



# **FVCBankcorp, Inc.**

**2016** Annual Report



**March 10, 2017**

**To Our Shareholders:**

2016 was a pivotal year in FVCBankcorp, Inc.'s (the "Company") existence, as we achieved record earnings and higher asset growth than the preceding year. We are excited about new opportunities in the market and our momentum as we begin the 10<sup>th</sup> year of operations. I am delighted to share our financial performance with you.

The Company reported consolidated earnings of \$1.7 million for the fourth quarter of 2016, or \$0.20 diluted earnings per share, an increase of \$711 thousand, or 69.1%, compared with the 2015 fourth quarter net income of \$1.0 million, or \$0.12 diluted earnings per share. Net income was \$6.9 million and \$5.4 million for the years ended December 31, 2016, and 2015, respectively, an increase of \$1.5 million, or 27.9%. Diluted earnings per share was \$0.79 and \$0.64 for the respective periods. The increase in net income reflects the strong loan growth funded by low-cost deposits.

Total assets increased to \$909.3 million, compared with \$737.0 million as of December 31, 2016, and 2015, respectively, an increase of \$172.5 million, or 23.4%. Loans receivable totaled \$768.1 million as of December 31, 2016, compared with \$623.6 million as of December 31, 2015, an increase of \$144.5 million, or 23.2%. The Company deployed proceeds from the subordinated debt offering and excess liquidity to purchase investment securities. The subordinated debt offering enabled us to continue our growth while maintaining adequate capital without diluting our shareholders. We ended the year with our strongest quarterly loan growth to date; loans increased \$80.4 million fueled by a robust loan pipeline and customer transactions required to close before year-end.

Total deposits increased to \$776.0 million as of December 31, 2016, compared with \$626.6 million as of December 31, 2015, an increase of \$149.4 million, or 23.8%. Noninterest-bearing deposits increased to \$165.7 million from \$129.1 million as of December 31, 2016, and 2015, respectively, an increase of \$36.6 million, or 28.3%. Noninterest-bearing deposits comprised 21.3% and 20.6% of total deposits at December 31, 2016, and 2015, respectively. Wholesale deposits totaled \$62.2 million as of December 31, 2016, compared with \$55.4 million as of December 31, 2015, representing only 8.0% and 8.8% of total deposits for the respective periods. The increase in core deposits and, specifically, noninterest-bearing deposits, is primarily attributable to the Company's relationship banking strategy with our growing customer base.

We continue our efforts and our commitment to enhance shareholder value. Tangible book value per share increased to \$9.79 from \$8.95 as of December 31, 2016, and 2015, respectively, representing \$0.84, or 9.4% for the 12-month period.

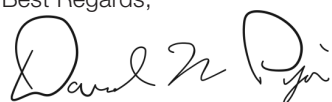
Net interest income increased to \$27.2 million, compared with \$22.9 million for the years ended December 31, 2016, and 2015, respectively, representing an increase of \$4.3 million, or 18.8% for the 12-month period. Net interest income for the year ended December 31, 2016, also includes a full six months of the Company's \$25 million subordinated debt issued on June 20, 2016. The Company's net interest margin was 3.53% and 3.69% for the years ended December 31, 2016, and 2015, respectively.

Noninterest expenses increased \$1.7 million, or 11.9% for the years ended December 31, 2016, and 2015, respectively. The efficiency ratio improved to 58.16%, compared with 61.46%, for the years ended December 31, 2016, and 2015, respectively. We also improved efficiency while opening our sixth branch in Ashburn, Virginia in the fourth quarter of 2016.

Asset quality remains strong as nonperforming assets and loans 90 days or more past due totaled only \$249 thousand, or 0.03% of total assets. The Company recognized charge-offs totaling \$1.3 million related to the disposition of five nonaccrual loans for the year ended December 31, 2016. We continue to diligently monitor our loan portfolio to identify early warning signs and proactively manage the loans.

We are grateful to our dedicated employees who consistently strive to exceed customer expectations. We appreciate the support of our shareholders who continue to refer new customers and maintain their own banking relationship with us. We look forward to a successful 2017 as we continue to enhance earnings while growing our balance sheet with relationship driven loans and deposits.

Best Regards,

A handwritten signature in black ink, appearing to read "David W. Pijor". The signature is fluid and cursive, with the first name "David" being the most prominent.

David W. Pijor  
Chairman, President and Chief Executive Officer





## DIRECTORS

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**David W. Pijor**  
Chairman

**L. Burwell Gunn**  
Vice Chairman

**Scott Laughlin**

**Thomas L. Patterson**

**Devin Satz**

**Lawrence W. Schwartz**

**Sidney G. Simmonds**

**Daniel M. Testa**

**Philip “Trey” R. Wills III**

## EXECUTIVE OFFICERS

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**David W. Pijor**  
President  
Chief Executive Officer

**Patricia A. Ferrick**  
Executive Vice President  
Chief Financial Officer

**William G. Byers**  
Executive Vice President  
Chief Lending Officer

**B. Todd Dempsey**  
Executive Vice President  
Chief Operating Officer

**Michael G. Nassy**  
Executive Vice President  
Chief Credit Officer

## REGIONAL LENDING OFFICERS

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**Alissa Curry Briggs**  
Senior Vice President  
Regional Lending Executive

**James C. Elliott**  
Senior Vice President  
Regional Lending Executive

**Lance D. Nobles**  
Senior Vice President  
Regional Lending Executive

**Christopher O. Turley**  
Senior Vice President  
Regional Lending Executive

## OFFICERS

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**Michelle L. Buckles**  
Senior Vice President  
Compliance

**Terry L. Elliott**  
Senior Vice President  
Lending

**Terry R. Frey**  
Senior Vice President  
Lending

**Alberta A. Gibson**  
Senior Vice President  
Human Resources

**Michael Y. Huang**  
Senior Vice President  
Finance

**Sharon L. Jackson**  
Senior Vice President  
Retail

**Todd E. Lattimer**  
Senior Vice President  
Lending

**Jacqueline S. Marbell-Edson**  
Senior Vice President  
Loan Administration

**Farideh Mullafiroze**  
Senior Vice President  
Business Development

**Joshua F. Steele**  
Senior Vice President  
Lending

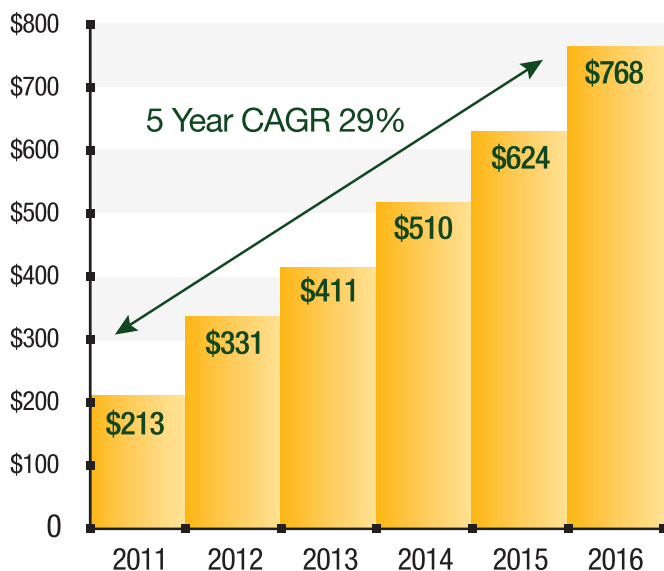
**Brian R. Tower**  
Senior Vice President  
Lending

**Huong K. Van**  
Senior Vice President  
Lending

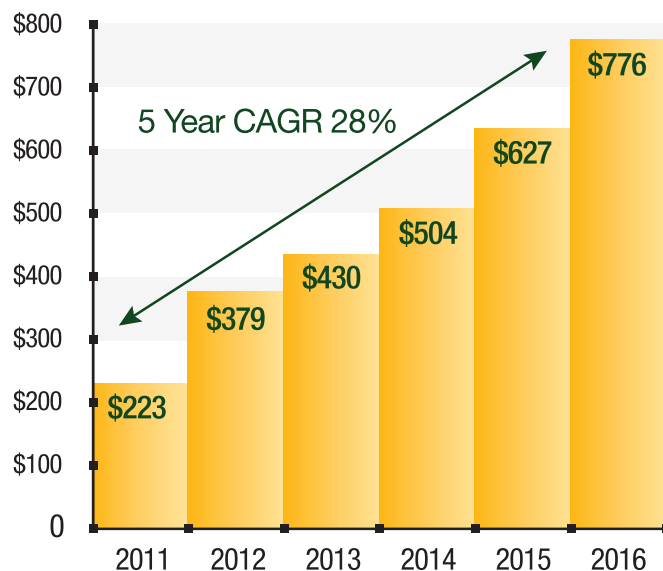
**Steffany R. Watson**  
Senior Vice President  
Cash Management

# Loan and Deposit Growth

## Gross Loans (mm)

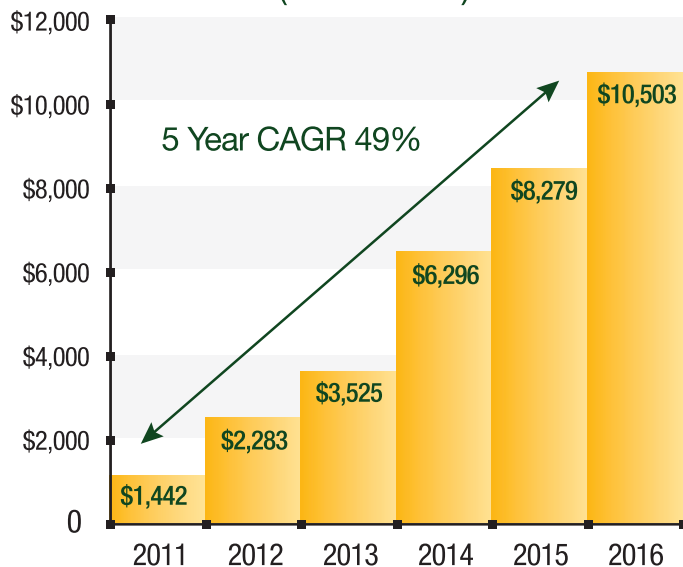


## Total Deposits (mm)

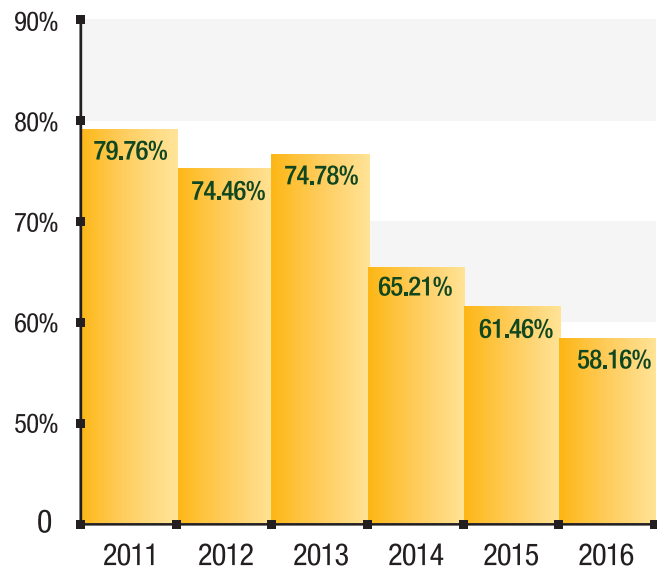


# Increasing Profitability

## Income Before Taxes (thousands)



## Efficiency Ratio



# Selected Financial Data

For the year ended December 31, (Unaudited)

