Village Bank & Trust Financial Corp.
Form 10-K
March 30, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

Commission file number 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Virginia	**16-1694602**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

13319 Midlothian Turnpike, Midlothian, Virginia	**23113**
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number: **804-897-3900**

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

Title of each class	Name of each exchange on which registered
Common Stock, $4.00 par value	The Nasdaq Stock Market

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

None

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form10-K or any amendment to this Form 10-K.¨

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

Large Accelerated Filer o	Accelerated Filer o
Non-Accelerated Filer o (Do not check if smaller reporting company)	Smaller Reporting Company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No þ

The aggregate market value of common stock held by non-affiliates of the registrant as of the last business day of the Registrant's most recent completed second fiscal quarter was approximately $12,715,000.

The number of shares of common stock outstanding as of February 28, 2016 was 1,417,775.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be used in conjunction with the 2016 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

Village Bank and Trust Financial Corp.

Form 10-K

TABLE OF CONTENTS

Part I

In addition to historical information, the following report contains forward-looking statements that are subject to risks and uncertainties that could cause Village Bank and Trust Financial Corp.'s actual results to differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of the report. For discussion of factors that may cause our actual future results to differ materially from those anticipated, please see "ITEM 7 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" herein.

ITEM 1. BUSINESS

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

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

Bank revenues are derived from interest and fees received in connection with loans, deposits, and mortgage services. Administrative and operating expenses are the major expenses, followed by interest paid on deposits and borrowings. Revenues from the mortgage company consist primarily of gains from the sale of loans and loan origination fees and its major expenses consist of personnel, occupancy, data processing, and other operating expenses. In 2015, revenue (after intercompany eliminations) generated by the Bank totaled $18.6 million and the mortgage company generated $7.3 million in revenue.

Business Strategy

We are implementing strategies that we believe, overtime, will help us achieve our goal of delivering long term total shareholder returns that rank in the top quartile of a nationwide peer group. To achieve this goal, we believe that we will need to become a top performer in return on equity, produce sustainable earnings growth, achieve best quartile earnings volatility in our industry and deliver best quartile asset quality in the worst part of the economic cycle. Our current business strategies include the following:

- *Grow our general commercial and consumer banking businesses*. Our strategy is to offer commercial and retail customers all of the basic products and services they need while maintaining the quick response and personal service of a community bank. During the past two years, we have made significant investments in our people and products. In commercial banking, we expanded our commercial banking team, enhanced our Small Business Administration (“SBA”) lending capabilities, and installed a more intensive sales process. In consumer banking, we upgraded all automated teller machines (“ATMs”), installed mobile deposit capture, switched debit card providers to increase exchange fees, enhanced our rewards program, expanded our customer care team staff and hours, fully implemented our overdraft protection program and installed a more efficient and competitive consumer lending process and updated loan products.

- *Reposition our real estate lending to emphasize both construction and commercial mortgage lending on income producing properties while being selective and targeted in our land acquisition and development and single family construction lending*. Real estate lending will continue to be an important part of our business strategy, but we intend to be diligent in managing overall portfolio concentrations and focus on real estate sectors that will perform better during difficult times.

- *Grow low cost core deposits by emphasizing relationship banking in every division. In turn, this will lower funding costs, enhance return on assets and return on equity and help us develop long term, mutually important relationships with our clients*. We have enhanced our deposit products, realigned our treasury services and small business banking, and established performance expectations and incentives for commercial bankers to grow deposits. We will also focus on deposit-rich business and consumer market segments. During the past two years, we have significantly enhanced our product and service offerings for businesses and consumers and this has yielded 24% growth in business checking, savings and money market deposit products since year end 2013 and 13% growth total checking, savings and money market deposits during that time. Our goal is to have these low cost relationship deposit categories account for 70% of our funding and to have noninterest bearing demand deposits account for 25% of our funding by year end 2019.

- *Drive fee income growth by growing mortgage banking and enhancing fee generating services, both of which will improve return on assets and return on equity*. We have been installing and updating business and consumer banking products and services that generate fee income. For each of the past two years, we have achieved double digit fee income on banking services. Mortgage revenues increased 31% in 2015 producing pretax earnings in excess of $1 million .

- *Streamline and rationalize our processes and organization to improve productivity and efficiency*. Operational efficiency and excellence are critical to becoming a high return on equity bank. We embrace the need to continuously improve how we get business done and to be nimble and versatile.

- *Achieve excellence in all risk management and credit processes*. We strive to achieve best quartile performance on credit quality metrics in the worst part of the business cycle and sustainable earnings growth over time. Risk taking is a fundamental part of banking. Top performing banks are very good at identifying, evaluating, measuring, tracking, managing, mitigating and getting paid for the risks the organization takes. We are committed to building and sustaining the culture, talent, tools, policies, processes, resources and discipline needed to be a top performer in our risk management and credit processes.

