollars in thousands)</i>	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
Balance outstanding at year end ¹	\$ 16,360	\$ 14,917
Maximum balance at any month end during the year	\$ 17,178	\$ 22,912
Average balance for the year	\$ 15,533	\$ 18,883
Weighted average rate for the year	1.05 %	1.12 %
Weighted average rate on borrowings at year end	0.82 %	0.71 %
Estimated fair value at year end	\$ 16,360	\$ 14,917

¹ Consists of repurchase transactions with customers, which generally mature the day following the day sold and are secured by investment securities.

Long-term borrowings at December 31, 2019 consist of advances under a non-recourse revolving bank line of credit secured by loans at C&F Finance and advances from the FHLB, which are secured by a blanket floating lien on all qualifying closed-end and revolving, open-end loans secured by 1-4 family residential properties, including loans held for sale. The interest rate on the revolving bank line of credit, which matures in 2022, floats at the one-month LIBOR rate plus 200 basis points. The outstanding balance on this line was \$75.03 million as of December 31, 2019. C&F Finance’s revolving bank line of credit agreement contains covenants regarding C&F Finance’s capital adequacy, collateral performance, adequacy of the allowance for loan losses and interest expense coverage. C&F Finance satisfied all such covenants during 2019. Long-term advances from the FHLB at December 31, 2019 consist of \$37.00 million of convertible advances and \$7.50 million of fixed rate hybrid advances. The convertible advances have fixed rates of interest unless the FHLB exercises its option to convert the interest on these advances from fixed rate to variable rate. The fixed rate hybrid advances provide fixed-rate funding until the stated maturity date. C&F Bank may add interest rate caps or floors at a future date, at which time the cost of the caps or floors will be added to the advance rate. The table below presents selected information for the FHLB advances at December 31, 2019:

<i>(Dollars in thousands)</i>		<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Next Conversion Option Date</u>
Fixed Rate Hybrid Advances				
	\$ 7,500	1.78 %	08/21/20	
Convertible Advances				
	\$ 7,500	1.48 %	09/19/22	09/20/21
	\$ 7,500	1.96 %	09/29/23	09/29/22
	\$ 5,000	2.32 %	10/25/24	10/25/23
	\$ 5,000	2.53 %	11/28/25	11/29/24
	\$ 5,000	2.83 %	12/29/26	12/29/25
	\$ 7,000	2.01 %	12/03/27	12/03/26

The contractual maturities of long-term borrowings at December 31, 2019 are as follows:

<i>(Dollars in thousands)</i>	<u>Fixed Rate</u>	<u>Floating Rate</u>	<u>Total</u>
2020	\$ 7,500	\$ —	\$ 7,500
2021	—	—	—
2022	7,500	75,029	82,529
2023	7,500	—	7,500
2024	5,000	—	5,000
Thereafter	17,000	—	17,000
	<u>\$ 44,500</u>	<u>\$ 75,029</u>	<u>\$ 119,529</u>

The Corporation's available sources of credit for future borrowings total approximately \$368.07 million at December 31, 2019, which consists of \$159.65 million available from the FHLB, \$44.97 million on C&F Finance's revolving bank line of credit, \$18.45 million available from the FRB, \$95.00 million under unsecured federal funds agreements with third party financial institutions and \$50.00 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 FRB or the FHLB above the current lendable collateral value.

C&F Financial Statutory Trust I (Trust I), C&F Financial Statutory Trust II (Trust II) and Central Virginia Bankshares Statutory Trust I (CVBK Trust I) are wholly-owned non-operating subsidiaries of the Corporation, formed for the purpose of issuing trust preferred capital securities. Collectively, these trusts have issued \$25.00 million of trust preferred capital securities to institutional investors through private placements and \$775,000 in common equity that is held by the Corporation. Trust preferred capital securities of \$5.00 million issued by CVBK Trust I, \$10.00 million issued by Trust I, and \$10.00 million issued by Trust II mature in 2033, 2035 and 2037, respectively, and are redeemable at the Corporation's option. Each of the trusts is required to make quarterly distributions to the holders of the securities at a rate based on the three-month LIBOR plus a spread of between 1.57 percent and 3.15 percent. During 2019, 2018 and 2017, the Corporation used interest rate swaps in designated cash flow hedges of interest payments on the trust preferred capital securities to mitigate the effects of changes in interest rates. At December 31, 2019, the effect of the interest rate swaps was a fixed rate of interest on the securities issued by CVBK Trust I, Trust I and Trust II of 4.64 percent, 3.32 percent and 5.10 percent, respectively. The principal assets of CVBK Trust I, Trust I and Trust II are trust preferred capital notes of the Corporation of \$5.16 million, \$10.31 million and \$10.31 million, respectively, which have like maturities and like interest rates to the trust preferred capital securities. The interest payments by the Corporation on the notes will be used by the trusts to pay the quarterly distributions on the trust preferred capital securities.

The trust preferred capital securities issued by CVBK Trust I were recorded at fair value at the Corporation's acquisition of CVBK in 2013. The resulting fair value adjustment was a discount of \$716,000, which is being amortized over 20 years on a straight-line basis, and the balance of which was \$494,000 as of December 31, 2019.

Subject to certain exceptions and limitations, the Corporation 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 capital securities.

NOTE 11: Equity, Other Comprehensive Income and Earnings Per Share

Equity and Noncontrolling Interest

During the years ended December 31, 2019 and 2018, the Corporation repurchased 86,523 shares and 21,232 shares of its common stock, respectively, for an aggregate cost of \$4.39 million and \$1.11 million, respectively, under share repurchase programs authorized by its Board of Directors. Additionally, during the years ended December 31, 2019, 2018 and 2017, the Corporation withheld 9,909 shares, 7,982 shares and 9,899 shares of its common stock, respectively, from employees to satisfy tax withholding obligations upon vesting of restricted stock.

In 2019, C&F Select LLC, a subsidiary of C&F Mortgage, issued a 49 percent ownership interest to an unrelated investor. In exchange for this noncontrolling interest in C&F Select LLC, C&F Bank received a note receivable from the investor for \$490,000, which is included in loans the Consolidated Balance Sheets and is secured by cash deposits at C&F Bank.

Accumulated Other Comprehensive Income (Loss)

The following table presents the cumulative balances of the components of accumulated other comprehensive loss, net of deferred taxes of \$604,000 and \$1.23 million as of December 31, 2019 and 2018, respectively.

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Net unrealized gains (losses) on securities	\$ 1,560	\$ (1,375)
Net unrecognized (losses) gains on cash flow hedges	(69)	215
Net unrecognized losses on defined benefit plan	(3,740)	(3,512)
Total accumulated other comprehensive loss	<u>\$ (2,249)</u>	<u>\$ (4,672)</u>

Earnings Per Share (EPS)

The components of the Corporation’s EPS calculations are as follows:

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Net income attributable to C&F Financial Corporation.	\$ 18,859	\$ 18,020	\$ 6,572
Weighted average number of shares used in earnings per share—basic	3,450,745	3,501,221	3,486,510
Effect of dilutive securities—stock option awards.	—	—	79
Weighted average number of shares used in earnings per share—assuming dilution	<u>3,450,745</u>	<u>3,501,221</u>	<u>3,486,589</u>

The Corporation has applied the two-class method of computing basic and diluted EPS for each period presented because the Corporation’s unvested restricted shares outstanding contain rights to nonforfeitable dividends equal to dividends on the Corporation’s common stock. Accordingly, the weighted average number of shares used in the calculation of basic and diluted EPS includes both vested and unvested shares outstanding.

NOTE 12: Income Taxes

Principal components of income tax expense as reflected in the Consolidated Statements of Income are as follows:

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Current taxes	\$ 4,728	\$ 3,889	\$ 1,989
Deferred taxes	354	632	9,405
	<u>\$ 5,082</u>	<u>\$ 4,521</u>	<u>\$ 11,394</u>

Income tax expense for the years ended December 31, 2019, 2018 and 2017 differed from the federal statutory rate applied to income before income taxes for the following reasons:

<i>(Dollars in thousands)</i>	Year Ended December 31,					
	2019		2018		2017	
	Amount	Percent	Amount	Percent	Amount	Percent
Income tax at statutory rates	\$ 5,026	21.0 %	\$ 4,734	21.0 %	\$ 6,288	35.0 %
State income taxes	695	2.9	575	2.6	348	1.9
Tax-exempt interest income	(476)	(2.0)	(592)	(2.6)	(1,162)	(6.5)
Carrying cost of tax-exempt assets	23	0.1	18	0.1	32	0.2
Share based compensation	(126)	(0.5)	(103)	(0.5)	(284)	(1.6)
Income from bank-owned life insurance	(149)	(0.6)	(89)	(0.4)	(151)	(0.8)
Investments in qualified housing projects	(93)	(0.4)	(85)	(0.4)	(135)	(0.8)
Merger related expenses	96	0.4	—	—	—	—
Remeasurement of net deferred tax assets	—	—	—	—	6,643	37.0
Other	86	0.3	63	0.3	(185)	(1.0)
	<u>\$ 5,082</u>	<u>21.2 %</u>	<u>\$ 4,521</u>	<u>20.1 %</u>	<u>\$ 11,394</u>	<u>63.4 %</u>

The Tax Cuts and Jobs Act of 2017, which was signed into law on December 22, 2017, permanently lowered the federal corporate income tax rate to 21 percent from the previous maximum rate of 35 percent, effective January 1, 2018. In the year ended December 31, 2017, as a result of the reduction in the federal corporate income tax rate, the Corporation recorded a one-time remeasurement adjustment to its net federal deferred tax asset of \$6.64 million, which was recognized in income tax expense.