(dollars in thousands, except per share data)

|                                                                      | 2016       | 2015       | 2014       | 2013       | 2012       | 2011       |
|----------------------------------------------------------------------|------------|------------|------------|------------|------------|------------|
| <b>Selected Balances</b>                                             |            |            |            |            |            |            |
| Total assets                                                         | \$ 909,305 | \$ 736,807 | \$ 604,756 | \$ 506,717 | \$ 422,761 | \$ 261,037 |
| Total investment securities                                          | 113,988    | 67,795     | 62,697     | 56,890     | 29,128     | 25,830     |
| Total loans                                                          | 768,102    | 623,559    | 509,938    | 411,040    | 331,428    | 213,361    |
| Allowance for loan losses                                            | (6,452)    | (6,239)    | (5,565)    | (4,792)    | (3,757)    | (2,754)    |
| Total deposits                                                       | 775,991    | 626,640    | 504,220    | 429,990    | 378,702    | 223,369    |
| Subordinated notes, net of issuance costs                            | 24,247     | - -        | - -        | - -        | - -        | - -        |
| Other borrowings                                                     | 27,000     | 35,650     | 32,500     | 14,500     | 2,500      | 2,500      |
| Total shareholders' equity                                           | 79,811     | 72,752     | 66,815     | 60,903     | 39,143     | 33,785     |
| <b>Summary Results of Operations</b>                                 |            |            |            |            |            |            |
| Interest income                                                      | \$ 32,587  | \$ 26,557  | \$ 22,473  | \$ 18,491  | \$ 15,095  | \$ 12,169  |
| Interest expense                                                     | 5,387      | 3,665      | 3,288      | 2,960      | 2,515      | 2,293      |
| Net interest income                                                  | 27,200     | 22,892     | 19,185     | 15,531     | 12,580     | 9,875      |
| Provision for loan losses                                            | 1,471      | 1,073      | 886        | 803        | 1,227      | 649        |
| Net interest income after provision for loan losses                  | 25,729     | 21,819     | 18,299     | 14,728     | 11,353     | 9,226      |
| Noninterest income - gains on sales of securities available-for-sale | 71         | 68         | 77         | 204        | 23         | 5          |
| Noninterest income - gains on sales of loans                         | - -        | - -        | 196        | - -        | - -        | - -        |
| Noninterest income - services charges and other income               | 1,149      | 1,093      | 1,040      | 821        | 1,075      | 464        |
| Noninterest expense                                                  | 16,446     | 14,701     | 13,316     | 12,228     | 10,168     | 8,253      |
| Income before taxes                                                  | 10,503     | 8,279      | 6,296      | 3,525      | 2,283      | 1,442      |
| Income tax expense (benefit)                                         | 3,571      | 2,860      | 2,162      | 1,297      | 805        | (558)      |
| Net income                                                           | 6,932      | 5,419      | 4,133      | 2,228      | 1,478      | 2,000      |
| <b>Per Share Data*</b>                                               |            |            |            |            |            |            |
| Net income, basic                                                    | \$ 0.85    | \$ 0.67    | \$ 0.51    | \$ 0.31    | \$ 0.28    | \$ 0.45    |
| Net income, diluted                                                  | \$ 0.79    | \$ 0.64    | \$ 0.51    | \$ 0.31    | \$ 0.28    | \$ 0.45    |
| Book value                                                           | \$ 9.80    | \$ 8.97    | \$ 8.24    | \$ 7.53    | \$ 7.06    | \$ 6.61    |
| Tangible Book value                                                  | \$ 9.79    | \$ 8.95    | \$ 8.22    | \$ 7.51    | \$ 7.02    | \$ 6.61    |
| Shares outstanding                                                   | 8,143,127  | 8,113,025  | 8,110,153  | 8,088,644  | 5,544,994  | 5,113,095  |
| <b>Significant Ratios</b>                                            |            |            |            |            |            |            |
| Net interest margin                                                  | 3.53%      | 3.69%      | 3.63%      | 3.59%      | 4.09%      | 4.15%      |
| Efficiency ratio                                                     | 58.16%     | 61.46%     | 65.21%     | 74.78%     | 74.46%     | 79.76%     |
| Return on average assets                                             | 0.88%      | 0.85%      | 0.76%      | 0.50%      | 0.47%      | 0.81%      |
| Return on average equity                                             | 8.91%      | 7.70%      | 6.45%      | 4.21%      | 4.11%      | 7.51%      |
| Total risk based capital (to risk weighted assets)                   | 13.16%     | 12.20%     | 13.62%     | 15.89%     | 12.29%     | 14.27%     |
| Tier 1 capital (to risk weighted assets)                             | 12.37%     | 11.25%     | 12.53%     | 14.71%     | 11.13%     | 13.14%     |
| Common equity tier 1 (CET1) capital (to risk weighted assets)        | 12.37%     | 11.25%     | N/A        | N/A        | N/A        | N/A        |
| Tier 1 capital (to average assets)                                   | 11.89%     | 10.82%     | 10.96%     | 12.58%     | 9.16%      | 12.44%     |
| <b>Asset Quality</b>                                                 |            |            |            |            |            |            |
| Nonperforming assets and loans 90+ past due                          | \$ 249     | \$ 2,559   | \$ 1,601   | \$ 2,988   | \$ 4,623   | \$ 5,902   |
| Nonperforming assets and loans 90+ past due to total assets          | 0.03%      | 0.35%      | 0.26%      | 0.59%      | 1.09%      | 2.26%      |
| Allowance for loan losses to loans                                   | 0.84%      | 1.00%      | 1.09%      | 1.17%      | 1.13%      | 1.29%      |
| Allowance for loan losses to nonperforming assets                    | 2,591.16%  | 243.81%    | 347.51%    | 160.37%    | 81.27%     | 46.67%     |
| Net charge-offs (recovery)                                           | \$ 1,257   | \$ 399     | \$ 113     | \$ (231)   | \$ 225     | \$ - -     |
| Net charge-offs (recovery) to average loans                          | 0.19%      | 0.07%      | 0.03%      | (0.06%)    | 0.07%      | 0.00%      |

\* Adjusted for 5-for-4 stock splits in 2016 and 2015





# Consolidated Financial Report

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## FVCBankcorp, Inc. and Subsidiary

Fairfax, Virginia  
December 31, 2016

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# Independent Auditor's Report

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**To the Board of Directors and Shareholders  
FVCBankcorp, Inc.  
Fairfax, Virginia**



## **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of FVCBankcorp, Inc. and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

## **Management's Responsibility for the Financial Statements**

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

## **Auditor's Responsibility**

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

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

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FVCBankcorp, Inc. and its subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Yount, Hyde & Barbour, P.C.*

Winchester, Virginia  
March 10, 2017

# Consolidated Financial Statements

## Consolidated Balance Sheets

December 31, 2016 and 2015

| Assets                                                                                                                               | 2016                  | 2015                  |
|--------------------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| Cash and due from banks                                                                                                              | \$ 5,174,470          | \$ 5,257,136          |
| Interest-bearing deposits at other financial institutions                                                                            | 3,509,686             | 23,442,934            |
| Securities held-to-maturity (fair market value of \$1,754,084 in 2016 and \$2,244,390 in 2015)                                       | 1,759,763             | 2,246,992             |
| Securities available-for-sale, at fair market value                                                                                  | 112,228,111           | 65,547,520            |
| Restricted stock, at cost                                                                                                            | 4,431,900             | 4,048,000             |
| Loans, net of allowance for loan losses of \$6,452,481 for 2016 and \$6,238,606 for 2015                                             | 761,649,079           | 617,320,037           |
| Premises and equipment, net                                                                                                          | 1,270,742             | 1,511,900             |
| Accrued interest receivable                                                                                                          | 2,496,427             | 1,908,487             |
| Prepaid expenses                                                                                                                     | 603,182               | 648,459               |
| Deferred tax assets, net                                                                                                             | 4,368,117             | 3,684,617             |
| Core deposit intangible                                                                                                              | 119,000               | 139,400               |
| Bank owned life insurance (BOLI)                                                                                                     | 10,828,189            | 10,524,789            |
| Other assets                                                                                                                         | 866,456               | 527,148               |
| Total assets                                                                                                                         | <u>\$ 909,305,122</u> | <u>\$ 736,807,419</u> |
| <b>Liabilities and Shareholders' Equity</b>                                                                                          |                       |                       |
| <b>Liabilities</b>                                                                                                                   |                       |                       |
| Deposits:                                                                                                                            |                       |                       |
| Noninterest-bearing                                                                                                                  | \$ 165,661,647        | \$ 129,078,409        |
| Interest-bearing checking, savings and money market                                                                                  | 369,281,290           | 285,622,930           |
| Time deposits                                                                                                                        | 241,048,042           | 211,938,452           |
| Total deposits                                                                                                                       | <u>\$ 775,990,979</u> | <u>\$ 626,639,791</u> |
| FHLB advances                                                                                                                        | \$ 27,000,000         | \$ 35,650,000         |
| Subordinated notes, net of issuance costs                                                                                            | 24,247,346            | - -                   |
| Accrued interest payable                                                                                                             | 170,367               | 132,743               |
| Accrued expenses and other liabilities                                                                                               | 2,084,992             | 1,633,195             |
| Total liabilities                                                                                                                    | <u>\$ 829,493,684</u> | <u>\$ 664,055,729</u> |
| <b>Commitments and Contingent Liabilities</b>                                                                                        |                       |                       |
| <b>Shareholders' Equity</b>                                                                                                          |                       |                       |
| Preferred stock                                                                                                                      |                       |                       |
| \$0.01 par value, authorized 1,000,000 shares; no shares issued and outstanding in 2016 and 2015                                     | \$ - -                | \$ - -                |
| Common stock                                                                                                                         |                       |                       |
| \$0.01 par value, authorized 20,000,000 shares; 8,143,127 and 6,490,420 shares issued and outstanding in 2016 and 2015, respectively | 81,431                | 64,904                |
| Additional paid-in capital                                                                                                           | 63,139,580            | 62,343,894            |
| Retained earnings                                                                                                                    | 17,889,459            | 10,956,822            |
| Accumulated other comprehensive (loss), net                                                                                          | (1,299,032)           | (613,930)             |
| Total shareholders' equity                                                                                                           | <u>\$ 79,811,438</u>  | <u>\$ 72,751,690</u>  |
| Total liabilities and shareholders' equity                                                                                           | <u>\$ 909,305,122</u> | <u>\$ 736,807,419</u> |

See Notes to Consolidated Financial Statements.

# Consolidated Statements of Income

For the Years Ended December 31, 2016 and 2015

|                                                         | 2016                 | 2015                 |
|---------------------------------------------------------|----------------------|----------------------|
| <b>Interest and Dividend Income</b>                     |                      |                      |
| Interest and fees on loans                              | \$ 30,595,706        | \$ 25,340,584        |
| Interest and dividends on securities held-to-maturity   | 28,435               | 40,058               |
| Interest and dividends on securities available-for-sale | 1,691,363            | 998,877              |
| Dividends on restricted stock                           | 170,320              | 145,453              |
| Interest on deposits at other financial institutions    | 101,396              | 32,081               |
| Interest on federal funds sold                          | 4                    | -                    |
| Total interest and dividend income                      | <u>\$ 32,587,224</u> | <u>\$ 26,557,053</u> |
| <b>Interest Expense</b>                                 |                      |                      |
| Interest on deposits                                    | \$ 4,473,459         | \$ 3,618,983         |
| Interest on federal funds purchased                     | 475                  | 428                  |
| Interest on short-term debt                             | 39,415               | 11,869               |
| Interest on long-term debt                              | 32,251               | 33,250               |
| Interest on subordinated notes                          | 841,165              | -                    |
| Total interest expense                                  | <u>\$ 5,386,765</u>  | <u>\$ 3,664,530</u>  |
| <b>Net Interest Income</b>                              | \$ 27,200,459        | 22,892,523           |
| Provision for loan losses                               | <u>1,471,000</u>     | <u>1,072,820</u>     |
| Net interest income after provision for loan losses     | <u>\$ 25,729,459</u> | <u>\$ 21,819,703</u> |
| <b>Noninterest Income</b>                               |                      |                      |
| Service charges on deposit accounts                     | \$ 564,005           | \$ 565,963           |
| Gains on sale of securities available-for-sale          | 71,124               | 67,482               |
| BOLI income                                             | 303,400              | 325,437              |
| Other fee income                                        | 281,595              | 202,021              |
| Total noninterest income                                | <u>\$ 1,220,124</u>  | <u>\$ 1,160,903</u>  |
| <b>Noninterest Expenses</b>                             |                      |                      |
| Salaries and employee benefits                          | \$ 9,803,624         | \$ 8,807,837         |
| Occupancy and equipment expense                         | 2,097,731            | 1,950,856            |
| Data processing and network administration              | 911,497              | 838,663              |
| State franchise taxes                                   | 747,970              | 680,297              |
| Audit, legal and consulting fees                        | 376,116              | 331,540              |
| Loan related expenses                                   | 363,362              | 138,747              |
| FDIC insurance                                          | 355,856              | 367,168              |
| Marketing, business development and advertising         | 349,686              | 256,475              |
| Director fees                                           | 336,600              | 279,128              |
| Postage, courier and telephone                          | 206,006              | 195,111              |
| Internet banking                                        | 186,058              | 150,471              |
| Dues, memberships & publications                        | 114,292              | 109,225              |
| Bank insurance                                          | 108,736              | 84,826               |
| Printing and supplies                                   | 107,632              | 102,282              |
| Bank charges                                            | 67,127               | 65,025               |
| State assessments                                       | 56,122               | 100,409              |
| Core deposit intangible amortization                    | 20,400               | 20,400               |
| Other operating expenses                                | 237,008              | 223,278              |
| Total noninterest expenses                              | <u>\$ 16,445,823</u> | <u>\$ 14,701,738</u> |
| Net income before income tax expense                    | \$ 10,503,760        | \$ 8,278,868         |
| Income tax expense                                      | <u>3,571,123</u>     | <u>2,859,797</u>     |
| Net income                                              | <u>\$ 6,932,637</u>  | <u>\$ 5,419,071</u>  |
| Earnings per share, basic                               | <u>\$ 0.85</u>       | <u>\$ 0.67</u>       |
| Earnings per share, diluted                             | <u>\$ 0.79</u>       | <u>\$ 0.64</u>       |

See Notes to Consolidated Financial Statements.