- *Achieve full compliance with Regulatory Agreements to reduce related costs and enhance our flexibility as we grow the business*. We earned release from the formal agreement with the FDIC and Virginia Bureau of Financial Institutions during 2015. We are working hard to eliminate the informal memorandum of understanding with those authorities and the written agreement with the Federal Reserve Bank of Richmond during 2016.

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

4

Market Area

The Company, the Bank, and the mortgage company are headquartered in Chesterfield County and primarily serve the Central Virginia region and the Richmond Metropolitan Statistical Area (the "Richmond MSA". At the end of 2014, the Richmond MSA was the nation's 44th largest metro area. At the end of 2015, its population was 1,263,617 representing approximately 15% of the total population in the Commonwealth of Virginia with a median age of 38.1 years.

The unemployment rate for Richmond MSA was 4.1% in December 2015 compared to 4.2% for the Commonwealth of Virginia and 5.0% for the nation. At December 31, 2014 the unemployment rate for Richmond MSA 4.7%, 4.8% for the Commonwealth of Virginia and 5.6% for the nation.

Banking Services

We currently conduct business from eleven full-service branch banking offices, one offsite ATM and two mortgage loan production offices in Central Virginia in the counties of Chesterfield, Hanover, Henrico and Powhatan. We also have a mortgage loan production office in Manassas, Virginia.

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

Lending Services. We offer a full range of short-to-medium term commercial and personal loans. We also provide a wide range of real estate finance services. Our primary focus is on making loans in the Central Virginia market where we have branch banking offices. We also originate mortgage loans for sale in our Northern Virginia mortgage loan production office. We will periodically offer residential construction-to-permanent financing to clients of the mortgage production office in Northern Virginia.

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

- *Commercial Real Estate Acquisition, Development, Construction and Mortgage Lending*. We make loans to our clients for the purposes of acquiring, developing, constructing and owning commercial real estate. These properties may be owner-occupied or may be held for investment purposes and repaid from rental income or from the sale of the property.

- *Consumer Lending*. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. We also originate fixed and variable rate mortgage loans and real estate construction and acquisition loans. Residential loans originated by our mortgage company are usually sold in the secondary mortgage market.

- *Loan Participations*. We sell loan participations in the ordinary course of business when a loan originated by us exceeds our legal lending limit or we otherwise deem it prudent to share the risk with another lending institution. Additionally, we purchase loan participations from other banks, usually without recourse against that bank. We underwrite purchased loan participations in accordance with normal underwriting practices.

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

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

Lending Limit. As of December 31, 2015, our legal lending limit for loans to one borrower was approximately $6,404,000. However, we generally limit credit to any one individual or entity to a maximum of $4,000,000.

Competition

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

At June 30, 2015, the latest date such information is available from the FDIC, the Bank's deposit market share in Chesterfield County was 5.29%, 4.41% in Hanover County, 7.39% in Powhatan County, 0.41% in the Richmond MSA and 0.09% in Henrico County.

Regulation

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

General. The discussion below is only a summary of the principal laws and regulations that comprise the regulatory framework applicable to us. The descriptions of these laws and regulations, as well as descriptions of laws and regulations contained elsewhere herein, do not purport to be complete and are qualified in their entirety by reference to applicable laws and regulations. In recent years, regulatory compliance by financial institutions such as ours has placed a significant burden on us both in costs and employee time commitment.

Bank Holding Company. The Company is a bank holding company under the federal Bank Holding Company Act of 1956, as amended, and is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and Virginia Bureau of Financial Institutions (the “BFI”). As a bank holding company, the Company is required to furnish to the Federal Reserve annual and quarterly reports of its operations and such additional information as the Federal Reserve may require. The Federal Reserve, FDIC and BFI also may conduct examinations of the Company and/or the Bank.

Bank Regulation. As a Virginia-chartered bank that is not a member of the Federal Reserve, the Bank is subject to regulation, supervision and examination by the BFI and the FDIC. Federal and state law also specify the activities in which the Bank may engage, the investments it may make and the aggregate amount of loans that may be granted to one borrower. Various consumer and compliance laws and regulations also affect the Bank’s operations. Earnings are affected by general economic conditions, management policies and the legislative and governmental actions of various regulatory authorities, including those referred to above. The BFI and the FDIC conduct regular examinations, reviewing such matters as the overall safety and soundness of the institution, the adequacy of loan loss reserves, quality of loans and investments, management practices, compliance with laws, and other aspects of the Bank’s operations. In addition to these regular examinations, the Bank must furnish the FDIC and BFI with periodic reports containing a full and accurate statement of its affairs. Supervision, regulation and examination of banks by these agencies are intended primarily for the protection of depositors rather than shareholders.