The Corporation's net deferred income taxes totaled \$11.2 million and \$12.2 million at December 31, 2019 and 2018, respectively. The tax effects of each type of significant item that gave rise to deferred taxes are:

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Deferred tax asset		
Allowances for loan losses and OREO losses	\$ 8,227	\$ 8,567
Nonqualified defined contribution plan	3,247	2,925
Fair value adjustments related to business combinations	1,053	1,643
Share-based compensation	863	825
Lease liabilities	667	—
Reserve for indemnification losses	645	663
Interest on nonaccrual loans	226	346
Cash flow hedges	24	—
Net unrealized loss on securities available for sale	—	365
Other	1,559	1,415
Deferred tax asset	16,511	16,749
Deferred tax liability		
Goodwill and other intangible assets	(2,818)	(2,838)
Depreciation	(972)	(1,024)
Right of use assets	(664)	—
Defined benefit plan	(423)	(620)
Net unrealized gain on securities available for sale	(415)	—
Cash flow hedges	—	(74)
Deferred tax liability	(5,292)	(4,556)
Net deferred tax asset	\$ 11,219	\$ 12,193

The Corporation files income tax returns in the U.S. federal jurisdiction and several states. With few exceptions, the Corporation is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2016.

NOTE 13: Employee Benefit Plans

C&F Bank maintains a Defined Contribution Profit-Sharing Plan (the Profit-Sharing Plan) sponsored by the Virginia Bankers Association (VBA). The Profit-Sharing Plan includes a 401(k) savings provision that authorizes a maximum voluntary deferral of up to 95 percent of covered compensation (with a partial company match), subject to statutory limitations. The Profit-Sharing Plan provides for an annual discretionary contribution to the account of each eligible employee based in part on C&F Bank's profitability for a given year and on each participant's yearly earnings. All full-time employees who have attained the age of 18 and have at least one month of service are eligible to participate. Contributions and earnings may be invested in various investment vehicles offered through the VBA. All employee contributions are fully vested upon contribution. An employee is 20 percent vested in C&F Bank's contributions after two years of service, 40 percent after three years, 60 percent after four years, 80 percent after five years and fully vested after six years, or earlier in the event of retirement, death or attainment of age 65 while an employee. The amounts charged to expense under this plan were \$903,000, \$896,000 and \$799,000 in 2019, 2018 and 2017, respectively.

C&F Mortgage maintains a Defined Contribution 401(k) Savings Plan that authorizes a voluntary salary deferral of up to 100 percent of compensation (with a discretionary company match), subject to statutory limitations. Substantially all employees who have attained the age of 18 are eligible to participate on the first day of the next month following employment date. The plan provides for an annual discretionary contribution to the account of each eligible employee based in part on C&F Mortgage's profitability for a given year and on each participant's contributions to the plan. Contributions may be invested in various investment funds offered under the plan. All employee contributions are fully vested upon contribution. An employee is vested 25 percent in the employer's contributions after two years of service,

50 percent after three years, 75 percent after four years, and fully vested after five years. The amounts charged to expense under this plan were \$392,000, \$220,000 and \$216,000 in 2019, 2018 and 2017, respectively.

C&F Finance maintains a Defined Contribution 401(k) and Profit-Sharing Plan sponsored by the VBA with plan features similar to the Profit-Sharing Plan of C&F Bank. The amounts charged to expense under this plan were \$223,000, \$190,000 and \$223,000 in 2019, 2018 and 2017, respectively.

Individual performance bonuses are awarded annually to certain senior members of management of C&F Bank and C&F Finance under the Corporation's Management Incentive Plan (MIP). The Corporation's Compensation Committee determines the bonuses to be paid to the Chief Executive Officer and the President of the Corporation. The Chief Executive Officer recommends the bonuses to be paid to the remaining officers participating in the MIP. In determining the awards, individual performance and the Corporation's performance, including growth rate, returns on average assets and equity, asset quality measures and absolute levels of income are considered. In addition, the Compensation Committee, based on the recommendations of the Chief Executive Officer, determines the bonuses to be paid to other members of management of C&F Bank and C&F Finance who do not participate in the MIP. The expense for these bonus awards is accrued in the year of performance. Expenses under these plans were \$1.97 million, \$1.95 million and \$1.70 million in 2019, 2018 and 2017, respectively. In accordance with employment agreements for certain senior officers of C&F Mortgage, performance bonuses of \$1.48 million, \$762,000 and \$759,000 were expensed in 2019, 2018 and 2017, respectively. Performance used in determining the awards is directly related to the profitability of C&F Mortgage.

C&F Bank has a non-contributory, defined benefit pension plan (Cash Balance Plan) for all full-time employees over 21 years of age. Under the Cash Balance Plan, the benefit account for each participant will grow each year with annual pay credits based on age and years of service and monthly interest credits based on the prior year's December average yield on 30-year Treasuries plus 150 basis points. C&F Bank funds pension costs in accordance with the funding provisions of the Employee Retirement Income Security Act.

The Corporation has a nonqualified deferred compensation plan for certain executives. The plan allows for elective salary and bonus deferrals. The plan also allows for employer contributions to make up for limitations on covered compensation imposed by the Internal Revenue Code with respect to the Profit-Sharing Plan and Cash Balance Plan and to enhance retirement benefits by providing supplemental contributions from time to time. Expenses under this plan were \$294,000, \$297,000 and \$253,000 in 2019, 2018 and 2017, respectively. Investments for this plan are held in a Rabbi trust. These investments are included in other assets and the related liability is included in other liabilities.

On December 16, 2014, the Corporation approved an additional compensation benefit for the Corporation's Chief Executive Officer at the time to provide post-retirement medical and dental insurance premiums for him and his spouse for life. There were no expenses under this arrangement in 2019; however, in 2018 and 2017 expenses were \$88,000 and \$81,000, respectively. The related liability is included in other liabilities.

The following table summarizes the projected benefit obligations, plan assets, funded status and rate assumptions associated with the Cash Balance Plan based upon actuarial valuations.

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Change in benefit obligation		
Projected benefit obligation, beginning	\$ 17,205	\$ 17,808
Service cost	1,218	1,232
Interest cost	609	521
Actuarial loss (gain)	2,834	(1,308)
Benefits paid	(1,072)	(1,048)
Projected benefit obligation, ending	<u>20,794</u>	<u>17,205</u>
Change in plan assets		
Fair value of plan assets, beginning	20,156	19,254
Actual return on plan assets	3,722	(1,050)
Employer contributions	—	3,000
Benefits paid	(1,072)	(1,048)
Fair value of plan assets, ending	<u>22,806</u>	<u>20,156</u>
Funded status	<u>\$ 2,012</u>	<u>\$ 2,951</u>
Amounts recognized as an other asset	<u>\$ 2,012</u>	<u>\$ 2,951</u>
Amounts recognized in accumulated other comprehensive loss		
Net loss	\$ 5,239	\$ 5,017
Prior service credits	(504)	(572)
Deferred taxes	(995)	(933)
Total recognized in accumulated other comprehensive loss	<u>\$ 3,740</u>	<u>\$ 3,512</u>
Weighted-average assumptions for benefit obligation at valuation date		
Discount rate	2.9 %	4.0 %
Rate of compensation increase	3.0	3.0
Interest crediting rate	5.0	5.0

The accumulated benefit obligation was \$20.79 million and \$17.21 million as of the actuarial valuation dates December 31, 2019 and 2018, respectively.

The following table summarizes the components of net periodic benefit cost and rate assumptions associated with the Cash Balance Plan.

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Components of net periodic benefit cost:			
Service cost, included in salaries and employee benefits	\$ 1,218	\$ 1,232	\$ 1,120
Other components of net periodic benefit cost:			
Interest cost	609	521	552
Expected return on plan assets	(1,297)	(1,413)	(1,138)
Amortization of prior service credit	(68)	(62)	(61)
Amortization of net obligation at transition	—	—	—
Recognized net actuarial losses	187	125	154
Other components of net periodic benefit cost, included in other noninterest income	(569)	(829)	(493)
Net periodic benefit cost	\$ 649	\$ 403	627
January 1,			
2019 2018 2017			
Weighted-average assumptions for net periodic benefit cost			
Discount rate	4.0 %	3.3 %	3.7 %
Expected return on plan assets	7.3	7.3	7.3
Rate of compensation increase	3.0	3.0	3.0

The benefits expected to be paid by the plan in the next ten years are as follows:

<i>(Dollars in thousands)</i>	
2020	\$ 4,460
2021	615
2022	828
2023	1,492
2024	1,252
2025 – 2029	7,466
	\$ 16,113

C&F Bank selects the expected long-term rate of return on assets in consultation with its investment advisors and actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed, especially with respect to real rates of return (net of inflation), for the major asset classes held or anticipated to be held by the trust and for the trust itself. Undue weight is not given to recent experience, which may not continue over the measurement period. Higher significance is placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly within periodic costs).

C&F Bank's defined benefit pension plan's weighted average asset allocations by asset category are as follows:

	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
Mutual funds-fixed income	38 %	42 %
Mutual funds-equity	62	58
Cash and equivalents	*	*
	<u>100 %</u>	<u>100 %</u>

* Less than one percent.

The following table summarizes the fair value of the defined benefit plan assets as of December 31, 2019 and 2018. For more information about fair value measurements, see "Note 18: Fair Value of Assets and Liabilities."

<i>(Dollars in thousands)</i>	<u>December 31, 2019</u>			<u>Assets at Fair Value</u>
	<u>Fair Value Measurements Using</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Mutual funds-fixed income ¹	\$ 8,744	\$ —	\$ —	\$ 8,744
Mutual funds-equity ²	14,062	—	—	14,062
Cash and equivalents ³	—	—	—	—
Total pension plan assets	<u>\$ 22,806</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 22,806</u>

<i>(Dollars in thousands)</i>	<u>December 31, 2018</u>			<u>Assets at Fair Value</u>
	<u>Fair Value Measurements Using</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Mutual funds-fixed income ¹	\$ 8,497	\$ —	\$ —	\$ 8,497
Mutual funds-equity ²	11,659	—	—	11,659
Cash and equivalents ³	—	—	—	—
Total pension plan assets	<u>\$ 20,156</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 20,156</u>

¹ This category includes investments in mutual funds focused on fixed income securities with both short-term and long-term investments. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the funds.

² This category includes investments in mutual funds focused on equity securities with a diversified portfolio and includes investments in large cap and small cap funds, growth funds, international focused funds and value funds. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the funds.

³ This category comprises cash and short-term cash equivalent funds. The funds are valued at cost which approximates fair value.

The trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 40 percent fixed income and 60 percent equities. The investment advisor selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the plan's investment strategy. The investment manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the trustee to administer the investments of the trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the trust.