# Consolidated Statements of Comprehensive Income

For the Years Ended December 31, 2016 and 2015

|                                                                                                          | 2016                       | 2015                       |
|----------------------------------------------------------------------------------------------------------|----------------------------|----------------------------|
| <b>Net income</b>                                                                                        | \$ 6,932,637               | \$ 5,419,071               |
| Other comprehensive (loss):                                                                              |                            |                            |
| Unrealized (loss) on securities available for sale, net of tax \$(345,959) and \$(85,388), respectively  | (638,160)                  | (165,753)                  |
| Reclassification adjustment for gains realized in income, net of tax \$24,182 and \$22,944, respectively | (46,942)                   | (44,538)                   |
| Total other comprehensive (loss)                                                                         | <u>\$ (685,102)</u>        | <u>\$ (210,291)</u>        |
| <b>Total comprehensive income</b>                                                                        | <u><u>\$ 6,247,535</u></u> | <u><u>\$ 5,208,780</u></u> |

See Notes to Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

For the Years Ended December 31, 2016 and 2015

|                                                                                                    | 2016                    | 2015                    |
|----------------------------------------------------------------------------------------------------|-------------------------|-------------------------|
| <b>Cash Flows From Operating Activities</b>                                                        |                         |                         |
| Reconciliation of net income to net cash provided by operating activities:                         |                         |                         |
| Net income                                                                                         | \$ 6,932,637            | \$ 5,419,071            |
| Depreciation                                                                                       | 523,392                 | 563,579                 |
| Provision for loan losses                                                                          | 1,471,000               | 1,072,820               |
| Net amortization of premium of securities                                                          | 386,164                 | 199,397                 |
| Net amortization of deferred loan costs and purchase premiums                                      | 423,970                 | 170,136                 |
| Stock-based compensation expense                                                                   | 697,809                 | 705,000                 |
| BOLI income                                                                                        | (303,400)               | (325,437)               |
| Realized gains on securities sales                                                                 | (71,124)                | (67,482)                |
| Deferred income tax (benefit)                                                                      | (313,357)               | (365,885)               |
| Core deposits intangible amortization                                                              | 20,400                  | 20,400                  |
| Changes in assets and liabilities:                                                                 |                         |                         |
| (Increase) in accrued interest receivable, prepaid expenses and other assets                       | (881,971)               | (595,922)               |
| Increase in accrued interest payable, accrued expenses and other liabilities                       | 489,421                 | 545,397                 |
| Net cash provided by operating activities                                                          | <u>\$ 9,374,941</u>     | <u>\$ 7,341,074</u>     |
| <b>Cash Flows From Investing Activities</b>                                                        |                         |                         |
| Maturities of certificates of deposits purchased for investment                                    | \$ 245,000              | \$ 1,000,000            |
| Decrease (increase) in interest-bearing deposits at other financial institutions                   | 19,933,248              | (12,527,725)            |
| Purchases of securities held-to-maturity                                                           | (1,496,475)             | (2,246,047)             |
| Purchases of securities available-for-sale                                                         | (67,229,584)            | (31,874,397)            |
| Proceeds from sales of securities available-for-sale                                               | 3,955,150               | 19,513,845              |
| Proceeds from maturities and calls of securities held-to-maturity                                  | 2,000,000               | -                       |
| Proceeds from maturities and calls of securities available-for-sale                                | 2,500,000               | 913,043                 |
| Proceeds from prepayments of securities available-for-sale                                         | 12,462,261              | 7,145,904               |
| Net (purchase) of restricted stock                                                                 | (383,900)               | (160,750)               |
| Net (increase) in loans                                                                            | (146,224,012)           | (114,201,576)           |
| Proceeds from recovery of charged off loans                                                        | -                       | 11,534                  |
| (Purchases) of premises and equipment                                                              | (282,234)               | (330,872)               |
| Net cash (used in) investing activities                                                            | <u>\$ (174,520,546)</u> | <u>\$ (132,757,041)</u> |
| <b>Cash Flows From Financing Activities</b>                                                        |                         |                         |
| Net increase in noninterest-bearing, interest-bearing checking, savings, and money market deposits | \$ 120,241,598          | \$ 109,220,424          |
| Net increase in time deposits                                                                      | 29,109,590              | 13,198,999              |
| (Decrease) increase in FHLB advances                                                               | (8,650,000)             | 3,150,000               |
| Issuance of subordinated notes, net                                                                | 24,247,346              | -                       |
| Cash paid in lieu of fractional shares                                                             | (5,250)                 | (3,348)                 |
| Common stock issuance                                                                              | 119,654                 | 26,325                  |
| Net cash provided by financing activities                                                          | <u>\$ 165,062,938</u>   | <u>\$ 125,592,400</u>   |
| Net (decrease) increase in cash and cash equivalents                                               | \$ (82,667)             | \$ 176,433              |
| Cash and cash equivalents, beginning of year                                                       | 5,257,136               | 5,080,703               |
| Cash and cash equivalents, end of year                                                             | <u>\$ 5,174,469</u>     | <u>\$ 5,257,136</u>     |
| <b>Supplemental Disclosures of Cash Flow Information</b>                                           |                         |                         |
| Cash payments for interest                                                                         | <u>\$ 5,349,141</u>     | <u>\$ 3,644,211</u>     |
| Cash payments for income taxes                                                                     | <u>\$ 3,040,000</u>     | <u>\$ 2,625,000</u>     |
| <b>Supplemental Disclosures of Noncash Investing Activity</b>                                      |                         |                         |
| Unrealized (losses) on securities available-for-sale                                               | <u>\$ (1,055,243)</u>   | <u>\$ (318,623)</u>     |

See Notes to Consolidated Financial Statements.

# Consolidated Statements of Changes in Shareholders' Equity

For the Years Ended December 31, 2016 and 2015

|                                                                  | Shares    | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss) | Total         |
|------------------------------------------------------------------|-----------|-----------------|----------------------------------|----------------------|-------------------------------------------------|---------------|
| <b>Balance at December 31, 2014</b>                              | 5,190,498 | \$ 25,952,490   | \$ 35,728,331                    | \$ 5,537,751         | \$ (403,639)                                    | \$ 66,814,933 |
| Net income                                                       | --        | --              | --                               | 5,419,071            | --                                              | 5,419,071     |
| Other comprehensive loss                                         | --        | --              | --                               | --                   | (210,291)                                       | (210,291)     |
| 5-for-4 stock split                                              | 1,297,485 | 6,487,425       | (6,490,773)                      | --                   | --                                              | (3,348)       |
| Common stock issuance for options exercised                      | 2,437     | 12,185          | 14,140                           | --                   | --                                              | 26,325        |
| Par value change from \$5.00 to \$0.01                           | --        | (32,387,196)    | 32,387,196                       | --                   | --                                              | --            |
| Stock-based compensation expense, net of tax benefit of \$90,526 | --        | --              | 705,000                          | --                   | --                                              | 705,000       |
| <b>Balance at December 31, 2015</b>                              | 6,490,420 | \$ 64,904       | \$ 62,343,894                    | \$ 10,956,822        | \$ (613,930)                                    | \$ 72,751,690 |
| Net income                                                       | --        | --              | --                               | 6,932,637            | --                                              | 6,932,637     |
| Other comprehensive loss                                         | --        | --              | --                               | --                   | (685,102)                                       | (685,102)     |
| 5-for-4 stock split                                              | 1,627,379 | 16,274          | (21,524)                         | --                   | --                                              | (5,250)       |
| Common stock issuance for options exercised                      | 25,328    | 253             | 119,401                          | --                   | --                                              | 119,654       |
| Stock-based compensation expense, net of tax benefit of \$91,953 | --        | --              | 697,809                          | --                   | --                                              | 697,809       |
| <b>Balance at December 31, 2016</b>                              | 8,143,127 | \$ 81,431       | \$ 63,139,580                    | \$ 17,889,459        | \$ (1,299,032)                                  | \$ 79,811,438 |

See Notes to Consolidated Financial Statements.

# Notes to Consolidated Financial Statements

## Note 1. Organization and Summary of Significant Accounting Policies

### Organization

FVCBankcorp, Inc. (the “Company”), a Virginia corporation, was formed in 2015 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company is headquartered in Fairfax, Virginia. The Company conducts its business activities through the branch offices of its wholly owned subsidiary bank, First Virginia Community Bank (the “Bank”). The Company exists primarily for the purposes of holding the stock of its subsidiary, the Bank.

The Bank was organized under the laws of the Commonwealth of Virginia to engage in a general banking business serving the community in and around Fairfax, Virginia. The Bank commenced regular operations on November 27, 2007 and is a member of the Federal Reserve System and the Federal Deposit Insurance Corporation. It is subject to the regulations of the Federal Reserve System and the State Corporation Commission of Virginia. Consequently, it undergoes periodic examinations by these regulatory authorities.

### Principles of Consolidation

The consolidated financial statements include the accounts of FVCBankcorp, Inc. and its wholly owned subsidiary. All material intercompany balances and transactions have been eliminated in consolidation.

### Significant Accounting Policies

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The more significant of these policies are summarized below.

### Stock Split and Par Value

On May 26, 2016, the Company declared a five-for-four common stock split. The earnings per share for the years ended December 31, 2016 and 2015 have been retroactively adjusted for this split as if it occurred on January 1, 2015.

On March 23, 2015, the Company declared a five-for-four common stock split. The earnings per share for the year ended December 31, 2015 have been retroactively adjusted for this split as if it occurred on January 1, 2015. On October 30, 2015, the Company reduced the par value of its common stock from \$5.00 per share to \$0.01 per share.

### Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold. Generally, federal funds are purchased and sold for one day periods.

## Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Restricted stock, such as Federal Reserve Bank stock, Federal Home Loan Bank (FHLB) stock and Community Bankers’ Bank stock, is carried at cost, based on the redemption provisions of these correspondent banks.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) whether the Company intends to sell the security, whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized costs basis and whether the Company expects to recover the security’s entire cost basis. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

## Loans

The Company grants commercial real estate, commercial non-real estate and consumer loans to its customers. A substantial portion of the loan portfolio includes commercial loans throughout the greater Washington, D.C. metropolitan area, initially focusing on the counties of Arlington, Fairfax, Loudoun and Prince William, Virginia. The ability of the Company’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

The recorded investment in loans that management has the intent and ability to hold represents the customers unpaid principal balances, net of partial charge-offs. Interest income is accrued on the unpaid principal balance. Loan origination and commitment fees and certain direct costs are deferred and the net amount is amortized as an adjustment of the related loans’ yield. The Company is amortizing these amounts over the loans’ contractual lives.

Past due status is monitored based on customers’ contractual payment status for all loans. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan becomes 90 days delinquent unless the credit is well-secured and in process of collection. Nonperforming loans are placed either on nonaccrual status pending further collection efforts or charged off if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on loans in nonaccrual status is accounted for on the cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

## Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower’s financial condition, the Company may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Company strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, the Company measures any impairment on the restructuring as noted above for impaired loans.

## Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Charge-offs of loans are made by portfolio segment at the time that the collection of the full principal, in management's judgment, is doubtful. This methodology for determining charge-offs is consistently applied to each segment.

The allowance consists of specific, general and unallocated reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Company selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

Larger balance, non-homogeneous loans are individually evaluated for possible impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Smaller balance, homogeneous loans are collectively evaluated for impairment.

The Company recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans for which the terms have been modified resulting in a concession and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment based on expected future cash flows discounted using the loan's effective rate immediately prior to the restructuring.

General reserves cover non-impaired loans and are based on peer group historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions; changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of losses inherent in the loan portfolio. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used for estimating the specific and general losses in the loan portfolio.

Portfolio segments identified by the Company include commercial real estate, commercial and industrial, commercial construction, consumer residential, consumer nonresidential and consumer construction. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to-income, collateral type and loan-to-value ratios for consumer loans. The Company uses the same segments and classes for analyzing adequacy of general allowances.