Agreements with Regulators. In February 2012, the Bank entered into a Stipulation and Consent to the Issuance of a Consent Order with the FDIC and the BFI (the “Supervisory Authorities”), and the Supervisory Authorities issued the related Consent Order effective February 3, 2012. In June 2012, the Company entered into a written agreement (“Written Agreement”) with the Federal Reserve Bank of Richmond (“Reserve Bank”). A description of the terms and conditions of these Agreements is provided in *Note 12. Commitments and contingencies* of the *Notes to Consolidated Financial Statements*.

On December 22, 2015, the Bank received notification from the FDIC and the BFI that the Consent Order was terminated effective December 14, 2015. The Consent Order was terminated as a result of the steps the Company and the Bank took to, among other things, improve asset quality, increase capital, augment management and board oversight, and increase earnings. The Written Agreement with the Reserve Bank continues in effect.

In place of the Consent Order, the Bank’s Board of Directors has made certain written assurances to the FDIC and Virginia BFI in the form of a Memorandum of Understanding (“MOU”) that became effective November 17, 2015. The MOU contains provisions concerning asset quality, earnings, regulatory violations, minimum capital levels, asset growth, restrictions on paying dividends and a requirement to furnish progress reports to the FDIC and Virginia BFI. The MOU is considered an informal regulatory action.

The following description summarizes some of the laws and regulations to which we are subject.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. In July 2010, the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law, incorporating numerous financial institution regulatory reforms. Certain of these reforms are yet to be implemented through regulations to be adopted by various federal banking and securities regulatory agencies. The following discussion describes the material elements of the regulatory framework that currently apply. The Dodd-Frank Act implements far-reaching reforms of major elements of the financial landscape, particularly for larger financial institutions. Many of its provisions do not directly impact community-based institutions like the Bank. For instance, provisions that regulate derivative transactions and limit derivatives trading activity of federally-insured institutions, enhance supervision of "systemically significant" institutions, impose new regulatory authority over hedge funds, limit proprietary trading by banks, and phase-out the eligibility of trust preferred securities for Tier 1 capital are among the provisions that do not directly impact the Bank either because of exemptions for institutions below a certain asset size or because of the nature of the Bank's operations. Provisions that do impact the Bank include the following:

- *FDIC Assessments*. The Dodd-Frank Act changes the assessment base for federal deposit insurance from the amount of insured deposits to average consolidated total assets less its average tangible equity. In addition, it increases the minimum size of the Deposit Insurance Fund ("DIF") and eliminates its ceiling, with the burden of the increase in the minimum size on institutions with more than $10 billion in assets.
- *Deposit Insurance.* The Dodd-Frank Act makes permanent the $250,000 limit for federal deposit insurance at all insured depository institutions.
- *Interest on Demand Deposits.* The Dodd-Frank Act provides that depository institutions may pay interest on demand deposits, including business transaction and other accounts.
- *Consumer Financial Protection Bureau.* The Dodd-Frank Act centralizes responsibility for consumer financial protection by creating the Consumer Financial Protection Bureau, responsible for implementing federal consumer protection laws, although banks below $10 billion in assets will continue to be examined and supervised for compliance with these laws by their federal bank regulator.
- *Mortgage Lending.* Additional requirements are imposed on mortgage lending, including minimum underwriting standards, prohibitions on certain yield-spread compensation to mortgage originators, special consumer protections for mortgage loans that do not meet certain provision qualifications, prohibitions and limitations on certain mortgage terms and various mandated disclosures to mortgage borrowers.
- *Holding Company Capital Levels.* Bank regulators are required to establish minimum capital levels for holding companies that are at least as stringent as those currently applicable to banks. In addition, all trust preferred securities issued after May 19, 2010 will be counted as Tier 2 capital, but the Company's currently outstanding trust preferred securities will continue to qualify as Tier 1 capital.
- *De Novo Interstate Branching.* National and state banks are permitted to establish de novo interstate branches outside of their home state, and bank holding companies and banks must be well-capitalized and well managed in order to acquire banks located outside their home state.
- *Transactions with Affiliates.* The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of "covered transactions" and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.
- *Transactions with Insiders.* Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution's board of directors.
- *Corporate Governance.* The Dodd-Frank Act includes corporate governance revisions that apply to all public companies, not just financial institutions, including with regard to executive compensation and proxy access to shareholders.