NOTE 14: Related Party Transactions

Loans outstanding to the Corporation’s management, including directors and senior officers and certain of their affiliates, totaled \$2.26 million and \$2.05 million at December 31, 2019 and 2018, respectively. For the year ended December 31, 2019, the Corporation named new senior officers with loans outstanding at C&F Bank of \$368,000, made loan advances to directors and senior officers totaling \$13,000, and received repayments totaling \$169,000. Total deposits of directors and senior officers were \$7.21 million and \$4.93 million at December 31, 2019 and 2018, respectively. In the opinion of management, these transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates, collateral and repayment terms, as those prevailing at the same time for comparable transactions with unrelated persons, and, in the opinion of management and the Corporation’s Board of Directors, do not involve more than normal risk or present other unfavorable features.

NOTE 15: Share-Based Plans

On April 16, 2013, the Corporation’s shareholders approved the C&F Financial Corporation 2013 Stock and Incentive Compensation Plan (the 2013 Plan) for the grant of equity awards to certain key employees of the Corporation, as well as non-employee directors (including non-employee regional or advisory directors). The 2013 Plan authorizes the Corporation to issue equity awards in the form of stock options, tandem stock appreciation rights, restricted stock, restricted stock units and/or other stock-based awards. Since the 2013 Plan’s approval, equity awards have only been issued in the form of restricted stock.

Prior to the approval of the 2013 Plan, the Corporation granted equity awards under the Amended and Restated C&F Financial Corporation 2004 Incentive Stock Plan (the Amended 2004 Plan). The Amended 2004 Plan authorized the Corporation to issue equity awards in the form of stock options, stock appreciation rights, restricted stock and/or restricted stock units to key employees and non-employee directors. Since 2006, all equity awards that were issued under the Amended 2004 Plan were in the form of restricted stock, which were accounted for using the fair market value of the Corporation’s common stock on the date the restricted shares are awarded. Stock options issued under the Amended 2004 Plan prior to 2006 were issued to employees at an exercise price equal to the fair market value of the Corporation’s common stock on the date granted. As of December 31, 2017, there were no remaining outstanding stock options for the Corporation’s common stock and none were granted in 2018 or 2019. Stock option transactions under the various plans for the periods indicated were as follows:

	2017	
	Shares	Weighted-Average Exercise Price
<i>(Dollars in thousands, except for per share amounts)</i>		
Outstanding at beginning of year	2,250	\$ 37.17
Granted	—	—
Exercised	(2,250)	37.17
Cancelled	—	—
Outstanding and exercisable at end of year	—	—

As permitted under the 2013 Plan and Amended 2004 Plan, the Corporation awards shares of restricted stock to certain key employees and non-employee directors. Restricted shares awarded to employees generally vest on the fifth anniversary of the grant date and restricted shares awarded to non-employee directors generally vest on the third anniversary of the grant date. A summary of the activity for restricted stock awards for the periods indicated is presented below:

	2019		2018		2017	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Nonvested at beginning of year	139,455	\$ 45.75	137,880	\$ 43.52	141,755	\$ 39.77
Granted	36,115	53.75	30,185	52.82	29,625	52.73
Vested	(32,155)	40.69	(26,450)	42.41	(31,810)	35.42
Cancelled	(1,395)	51.05	(2,160)	42.54	(1,690)	43.16
Nonvested at end of year	<u>142,020</u>	<u>48.88</u>	<u>139,455</u>	<u>45.75</u>	<u>137,880</u>	<u>43.52</u>

Compensation is accounted for using the fair value of the Corporation's common stock on the date the restricted shares are awarded. Compensation expense is charged to income ratably over the required service periods, and was \$1.47 million in 2019, \$1.35 million in 2018 and \$1.45 million in 2017. As of December 31, 2019, there was \$3.33 million of total unrecognized compensation cost related to restricted stock granted under the 2013 Plan. This amount is expected to be recognized through 2024.

NOTE 16: Regulatory Requirements and Restrictions

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Federal banking regulations also impose regulatory capital requirements on bank holding companies. Under the small bank holding company policy statement of the Federal Reserve Board, which applies to certain bank holding companies with consolidated total assets of less than \$3 billion, the Corporation is not subject to regulatory capital requirements.

As of December 31, 2019, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized under regulations applicable at December 31, 2019, the Bank was required to maintain minimum total risk-based, Tier 1 risk-based, CET1 risk-based and Tier 1 leverage ratios as set forth in the table below.

The Corporation's and the Bank's actual capital amounts and ratios as of December 31, 2019 and 2018 are presented in the following table along with regulatory requirements for the Bank and requirements that apply to bank holding companies that are subject to regulatory capital requirements for bank holding companies. The Corporation's consolidated capital is determined under regulations that apply to bank holding companies that are not small bank holding companies. Total risk-weighted assets at December 31, 2019 for the Corporation were \$1.32 billion and for the Bank were \$1.29 billion. Total risk-weighted assets at December 31, 2018 for both the Corporation and the Bank were \$1.20 billion. Management believes that, as of December 31, 2019, the Bank met all capital adequacy requirements to which it is subject.

<i>(Dollars in thousands)</i>	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>As of December 31, 2019:</i>						
Total Capital (to Risk-Weighted Assets)						
Corporation.....	\$ 195,927	14.9 %	\$ 105,544	8.0 %	N/A	N/A
C&F Bank.....	181,369	14.0	103,307	8.0	\$ 129,134	10.0 %
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation.....	179,233	13.6	79,158	6.0	N/A	N/A
C&F Bank.....	165,021	12.8	77,480	6.0	103,307	8.0
Common Equity Tier 1 Capital (to Risk-Weighted Assets)						
Corporation.....	154,233	11.7	59,369	4.5	N/A	N/A
C&F Bank.....	165,021	12.8	58,110	4.5	83,937	6.5
Tier 1 Capital (to Average Assets)						
Corporation.....	179,233	11.1	64,863	4.0	N/A	N/A
C&F Bank.....	165,021	10.3	64,201	4.0	80,251	5.0
<i>As of December 31, 2018:</i>						
Total Capital (to Risk-Weighted Assets)						
Corporation.....	\$ 183,781	15.3 %	\$ 96,274	8.0 %	N/A	N/A
C&F Bank.....	181,685	15.1	96,088	8.0	\$ 120,110	10.0 %
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation.....	168,504	14.0	72,205	6.0	N/A	N/A
C&F Bank.....	166,437	13.9	72,066	6.0	96,088	8.0
Common Equity Tier 1 Capital (to Risk-Weighted Assets)						
Corporation.....	143,590	11.9	54,154	4.5	N/A	N/A
C&F Bank.....	166,437	13.9	54,050	4.5	78,072	6.5
Tier 1 Capital (to Average Tangible Assets)						
Corporation.....	168,504	11.3	59,759	4.0	N/A	N/A
C&F Bank.....	166,437	11.2	59,666	4.0	74,582	5.0

In addition to the regulatory risk-based capital amounts presented above, the Bank must maintain a capital conservation buffer of additional capital as required by the Basel III Final Rule. The capital conservation buffer requirement was phased in from January 1, 2016 until January 1, 2019 in equal annual installments of 0.625 percent. Accordingly, at December 31, 2019, the Bank was required to maintain a capital conservation buffer of 2.5 percent and exceeded the total capital conservation buffer and the tier 1 capital conservation buffer by 355 and 428 basis points, respectively. At December 31, 2018, the Bank was required to maintain a capital conservation buffer of 1.875 percent and exceeded the total capital conservation buffer and the tier 1 capital conservation buffer by 525 and 598 basis points, respectively.

Between 2003 and 2007, the Corporation's statutory business trusts issued \$25.00 million of aggregate trust preferred securities. Based on the Corporation's Tier 1 capital levels, the entire \$25.00 million of trust preferred securities was included in the Corporation's Tier 1 capital as of December 31, 2019 and 2018.

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by C&F Bank to the Corporation. The total amount of dividends that may be paid at any date by C&F Bank is generally limited to

the retained earnings of C&F Bank, while other measures of capital adequacy may also restrict the Bank’s ability to declare dividends. Loans or advances are limited to 10 percent of C&F Bank’s capital stock and surplus on a secured basis.

NOTE 17: Commitments and Contingent Liabilities

The Corporation enters into commitments to extend credit in the normal course of business to meet the financing needs of its customers, including loan commitments and standby letters of credit. These instruments involve elements of credit and interest rate risk in excess of the amounts recorded on the Consolidated Balance Sheets. The Corporation’s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of these instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Collateral is obtained based on management’s credit assessment of the customer.

Loan commitments are agreements to extend credit to a customer provided that there are no violations of the terms of the contract prior to funding. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Because many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer’s creditworthiness on a case-by-case basis. The amount of loan commitments at the Bank was \$256.15 million at December 31, 2019 and \$244.17 million at December 31, 2018, which does not include IRLCs at C&F Mortgage, which are discussed in Note 20.

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 contract amount of standby letters of credit, whose contract amounts represent credit risk, was \$16.60 million at December 31, 2019 and \$19.34 million at December 31, 2018.

The mortgage banking segment sells substantially all of the residential mortgage loans it originates to third-party investors. As is customary in the industry, the agreements with these investors require the mortgage banking segment to extend representations and warranties with respect to program compliance, borrower misrepresentation, fraud, and early payment performance. Under the agreements, the investors are entitled to make loss claims and repurchase requests of the mortgage banking segment for loans that contain covered deficiencies. The mortgage banking segment has obtained early payment default recourse waivers for a significant portion of its business. Recourse periods for early payment default for the remaining investors vary from 90 days up to one year. Recourse periods for borrower misrepresentation or fraud, or underwriting error do not have a stated time limit. The mortgage banking segment maintains an allowance for indemnifications that represents management’s estimate of losses that are probable of arising under these recourse provisions. As performance data for loans that have been sold is not made available to the mortgage banking segment by the investors, the evaluation of potential losses is inherently subjective. A schedule of expected losses on loans with claims or indemnifications is maintained to ensure the reserve is adequate to cover estimated losses. The following table presents the changes in the allowance for indemnification losses for the periods presented:

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2019	2018
Allowance, beginning of period	\$ 2,541	\$ 2,489
Provision for indemnification losses	—	52
Payments	(66)	—
Allowance, end of period	<u>\$ 2,475</u>	<u>\$ 2,541</u>

NOTE 18: Fair Value of Assets and Liabilities

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP requires that valuation techniques maximize the use of observable inputs and

minimize the use of unobservable inputs. U.S. GAAP also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of the three levels. These levels are:

- Level 1—Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 assets and liabilities include debt securities traded in an active exchange market, as well as U.S. Treasury securities.
- Level 2—Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Valuation is determined using model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Corporation's estimates of assumptions that market participants would use in pricing the respective asset or liability. Valuation techniques may include the use of pricing models, discounted cash flow models and similar techniques.