## Premises and Equipment

Leasehold improvements, computer software, furniture, fixtures and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the assets' estimated useful lives or life of lease. Estimated useful lives are 10 years for leasehold improvements and 3 to 7 years for computer software, furniture, fixtures and equipment.

## Intangible Assets

The Company's intangible assets were acquired in the acquisition of 1st Commonwealth Bank of Virginia in 2012. ASC 350, Intangibles-Goodwill and Other (ASC 350), prescribes accounting for intangible assets subsequent to initial recognition. Acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful lives. Intangible assets related to acquisition are amortized. The core deposit intangible asset, based on an independent valuation, is being amortized over its estimated life of 10 years.

## Foreclosed Properties

Assets acquired through, or in lieu of, loan foreclosure are held for sale. At the time of acquisition, these properties are recorded at fair value less estimated selling costs, with any write down charged to the allowance for loan losses. Subsequent to foreclosure, valuations of the assets are periodically performed by management. Adjustments are made for subsequent decline in the fair market value of the assets less selling costs. Revenue and expenses from operations and valuation changes are included in net expenses from foreclosed assets. The Company had no foreclosed assets during the years ended December 31, 2016 and 2015.

The Company had no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process as of December 31, 2016 and 2015.

## Bank Owned Life Insurance

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

## Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed surrendered when (1) the assets have been isolated from the Company – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

## Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenue 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, the valuation of deferred tax assets, and the fair value of financial instruments.



## **Income Taxes**

Deferred taxes are provided on a liability method whereby deferred tax assets and liabilities are recognized for deductible temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

## **Advertising Costs**

The Company follows the policy of charging all of advertising to expense as incurred.

## **Comprehensive Income (Loss)**

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income (loss) includes unrealized gains (losses) on securities available-for-sale, which are also recognized as separate components of equity. Items reclassified out of accumulated other comprehensive income (loss) to net income relate solely to realized gains (losses) on sales of securities available-for-sale and appear under the caption "Gains on sale of securities available-for-sales" in the Company's statements of income.

## **Fair Value of Financial Instruments**

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

## **Stock Compensation Plans**

Authoritative accounting guidance requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost is measured based on the fair value of the equity or liability instruments issued. The guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The guidance requires entities to measure the cost of employee services recognized in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. The Company uses the Black-Scholes option-pricing model to meet the fair value objective as outlined in the accounting literature.

## Retirement Plan

Employee 401(k) expense is the amount of matching contributions paid by the Company. 401(k) expense was \$180,214 and \$172,095 for the years ended December 31, 2016 and 2015, respectively.

## Earnings Per Share

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

## Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's method of presentation. None of these reclassifications were significant.

## Recent Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently assessing the impact that ASU 2016-01 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements.

During March 2016, the FASB issued ASU No. 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Shares-Based Payment Accounting.” The amendments in this ASU simplify several aspects of the accounting for share-based payment award transactions including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is currently assessing the impact that ASU 2016-09 will have on its consolidated financial statements.

During June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements.

During August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments”, to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business”. The amendments in this ASU clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business—inputs, processes, and outputs. While an integrated set of assets and activities (collectively referred to as a “set”) that is a business usually has outputs, outputs are not required to be present. In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs. The amendments in this ASU provide a screen to determine when a set is not a business. If the screen is not met, the amendments (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The ASU provides a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this ASU should be applied prospectively on or after the effective date. No disclosures are required at transition. The Company does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment”. The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are U.S. Securities and Exchange Commission (SEC) filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Public business entities that are not SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

## **Note 2.      Restrictions on Cash and Amounts Due From Banks**

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To comply with Federal Reserve regulations, the Company is required to maintain average balances with the Federal Reserve Bank. At December 31, 2016 and 2015, these reserve balance requirements amounted to \$646,000 and \$0, respectively.

### Note 3. Securities

Amortized cost and fair values of securities held-to-maturity and securities available-for-sale as of December 31, 2016 and 2015, are as follows:

| 2016                                                    |                       |                        |                           |                       |
|---------------------------------------------------------|-----------------------|------------------------|---------------------------|-----------------------|
|                                                         | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value            |
| <b>Held-to-maturity</b>                                 |                       |                        |                           |                       |
| Securities of state and local municipalities tax exempt | \$ 263,285            | \$ - -                 | \$ (4,197)                | \$ 259,088            |
| Securities of U.S. government and federal agencies      | 1,496,478             | - -                    | (1,482)                   | 1,494,996             |
| Total Held-to-maturity Securities                       | <u>\$ 1,759,763</u>   | <u>\$ - -</u>          | <u>(5,679)</u>            | <u>\$ 1,754,084</u>   |
| <b>Available-for-sale</b>                               |                       |                        |                           |                       |
| Securities of U.S. government and federal agencies      | \$ 1,000,000          | \$ - -                 | \$ (38,970)               | \$ 961,030            |
| Securities of state and local municipalities tax exempt | 3,709,473             | - -                    | (91,738)                  | 3,617,735             |
| Securities of state and local municipalities taxable    | 2,832,466             | 1,190                  | (63,057)                  | 2,770,599             |
| Corporate bonds                                         | 7,000,000             | 81,223                 | (57,330)                  | 7,023,893             |
| Corporate securities                                    | 466,650               | 44,550                 | - -                       | 511,200               |
| Certificates of deposit                                 | 740,000               | 4,301                  | - -                       | 744,301               |
| SBA pass-through securities                             | 317,427               | - -                    | (11,637)                  | 305,790               |
| Mortgage-backed securities                              | 80,787,404            | - -                    | (1,362,361)               | 79,425,043            |
| Collateralized mortgage obligations                     | 17,360,132            | 6,449                  | (498,061)                 | 16,868,520            |
| Total Available-for-sale Securities                     | <u>\$ 114,213,552</u> | <u>\$ 137,713</u>      | <u>\$ (2,123,154)</u>     | <u>\$ 112,228,111</u> |
| 2015                                                    |                       |                        |                           |                       |
|                                                         | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value            |
| <b>Held-to-maturity</b>                                 |                       |                        |                           |                       |
| Securities of state and local municipalities tax exempt | \$ 263,141            | \$ 4,048               | \$ - -                    | \$ 267,189            |
| Securities of U.S. government and federal agencies      | 1,983,851             | 69                     | (6,719)                   | 1,977,201             |
| Total Held-to-maturity Securities                       | <u>\$ 2,246,992</u>   | <u>\$ 4,117</u>        | <u>(6,719)</u>            | <u>\$ 2,244,390</u>   |
| <b>Available-for-sale</b>                               |                       |                        |                           |                       |
| Securities of U.S. government and federal agencies      | \$ 1,500,000          | \$ - -                 | \$ (16,062)               | \$ 1,483,938          |
| Securities of state and local municipalities tax exempt | 1,726,350             | 2,249                  | (234)                     | 1,728,365             |
| Securities of state and local municipalities taxable    | 1,306,314             | 1,686                  | - -                       | 1,308,000             |
| Corporate bonds                                         | 2,000,000             | - -                    | (59,130)                  | 1,940,870             |
| Certificates of deposit                                 | 985,000               | 7,411                  | - -                       | 992,411               |
| SBA pass-through securities                             | 380,583               | - -                    | (9,439)                   | 371,144               |
| Mortgage-backed securities                              | 37,403,209            | 17,760                 | (261,189)                 | 37,159,780            |
| Collateralized mortgage obligations                     | 21,176,262            | 6,905                  | (620,155)                 | 20,563,012            |
| Total Available-for-sale Securities                     | <u>\$ 66,477,718</u>  | <u>\$ 36,011</u>       | <u>\$ (966,209)</u>       | <u>\$ 65,547,520</u>  |

At December 31, 2016 and 2015, securities with a market value of \$807,411 and \$957,951 were pledged to secure borrowings at the Federal Reserve Bank.

At December 31, 2016 and 2015, securities with a market value of \$9,165,968 and \$5,144,064 were pledged to secure borrowings at the Federal Home Loan Bank of Atlanta.

At December 31, 2016 and 2015, securities with a market value of \$92,756,879 and \$41,963,694 were pledged to secure public deposits with the Treasury Board of Virginia at the Community Bankers' Bank.

The following table shows fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2016 and 2015, respectively. The reference point for determining when securities are in an unrealized loss position is month-end. Therefore, it is possible that a security's market value exceeded its amortized cost on other days during the past twelve-month period. Available-for-sale securities that have been in a continuous unrealized loss position are as follows:

| At December 31, 2016                                    | Less Than 12 Months  |                       | 12 Months or Longer |                     | Total                 |                       |
|---------------------------------------------------------|----------------------|-----------------------|---------------------|---------------------|-----------------------|-----------------------|
|                                                         | Fair Value           | Unrealized Losses     | Fair Value          | Unrealized Losses   | Fair Value            | Unrealized Losses     |
| Securities of U.S. government and federal agencies      | \$ 961,030           | \$ (38,970)           | \$ --               | \$ --               | \$ 961,030            | \$ (38,970)           |
| Securities of state and local municipalities tax exempt | 3,617,735            | (91,738)              | --                  | --                  | 3,617,735             | (91,738)              |
| Securities of state and local municipalities taxable    | 1,979,109            | (63,057)              | --                  | --                  | 1,979,109             | (63,057)              |
| Corporate bonds                                         | 942,670              | (57,330)              | --                  | --                  | 942,670               | (57,330)              |
| SBA pass-through securities                             | 305,790              | (11,637)              | --                  | --                  | 305,790               | (11,637)              |
| Mortgage-backed securities                              | 78,598,292           | (1,344,371)           | 826,751             | (17,990)            | 79,425,043            | (1,362,361)           |
| Collateralized mortgage obligations                     | 5,958,540            | (102,821)             | 8,955,627           | (395,240)           | 14,914,167            | (498,061)             |
| Total                                                   | <u>\$ 92,363,166</u> | <u>\$ (1,709,924)</u> | <u>\$ 9,782,378</u> | <u>\$ (413,230)</u> | <u>\$ 102,145,544</u> | <u>\$ (2,123,154)</u> |

| At December 31, 2015                                    | Less Than 12 Months  |                     | 12 Months or Longer  |                     | Total                |                     |
|---------------------------------------------------------|----------------------|---------------------|----------------------|---------------------|----------------------|---------------------|
|                                                         | Fair Value           | Unrealized Losses   | Fair Value           | Unrealized Losses   | Fair Value           | Unrealized Losses   |
| Securities of U.S. government and federal agencies      | \$ --                | \$ --               | \$ 1,483,938         | \$ (16,062)         | \$ 1,483,938         | \$ (16,062)         |
| Securities of state and local municipalities tax exempt | 288,490              | (234)               | --                   | --                  | 288,490              | (234)               |
| Corporate bonds                                         | 1,940,870            | (59,130)            | --                   | --                  | 1,940,870            | (59,130)            |
| SBA pass-through securities                             | --                   | --                  | 371,144              | (9,439)             | 371,144              | (9,439)             |
| Mortgage-backed securities                              | 33,795,118           | (252,341)           | 1,184,231            | (8,848)             | 34,979,349           | (261,189)           |
| Collateralized mortgage obligations                     | 9,893,597            | (223,514)           | 8,845,178            | (396,641)           | 18,738,775           | (620,155)           |
| Total                                                   | <u>\$ 45,918,075</u> | <u>\$ (535,219)</u> | <u>\$ 11,884,491</u> | <u>\$ (430,990)</u> | <u>\$ 57,802,566</u> | <u>\$ (966,209)</u> |

As of December 31, 2016 and 2015, the Company had two and one, respectively, held-to-maturity security in an unrealized loss position of less than twelve months. The fair value of the securities was \$1,754,084 and \$993,281 and the unrealized losses were \$5,679 and \$6,719, respectively.

*Securities of U.S. government and federal agencies:* The unrealized losses were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016.

*Securities of state and local municipalities:* The unrealized losses on the investments in securities of state and local municipalities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016. Seven of these nine investments carries an S&P investment grade rating of AA- or above. Remaining two investments carry a Moody's investment grade rating of Aa3 or above.

*Corporate bonds:* The unrealized losses on the investments in corporate bonds were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016. One of these six investments carries an S&P investment grade rating of A. Remaining five investments do not carry ratings.

*SBA pass-through securities:* The unrealized losses on the Company's investment in SBA pass-through securities were caused by interest rate increases. Repayment of the principal on those investments is guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016.

*Mortgage-backed securities:* The unrealized losses on the Company's investment in mortgage-backed securities were caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016.

*Collateralized mortgage obligations (CMOs):* The unrealized loss associated with CMOs was caused by interest rate increases. The contractual cash flows of these investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016.