The Company is continually evaluating the effects of the Dodd-Frank Act, together with implementing the regulations that have been proposed and adopted. The ultimate effects of the Dodd-Frank Act and the resulting rulemaking cannot be predicted at this time, but it has increased the Company's operating and compliance costs in the short-term, and it could have a material adverse effect on the Company's results of operation and financial condition.

Insurance of Accounts, Assessments and Regulation by the FDIC. Our deposits are insured by the FDIC up to the limits set forth under applicable law, currently $250,000. We are subject to the deposit insurance assessments of the DIF. The amount of the assessment is a function of the institution's risk category, of which there are four, and its assessment base. An institution's risk category is determined according to its supervisory ratings and capital levels and is used to determine the institution's assessment rate. The assessment base is an institution's average consolidated total assets less its average tangible equity.

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

Payment of Dividends. The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. Virtually all of the Company’s cash revenues will result from dividends paid to it by the Bank, which is subject to laws and regulations that limit the amount of dividends that it can pay. Under Virginia law, a bank may not declare a dividend in excess of its accumulated retained earnings without BFI approval. As of December 31, 2015, the Bank did not have any accumulated retained earnings. In addition, the Bank may not declare or pay any dividend if, after making the dividend, the Bank would be "undercapitalized," as defined in FDIC regulations.

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

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

The Company is subject to a Written Agreement with the Reserve Bank pursuant to which the Company is required to obtain the prior written approval of the Reserve Bank to declare or pay any dividends on its common stock or preferred stock, take dividends or any other form of payment representing a reduction in capital from the Bank or make any payments on its trust preferred securities.

The Bank was subject to a Consent Order with the FDIC and the BFI that also required the Bank to obtain prior written regulatory approval to declare or pay any dividends, pay bonuses or make any other form of payment outside the ordinary course of business resulting in a reduction of capital. Under the MOU, the Bank remains subject to this requirement.

Capital Adequacy. Both the Company and the Bank are required to comply with the capital adequacy standards established by the Federal Reserve, in the case of the Company, and the FDIC, in the case of the Bank. In June 2012, the federal bank regulatory agencies jointly issued proposed rules to revise the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to be consistent with the agreements reached by the Basel Committee on Banking Supervision in “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems” (“Basel III”) and certain provisions of the Dodd-Frank Act. The proposed rules applied to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more, and top-tier savings and loan holding companies (“banking organizations”). On July 2, 2013, the federal bank regulatory agencies approved certain revisions to the proposed rules and finalized new capital requirements for banking organizations.

Among other things, the final rules establish a revised definition of regulatory capital, a new common equity Tier 1 minimum capital requirement ("CET1"), a higher minimum Tier 1 capital requirement, and a supplementary leverage ratio that incorporates a broader set of exposures in the denominator. The final rules also establish limits on a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified amount of CET1 capital in addition to the necessary amount to meet its minimum risk-based capital requirements.

Effective January 1, 2015, the final rules require the Company and the Bank to comply with the following new minimum capital ratios: (i) a new ratio of CET1 to risk-weighted assets of 4.5%; (ii) a ratio of Tier 1 capital to risk-weighted assets of 6.0% (iii) a ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of 8.0%; and (iv) a leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter). These are the initial capital requirements, which will be phased in over a four-year period that began on January 1, 2015. When fully phased in, Basel III will require the Company and the Bank to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%.

Basel III will also provide for a "countercyclical capital buffer," generally designed to absorb losses during periods of economic stress and to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. The buffer would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented (potentially resulting in total buffers of between 2.5% and 5%).

The Basel III capital framework is also expected to provide for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 are to be phased-in over a three-year period which began on January 1, 2016.

Additionally, the bank regulatory agencies' final rules revised the "prompt corrective action" regulations pursuant to Section 38 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (the "FDIC Act") by (i) introducing a CET1 capital ratio requirement at each level (other than critically undercapitalized), with the required ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum ratio for well-capitalized status being 8.0%; and (iii) eliminating the provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized. These new thresholds were effective for the Bank as of January 1, 2015. The minimum total capital to risk-weighted assets ratio (10.0%) and minimum leverage ratio (5.0%) for well-capitalized status were unchanged by the final rules. As of December 31, 2015, the Bank met the new minimum ratios to be classified as a well capitalized financial institution.

Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to banks in the three “undercapitalized” categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company’s obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary’s assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution and a lower capital category based on supervisory factors other than capital.