U.S. GAAP allows an entity the irrevocable option to elect fair value (the fair value option) for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Corporation has elected to use fair value accounting for its entire portfolio of LHFS.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a recurring basis in the financial statements.

Securities available for sale. The Corporation primarily values its investment portfolio using Level 2 fair value measurements, but may also use Level 1 or Level 3 measurements if required by the composition of the portfolio. At December 31, 2019 and 2018, the Corporation's entire investment securities portfolio was comprised of securities available for sale, which were valued using Level 2 fair value measurements. The Corporation has contracted with third party portfolio accounting service vendors for valuation of its securities portfolio. The vendors' sources for security valuation are ICE Data Services (ICE) and Thomson Reuters Pricing Service (TRPS). Each source provides opinions, known as evaluated prices, as to the value of individual securities based on model-based pricing techniques that are partially based on available market data, including prices for similar instruments in active markets and prices for identical assets in markets that are not active. ICE provides evaluated prices for the Corporation's obligations of states and political subdivisions category of securities. ICE uses proprietary pricing models and pricing systems, mathematical tools and judgment to determine an evaluated price for a security based upon a hierarchy of market information regarding that security or securities with similar characteristics. TRPS provides evaluated prices for the Corporation's U.S. government agencies and corporations and mortgage-backed categories of securities. Fixed-rate callable securities of the U.S. government agencies and corporations category are individually evaluated on an option adjusted spread basis for callable issues or on a nominal spread basis incorporating the term structure of agency market spreads and the appropriate risk free benchmark curve for non-callable issues. Pass-through mortgage-backed securities (MBS) in the mortgage-backed category are grouped into aggregate categories defined by issuer program, weighted average coupon, and weighted average maturity. Each aggregate is benchmarked to relative to-be-announced mortgage backed securities (TBA securities) or other benchmark prices. TBA securities prices are obtained from market makers and live trading systems. Collateralized mortgage obligations in the mortgage-backed category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Each evaluation is determined using an option adjusted spread and prepayment model based on volatility-driven, multi-dimensional spread tables. Fixed-rate securities issued by the Small Business Association in the mortgage backed category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics.

Loans held for sale. Fair value of the Corporation's LHFS is based on observable market prices for similar instruments traded in the secondary mortgage loan markets in which the Corporation conducts business. The Corporation's portfolio of LHFS is classified as Level 2.

Derivative asset - IRLCs. The Corporation recognizes IRLCs at fair value. Fair value of IRLCs is based on either (i) the price of the underlying loans obtained from an investor for loans that will be delivered on a best efforts basis or (ii) the observable price for individual loans traded in the secondary market for loans that will be delivered on a mandatory basis. All of the Corporation's IRLCs are classified as Level 2.

Derivative asset/liability – interest rate swaps on loans. The Corporation recognizes interest rate swaps at fair value. The Corporation has contracted with a third party vendor to provide valuations for these interest rate swaps using standard valuation techniques. All of the Corporation's interest rate swaps on loans are classified as Level 2.

Derivative asset/liability - cash flow hedges. The Corporation recognizes cash flow hedges at fair value. The fair value of the Corporation's cash flow hedges is determined using the discounted cash flow method. All of the Corporation's cash flow hedges are classified as Level 2.

Derivative asset/liability – forward sales of TBA securities. The Corporation recognizes forward sales of TBA securities at fair value. The fair value of forward sales of TBA securities is based on prices obtained from market makers and live trading systems for TBA securities of similar issuer programs, coupons and maturities. All of the Corporation's forward sales of TBA securities are classified as Level 2.

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis.

<i>(Dollars in thousands)</i>	December 31, 2019			Assets/Liabilities at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Assets:				
Securities available for sale				
U.S. government agencies and corporations	\$ —	\$ 21,440	\$ —	\$ 21,440
Mortgage-backed securities	—	86,585	—	86,585
Obligations of states and political subdivisions	—	81,708	—	81,708
Total securities available for sale	—	189,733	—	189,733
Loans held for sale	—	90,500	—	90,500
Derivatives				
IRLC	—	1,083	—	1,083
Interest rate swaps on loans	—	2,462	—	2,462
Total assets	<u>\$ —</u>	<u>\$ 283,778</u>	<u>\$ —</u>	<u>\$ 283,778</u>
Liabilities:				
Derivatives				
Interest rate swaps on loans	\$ —	\$ 2,462	\$ —	\$ 2,462
Cash flow hedges	—	145	—	145
Forward sales of TBA securities	—	25	—	25
Total liabilities	<u>\$ —</u>	<u>\$ 2,632</u>	<u>\$ —</u>	<u>\$ 2,632</u>

<i>(Dollars in thousands)</i>	December 31, 2018			Assets/Liabilities at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Assets:				
Securities available for sale				
U.S. government agencies and corporations	\$ —	\$ 17,473	\$ —	\$ 17,473
Mortgage-backed securities	—	104,983	—	104,983
Obligations of states and political subdivisions	—	92,454	—	92,454
Total securities available for sale	—	214,910	—	214,910
Loans held for sale	—	41,895	—	41,895
Derivatives				
IRLC	—	636	—	636
Interest rate swaps on loans	—	1,607	—	1,607
Cash flow hedges	—	289	—	289
Total assets	<u>\$ —</u>	<u>\$ 259,337</u>	<u>\$ —</u>	<u>\$ 259,337</u>
Liabilities:				
Derivatives - interest rate swaps on loans	\$ —	\$ 1,607	\$ —	\$ 1,607
Total liabilities	<u>\$ —</u>	<u>\$ 1,607</u>	<u>\$ —</u>	<u>\$ 1,607</u>

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Corporation may be required, from time to time, to measure and recognize certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a nonrecurring basis in the financial statements.

Impaired loans. The Corporation 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 Corporation 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 Corporation 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 Corporation 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 Corporation 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.

OREO. Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure. Initial fair value is based upon appraisals the Corporation obtains from independent licensed appraisers. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intent with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations indicate a further deterioration in market conditions. As such, the Corporation records OREO as a nonrecurring fair value measurement classified as Level 3.

The following table presents the balances of assets measured at fair value on a nonrecurring basis.

<i>(Dollars in thousands)</i>	December 31, 2019			Assets at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Impaired loans, net	\$ —	\$ —	\$ 102	\$ 102
Other real estate owned, net	—	—	268	268
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 370</u>	<u>\$ 370</u>

<i>(Dollars in thousands)</i>	December 31, 2018			Assets at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Impaired loans, net	\$ —	\$ —	\$ 102	\$ 102
Other real estate owned, net	—	—	246	246
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 348</u>	<u>\$ 348</u>

The following table presents quantitative information about Level 3 fair value measurements for financial assets measured at fair value on a nonrecurring basis as of December 31, 2019:

<i>(Dollars in thousands)</i>	Fair Value Measurements at December 31, 2019			
	Fair Value	Valuation Technique(s)	Unobservable Inputs	Range of Inputs
Impaired loans, net	\$ 102	Appraisals	Discount to reflect current market conditions and estimated selling costs	30%
Other real estate owned, net	268	Appraisals	Discount to reflect current market conditions and estimated selling costs	33%-75%
Total	<u>\$ 370</u>			

Fair Value of Financial Instruments

FASB ASC 825, *Financial Instruments*, requires disclosure about fair value of financial instruments, including those financial assets and financial liabilities that are not required to be measured and reported at fair value on a recurring or nonrecurring basis. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation. The Corporation uses the exit 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 Corporation's financial instruments whether or not recognized on the Consolidated Balance Sheets at fair value.

<i>(Dollars in thousands)</i>	Carrying Value	Fair Value Measurements at December 31, 2019 Using			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and short-term investments	\$ 165,433	\$ 165,433	\$ —	\$ —	\$ 165,433
Securities available for sale	189,733	—	189,733	—	189,733
Loans, net.	1,082,318	—	—	1,082,783	1,082,783
Loans held for sale	90,500	—	90,500	—	90,500
Derivatives					
IRLC	1,083	—	1,083	—	1,083
Interest rate swaps on loans.	2,462	—	2,462	—	2,462
Bank-owned life insurance	16,044	—	16,044	—	16,044
Accrued interest receivable	6,776	6,776	—	—	6,776
Financial liabilities:					
Demand deposits	869,194	869,194	—	—	869,194
Time deposits	422,056	—	423,605	—	423,605
Borrowings	161,170	—	154,964	—	154,964
Derivatives					
Cash flow hedges	145	—	145	—	145
Interest rate swaps on loans.	2,462	—	2,462	—	2,462
Forward sales of TBA securities	25	—	25	—	25
Accrued interest payable	1,291	1,291	—	—	1,291

<i>(Dollars in thousands)</i>	Carrying Value	Fair Value Measurements at December 31, 2018 Using			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and short-term investments	\$ 115,013	\$ 115,013	\$ —	\$ —	\$ 115,013
Securities available for sale	214,910	—	214,910	—	214,910
Loans, net.	1,028,097	—	—	1,021,145	1,021,145
Loans held for sale	41,895	—	41,895	—	41,895
Derivatives					
IRLC	636	—	636	—	636
Interest rate swaps on loans.	1,607	—	1,607	—	1,607
Cash flow hedges	289	—	289	—	289
Bank-owned life insurance	16,065	—	16,065	—	16,065
Accrued interest receivable	7,436	7,436	—	—	7,436
Financial liabilities:					
Demand deposits	835,101	835,101	—	—	835,101
Time deposits	346,560	—	343,507	—	343,507
Borrowings	159,691	—	152,015	—	152,015
Derivatives - interest rate swaps on					
loans	1,607	—	1,607	—	1,607
Accrued interest payable	920	920	—	—	920

The Corporation assumes interest rate risk (the risk that general interest rate levels will change) in the normal course of operations. As a result, the fair values of the Corporation's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Corporation. Management attempts to match maturities of assets and liabilities to the extent believed necessary to balance minimizing interest rate risk and increasing net interest income in current market conditions. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do

so in a falling rate environment. Management monitors interest rates, maturities and repricing dates of assets and liabilities and attempts to manage interest rate risk by adjusting terms of new loans, deposits and borrowings and by investing in securities with terms that mitigate the Corporation's overall interest rate risk.