The amortized cost and fair value of securities available-for-sale as of December 31, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without penalties.

|                                | Held-to-maturity    |                     | Available-for-sale    |                       |
|--------------------------------|---------------------|---------------------|-----------------------|-----------------------|
|                                | Amortized Cost      | Fair Value          | Amortized Cost        | Fair Value            |
| Less than 1 year               | \$ --               | \$ --               | \$ 716,650            | \$ 762,305            |
| After 1 year through 5 years   | --                  | --                  | 4,178,006             | 4,147,327             |
| After 5 years through 10 years | 1,496,478           | 1,494,996           | 22,767,949            | 22,526,543            |
| After 10 years                 | 263,285             | 259,088             | 86,550,947            | 84,791,936            |
| Total                          | <u>\$ 1,759,763</u> | <u>\$ 1,754,084</u> | <u>\$ 114,213,552</u> | <u>\$ 112,228,111</u> |

For the years ended December 31, 2016 and 2015, proceeds from maturities, calls and principal repayments of securities were \$16,962,261 and \$8,058,947, respectively. During 2016 and 2015, proceeds from sales of securities available-for-sale amounted to \$3,955,150 and \$19,513,845, gross realized gains were \$71,124 and \$144,215 and gross realized losses were \$0 and \$76,733, respectively.

#### Note 4. Loans and Allowance for Loan Losses

A summary of loan balances by type follows:

|                                            | 2016                  | 2015                  |
|--------------------------------------------|-----------------------|-----------------------|
| Commercial real estate                     | \$ 476,851,256        | \$ 376,426,381        |
| Commercial and industrial                  | 112,060,996           | 89,502,318            |
| Commercial construction                    | 53,166,871            | 49,833,719            |
| Consumer residential                       | 106,549,420           | 84,463,861            |
| Consumer nonresidential                    | 19,547,551            | 19,127,221            |
| Consumer construction                      | --                    | 3,855,706             |
|                                            | <u>\$ 768,176,094</u> | <u>\$ 623,209,206</u> |
| Less:                                      |                       |                       |
| Allowance for loan losses                  | 6,452,481             | 6,238,606             |
| Unearned income and (unamortized premiums) | 74,534                | (349,437)             |
| Loans, net                                 | <u>\$ 761,649,079</u> | <u>\$ 617,320,037</u> |

An analysis of the allowance for loan losses for the years ended December 31, 2016 and 2015 follows:

|                                              | Commercial<br>Real Estate | Commercial<br>and Industrial | Commercial<br>Construction | Consumer<br>Residential | Consumer<br>Nonresidential | Consumer<br>Construction | Unallocated       | Total               |
|----------------------------------------------|---------------------------|------------------------------|----------------------------|-------------------------|----------------------------|--------------------------|-------------------|---------------------|
| <b>2016 Allowance<br/>for credit losses:</b> |                           |                              |                            |                         |                            |                          |                   |                     |
| Beginning Balance                            | \$ 4,001,842              | \$ 1,442,338                 | \$ 301,494                 | \$ 281,965              | \$ 98,612                  | \$ 23,327                | \$ 89,028         | \$ 6,238,606        |
| Charge-offs                                  | (512,442)                 | (668,513)                    | --                         | (76,170)                | --                         | --                       | --                | (1,257,125)         |
| Recoveries                                   | --                        | --                           | --                         | --                      | --                         | --                       | --                | --                  |
| Provision                                    | 776,833                   | 257,996                      | 73,332                     | 294,569                 | 22,945                     | (23,327)                 | 68,652            | 1,471,000           |
| Ending Balance                               | <u>\$ 4,266,233</u>       | <u>\$ 1,031,821</u>          | <u>\$ 374,826</u>          | <u>\$ 500,364</u>       | <u>\$ 121,557</u>          | <u>\$ --</u>             | <u>\$ 157,680</u> | <u>\$ 6,452,481</u> |

|                                              | Commercial<br>Real Estate | Commercial<br>and Industrial | Commercial<br>Construction | Consumer<br>Residential | Consumer<br>Nonresidential | Consumer<br>Construction | Unallocated      | Total               |
|----------------------------------------------|---------------------------|------------------------------|----------------------------|-------------------------|----------------------------|--------------------------|------------------|---------------------|
| <b>2015 Allowance<br/>for credit losses:</b> |                           |                              |                            |                         |                            |                          |                  |                     |
| Beginning Balance                            | \$ 3,721,334              | \$ 1,276,356                 | \$ 233,751                 | \$ 204,790              | \$ 66,204                  | \$ --                    | \$ 62,234        | \$ 5,564,669        |
| Charge-offs                                  | (98,396)                  | (312,021)                    | --                         | --                      | --                         | --                       | --               | (410,417)           |
| Recoveries                                   | 11,534                    | --                           | --                         | --                      | --                         | --                       | --               | 11,534              |
| Provision                                    | 367,370                   | 478,003                      | 67,743                     | 77,175                  | 32,408                     | 23,327                   | 26,794           | 1,072,820           |
| Ending Balance                               | <u>\$ 4,001,842</u>       | <u>\$ 1,442,338</u>          | <u>\$ 301,494</u>          | <u>\$ 281,965</u>       | <u>\$ 98,612</u>           | <u>\$ 23,327</u>         | <u>\$ 89,028</u> | <u>\$ 6,238,606</u> |

The following table presents the recorded investment in loans and impairment method as of December 31, 2016 and 2015 by portfolio segment:

|                                              | Commercial<br>Real Estate | Commercial<br>and Industrial | Commercial<br>Construction | Consumer<br>Residential | Consumer<br>Nonresidential | Consumer<br>Construction | Unallocated       | Total               |
|----------------------------------------------|---------------------------|------------------------------|----------------------------|-------------------------|----------------------------|--------------------------|-------------------|---------------------|
| <b>2016 Allowance<br/>for credit losses:</b> |                           |                              |                            |                         |                            |                          |                   |                     |
| Ending Balance                               |                           |                              |                            |                         |                            |                          |                   |                     |
| Individually evaluated<br>for impairment     | \$ --                     | \$ --                        | \$ --                      | \$ --                   | \$ --                      | \$ --                    | \$ --             | \$ --               |
| Collectively evaluated<br>for impairment     | 4,266,233                 | 1,031,821                    | 374,826                    | 500,364                 | 121,557                    | --                       | 157,680           | 6,452,481           |
|                                              | <u>\$ 4,266,233</u>       | <u>\$ 1,031,821</u>          | <u>\$ 374,826</u>          | <u>\$ 500,364</u>       | <u>\$ 121,557</u>          | <u>\$ --</u>             | <u>\$ 157,680</u> | <u>\$ 6,452,481</u> |

|                                          |                       |                       |                      |                       |                      |              |              |                       |
|------------------------------------------|-----------------------|-----------------------|----------------------|-----------------------|----------------------|--------------|--------------|-----------------------|
| <b>Financing receivables:</b>            |                       |                       |                      |                       |                      |              |              |                       |
| Ending Balance                           |                       |                       |                      |                       |                      |              |              |                       |
| Individually evaluated<br>for impairment | \$ 10,276,080         | \$ 1,633,583          | \$ --                | \$ --                 | \$ --                | \$ --        | \$ --        | \$ 11,909,662         |
| Collectively evaluated<br>for impairment | 466,575,176           | 110,427,413           | 53,166,871           | 106,549,420           | 19,547,551           | --           | --           | 756,266,432           |
|                                          | <u>\$ 476,851,256</u> | <u>\$ 112,060,996</u> | <u>\$ 53,166,871</u> | <u>\$ 106,549,420</u> | <u>\$ 19,547,551</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 768,176,094</u> |

|                                              | Commercial<br>Real Estate | Commercial<br>and Industrial | Commercial<br>Construction | Consumer<br>Residential | Consumer<br>Nonresidential | Consumer<br>Construction | Unallocated      | Total               |
|----------------------------------------------|---------------------------|------------------------------|----------------------------|-------------------------|----------------------------|--------------------------|------------------|---------------------|
| <b>2015 Allowance<br/>for credit losses:</b> |                           |                              |                            |                         |                            |                          |                  |                     |
| Ending Balance                               |                           |                              |                            |                         |                            |                          |                  |                     |
| Individually evaluated<br>for impairment     | \$ 686,667                | \$ 590,355                   | \$ --                      | \$ --                   | \$ --                      | \$ --                    | \$ --            | \$ 1,277,022        |
| Collectively evaluated<br>for impairment     | 3,315,175                 | 851,983                      | 301,494                    | 281,965                 | 98,612                     | 23,327                   | 89,028           | 4,961,584           |
|                                              | <u>\$ 4,001,842</u>       | <u>\$ 1,442,338</u>          | <u>\$ 301,494</u>          | <u>\$ 281,965</u>       | <u>\$ 98,612</u>           | <u>\$ 23,327</u>         | <u>\$ 89,028</u> | <u>\$ 6,238,606</u> |

#### Financing receivables:

|                                          |                       |                      |                      |                      |                      |                     |              |                       |
|------------------------------------------|-----------------------|----------------------|----------------------|----------------------|----------------------|---------------------|--------------|-----------------------|
| Ending Balance                           |                       |                      |                      |                      |                      |                     |              |                       |
| Individually evaluated<br>for impairment | \$ 4,875,051          | \$ 4,048,385         | \$ --                | \$ 110,262           | \$ --                | \$ --               | \$ --        | \$ 9,033,698          |
| Collectively evaluated<br>for impairment | 371,551,330           | 85,453,933           | 49,833,719           | 84,353,599           | 19,127,221           | 3,855,706           | --           | 614,175,508           |
|                                          | <u>\$ 376,426,381</u> | <u>\$ 89,502,318</u> | <u>\$ 49,833,719</u> | <u>\$ 84,463,861</u> | <u>\$ 19,127,221</u> | <u>\$ 3,855,706</u> | <u>\$ --</u> | <u>\$ 623,209,206</u> |

Impaired loans by class as of December 31, 2016 and 2015 are summarized as follows:

|                                    | Recorded<br>Investment | Unpaid Principal<br>Balance | Related Allowance   | Average Recorded<br>Investment | Interest Income<br>Recognized |
|------------------------------------|------------------------|-----------------------------|---------------------|--------------------------------|-------------------------------|
| <b>2016</b>                        |                        |                             |                     |                                |                               |
| <b>With an allowance recorded:</b> |                        |                             |                     |                                |                               |
| Commercial real estate             | \$ --                  | \$ --                       | \$ --               | \$ --                          | \$ --                         |
| Commercial and industrial          | --                     | --                          | --                  | --                             | --                            |
| Commercial construction            | --                     | --                          | --                  | --                             | --                            |
| Consumer residential               | --                     | --                          | --                  | --                             | --                            |
| Consumer nonresidential            | --                     | --                          | --                  | --                             | --                            |
| Consumer construction              | --                     | --                          | --                  | --                             | --                            |
|                                    | <u>\$ --</u>           | <u>\$ --</u>                | <u>\$ --</u>        | <u>\$ --</u>                   | <u>\$ --</u>                  |
| <b>With no related allowance:</b>  |                        |                             |                     |                                |                               |
| Commercial real estate             | \$ 10,276,079          | \$ 10,324,523               | \$ --               | \$ 10,240,475                  | \$ 506,804                    |
| Commercial and industrial          | 1,633,583              | 1,647,783                   | --                  | 1,761,146                      | 93,209                        |
| Commercial construction            | --                     | --                          | --                  | --                             | --                            |
| Consumer residential               | --                     | --                          | --                  | --                             | --                            |
| Consumer nonresidential            | --                     | --                          | --                  | --                             | --                            |
| Consumer construction              | --                     | --                          | --                  | --                             | --                            |
|                                    | <u>\$ 11,909,662</u>   | <u>\$ 11,972,306</u>        | <u>\$ --</u>        | <u>\$ 12,001,621</u>           | <u>\$ 600,013</u>             |
| <b>2015</b>                        |                        |                             |                     |                                |                               |
| <b>With an allowance recorded:</b> |                        |                             |                     |                                |                               |
| Commercial real estate             | \$ 1,144,670           | \$ 1,187,663                | \$ 686,667          | \$ 1,196,200                   | \$ 64,722                     |
| Commercial and industrial          | 1,024,744              | 1,024,743                   | 590,355             | 1,444,976                      | 58,431                        |
| Commercial construction            | --                     | --                          | --                  | --                             | --                            |
| Consumer residential               | --                     | --                          | --                  | --                             | --                            |
| Consumer nonresidential            | --                     | --                          | --                  | --                             | --                            |
| Consumer construction              | --                     | --                          | --                  | --                             | --                            |
|                                    | <u>\$ 2,169,414</u>    | <u>\$ 2,212,406</u>         | <u>\$ 1,277,022</u> | <u>\$ 2,641,176</u>            | <u>\$ 123,153</u>             |
| <b>With no related allowance:</b>  |                        |                             |                     |                                |                               |
| Commercial real estate             | \$ 3,730,381           | \$ 3,730,381                | \$ --               | \$ 3,644,452                   | \$ 188,026                    |
| Commercial and industrial          | 3,023,641              | 3,037,842                   | --                  | 3,690,837                      | 112,221                       |
| Commercial construction            | --                     | --                          | --                  | --                             | --                            |
| Consumer residential               | 110,262                | 116,737                     | --                  | 116,737                        | --                            |
| Consumer nonresidential            | --                     | --                          | --                  | --                             | --                            |
| Consumer construction              | --                     | --                          | --                  | --                             | --                            |
|                                    | <u>\$ 6,864,284</u>    | <u>\$ 6,884,960</u>         | <u>\$ --</u>        | <u>\$ 7,452,026</u>            | <u>\$ 300,247</u>             |

No additional funds are committed to be advanced in connection with the impaired loans. There were no nonaccrual loans excluded from the impaired loan disclosure.