In February 2012, the Bank entered into the Consent Order with the Supervisory Authorities that provided that, within 90 days from the date of the order and during the life of the order, the Bank must have a leverage capital ratio equal to or greater than 8% of its total assets, and total risk-based capital equal to or greater than 11% of the Bank’s total risk-weighted assets. The MOU that replaced the Consent Order in November 2015 provides that the Bank must maintain a leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 12%. At December 31, 2015, the Bank’s Tier 1 risk-based capital ratio was 12.85%, its total risk-based capital ratio was 14.02% and its leverage ratio was 9.33%. More information concerning our regulatory ratios at December 31, 2015 is included in Note 13 to the *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K.

Restrictions on Transactions with Affiliates. Both the Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

- A bank’s loans or extensions of credit, including purchases of assets subject to an agreement to repurchase, to affiliates;
- A bank’s investment in affiliates;
- Assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- The amount of loans or extensions of credit to third parties collateralized by the securities or debt obligations of affiliates;
- Transactions involving the borrowing or lending of securities and any derivative transaction that results in credit exposure to an affiliate; and
- A bank’s guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank’s capital and surplus and, as to all affiliates combined, to 20% of a bank’s capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The

Bank must also comply with other provisions designed to avoid acquiring low-quality assets from its affiliates.

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

On September 30, 2010, the Company sold its headquarters building at the Watkins Centre to the Bank. This transaction allowed us to repay the outstanding mortgage loan on the building resulting in a reduction of our interest expense and improvement in earnings on a consolidated basis. The Federal Reserve Bank has determined that the sale of the headquarters building from the Company to the Bank was not permitted under Section 23A of the Federal Reserve Act as the amount of the transaction exceeded 10% of the Bank's capital stock and surplus. As a result, the Federal Reserve Bank has directed the Company to take corrective action. The Company has taken and continues to take active steps to correct this violation including offering the building for sale. While the Company has not been successful in these efforts and continues to update the Federal Reserve Bank on such efforts, it is currently in negotiations with a serious buyer.

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

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

Support of Subsidiary Institutions. Under the Dodd-Frank Act, and previously under Federal Reserve policy, we are required to act as a source of financial strength for our bank subsidiary, Village Bank, and to commit resources to support the Bank. This support can be required at times when it would not be in the best interest of our shareholders or creditors to provide it. In the unlikely event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of the Bank would be assumed by the bankruptcy trustee and entitled to a priority of payment. On December 31, 2012, the Company made a capital contribution of $1,500,000 to the Bank to improve its capital ratios. In addition, on December 4, 2013, the Company raised $1,684,075 through the sale of 67,907 shares of its common stock to its board of directors and executive management team at a price of $24.80 per share in a private placement. The total amount raised was contributed to the Bank as additional capital.

On March 27, 2015, the Company completed a rights offering to shareholders (the "Rights Offering") and concurrent standby offering to Kenneth R. Lehman (the "Standby Offering"), in which the Company issued an aggregate of 1,051,866 shares of common stock (the total number of shares offered) at $13.87 per share for aggregate gross proceeds of $14,589,381 (including the value of the Company's preferred stock exchanged by Mr. Lehman for shares of common stock of $4,618,813). In connection with the Rights Offering, 283,293 shares were issued to shareholders upon exercise of their basic subscription rights and 191,773 shares were issued to shareholders upon exercise of their oversubscription privileges (approximately 36.9% of the total number of shares requested pursuant to oversubscription privileges). In connection with the Standby Offering, Mr. Lehman purchased an aggregate of 576,800 shares of the Company's common stock, 333,007 of which were issued in exchange for 9,023 shares of the Company's preferred stock and 243,793 of which were purchased for cash. Also, as part of the Standby Offering, Mr. Lehman forgave $2,215,009 in accrued and unpaid dividends on the preferred stock. The Company made a capital contribution of $5,000,000 to the Bank from the cash proceeds of this offering.

Incentive Compensation Policies and Restrictions. In July 2010, the federal banking agencies issued guidance that applies to all banking organizations supervised by the agencies (thereby including both the Company and the Bank). Pursuant to the guidance, to be consistent with safety and soundness principles, a banking organization's incentive compensation arrangements should: (1) provide employees with incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance including active and effective oversight by the banking organization's board of directors. Monitoring methods and processes used by a banking organization should be commensurate with the size and complexity of the organization and its use of incentive compensation. At December 31, 2015, we had not been made aware of any instances of non-compliance with this guidance.

Emergency Economic Stabilization Act of 2008. In response to unprecedented market turmoil during the third quarter of 2008, the Emergency Economic Stabilization Act of 2008 (“EESA”) was enacted on October 3, 2008. EESA authorized the U.S. Treasury to provide up to $700 billion to support the financial services industry. Pursuant to the EESA, the U.S. Treasury was initially authorized to use $350 billion for the Troubled Asset Relief Program (“TARP”), of which the U.S. Treasury allocated $250 billion to the TARP Capital Purchase Program (the “TARP Program”).