NOTE 19: Business Segments

The Corporation operates in a decentralized fashion in three principal business segments: retail banking, mortgage banking and consumer finance. Revenues from retail banking operations consist primarily of interest earned on loans and investment securities and fees earned on deposit accounts and debit card interchange activity. Mortgage banking operating revenues consist principally of gains on sales of loans in the secondary market, mortgage banking fee income related to loan originations, and interest earned on mortgage loans held for sale. Revenues from consumer finance consist primarily of interest earned on purchased retail installment sales contracts.

C&F Wealth Management derives revenues from offering wealth management services and insurance products through third-party service providers. The Corporation's revenues and expenses are comprised primarily of interest expense associated with the Corporation's trust preferred capital notes, general corporate expenses, and changes in the value of the rabbi trust and deferred compensation liability related to its nonqualified deferred compensation plan. The results of C&F Wealth Management and the Corporation are not significant to the Corporation on a consolidated basis and are included in "Other."

	Year Ended December 31, 2019					
<i>(Dollars in thousands)</i>	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 59,465	\$ 2,699	\$ 41,389	\$ 4	\$ (8,547)	\$ 95,010
Gains on sales of loans	—	10,603	—	—	—	10,603
Other noninterest income	11,392	5,103	565	4,349	—	21,409
Total operating income	<u>70,857</u>	<u>18,405</u>	<u>41,954</u>	<u>4,353</u>	<u>(8,547)</u>	<u>127,022</u>
Expenses:						
Provision for loan losses	360	—	8,155	—	—	8,515
Interest expense	10,181	1,618	10,169	1,135	(8,547)	14,556
Salaries and employee benefits	28,231	5,965	8,668	4,337	—	47,201
Depreciation and amortization	3,242	246	196	182	—	3,866
Other noninterest expenses	17,091	5,467	5,338	1,056	—	28,952
Total operating expenses	<u>59,105</u>	<u>13,296</u>	<u>32,526</u>	<u>6,710</u>	<u>(8,547)</u>	<u>103,090</u>
Income (loss) before income taxes	11,752	5,109	9,428	(2,357)	—	23,932
Income tax expense (benefit)	1,837	1,336	2,560	(651)	—	5,082
Net income (loss)	<u>\$ 9,915</u>	<u>\$ 3,773</u>	<u>\$ 6,868</u>	<u>\$ (1,706)</u>	<u>\$ —</u>	<u>\$ 18,850</u>
Total assets	<u>\$ 1,468,627</u>	<u>\$ 102,467</u>	<u>\$ 314,431</u>	<u>\$ 30,299</u>	<u>\$ (258,392)</u>	<u>\$ 1,657,432</u>
Goodwill	<u>\$ 3,702</u>	<u>\$ —</u>	<u>\$ 10,723</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 14,425</u>
Capital expenditures	<u>\$ 2,270</u>	<u>\$ 246</u>	<u>\$ 123</u>	<u>\$ 67</u>	<u>\$ —</u>	<u>\$ 2,706</u>

	Year Ended December 31, 2018					
<i>(Dollars in thousands)</i>	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 55,019	\$ 2,018	\$ 42,789	\$ 6	\$ (7,284)	\$ 92,548
Gains on sales of loans	—	7,841	—	—	—	7,841
Other noninterest income	11,029	4,015	738	2,135	—	17,917
Total operating income	<u>66,048</u>	<u>13,874</u>	<u>43,527</u>	<u>2,141</u>	<u>(7,284)</u>	<u>118,306</u>
Expenses:						
Provision for loan losses	100	—	10,906	—	—	11,006
Interest expense	6,842	904	9,413	1,152	(7,284)	11,027
Salaries and employee benefits	26,632	5,298	8,542	1,531	—	42,003
Depreciation and amortization	3,014	269	211	177	—	3,671
Other noninterest expenses	16,869	4,803	5,303	1,083	—	28,058
Total operating expenses	<u>53,457</u>	<u>11,274</u>	<u>34,375</u>	<u>3,943</u>	<u>(7,284)</u>	<u>95,765</u>
Income (loss) before income taxes	12,591	2,600	9,152	(1,802)	—	22,541
Income tax expense (benefit)	1,958	697	2,460	(594)	—	4,521
Net income (loss)	<u>\$ 10,633</u>	<u>\$ 1,903</u>	<u>\$ 6,692</u>	<u>\$ (1,208)</u>	<u>\$ —</u>	<u>\$ 18,020</u>
Total assets	<u>\$ 1,351,932</u>	<u>\$ 51,226</u>	<u>\$ 296,876</u>	<u>\$ 16,461</u>	<u>\$ (195,084)</u>	<u>\$ 1,521,411</u>
Goodwill	<u>\$ 3,702</u>	<u>\$ —</u>	<u>\$ 10,723</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 14,425</u>
Capital expenditures	<u>\$ 3,178</u>	<u>\$ 133</u>	<u>\$ 59</u>	<u>\$ 4</u>	<u>\$ —</u>	<u>\$ 3,374</u>

	Year Ended December 31, 2017					
<i>(Dollars in thousands)</i>	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 49,564	\$ 1,660	\$ 44,745	\$ 1	\$ (6,377)	\$ 89,593
Gains on sales of loans	—	8,553	—	—	—	8,553
Other noninterest income	10,501	4,095	878	3,205	—	18,679
Total operating income	<u>60,065</u>	<u>14,308</u>	<u>45,623</u>	<u>3,206</u>	<u>(6,377)</u>	<u>116,825</u>
Expenses:						
Provision for loan losses	200	—	16,235	—	—	16,435
Interest expense	6,076	587	8,164	1,151	(6,377)	9,601
Salaries and employee benefits	25,132	5,945	9,272	3,248	—	43,597
Depreciation and amortization	2,818	239	212	178	—	3,447
Other noninterest expenses	15,133	4,946	5,209	491	—	25,779
Total operating expenses	<u>49,359</u>	<u>11,717</u>	<u>39,092</u>	<u>5,068</u>	<u>(6,377)</u>	<u>98,859</u>
Income (loss) before income taxes	10,706	2,591	6,531	(1,862)	—	17,966
Income tax expense (benefit)	5,727	1,606	4,198	(137)	—	11,394
Net income (loss)	<u>\$ 4,979</u>	<u>\$ 985</u>	<u>\$ 2,333</u>	<u>\$ (1,725)</u>	<u>\$ —</u>	<u>\$ 6,572</u>
Total assets	<u>\$ 1,336,100</u>	<u>\$ 64,513</u>	<u>\$ 291,774</u>	<u>\$ 11,220</u>	<u>\$ (194,551)</u>	<u>\$ 1,509,056</u>
Goodwill	<u>\$ 3,702</u>	<u>\$ —</u>	<u>\$ 10,723</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 14,425</u>
Capital expenditures	<u>\$ 3,524</u>	<u>\$ 410</u>	<u>\$ 232</u>	<u>\$ 14</u>	<u>\$ —</u>	<u>\$ 4,180</u>

In 2019, the Corporation recorded merger related expenses of \$709,000 (\$653,000 after income taxes) in connection with its acquisition of Peoples, of which \$236,000 (\$196,000 after income taxes) was allocated to the retail banking segment and the remainder was recorded as a holding company expense.

The retail banking segment extends two warehouse lines of credit to the mortgage banking segment, providing a portion of the funds needed to originate mortgage loans. The retail banking segment charges the mortgage banking segment interest at the daily FHLB advance rate plus a spread ranging from 50 basis points to 175 basis points. The retail banking segment also provides the consumer finance segment with a portion of the funds needed to purchase loan contracts by means of variable rate notes that carry interest at one-month LIBOR plus 200 basis points and fixed rate notes that carry interest at rates ranging from 2.0 percent to 8.0 percent. The retail banking segment acquires certain residential real estate loans from the mortgage banking segment at prices similar to those paid by third-party investors. These transactions are eliminated to

reach consolidated totals. Certain corporate overhead costs incurred by the retail banking segment are not allocated to the mortgage banking, consumer finance and other segments.

NOTE 20: Derivative Financial Instruments

The Corporation uses derivative financial instruments primarily to manage risks to the Corporation associated with changing interest rates, and to assist customers with their risk management objectives. The Corporation designates certain interest rate swaps as hedging instruments in qualifying cash flow hedges. The changes in fair value of these designated hedging instruments is reported as a component of other comprehensive income. Derivative contracts that are not designated in a qualifying hedging relationship include customer accommodation loan swaps and contracts related to mortgage banking activities.

Cash flow hedges. The Corporation designates interest rate swaps as cash flow hedges when they are used to manage exposure to variability in cash flows on variable rate borrowings such as the Corporation's trust preferred capital notes. These interest rate swaps are derivative financial instruments that manage the risk of variability in cash flows by exchanging variable-rate interest payments on a notional amount of the Corporation's borrowings for fixed-rate interest payments. Interest rate swaps designated as cash flow hedges are expected to be highly effective in offsetting the effect of changes in interest rates on the amount of variable-rate interest payments, and the Corporation assesses the effectiveness of each hedging relationship quarterly. If the Corporation determines that a cash flow hedge is no longer highly effective, future changes in the fair value of the hedging instrument would be reported in earnings. As of December 31, 2019, the Corporation has designated cash flow hedges to manage its exposure to variability in cash flows on certain variable rate borrowings for periods that end between June 2024 and June 2029.

All interest rate swaps were entered into with counterparties that met the Corporation's credit standards and the agreements contain collateral provisions protecting the at-risk party. The Corporation believes that the credit risk inherent in these derivative contracts is not significant.