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Company uses the following definitions for risk ratings:

**Pass** – Loans listed as pass include larger non-homogeneous loans not meeting the risk rating definitions below and smaller, homogeneous loans not assessed on an individual basis.

**Special Mention** – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard** – Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the enhanced possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful** – Loans classified as doubtful include those loans which have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently known facts, conditions and values, improbable.

**Loss** – Loans classified as loss include those loans which are considered uncollectible and of such little value that their continuance as loans is not warranted. Even though partial recovery may be achieved in the future, it is neither practical nor desirable to defer writing off these loans.

Based on the most recent analysis performed, the risk category of loans by class of loans was as follows as of December 31, 2016 and 2015:

|                                | Commercial<br>Real Estate | Commercial<br>and Industrial | Commercial<br>Construction | Consumer<br>Residential | Consumer<br>Nonresidential | Consumer<br>Construction | Total                 |
|--------------------------------|---------------------------|------------------------------|----------------------------|-------------------------|----------------------------|--------------------------|-----------------------|
| <b>As of December 31, 2016</b> |                           |                              |                            |                         |                            |                          |                       |
| Grade:                         |                           |                              |                            |                         |                            |                          |                       |
| Pass                           | \$ 465,512,835            | \$ 109,653,413               | \$ 53,166,871              | \$ 104,055,903          | \$ 19,528,306              | \$ --                    | \$ 751,917,328        |
| Special mention                | 8,590,646                 | 2,163,501                    | --                         | 2,493,517               | 19,245                     | --                       | 13,266,909            |
| Substandard                    | 2,747,775                 | 244,082                      | --                         | --                      | --                         | --                       | 2,991,857             |
| Doubtful                       | --                        | --                           | --                         | --                      | --                         | --                       | \$ --                 |
| Loss                           | --                        | --                           | --                         | --                      | --                         | --                       | --                    |
| Total                          | <u>\$ 476,851,256</u>     | <u>\$ 112,060,996</u>        | <u>\$ 53,166,871</u>       | <u>\$ 106,549,420</u>   | <u>\$ 19,547,551</u>       | <u>\$ --</u>             | <u>\$ 768,176,094</u> |
|                                | Commercial<br>Real Estate | Commercial<br>and Industrial | Commercial<br>Construction | Consumer<br>Residential | Consumer<br>Nonresidential | Consumer<br>Construction | Total                 |
| <b>As of December 31, 2015</b> |                           |                              |                            |                         |                            |                          |                       |
| Grade:                         |                           |                              |                            |                         |                            |                          |                       |
| Pass                           | \$ 369,211,680            | \$ 82,337,794                | \$ 49,833,719              | \$ 84,353,599           | \$ 19,127,221              | \$ 3,855,706             | \$ 608,719,719        |
| Special mention                | 3,536,698                 | 4,363,035                    | --                         | --                      | --                         | --                       | 7,899,733             |
| Substandard                    | 3,678,003                 | 2,801,489                    | --                         | 110,262                 | --                         | --                       | 6,589,754             |
| Doubtful                       | --                        | --                           | --                         | --                      | --                         | --                       | --                    |
| Loss                           | --                        | --                           | --                         | --                      | --                         | --                       | --                    |
| Total                          | <u>\$ 376,426,381</u>     | <u>\$ 89,502,318</u>         | <u>\$ 49,833,719</u>       | <u>\$ 84,463,861</u>    | <u>\$ 19,127,221</u>       | <u>\$ 3,855,706</u>      | <u>\$ 623,209,206</u> |

Past due and nonaccrual loans presented by loan class were as follows as of December 31, 2016 and 2015:

|                                | 30-59 days<br>past due | 60-89 days<br>past due | 90 days or more<br>past due | Total<br>past due   | Current               | Total loans           | 90+ days past due<br>and still accruing | Nonaccruals         |
|--------------------------------|------------------------|------------------------|-----------------------------|---------------------|-----------------------|-----------------------|-----------------------------------------|---------------------|
| <b>As of December 31, 2016</b> |                        |                        |                             |                     |                       |                       |                                         |                     |
| Commercial real estate         | \$ 906,738             | \$ 1,605,427           | \$ 155,200                  | \$ 2,667,365        | \$ 474,183,891        | \$ 476,851,256        | \$ 155,200                              | \$ -                |
| Commercial and industrial      | --                     | 211,548                | 94,082                      | 305,630             | 111,755,366           | 112,060,996           | --                                      | 94,082              |
| Commercial construction        | --                     | --                     | --                          | --                  | 53,166,871            | 53,166,871            | --                                      | --                  |
| Consumer residential           | 1,135,961              | --                     | --                          | 1,135,961           | 105,413,459           | 106,549,420           | --                                      | --                  |
| Consumer nonresidential        | --                     | 9,986                  | --                          | 9,986               | 19,537,565            | 19,547,551            | --                                      | --                  |
| Consumer construction          | --                     | --                     | --                          | --                  | --                    | --                    | --                                      | --                  |
| Total                          | <u>\$ 2,042,699</u>    | <u>\$ 1,826,961</u>    | <u>\$ 249,282</u>           | <u>\$ 4,118,942</u> | <u>\$ 764,057,152</u> | <u>\$ 768,176,094</u> | <u>\$ 155,200</u>                       | <u>\$ 94,082</u>    |
|                                | 30-59 days<br>past due | 60-89 days<br>past due | 90 days or more<br>past due | Total<br>past due   | Current               | Total loans           | 90+ days past due<br>and still accruing | Nonaccruals         |
| <b>As of December 31, 2015</b> |                        |                        |                             |                     |                       |                       |                                         |                     |
| Commercial real estate         | \$ 445,418             | \$ --                  | \$ --                       | \$ 445,418          | \$ 375,980,963        | \$ 376,426,381        | \$ --                                   | \$ 1,144,670        |
| Commercial and industrial      | 1,791,576              | --                     | --                          | 1,791,576           | 87,710,742            | 89,502,318            | --                                      | 1,303,841           |
| Commercial construction        | --                     | --                     | --                          | --                  | 49,833,719            | 49,833,719            | --                                      | --                  |
| Consumer residential           | 162,716                | --                     | --                          | 162,716             | 84,301,145            | 84,463,861            | --                                      | 110,262             |
| Consumer nonresidential        | --                     | 9,860                  | --                          | 9,860               | 19,117,361            | 19,127,221            | --                                      | --                  |
| Consumer construction          | --                     | --                     | --                          | --                  | 3,855,706             | 3,855,706             | --                                      | --                  |
| Total                          | <u>\$ 2,399,710</u>    | <u>\$ 9,860</u>        | <u>\$ --</u>                | <u>\$ 2,409,570</u> | <u>\$ 620,799,636</u> | <u>\$ 623,209,206</u> | <u>\$ --</u>                            | <u>\$ 2,558,773</u> |

There were overdrafts of \$77,479 and \$79,819 at December 31, 2016 and 2015 which have been reclassified from deposits to loans. At December 31, 2016 and 2015, loans with a carrying value of \$81,107,118 and \$92,764,019 were pledged to the Federal Home Loan Bank of Atlanta.

There were no troubled debt restructurings that subsequently defaulted during the year ended December 31, 2016 and 2015. A summary of activity in troubled debt restructurings presented by loan class follows for the years ended December 31, 2016 and 2015:

|                                             | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---------------------------------------------|---------------------|--------------------------------------------------|---------------------------------------------------|
| <b>For the year ended December 31, 2016</b> |                     |                                                  |                                                   |
| <b>Troubled Debt Restructurings</b>         |                     |                                                  |                                                   |
| Commercial real estate                      | 1                   | \$ 6,182,709                                     | \$ 6,182,709                                      |
| Commercial and industrial                   | 2                   | 677,774                                          | 677,774                                           |
| Commercial construction                     | --                  | --                                               | --                                                |
| Consumer residential                        | --                  | --                                               | --                                                |
| Consumer nonresidential                     | --                  | --                                               | --                                                |
| Consumer construction                       | --                  | --                                               | --                                                |
| Total                                       | 3                   | \$ 6,860,483                                     | \$ 6,860,483                                      |

|                                             | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---------------------------------------------|---------------------|--------------------------------------------------|---------------------------------------------------|
| <b>For the year ended December 31, 2015</b> |                     |                                                  |                                                   |
| <b>Troubled Debt Restructurings</b>         |                     |                                                  |                                                   |
| Commercial real estate                      | 2                   | \$ 3,494,920                                     | \$ 3,567,476                                      |
| Commercial and industrial                   | 2                   | 861,288                                          | 861,288                                           |
| Commercial construction                     | --                  | --                                               | --                                                |
| Consumer residential                        | --                  | --                                               | --                                                |
| Consumer nonresidential                     | --                  | --                                               | --                                                |
| Consumer construction                       | --                  | --                                               | --                                                |
| Total                                       | 4                   | \$ 4,356,208                                     | \$ 4,428,764                                      |

As of December 31, 2016 and 2015, the Company has a recorded investment in troubled debt restructurings of \$11,522,972 and 5,074,007, respectively.

The concessions made in troubled debt restructurings were extensions of the maturity dates or reductions in the stated interest rate for the remaining life of the debt.

## Note 5. Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

|                                   | 2016         | 2015         |
|-----------------------------------|--------------|--------------|
| Leasehold improvements            | \$ 2,367,030 | \$ 2,331,233 |
| Furniture, fixtures and equipment | 3,010,721    | 2,833,726    |
| Computer software                 | 323,078      | 253,637      |
|                                   | \$ 5,700,829 | \$ 5,418,596 |
| Less: accumulated depreciation    | 4,430,087    | 3,906,696    |
|                                   | \$ 1,270,742 | \$ 1,511,900 |

For the years ended December 31, 2016 and 2015, depreciation expense was \$523,392 and \$563,579, respectively.

As of December 31, 2016, the Company has a non-cancellable lease agreement for the operating headquarters and a branch in Fairfax, Virginia. The lease states that if the Company holds possession of the premises after the expiration date, the Company shall become a tenant on a month-to-month basis. The monthly rental payment shall continue as provided unless notice is given. The lease expires December 31, 2017.

In January 2008, the Company entered into a non-cancellable lease agreement to operate a branch in Manassas, Virginia. The lease expires December 31, 2017. The lease contains an option to extend for two five-year periods.

In December 2010, the Company entered into a five-year lease agreement to operate a branch in Reston, Virginia. The lease, which is cancellable with penalty, expires December 31, 2020. The lease contains an option to extend for two five-year periods.

In October 2012, the Company assumed the remaining term of a non-cancellable 10-year lease agreement to operate a branch in Arlington, Virginia. The lease expires on July 31, 2018. The lease contains an option to extend for two five-year periods. As part of the acquisition accounting, the Company recorded a liability for the terms of the lease relative to the market terms at the time of the acquisition. The liability is accreted against rent expense over the remaining lease term.

In May 2013, the Company entered into a 10-year lease agreement to operate a branch in Springfield, Virginia. The lease, which is cancellable with penalty, expires August 31, 2023. The lease contains an option to extend for two five-year periods.

In March 2016, the Company entered into a 10-year lease agreement to operate a branch in Ashburn, Virginia. The lease, which is cancellable with penalty, expires August 31, 2026.

Total rent expense for the years ended December 31, 2016 and 2015 amounted to \$1,029,109 and \$981,577, respectively.