On May 1, 2009, the Company issued preferred stock and a warrant to purchase its common stock to the U.S. Treasury pursuant to the TARP Program. The amount of capital raised in that transaction was $14.7 million. Pursuant to the terms of the preferred stock, dividends may not be paid on common stock unless dividends have been paid on the preferred stock. The preferred stock does not have voting rights other than the right to vote as a class on the issuance of any preferred stock ranking senior, any change in its terms or any merger, exchange or similar transaction that would adversely affect its rights. Holders of the preferred stock also have the right to elect two directors if dividends have not been paid for six periods.

The Company has deferred nineteen (19) dividend payments as of December 31, 2015, but holders of the preferred stock have never nominated directors to the board. The Company received notification on February 26, 2016 from the Reserve Bank approving the payment of all accrued and deferred interest payments on trust preferred securities as of March 15, 2016 bringing the Company current as of that date.

In November 2013, the Company’s preferred stock was sold by the U.S. Treasury as part of its efforts to manage and recover its investments under the TARP Program. While the sale of the preferred stock to new owners did not result in any proceeds to the Company (nor did it change the Company’s capital position or accounting for these securities including accrual of dividends), it did eliminate certain restrictions put in place by the U.S. Treasury on TARP recipients.

USA Patriot Act. The USA Patriot Act became effective on October 26, 2001 and provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Among other provisions, the USA Patriot Act permits financial institutions, upon providing notice to the United States Treasury, to share information with one another in order to better identify and report to the federal government activities that may involve money laundering or terrorists’ activities. The USA Patriot Act is considered a significant banking law in terms of information disclosure regarding certain customer transactions. Certain provisions of the USA Patriot Act impose the obligation to establish anti-money laundering programs, including the development of a customer identification program, and the screening of all customers against any government lists of known or suspected terrorists. Although it does create a reporting obligation and compliance costs, the USA Patriot Act has not materially affected the Bank’s products, services or other business activities.

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

Other Safety and Soundness Regulations. There are a number of obligations and restrictions imposed on depository institutions by federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event the depository institution becomes in danger of default or is in default. The Federal banking agencies also have broad powers under current Federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized, as defined by the law. Federal regulatory authorities also have broad enforcement powers over us, including the power to impose fines and other civil and criminal penalties, and to appoint a receiver in order to conserve the assets of any such institution for the benefit of depositors and other creditors. At December 31, 2015, Village Bank met the ratio requirements to be classified as a well capitalized financial institution.

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

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

Volcker Rule. On December 10, 2013, five U.S. financial regulators, including the FDIC, adopted final rules implementing the Volcker Rule. The final rules prohibit banking entities from (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds. The Volcker Rule is intended to provide greater clarity with respect to both the extent of those primary prohibitions and of the related exemptions and exclusions. The final rules were effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2016. We believe that the adoption of this guidance will not have a material effect on the Company’s financial condition or results of operations.

Cybersecurity. In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution’s management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution’s operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If the Company fails to observe the regulatory guidance, it could be subject to various regulatory sanctions, including financial penalties. To date, we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, but our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers.

Employees

As of December 31, 2015, the Company and its subsidiaries had a total of 157 full-time employees and 9 part-time employees. None of the Company's employees are covered by a collective bargaining agreement. The Company considers its relations with its employees to be good.

Code of Ethics

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

Additional Information

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any reports, statements and other information we file at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operations of the Public Reference Room. Our SEC filings are also available on the SEC's Internet site (http://www.sec.gov).

The Company's common stock trades under the symbol "VBFC" on the Nasdaq Capital Market.

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

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

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

ITEM 1A. RISK FACTORS

Not applicable

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable

ITEM 2. PROPERTIES

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

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

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

ITEM 3. LEGAL PROCEEDINGS

In the course of its operations, the Company may become a party to legal proceedings. There are no material pending legal proceedings to which the Company is a party or of which the property of the Company is subject.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

16

Part Ii

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

On August 8, 2014, we completed a reverse split of our common stock. All financial information and per share amounts are presented as if the reverse split was effective at the beginning of the earliest period presented.