Unrealized gains or losses recorded in other comprehensive income related to cash flow hedges are reclassified into earnings in the same period(s) during which the hedged interest payments affect earnings. When a designated hedging instrument is terminated and the hedged interest payments remain probable of occurring, any remaining unrecognized gain or loss in other comprehensive income is reclassified into earnings in the period(s) during which the forecasted interest payments affect earnings. Amounts reclassified into earnings and interest receivable or payable under designated interest rate swaps are reported in interest expense. The Corporation does not expect any unrealized losses related to cash flow hedges to be reclassified into earnings in the next twelve months.

Loan swaps. The Bank also enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Bank simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and offsetting terms. The net result of these interest rate swaps is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. These back-to-back loan swaps are derivative financial instruments and are reported at fair value in "other assets" and "other liabilities" in the Consolidated Balance Sheets. Changes in the fair value of loan swaps are recorded in other noninterest expense and sum to zero because of the offsetting terms of swaps with borrowers and swaps with dealer counterparties.

Mortgage banking. The mortgage banking segment enters into IRLCs with customers to originate loans for which the interest rates are determined (or "locked") prior to funding. The mortgage banking segment is exposed to interest rate risk through fixed-rate IRLCs and mortgage loans from the time that interest rates are locked until the loans are sold in the secondary market. The mortgage banking segment mitigates this interest rate risk by either: (1) entering into forward sales contracts with investors at the time that interest rates are locked for mortgage loans to be delivered on a best efforts basis or (2) entering into forward sales contracts for TBA securities until it can enter into forward sales contracts with investors for mortgage loans to be delivered on a mandatory basis. IRLCs, forward sales of loans and forward sales of TBA securities are derivative financial instruments and are reported at fair value in other assets and other liabilities in the Consolidated Balance Sheets. Changes in the fair value of mortgage banking derivatives are recorded as a component of gains on sales of loans.

At December 31, 2019, the mortgage banking segment had \$63.35 million of IRLCs and \$65.77 million of unpaid principal on mortgage loans held for sale for which it managed interest rate risk using best-efforts forward sales contracts for \$129.12 million in mortgage loans. Also at December 31, 2019, the mortgage banking segment had \$11.72 million of IRLCs and \$21.98 million of unpaid principal on mortgage loans held for sale for which it managed interest rate risk using forward sales of \$24.0 million of TBA securities and mandatory-delivery forward sales contracts for \$6.73 million in mortgage loans. At December 31, 2018, C&F Mortgage had best-efforts forward sales contracts for all of its IRLCs and mortgage loans held for sale.

The following tables summarize key elements of the Corporation's derivative instruments other than forward sales of mortgage loans. The fair values of forward sales of mortgage loans were not material to the consolidated financial statements of the Corporation at December 31, 2019 or 2018.

<i>(Dollars in thousands)</i>	December 31, 2019		
	Notional Amount	Assets	Liabilities
Cash flow hedges:			
Interest rate swap contracts	\$ 25,000	\$ —	\$ 145
Not designated as hedges:			
Customer-related interest rate swap contracts:			
Matched interest rate swaps with borrower	74,266	2,454	8
Matched interest rate swaps with counterparty	74,266	8	2,454
Mortgage banking contracts:			
IRLCs	75,073	1,083	—
Forward sales of TBA securities	24,000	—	25
<i>(Dollars in thousands)</i>	December 31, 2018		
	Notional Amount	Assets	Liabilities
Cash flow hedges:			
Interest rate swap contracts	\$ 25,000	\$ 289	\$ —
Not designated as hedges:			
Customer-related interest rate swap contracts:			
Matched interest rate swaps with borrower	45,961	216	1,391
Matched interest rate swaps with counterparty	45,961	1,391	216
Mortgage banking contracts:			
IRLCs	44,324	636	—

The Corporation and the Bank are required to maintain cash collateral with dealer counterparties for interest rate swap relationships in a loss position. At December 31, 2019, \$2.49 million of cash collateral was maintained with dealer counterparties and was included in "Other assets" in the Consolidated Balance Sheets. At December 31, 2018, no collateral was required.

NOTE 21: Holding Company Condensed Financial Information

The following tables present the condensed balance sheets as of December 31, 2019 and 2018 and the condensed statements of comprehensive income and cash flows for the years ended December 31, 2019, 2018 and 2017 for the Corporation on a standalone basis:

<i>(Dollars in thousands)</i>	December 31,	
	2019	2018
Condensed Balance Sheets		
Assets		
Cash	\$ 11,464	\$ 316
Other assets	17,687	15,083
Investment in C&F Bank	175,254	174,244
Total assets	<u>\$ 204,405</u>	<u>\$ 189,643</u>
Liabilities and shareholders' equity		
Trust preferred capital notes	\$ 25,281	\$ 25,245
Other liabilities	14,326	12,440
Shareholders' equity	164,798	151,958
Total liabilities and shareholders' equity	<u>\$ 204,405</u>	<u>\$ 189,643</u>

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Condensed Statements of Comprehensive Income			
Interest expense on borrowings	\$ (1,135)	\$ (1,152)	\$ (1,151)
Dividends received from C&F Bank	22,632	6,312	5,008
Equity in undistributed net income of C&F Bank	(1,697)	13,228	3,482
Other income	2,108	45	1,331
Other expenses	(3,049)	(413)	(2,098)
Net income	<u>18,859</u>	<u>18,020</u>	<u>6,572</u>
Other comprehensive income (loss), net of tax	2,423	(2,785)	(569)
Comprehensive income	<u>\$ 21,282</u>	<u>\$ 15,235</u>	<u>\$ 6,003</u>

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Condensed Statements of Cash Flows			
Net cash provided by operating activities	\$ 20,524	\$ 5,801	\$ 4,202
Financing activities:			
Common stock repurchases	(4,385)	(1,105)	—
Cash dividends	(5,131)	(4,931)	(4,637)
Other financing activities, net	140	144	231
Net cash used in financing activities	<u>(9,376)</u>	<u>(5,892)</u>	<u>(4,406)</u>
Net increase (decrease) in cash and cash equivalents	11,148	(91)	(204)
Cash at beginning of year	316	407	611
Cash at end of year	<u>\$ 11,464</u>	<u>\$ 316</u>	<u>\$ 407</u>

NOTE 22: Other Noninterest Expenses

The following table presents the significant components in the Consolidated Statements of Income line “Noninterest Expenses-Other.”

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Data processing fees	\$ 8,127	\$ 7,452	\$ 6,687
Professional fees	3,265	3,044	2,416
Marketing and advertising expenses	1,781	1,601	1,522
Travel and educational expenses	1,329	1,231	1,077
Telecommunication expenses	1,328	1,331	1,300
All other noninterest expenses	8,245	8,762	8,494
Total other noninterest expenses	<u>\$ 24,075</u>	<u>\$ 23,421</u>	<u>\$ 21,496</u>

The table above includes merger related expenses for the year ended December 31, 2019 of approximately \$709,000, of which \$50,000 was included in data processing fees, \$614,000 was included in professional fees, \$1,000 was included in telecommunication expenses and \$44,000 was included in all other noninterest expenses. There were no merger related expenses for the years ended December 31, 2018 or 2017.

NOTE 23: Selected Quarterly Information (Unaudited)

<i>Dollars in thousands (except per share amounts)</i>	2019 Quarter Ended			
	March 31	June 30	September 30	December 31
Total interest income	\$ 22,951	\$ 24,276	\$ 23,992	\$ 23,791
Net interest income after provision for loan losses	17,252	18,815	18,423	17,449
Other income	7,103	8,202	8,230	8,477
Other expenses	19,677	19,549	20,302	20,491
Income before income taxes	4,678	7,468	6,351	5,435
Net income	3,771	5,842	4,885	4,352
Net income attributable to C&F Financial Corporation	3,771	5,843	4,880	4,365
Net income per share—basic and diluted	1.08	1.69	1.42	1.27
Dividends declared per share	0.37	0.37	0.37	0.38

<i>Dollars in thousands (except per share amounts)</i>	2018 Quarter Ended			
	March 31	June 30	September 30	December 31
Total interest income	\$ 22,744	\$ 22,651	\$ 23,691	\$ 23,462
Net interest income after provision for loan losses	16,868	17,987	18,488	17,172
Other income	6,446	7,241	6,627	5,444
Other expenses	18,539	18,761	18,674	17,758
Income before income taxes	4,775	6,467	6,441	4,858
Net income	3,892	5,070	5,101	3,957
Net income per share—basic and diluted	1.11	1.45	1.46	1.13
Dividends declared per share	0.34	0.34	0.36	0.37

NOTE 24: Subsequent Event

On January 1, 2020, the Corporation completed the acquisition of Peoples Bankshares, Incorporated (Peoples) and its banking subsidiary Peoples Community Bank for an aggregate purchase price of \$22.19 million in cash and stock. The financial position and results of operations of Peoples are not reflected in the Corporation’s financial statements as of December 31, 2019. Immediately prior to closing the acquisition, Peoples Community Bank had five retail bank offices in the Northern Neck region of Virginia, including its main office in Montross. In connection with the transaction, the

Corporation paid cash consideration of \$10.60 million and issued 209,871 shares of its common stock to the shareholders of Peoples. Upon completion of the transaction, Peoples was merged with and into the Corporation and Peoples Community Bank was merged with and into C&F Bank.

The acquisition will be accounted for as a business combination under ASC 805, *Business Combinations*. Under acquisition accounting, assets acquired and liabilities assumed are recorded at their acquisition date fair values, and any excess of the purchase price over the aggregate fair value of the net assets acquired is recognized as goodwill. At the time the financial statements were issued, the Corporation had not completed its accounting for the acquisition of Peoples, including its determination of the fair values of the assets acquired and liabilities assumed.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
C&F Financial Corporation
West Point, Virginia

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of C&F Financial Corporation and its subsidiaries (the Corporation) as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2019, 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, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Corporation's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 3, 2020 expressed an unqualified opinion on the effectiveness of the Corporation's internal control over financial reporting.

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 PCAOB and are required to be independent with respect to the Corporation 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. 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.

We have served as the Corporation's auditor since 1997.

Yount, Hyde & Barbour, P.C.