The minimum base rent for the remainder of the leases are as follows:

|            |    |                         |
|------------|----|-------------------------|
| 2017       | \$ | 1,055,246               |
| 2018       |    | 314,136                 |
| 2019       |    | 148,679                 |
| 2020       |    | 147,908                 |
| 2021       |    | 157,272                 |
| Thereafter |    | <u>416,259</u>          |
|            | \$ | <u><u>2,239,500</u></u> |

## Note 6. Time Deposits

Remaining maturities on certificates of deposit are as follows:

|      |    |                           |
|------|----|---------------------------|
| 2017 | \$ | 153,339,474               |
| 2018 |    | 62,307,739                |
| 2019 |    | 11,230,459                |
| 2020 |    | 8,030,752                 |
| 2021 |    | <u>6,139,618</u>          |
|      | \$ | <u><u>241,048,042</u></u> |

Total time deposits of \$250,000 and greater were \$75,872,386 and \$50,884,076 at December 31, 2016 and 2015, respectively.



## Note 7. Deposit Concentrations

At December 31, 2016 and 2015, the Company had four customer relationship, whose related balance on deposit exceeded 5% of outstanding deposits. These customer relationships comprise 25% of outstanding deposits at December 31, 2016 and 8% of outstanding deposits at December 31, 2015.

Brokered deposits totaled \$71,271,541 and \$98,959,198 at December 31, 2016 and 2015, respectively.

## Note 8. Federal Home Loan Bank (FHLB) Advances and Other Borrowings

FHLB advances at December 31, 2016 consist of the following:

|                                    | Amount               | Weighted<br>Average Rate |
|------------------------------------|----------------------|--------------------------|
| Daily rate advances maturing: 2017 | \$ 24,500,000        | 0.80%                    |
| Fixed rate advances maturing: 2017 | 2,500,000            | 1.33%                    |
| Total FHLB advances                | <u>\$ 27,000,000</u> | <u>0.85%</u>             |

At December 31, 2016, advances are collateralized by securities with a market value of \$9,165,968, 1-4 family residential loans with a book value of \$2,932,460, multi-family residential loan with a book value of \$7,611,973, home equity lines of credit with a book value of \$9,726,644 and commercial real estate loans with book value of \$60,836,041. The remaining lendable collateral value at December 31, 2016 totaled \$38,784,596.

The Company has unsecured lines of credit with correspondent banks totaling \$37,000,000 and \$37,000,000, respectively, at December 31, 2016 and 2015, available for overnight borrowing. At December 31, 2016 and 2015, these lines of credit with correspondent banks were not drawn upon.

## Note 9. Subordinated Notes

On June 20, 2016, the Company issued \$25,000,000 in private placement of fixed-to-floating subordinated notes due June 30, 2026. Interest is payable at 6.00% per annum, from and including June 20, 2016 to, but excluding June 30, 2021, payable semi-annually in arrears. From and including June 30, 2021 to the maturity date or early redemption date, the interest rate shall reset quarterly to an interest rate per annum equal to the then current three-month LIBOR rate plus 487 basis points, payable quarterly in arrears.

The Company may, at its option, beginning with the interest payment date of June 30, 2021 and on any scheduled interest payment date thereafter redeem the subordinated notes, in whole or in part, upon not fewer than 30 nor greater than 60 days' notice to holders, at a redemption price equal to 100% of the principal amount of the subordinated notes to be redeemed plus accrued and unpaid interest to, but excluding, the date of redemption. Any partial redemption will be made pro rata among all of the holders.

The subordinated notes may be included in Tier 1 capital for the Bank (with certain limitations applicable) under current regulatory guidelines and interpretations. As of December 31, 2016, \$21,000,000 of the Company's subordinated notes have been included in the Bank's Tier 1 Capital.

## Note 10. Related Party Transactions

Officers, directors and their affiliates had borrowings of \$8,811,847 and \$4,978,876 at December 31, 2016 and 2015 with the Company. During the years ended December 31, 2016 and 2015, total principal additions were \$5,235,095 and \$2,669,976 and total principal payments were \$1,402,124 and \$403,955, respectively.

Related party deposits amounted to \$24,059,602 and \$20,466,376 at December 31, 2016 and 2015, respectively.

## Note 11. Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2016 and 2015 are presented below:

|                                                  | 2016                | 2015                |
|--------------------------------------------------|---------------------|---------------------|
| <b>Deferred Tax Assets:</b>                      |                     |                     |
| Allowance for loan losses                        | \$ 2,193,844        | \$ 2,071,280        |
| Net operating loss carryforward                  | 446,812             | 475,031             |
| Premises and equipment and deferred rent         | 417,233             | 391,382             |
| Unrealized loss on securities available for sale | 686,410             | 316,267             |
| Directors - nonqualified stock options           | 364,321             | 272,368             |
| Organizational and start-up expenses             | 130,431             | 122,554             |
| Acquisition accounting adjustments               | 102,849             | 111,388             |
| Nonaccrual loan interest                         | 876                 | 43,154              |
| Deferred loan costs (fees)                       | 25,341              | (118,807)           |
| Net Deferred Tax Assets                          | <u>\$ 4,368,117</u> | <u>\$ 3,684,617</u> |

As part of the 2012 acquisition, the Company acquired approximately \$1.7 million of unused net operating carryforwards. The Company may utilize the carryforwards, subject to certain limitations, through 2032. The income tax expense charged to operations for the years ended December 31, 2016 and 2015 consists of the following:

|                      | 2016                | 2015                |
|----------------------|---------------------|---------------------|
| Current tax expense  | \$ 3,884,480        | \$ 3,225,682        |
| Deferred tax benefit | <u>(313,357)</u>    | <u>(365,885)</u>    |
|                      | <u>\$ 3,571,123</u> | <u>\$ 2,859,797</u> |

Income tax expense differed from amounts computed by applying the U.S. federal income tax rate of 34% to income, before income tax expense as a result of the following:

|                                                     | 2016                | 2015                |
|-----------------------------------------------------|---------------------|---------------------|
| Computed "expected" tax expense                     | \$ 3,571,278        | \$ 2,814,815        |
| Increase (decrease) in income taxes resulting from: |                     |                     |
| Non-deductible expense                              | 153,922             | 157,448             |
| Tax free income                                     | (135,531)           | (110,649)           |
| Other                                               | <u>(18,546)</u>     | <u>(1,817)</u>      |
|                                                     | <u>\$ 3,571,123</u> | <u>\$ 2,859,797</u> |

The Company files income tax returns in the U.S. federal jurisdiction. With few exceptions, the Company is no longer subject to U.S. federal examination by tax authorities for years prior to 2013.

## Note 12. Financial Instruments with Off-Balance Sheet Risk

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

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2016 and 2015, the following financial instruments were outstanding which contract amounts represent credit risk:

|                                                      | 2016          | 2015         |
|------------------------------------------------------|---------------|--------------|
| Commitments to grant loans                           | \$ 41,536,793 | \$ 6,716,250 |
| Unused commitments to fund loans and lines of credit | 142,566,701   | 128,093,674  |
| Commercial and standby letters of credit             | 3,424,258     | 2,131,978    |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments, if deemed necessary.

The Company maintains its cash accounts with the Federal Reserve and correspondent banks. The total amount of cash on deposit in correspondent banks exceeding the federally insured limits was \$108,858 and \$1,235 at December 31, 2016 and 2015, respectively.

## Note 13. Minimum Regulatory Capital Requirements

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

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (the Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. As a part of the new requirements, the Common Equity Tier 1 Capital ratio is calculated and utilized in the assessment of capital for all institutions. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. Management believes as of December 31, 2016 and 2015, the Company meets all capital adequacy requirement to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2016 and 2015, the most recent regulatory notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Federal and state banking regulations place certain restrictions on dividends paid by the Company. The total amount of dividends which may be paid at any date is generally limited to retained earnings of the Company.

The Bank's actual capital amounts and ratios are presented in the table.

|                                                               | Actual     |        | Minimum Capital Requirement |        | Well Capitalized Under Prompt Corrective Action Provisions |         |
|---------------------------------------------------------------|------------|--------|-----------------------------|--------|------------------------------------------------------------|---------|
|                                                               | Amount     | Ratio  | Amount                      | Ratio  | Amount                                                     | Ratio   |
| <i>(Amounts in Thousands)</i>                                 |            |        |                             |        |                                                            |         |
| <b>As of December 31, 2016:</b>                               |            |        |                             |        |                                                            |         |
| Total Risk Based Capital (to Risk Weighted Assets)            | \$ 108,764 | 13.16% | \$ 71,311                   | 8.625% | \$ 82,679                                                  | 10.000% |
| Tier 1 Capital (to Risk Weighted Assets)                      | \$ 102,312 | 12.37% | \$ 54,775                   | 6.625% | \$ 66,143                                                  | 8.000%  |
| Common Equity Tier 1 (CET1) Capital (to risk weighted assets) | \$ 102,312 | 12.37% | \$ 42,373                   | 5.125% | \$ 53,741                                                  | 6.500%  |
| Tier 1 Capital (to Average Assets)                            | \$ 102,312 | 11.89% | \$ 33,072                   | 4.000% | \$ 43,010                                                  | 5.000%  |
| <b>As of December 31, 2015:</b>                               |            |        |                             |        |                                                            |         |
| Total Risk Based Capital (to Risk Weighted Assets)            | \$ 79,485  | 12.20% | \$ 52,102                   | 8.000% | \$ 65,127                                                  | 10.000% |
| Tier 1 Capital (to Risk Weighted Assets)                      | \$ 73,246  | 11.25% | \$ 39,076                   | 6.000% | \$ 52,102                                                  | 8.000%  |
| Common Equity Tier 1 (CET1) Capital (to risk weighted assets) | \$ 73,246  | 11.25% | \$ 29,307                   | 4.500% | \$ 42,333                                                  | 6.500%  |
| Tier 1 Capital (to Average Assets)                            | \$ 73,246  | 10.82% | \$ 27,083                   | 4.000% | \$ 33,854                                                  | 5.000%  |

## Note 14. Stock-Based Compensation Plan

The Company's 2008 Stock Option Plan (the Plan), which is shareholder-approved, was adopted to advance the interests of the Company by providing selected key employees of the Company, their affiliates, and directors with the opportunity to acquire shares of common stock. The Plan granted options to purchase 4,687 shares of common stock to each of the 21 organizing shareholders of the Company, who had funds at risk during the Company's organizational period and assumed the financial risk that the Company would not open. These shares immediately vested upon grant.

The maximum number of shares with respect to which awards may be made is 2,023,437 shares of common stock, subject to adjustment for certain corporate events. On April 28, 2016, the shareholders approved an amendment to the Amended and Restated 2008 Stock Plan to increase the number of shares authorized for issuance under the Plan by 312,500 shares. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant, generally vest annually over three years of continuous service and have ten year contractual terms. At December 31, 2016, 181,506 shares were available to grant under the Plan.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option-pricing model for determining fair value. The model employs the following assumptions:

- Dividend yield – calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant;
- Expected life (term of options) – based on the average contractual life and vesting schedule for the respective options;
- Expected volatility – based on the monthly historical volatility of the stock price of similar banks over the expected life of the options;
- Risk-free interest rate – based upon the U.S. Treasury bill rate in effect at date of grant for bonds with a maturity equal to the expected life of the options.

|                          | 2016         | 2015   |
|--------------------------|--------------|--------|
| Dividend yield           | --           | --     |
| Expected life (in years) | 6.5          | 6.5    |
| Expected volatility      | 16.70-18.70% | 25.00% |
| Risk-free interest rate  | 1.05%        | 1.73%  |

A summary of option activity under the Plan as of December 31, 2016, and changes during the year then ended is presented below:

| Options                          | Shares           | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Term | Aggregate Intrinsic<br>Value (1) |
|----------------------------------|------------------|------------------------------------|---------------------------------------------------|----------------------------------|
| Outstanding at January 1, 2016   | 1,624,764        | \$ 8.73                            | 6.82                                              | \$ 8,236,569                     |
| Granted                          | 279,552          | 14.38                              |                                                   |                                  |
| Exercised                        | (50,353)         | 7.89                               |                                                   |                                  |
| Forfeited or expired             | (12,032)         | 9.44                               |                                                   |                                  |
| Outstanding at December 31, 2016 | <u>1,841,931</u> | <u>\$ 9.61</u>                     | 6.40                                              | <u>\$ 13,248,149</u>             |
| Exercisable at December 31, 2016 | <u>1,223,986</u> | <u>\$ 8.39</u>                     | 5.30                                              | <u>\$ 10,291,531</u>             |

**(1)** The aggregate intrinsic value of stock options represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2016. This amount changes based on changes in the market value of the Company's stock.

The weighted average grant date fair value of options granted during the years ended December 31, 2016 and 2015 was \$2.85 and \$3.93, respectively.