Market Information

Shares of the Company's common stock trade on the Nasdaq Capital Market under the symbol "VBFC". The high and low prices of shares (adjusted for reverse stock split) of the Company's common stock for the periods indicated were as follows:

	High	Low
2014		
1st quarter	$28.80	$20.48
2nd quarter	23.84	21.12
3rd quarter	30.08	20.32
4th quarter	27.22	16.22
2015		
1st quarter	$25.99	$14.15
2nd quarter	22.40	17.30
3rd quarter	23.75	18.00
4th quarter	21.80	18.25

Dividends

The Company has not paid any dividends on its common stock. We intend to retain all of our earnings to finance the Company's operations and we do not anticipate paying cash dividends for the foreseeable future. Any decision made by the board of directors to declare dividends in the future will depend on the Company's future earnings, capital requirements, financial condition and other factors deemed relevant by the board. Banking regulations limit the amount of cash dividends that may be paid without prior approval of the Bank's regulatory agencies. Such dividends are limited to the Bank's accumulated retained earnings. The Federal Reserve has issued guidelines that bank holding companies should inform and consult with the Federal Reserve in advance of declaring or paying a dividend that exceeds earnings for the period (e.g. quarter) for which the dividend is being paid or that could result in a material adverse charge to the organization's capital structure.

We also are subject to a Written Agreement with the Reserve Bank that includes a requirement that we will not pay dividends on our capital stock, including our Series A preferred stock, trust preferred securities or common stock without the prior consent of the Reserve Bank. Supervisory guidance from the Federal Reserve indicates that TARP Program recipients that are experiencing financial difficulties generally should eliminate, reduce or defer dividends on Tier 1 capital instruments, including trust preferred, preferred stock or common stock, if the holding company needs to conserve capital for safe and sound operation and to serve as a source of strength to its subsidiaries.

In addition, we are subject to an MOU with the FDIC and the BFI that includes a requirement that the Bank will not pay dividends without regulatory approval.

The Company has deferred interest payments on the junior subordinated debt securities of $1,273,000 as of December 31, 2015. Although we elected to defer payment of the interest due, the amount has been accrued and is included in interest expense. The Company received notification on February 26, 2016 from the Reserve Bank approving the payment of all accrued and deferred interest payments on trust preferred securities bringing the Company current as of March 2016.

In addition, the Company has deferred dividend payments on the preferred stock, including dividends that accrue on the unpaid balance. The total arrearage on our preferred stock as of December 31, 2015 is $2,077,000 and has been accrued and reflected as a reduction of retained earnings.

Holders

At February 18, 2016 there were approximately 1,032 active holders of common stock; including registered holders and beneficial holders of shares through banks, brokers and other nominees.

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

Purchases of Equity Securities

The Company did not repurchase any of its Common Stock during 2015.

ITEM 6. Selected Financial data

Not applicable

Item 7. Management's Discussion and Analysis of financial condition and results of operations

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

Caution About Forward-Looking Statements

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

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

- changes in assumptions underlying the establishment of allowances for loan losses, and other estimates;
- the risks of changes in interest rates on levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities, and interest sensitive assets and liabilities;
- the effects of future economic, business and market conditions;
- the inability of the Company and the Bank to comply with the requirements of agreements with its regulators;
- the inability to reduce nonperforming assets consisting of nonaccrual loans and foreclosed real estate;
- our inability to maintain our regulatory capital position;
- the Company's computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions despite security measures implemented by the Company;.
- changes in market conditions, specifically declines in the residential and commercial real estate market, volatility and disruption of the capital and credit markets, soundness of other financial institutions we do business with;
- risks inherent in making loans such as repayment risks and fluctuating collateral values;
- changes in operations of Village Bank Mortgage Corporation as a result of the activity in the residential real estate market;
- legislative and regulatory changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and other changes in banking, securities, and tax laws and regulations and their application by our regulators, and changes

in scope and cost of FDIC insurance and other coverages;

- exposure to repurchase loans sold to investors for which borrowers failed to provide full and accurate information on or related to their loan application or for which appraisals have not been acceptable or when the loan was not underwritten in accordance with the loan program specified by the loan investor;
- governmental monetary and fiscal policies;
- changes in accounting policies, rules and practices;
- reliance on our management team, including our ability to attract and retain key personnel;

19

- competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources;
- demand, development and acceptance of new products and services;
- problems with technology utilized by us;
- changing trends in customer profiles and behavior; and
- other factors described from time to time in our reports filed with the SEC.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

General

The Company's primary source of earnings is net interest income, and its principal market risk exposure is interest rate risk. The Company is not able to predict market interest rate fluctuations and its asset/liability management strategy may not prevent interest rate changes from having a material adverse effect on the Company's results of operations and financial condition. Because the Company has intentionally decreased assets over the last three years as it has been resolving problem assets and attempting to improve capital ratios as well as declines in yields on earning assets, net interest income has declined from $15,189,000 in 2013 to $13,018,000 in 2014 and to $12,637,000 in 2015.