Richmond, Virginia
March 3, 2020

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. The Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) 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 the Corporation's disclosure controls and procedures were effective as of December 31, 2019 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to the Corporation's management, including the Corporation'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 Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiaries to disclose material information required to be set forth in the Corporation's periodic reports.

Management's Report on Internal Control over Financial Reporting. Management of the Corporation is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). 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 Corporation's internal control over financial reporting as of December 31, 2019. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework (2013)*. Based on our assessment, we believe that, as of December 31, 2019, the Corporation's internal control over financial reporting was effective based on those criteria.

The effectiveness of the Corporation's internal control over financial reporting as of December 31, 2019 has been audited by Yount, Hyde & Barbour, P.C., the independent registered public accounting firm who also audited the Corporation's consolidated financial statements included in this Annual Report on Form 10-K. Yount, Hyde & Barbour, P.C.'s attestation report on the Corporation's internal control over financial reporting appears on the following page.

Changes in Internal Controls. There were no changes in the Corporation's internal control over financial reporting during the Corporation's fourth quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
C&F Financial Corporation
West Point, Virginia

Opinion on the Internal Control Over Financial Reporting

We have audited C&F Financial Corporation and its subsidiaries' (the Corporation's) internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2019 of C&F Financial Corporation and its subsidiaries, and our report dated March 3, 2020 expressed an unqualified opinion.

Basis for Opinion

The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Corporation 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 audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Yount, Hyde & Barbour, P.C.

Richmond, Virginia
March 3, 2020

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information with respect to the directors of the Corporation is contained in the 2020 Proxy Statement under the caption, "Election of Directors," and is incorporated herein by reference. The information regarding the Section 16(a) reporting requirements of the directors and executive officers is contained in the 2020 Proxy Statement under the caption, "Delinquent Section 16(a) Reports," and is incorporated herein by reference. The information concerning executive officers of the Corporation is included after Item 4 of this Form 10-K under the caption, "Executive Officers of the Registrant." The information regarding the Corporation's Audit Committee is contained in the 2020 Proxy Statement under the caption "Audit Committee Report" and is incorporated herein by reference.

The Corporation has adopted a Code of Business Conduct and Ethics (Code) that applies to its directors, executives and employees including the principal executive officer, principal financial officer, principal accounting officer and controller, or persons performing similar functions. This Code is posted on our Internet website at <http://www.cffc.com> under "Investor Relations." The Corporation will provide a copy of the Code to any person without charge upon written request to C&F Financial Corporation, c/o Secretary, P.O. Box 391, West Point, Virginia 23181. The Corporation intends to provide any required disclosure of any amendment to or waiver of the Code that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, on <http://www.cffc.com> under "Investor Relations" promptly following the amendment or waiver. The Corporation may elect to disclose any such amendment or waiver in a report on Form 8-K filed with the SEC either in addition to or in lieu of the website disclosure. The information contained on or connected to the Corporation's Internet website is not incorporated by reference in this report and should not be considered part of this or any other report that we file or furnish to the SEC.

The Corporation provides an informal process for security holders to send communications to its Board of Directors. Security holders who wish to contact the Board of Directors or any of its members may do so by addressing their written correspondence to C&F Financial Corporation, Board of Directors, c/o Corporate Secretary, P.O. Box 391, West Point, Virginia 23181. Correspondence directed to an individual board member will be referred, unopened, to that member. Correspondence not directed to a particular board member will be referred, unopened, to the Chairman of the Board.

ITEM 11. EXECUTIVE COMPENSATION

The information contained in the 2020 Proxy Statement under the captions, "Compensation Committee Interlocks and Insider Participation," "Compensation Policies and Practices as They Relate to Risk Management," "Executive Compensation" and "Compensation Committee Report," and the compensation tables that follow the Compensation Committee Report in the 2020 Proxy Statement are incorporated herein by reference. The information regarding director compensation contained in the 2020 Proxy Statement under the caption, "Director Compensation," is incorporated herein by reference.

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

The information contained in the 2020 Proxy Statement under the caption, "Security Ownership of Certain Beneficial Owners and Management," is incorporated herein by reference.

The information contained in the 2020 Proxy Statement under the caption, "Equity Compensation Plan Information," is incorporated herein by reference.

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

The information contained in the 2020 Proxy Statement under the caption, “Interest of Management in Certain Transactions,” is incorporated herein by reference. The information contained in the 2020 Proxy Statement under the caption, “Director Independence,” is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information contained in the 2020 Proxy Statement under the captions, “Principal Accountant Fees” and “Audit Committee Pre-Approval Policy,” is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Exhibits:

- 2.1 Agreement and Plan of Merger dated as of June 10, 2013 by and among C&F Financial Corporation, Special Purpose Sub, Inc. and Central Virginia Bankshares, Inc. (incorporated by reference to Exhibit 2.1 to Form 8-K filed June 14, 2013)
- 2.2 Agreement and Plan of Reorganization dated as of August 13, 2019 by and among C&F Financial Corporation and Peoples Bankshares, Incorporated (incorporated by reference to Appendix A to Pre-Effective Amendment No. 1 to Form S-4 filed October 15, 2019)
- 3.1 Amended and Restated Articles of Incorporation of C&F Financial Corporation, effective March 7, 1994 (incorporated by reference to Exhibit 3.1 to Form 10-Q filed November 8, 2017)
- 3.1.1 Amendment to Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)
- 3.2 Amended and Restated Bylaws of C&F Financial Corporation, as adopted February 23, 2016 (incorporated by reference to Exhibit 3.1 to Form 8-K filed February 29, 2016)
- 4.1 Description of Securities Registered under Section 12(b) of the Securities Exchange Act of 1934

Certain instruments relating to trust preferred securities not being registered have been omitted in accordance with Item 601(b)(4)(iii) of Regulation S-K. The registrant will furnish a copy of any such instrument to the Securities and Exchange Commission upon its request.

- *10.1 Amended and Restated Change in Control Agreement dated December 30, 2008 between C&F Financial Corporation and Larry G. Dillon (incorporated by reference to Exhibit 10.1 to Form 10-K filed March 9, 2009)
- *10.3 Amended and Restated Change in Control Agreement dated December 30, 2008 between C&F Financial Corporation and Thomas F. Cherry (incorporated by reference to Exhibit 10.3 to Form 10-K filed March 9, 2009)
- *10.3.1 Amendment to Amended and Restated Change in Control Agreement dated March 1, 2012 between C&F Financial Corporation and Thomas F. Cherry (incorporated by reference to Exhibit 10.3.1 to Form 10-K filed March 5, 2012)
- *10.4 C&F Financial Corporation Non-Qualified Deferred Compensation Plan for Executives (incorporated by reference to Exhibit 10.4 to Form 10-K filed March 8, 2018)
- *10.4.1 Adoption Agreement for the C&F Financial Corporation Non-Qualified Deferred Compensation Plan for Executives (As Restated Effective January 1, 2018) (incorporated by reference to Exhibit 10.4.1 to Form 10-K filed March 8, 2018)
- *10.4.2 Attachment to the Adoption Agreement for C&F Financial Corporation Non-Qualified Deferred Compensation Plan for Executives (As Restated Effective January 1, 2018) (incorporated by reference to Exhibit 10.4.2 to Form 10-K filed March 8, 2018)
- *10.5 C&F Financial Corporation Non-Qualified Deferred Compensation Plan for Directors (incorporated by reference to Exhibit 10.5 to Form 10-K filed March 8, 2018)
- *10.5.1 Adoption Agreement for the C&F Financial Corporation Non-Qualified Deferred Compensation Plan for Directors (As Restated Effective January 1, 2018) (incorporated by reference to Exhibit 10.5.1 to Form 10-K filed March 8, 2018)
- *10.9 C&F Financial Corporation Management Incentive Plan dated June 13, 2019 (incorporated by reference to Exhibit 10.9 to Form 8-K filed June 14, 2019)

- *10.12 Employment Agreement (Amended and Restated) between C&F Mortgage Corporation and Bryan McKernon, dated January 1, 2013 (incorporated by reference to Exhibit 10.12 to Form 10-K filed March 5, 2013)
- *10.14 Amended and Restated Change in Control Agreement dated December 30, 2008 between C&F Financial Corporation and Bryan McKernon (incorporated by reference to Exhibit 10.14 to Form 10-K filed March 9, 2009)
- *10.14.1 Amendment to Amended and Restated Change in Control Agreement dated March 1, 2012 between C&F Financial Corporation and Bryan McKernon (incorporated by reference to Exhibit 10.14.1 to Form 10-K filed March 5, 2012)
- 10.19 Amended and Restated Loan and Security Agreement by and between Wells Fargo Preferred Capital, Inc., various financial institutions and C&F Finance Company dated as of August 25, 2008 (incorporated by reference to Exhibit 10.19 to Form 8-K filed August 28, 2008)
- 10.19.1 First Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Preferred Capital, Inc., various financial institutions and C&F Finance Company dated as of July 1, 2010 (incorporated by reference to Exhibit 10.19.1 to Form 10-Q filed August 6, 2010)
- 10.19.2 Second Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of September 17, 2012 (incorporated by reference to Exhibit 10.19.2 to Form 10-Q filed November 8, 2012)
- 10.19.3 Third Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of November 12, 2013 (incorporated by reference to Exhibit 10.19.3 to Form 10-K filed March 7, 2014)
- 10.19.4 Fourth Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of September 2, 2015 (incorporated by reference to Exhibit 10.19.4 to Form 10-Q filed November 6, 2015)
- 10.19.5 Fifth Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of November 1, 2016 (incorporated by reference to Exhibit 10.19.5 to Form 10-Q filed November 7, 2016)
- 10.19.6 Sixth Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of June 28, 2017 (incorporated by reference to Exhibit 10.19.6 to Form 10-Q filed August 8, 2017)
- 10.19.7 Seventh Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of December 21, 2017 (incorporated by reference to Exhibit 10.19.7 to Form 10-K filed March 8, 2018)
- 10.19.8 Eighth Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of April 30, 2019 (incorporated by reference to Exhibit 10.19.8 to Form 10-Q filed May 8, 2019)
- *10.29 C&F Financial Corporation 2013 Stock and Incentive Compensation Plan (incorporated by reference to Appendix A to the Corporation's Proxy Statement filed March 15, 2013)
- *10.29.1 Form of C&F Financial Corporation Restricted Stock Agreement for Chief Executive Officer (approved December 15, 2015) (incorporated by reference to Exhibit 10.29.1 to Form 10-K filed March 4, 2016)
- *10.29.2 Form of C&F Financial Corporation Restricted Stock Agreement for Key Employees (approved December 15, 2015) (incorporated by reference to Exhibit 10.29.2 to Form 10-K filed March 4, 2016)
- *10.29.3 Form of C&F Financial Corporation Restricted Stock Agreement for Non-Employee Directors (approved December 15, 2015) (incorporated by reference to Exhibit 10.29.3 to Form 10-K filed March 4, 2016)
- *10.30 Form of C&F Financial Corporation Restricted Stock Agreement under 2013 Stock and Incentive Compensation Plan (approved May 21, 2013) (incorporated by reference to Exhibit 10.30 to Form 8-K filed May 24, 2013)