The compensation cost that has been charged to income for the plan was \$697,809 and \$705,000 for 2016 and 2015, respectively. As of December 31, 2016, there was unamortized compensation expense of \$1,304,206 that will be amortized over 43 months. Tax benefits recognized for qualified stock options during 2016 and 2015 totaled \$91,953 and \$90,526.

Stock option information has been retroactively adjusted for the five-for-four stock splits declared in May 2016 and March 2015.

## **Note 15. Fair Value Measurements**

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### **Determination of Fair Value**

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

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

## Fair Value Hierarchy

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

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

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

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

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

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

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015:

|                                                         |                                       | Fair Value Measurements at December 31, 2016 using         |                                        |                                       |
|---------------------------------------------------------|---------------------------------------|------------------------------------------------------------|----------------------------------------|---------------------------------------|
| Description                                             | Balance as of<br>December 31,<br>2016 | Quoted Prices<br>in Active Markets for<br>Identical Assets | Significant Other<br>Observable Inputs | Significant<br>Unobservable<br>Inputs |
|                                                         |                                       | (Level 1)                                                  | (Level 2)                              | (Level 3)                             |
| Assets                                                  |                                       |                                                            |                                        |                                       |
| Available-for-sale                                      |                                       |                                                            |                                        |                                       |
| Securities of U.S. government and federal agencies      | \$ 961,030                            | \$ --                                                      | \$ 961,030                             | \$ --                                 |
| Securities of state and local municipalities tax exempt | 3,617,735                             | --                                                         | 3,617,735                              | --                                    |
| Securities of state and local municipalities taxable    | 2,770,599                             | --                                                         | 2,770,599                              | --                                    |
| Corporate bonds                                         | 7,023,893                             | --                                                         | 7,023,893                              | --                                    |
| Corporate securities                                    | 511,200                               | --                                                         | 511,200                                | --                                    |
| Certificates of deposit                                 | 744,301                               | --                                                         | 744,301                                | --                                    |
| SBA pass-through securities                             | 305,790                               | --                                                         | 305,790                                | --                                    |
| Mortgage-backed securities                              | 79,425,043                            | --                                                         | 79,425,043                             | --                                    |
| Collateralized mortgage obligations                     | 16,868,520                            | --                                                         | 16,868,520                             | --                                    |
| Total Available-for-Sale Securities                     | \$ 112,228,111                        | \$ --                                                      | \$ 112,228,111                         | \$ --                                 |



|                                                         |                                       | Fair Value Measurements at December 31, 2015 using         |                                        |                                       |
|---------------------------------------------------------|---------------------------------------|------------------------------------------------------------|----------------------------------------|---------------------------------------|
| Description                                             | Balance as of<br>December 31,<br>2015 | Quoted Prices<br>in Active Markets for<br>Identical Assets | Significant Other<br>Observable Inputs | Significant<br>Unobservable<br>Inputs |
|                                                         |                                       | (Level 1)                                                  | (Level 2)                              | (Level 3)                             |
| Assets                                                  |                                       |                                                            |                                        |                                       |
| Available-for-sale                                      |                                       |                                                            |                                        |                                       |
| Securities of U.S. government and federal agencies      | \$ 1,483,938                          | \$ --                                                      | \$ 1,483,938                           | \$ --                                 |
| Securities of state and local municipalities tax exempt | 1,728,365                             | --                                                         | 1,728,365                              | --                                    |
| Securities of state and local municipalities taxable    | 1,308,000                             | --                                                         | 1,308,000                              | --                                    |
| Corporate bonds                                         | 1,940,870                             | --                                                         | 1,940,870                              | --                                    |
| Certificates of deposit                                 | 992,411                               | --                                                         | 992,411                                | --                                    |
| SBA pass-through securities                             | 371,144                               | --                                                         | 371,144                                | --                                    |
| Mortgage-backed securities                              | 37,159,780                            | --                                                         | 37,159,780                             | --                                    |
| Collateralized mortgage obligations                     | 20,563,012                            | --                                                         | 20,563,012                             | --                                    |
| Total Available-for-Sale Securities                     | <u>\$ 65,547,520</u>                  | <u>\$ --</u>                                               | <u>\$ 65,547,520</u>                   | <u>\$ --</u>                          |

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

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

*Impaired Loans:* Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction, has the value derived by discounting comparable sales due to lack of similar properties, or is discounted by the Company due to marketability, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Statements of Income. No loans were recorded at fair value at December 31, 2016.



The following table summarizes the Company's assets that were measured at fair value on a nonrecurring basis at December 31, 2015:

| Description                                | Fair Value Measurements at December 31, 2015 using |                                                            |                                        |                                       |
|--------------------------------------------|----------------------------------------------------|------------------------------------------------------------|----------------------------------------|---------------------------------------|
|                                            | Balance as of<br>December 31,<br>2015              | Quoted Prices<br>in Active Markets for<br>Identical Assets | Significant Other<br>Observable Inputs | Significant<br>Unobservable<br>Inputs |
|                                            |                                                    | (Level 1)                                                  | (Level 2)                              | (Level 3)                             |
| Assets                                     |                                                    |                                                            |                                        |                                       |
| Impaired Loans, net of valuation allowance | \$ 892,392                                         | \$ --                                                      | \$ --                                  | \$ 892,392                            |

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2015:

| Quantitative information about Level 3 Fair Value Measurements for December 31, 2015 |            |                            |                    |           |
|--------------------------------------------------------------------------------------|------------|----------------------------|--------------------|-----------|
| Assets                                                                               | Fair Value | Valuation Technique(s)     | Unobservable input | Range     |
| Impaired Loans                                                                       | \$ 434,389 | Business asset value       | Liquidation costs  | 5% - 100% |
|                                                                                      | \$ 458,003 | Discounted appraised value | Market discount    | 10% - 12% |

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following methods and assumptions were used by the Company in estimating fair values of financial instruments as disclosed herein:

### *Cash and Due from Banks and Federal Funds Sold*

The carrying amounts of cash and due from banks and federal funds sold approximate their fair value.

### *Interest-Bearing Deposits at Other Financial Institutions*

The carrying amounts of interest-bearing deposits at other financial institutions payable on demand, consisting of money market deposits, approximate fair value. Fair value of fixed-rate certificates of deposit is estimated based on discounted cash flow analyses using the remaining maturity of the underlying accounts and interest rates currently offered on certificates of deposit with similar original maturities.

### *Securities*

Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or third party vendor pricing models.

### *Restricted Stock*

The carrying amount of Federal Reserve Bank stock, Federal Home Loan Bank stock and Community Bankers' Bank Stock approximates fair value based on redemption provisions.

### *Loans Receivable*

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (for example, one to four family residential), credit-card loans and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for business real estate and business loans are estimated using a discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

### *Bank Owned Life Insurance*

Bank owned life insurance represents insurance policies on senior officers of the Company. The cash values of the policies are estimated using information provided by insurance carriers. These policies are carried at their cash surrender values, which approximates fair values.

### *Accrued Interest*

The carrying amount of accrued interest approximates fair value.

### *Deposits*

The carrying amounts of deposit liabilities payable on demand, consisting of NOW accounts, money market deposits, and saving deposits approximate fair value. Fair value of fixed-rate certificates of deposit is estimated based on discounted cash flow analyses using the remaining maturity of the underlying accounts and interest rates currently offered on certificates of deposit with similar original maturities.

### *FHLB Advances*

The fair value of FHLB advances is estimated based on discounted cash flow analyses using the remaining maturity of the underlying accounts and interest rates currently offered of advance with similar original maturities.

### *Subordinated Notes*

The fair value of the subordinated notes are estimated using discounted cash flow analyses based on the current borrowing rates for similar for similar types of borrowing arrangements.

### *Off-Balance Sheet Financial Instruments*

At December 31, 2016 and 2015, the fair values of loan commitments and standby letters of credit are immaterial. Therefore, they have not been included in the following table.

# Fair Value Measurements at December 31, 2016 using

|                                                 | Carrying Amount | Quoted Prices in Active Markets for Identical Assets | Significant Unobservable Inputs | Significant Unobservable Inputs |
|-------------------------------------------------|-----------------|------------------------------------------------------|---------------------------------|---------------------------------|
|                                                 |                 | (Level 1)                                            | (Level 2)                       | (Level 3)                       |
| Financial assets:                               |                 |                                                      |                                 |                                 |
| Cash and due from banks                         | \$ 5,174,470    | \$ 5,174,470                                         | \$ --                           | \$ --                           |
| Interest-bearing deposits at other institutions | 3,509,686       | 3,509,686                                            | --                              | --                              |
| Securities held-to-maturity                     | 1,759,763       | --                                                   | 1,754,084                       | --                              |
| Securities available-for-sale                   | 112,228,111     | --                                                   | 112,228,111                     | --                              |
| Restricted stock                                | 4,431,900       | --                                                   | 4,431,900                       | --                              |
| Loans, net                                      | 761,649,079     | --                                                   | --                              | 769,435,000                     |
| Bank owned life insurance                       | 10,828,189      | --                                                   | 10,828,189                      | --                              |
| Accrued interest receivable                     | 2,496,427       | --                                                   | 2,496,427                       | --                              |
| Financial liabilities:                          |                 |                                                      |                                 |                                 |
| Checking, savings and money market accounts     | \$ 534,942,937  | \$ --                                                | \$ 534,942,937                  | \$ --                           |
| Time deposits                                   | 241,048,042     | --                                                   | 240,449,000                     | --                              |
| FHLB advances and Subordinated notes            | 51,247,346      | --                                                   | 49,690,000                      | --                              |
| Accrued interest payable                        | 170,367         | --                                                   | 170,367                         | --                              |

# Fair Value Measurements at December 31, 2015 using

|                                                 | Carrying Amount | Quoted Prices in Active Markets for Identical Assets | Significant Unobservable Inputs | Significant Unobservable Inputs |
|-------------------------------------------------|-----------------|------------------------------------------------------|---------------------------------|---------------------------------|
|                                                 |                 | (Level 1)                                            | (Level 2)                       | (Level 3)                       |
| Financial assets:                               |                 |                                                      |                                 |                                 |
| Cash and due from banks                         | \$ 5,257,136    | \$ 5,257,136                                         | \$ --                           | \$ --                           |
| Interest-bearing deposits at other institutions | 23,442,934      | 23,442,934                                           | --                              | --                              |
| Securities held-to-maturity                     | 2,246,992       | --                                                   | 2,244,390                       | --                              |
| Securities available-for-sale                   | 65,547,520      | --                                                   | 65,547,520                      | --                              |
| Restricted stock                                | 4,048,000       | --                                                   | 4,048,000                       | --                              |
| Loans, net                                      | 617,320,037     | --                                                   | --                              | 619,338,000                     |
| Bank owned life insurance                       | 10,524,789      | --                                                   | 10,524,789                      | --                              |
| Accrued interest receivable                     | 1,908,487       | --                                                   | 1,908,487                       | --                              |
| Financial liabilities:                          |                 |                                                      |                                 |                                 |
| Checking, savings and money market accounts     | \$ 414,701,339  | \$ --                                                | \$ 414,701,339                  | \$ --                           |
| Time deposits                                   | 211,938,452     | --                                                   | 211,798,000                     | --                              |
| FHLB advances                                   | 35,650,000      | --                                                   | 35,428,000                      | --                              |
| Accrued interest payable                        | 132,743         | --                                                   | 132,743                         | --                              |

## Note 16. Earnings Per Share

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

Earnings per share has been retroactively adjusted for the five-for-four stock splits declared in May 2016 and March 2015.

The following shows the weighted average number of shares used in computing earnings per share and the effect of weighted average number of shares of dilutive potential common stock. Dilutive potential common stock has no effect on income available to common shareholders. There were 273,302 and 312,046 shares, respectively, excluded from 2016 and 2015 the calculation because their effects were anti-dilutive.

|                                       | 2016             | 2015             |
|---------------------------------------|------------------|------------------|
| Net income                            | \$ 6,932,637     | \$ 5,419,071     |
| Weighted average number of shares     | 8,135,769        | 8,110,656        |
| Options effect of dilutive securities | 602,208          | 362,221          |
| Weighted average diluted shares       | <u>8,737,977</u> | <u>8,472,877</u> |
| Basic EPS                             | \$ 0.85          | \$ 0.67          |
| Diluted EPS                           | \$ 0.79          | \$ 0.64          |

## Note 17. Subsequent Events

In preparing the financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through March 10, 2017, the date the financial statements were available to be issued.

## In Memoriam

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In February 2017, we lost a respected member of the FVCbank family. James D. Holter was our Senior Vice President of Information Technology. Highly skilled in IT, Jim was supportive of his co-workers, good-hearted and well liked. We enjoyed his company each day that we had the pleasure of working with him. Jim will be missed by everyone.

God speed to our good friend.



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