- *10.33 Change in Control Agreement dated October 9, 2012 between C&F Financial Corporation and John Anthony Seaman (incorporated by reference to Exhibit 10.33 to Form 10-K filed March 7, 2014)
- *10.34 Change in Control Agreement dated August 5, 2015 between C&F Financial Corporation and S. Dustin Crone (incorporated by reference to Exhibit 10.34 to Form 10-Q filed August 7, 2015)
- *10.35 Change in Control Agreement dated May 5, 2016 between C&F Financial Corporation and Jason E. Long (incorporated by reference to Exhibit 10.35 to Form 10-Q filed May 9, 2016)
- *10.36 Incentive Compensation Opportunity for 2019 for Larry G. Dillon (incorporated by reference to Item 5.02 of Form 8-K filed June 14, 2019)
- 21 Subsidiaries of the Registrant
- 23 Consent of Yount, Hyde & Barbour, P.C.
- 31.1 Certification of CEO pursuant to Rule 13a-14(a)
- 31.2 Certification of CFO pursuant to Rule 13a-14(a)
- 32 Certification of CEO/CFO pursuant to 18 U.S.C. Section 1350
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Presentation Linkbase Document

* Indicates management contract

ITEM 16. FORM 10-K SUMMARY

Not applicable.

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.

C&F FINANCIAL CORPORATION
(Registrant)

Date: March 3, 2020 By: /S/ THOMAS F. CHERRY
Thomas F. Cherry
President and Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/S/ THOMAS F. CHERRY Date: March 3, 2020
Thomas F. Cherry, President,
Chief Executive Officer and Director
(Principal Executive Officer)

/S/ JASON E. LONG Date: March 3, 2020
Jason E. Long,
Senior Vice President, Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)

/S/ DR. JULIE R. AGNEW Date: March 3, 2020
Dr. Julie R. Agnew, Director

/S/ J. P. CAUSEY JR. Date: March 3, 2020
J. P. Causey Jr., Director

/S/ LARRY G. DILLON Date: March 3, 2020
Larry G. Dillon, Executive Chairman

/S/ AUDREY D. HOLMES Date: March 3, 2020
Audrey D. Holmes, Director

/S/ JAMES H. HUDSON III Date: March 3, 2020
James H. Hudson III, Director

/S/ ELIZABETH R. KELLEY Date: March 3, 2020
Elizabeth R. Kelley, Director

/S/ JAMES T. NAPIER Date: March 3, 2020
James T. Napier, Director

/S/ C. ELIS OLSSON Date: March 3, 2020
C. Elis Olsson, Director

/S/ D. ANTHONY PEAY Date: March 3, 2020
D. Anthony Peay, Director

/S/ PAUL C. ROBINSON Date: March 3, 2020
Paul C. Robinson, Director

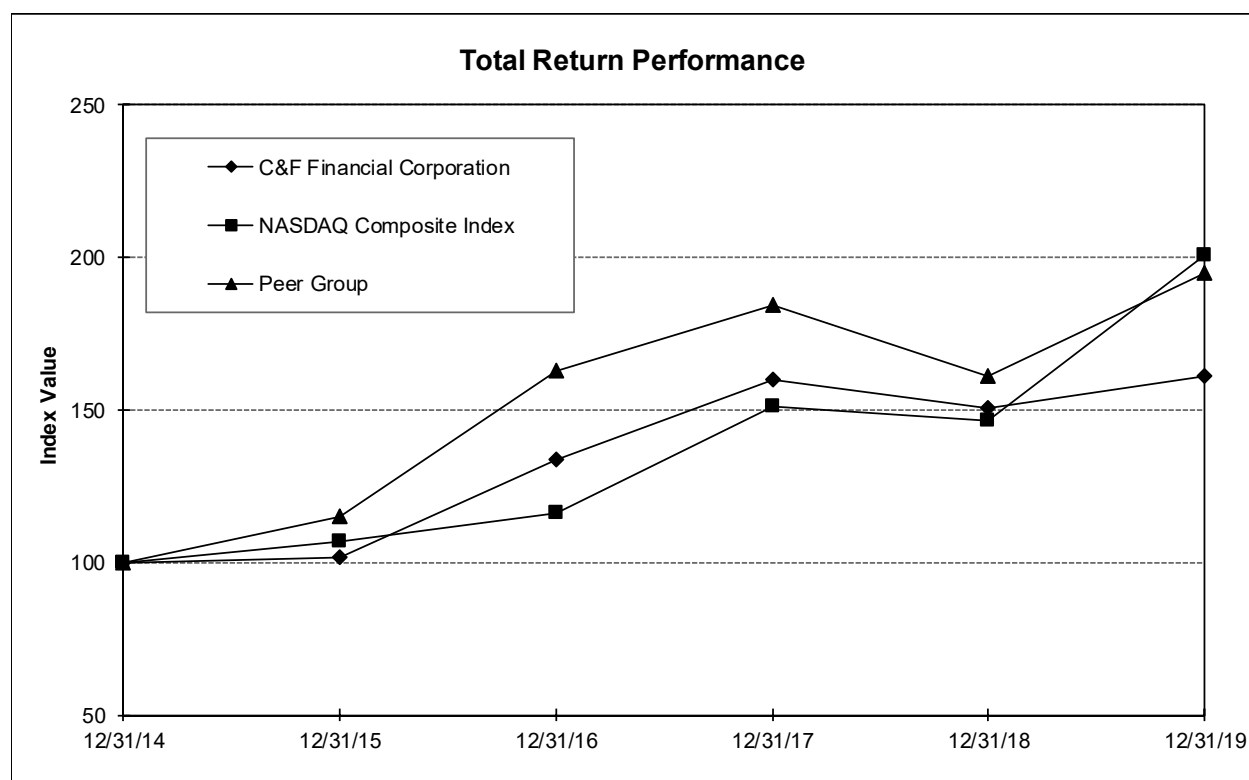
/S/ GEORGE R. SISSON III Date: March 3, 2020
George R. Sisson III, Director

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The following graph compares the yearly cumulative total shareholder return on the common stock of C&F Financial Corporation (the Corporation) with the yearly cumulative total shareholder return on stock included in (1) the NASDAQ Composite Index and (2) a group of peer commercial financial institutions identified by the Corporation (the Peer Group). The Peer Group consists of entities that meet the following criteria: (i) publicly-traded commercial financial institution headquartered in Virginia, Kentucky, Maryland, North Carolina, South Carolina, Tennessee and West Virginia and (ii) total assets as of December 31, 2018 of between \$900 million and \$3.0 billion. For 2019, the Peer Group consisted of 25 publicly-traded commercial financial institutions with a median asset size of \$1.7 billion based on total assets as of December 31, 2018. The following financial institutions were included in the Peer Group: American National Bankshares Inc. (VA), CapStar Financial Holdings, Inc. (TN), Community Bankers Trust Corporation (VA), The Community Financial Corporation (MD), First Community Bancshares, Inc. (VA), First Community Corporation (SC), First United Corporation (MD), FVCBankcorp, Inc. (VA), Howard Bancorp, Inc. (MD), Limestone Bancorp, Inc. (KY), MainStreet Bancshares, Inc. (VA), MVB Financial Corp. (WV), National Bankshares, Inc. (VA), Old Line Bancshares, Inc. (MD), Old Point Financial Corporation (VA), Peoples Bancorp of North Carolina, Inc. (NC), Premier Financial Bancorp, Inc. (WV), Reliant Bancorp, Inc. (TN), Select Bancorp, Inc. (NC), Severn Bancorp, Inc. (MD), Shore Bancshares, Inc. (MD), SmartFinancial, Inc. (TN), Southern First Bancshares, Inc. (SC), Southern National Bancorp of Virginia, Inc. (VA), Summit Financial Group, Inc. (WV).

The graph below assumes \$100 invested on December 31, 2014 in the Corporation, the NASDAQ Composite Index and the Peer Group, and shows the total return on such an investment as of December 31, 2019, assuming reinvestment of dividends. There can be no assurance that the Corporation's stock performance in the future will continue with the same or similar trends depicted in the graph below.

C&F Financial Corporation



<i>Index</i>	<i>Period Ending</i>					
	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19
C&F Financial Corporation	100.00	101.44	133.62	159.62	150.29	160.83
NASDAQ Composite Index	100.00	106.96	116.45	150.96	146.67	200.49
Peer Group	100.00	114.81	162.52	184.27	161.12	194.92

Investor Relations & Financial Statements



C&F Financial Corporation's Annual Report on Form 10-K and quarterly reports on Form 10-Q, as filed with the Securities and Exchange Commission, may be obtained without charge by visiting the Corporation's website at cffc.com.

Copies of these documents can also be obtained without charge upon written request. Requests for this or other financial information about C&F Financial Corporation should be directed to:

Jason E. Long

Chief Financial Officer, C&F Financial Corporation
P.O. Box 391, West Point, Virginia 23181

Stock Listing

NASDAQ[®]

Current market quotations for the common stock of C&F Financial Corporation are available under the symbol CFFI.

Stock Transfer Agent

American Stock Transfer & Trust Company, LLC
serves as transfer agent for the Corporation.

You may write them at:

6201 15th Avenue, Brooklyn, New York 11219
telephone them toll-free at: **800.937.5449**
or visit their website at: astfinancial.com



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