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

Results of Operations

The following presents management's discussion and analysis of the financial condition of the Company at December 31, 2015 and 2014, and results of operations for the Company for the years ended December 31, 2015, 2014 and 2013. This discussion should be read in conjunction with the Company's audited Financial Statements and the notes thereto appearing elsewhere in this Annual Report.

20

The following table sets forth selected financial ratios:

	2015	2014	2013
Performance Ratios			
Return on average assets	0.15 %	(0.24)%	(0.84)%
Return on average equity	2.30 %	(5.43)%	(17.17)%
Net interest margin*(1)*	3.40 %	3.46 %	3.66 %
Efficiency*(2)*	105.96%	104.48%	110.33%
Loans to deposits	84.27 %	75.72 %	73.53 %
Equity to assets	7.23 %	4.39 %	4.11 %
Asset Quality Ratios			
ALLL to loans at year-end	1.16 %	2.00 %	2.52 %
ALLL to loans at year-end excluding guaranteed student loans *(3)*	1.41 %	2.26 %	2.52 %
ALLL to nonaccrual loans	95.78 %	76.62 %	38.82 %
Nonperforming assets to total assets	2.37 %	4.63 %	7.97 %
Nonperforming loans to total loans	3.24 %	7.01 %	12.32 %
Net charge-offs to average loans	0.06 %	0.59 %	1.49 %

(1) Net interest margin is computed by dividing net interest income for the period by average interest earning assets.
(2) Efficiency ratio is computed by dividing noninterest expense by the sum of net interest income and noninterest income.
(3) Student loans are guaranteed by the Department of Education for approximately 98% of principal and interest and are evaluated separately for ALLL.

Such ratios are not measurements under accounting principles generally accepted in the United States ("GAAP") and are not intended to be a substitute for our balance sheet or income statement prepared in accordance with GAAP.

Income Statement Analysis

Summary

We recorded net income of $646,000 and net income available to common shareholders of $6,590,000 or $5.49 per fully diluted share in 2015 compared to a net loss of $1,037,000 and a net loss available to common shareholders of $2,473,000, or $(7.39) per fully diluted share, in 2014 and a net loss of $4,007,000 and a net loss available to common shareholders of $4,893,000, or $(18.06) per fully diluted share, in 2013. Certain items of income and expense affecting net income in each of the three years ended December 31, 2015 affect comparability and are not a result of ongoing operations. The impact these amounts had on our net income (loss) in 2015, 2014 and 2013 is illustrated in the following table (in thousands) which adjusts pretax earnings for gains and losses on sales of assets other than loan sales by the mortgage company, write down of assets held for sale, and the effect of problem assets ("pretax income as adjusted"). Such adjusted earnings is not a measurement under accounting principles generally accepted in the United States ("GAAP") and is not intended to be a substitute for our income statement prepared in accordance with GAAP.

	2015	2014	2013
Pretax income (loss) - GAAP	$646	$(1,037)	$(4,007)
Less: Gain (loss) on sale of securities	6	(210)	217
Add:			
(Recovery of) provision for loan losses	(2,000)	100	1,173
Write down of assets held for sale	2,649	-	-
Expenses related to foreclosed assets	153	1,244	7,082
	802	1,344	8,255
Pretax income as adjusted	$1,442	$517	$4,031

Pretax income as adjusted increased by $925,000 from 2014 to 2015 and decreased by $3,514,000 from 2013 to 2014. The reasons for these changes are presented in the following table (in thousands):

	2015 Compared to 2014	2014 Compared to 2013
Increase (decrease) in		
Net interest income	$(381)	$ (2,171)
Gains on sale of loans	1,627	(3,295)
Service charges and fees	275	(69)
Rental income	140	111
Other noninterest income	(89)	(686)
(Increase) decrease		
Salaries and benefits	(161)	1,220
Commissions	(390)	838
Occupancy	(40)	374
Professional and outside services	(380)	(130)
Other operating expenses	275	187
Other	49	107
Total	$925	$ (3,514)

The net income available to shareholders for the year ended December 31, 2015 was positively impacted by the forgiveness of principal and dividends on preferred stock amounting to $6,619,000 associated with the Rights Offering and concurrent Standby Offering completed in March 2015.

Net interest income

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

Net interest income decreased to $12,637,000 in 2015 from $13,018,000 in 2014 and $15,189,000 in 2013. The decline in net interest income of $381,000 in 2015 was a result of declines in both interest income and interest expense. Interest income declined by $1,074,000 in 2015 primarily due to a decline of 0.24% (24 basis points) in the yield on average earning assets. While yields on all interest earning assets declined with the exception of federal funds sold, the primary driver was a decline in the yield on loans which declined by 0.61% (61 basis points) due to a competitive lending environment. Interest expense declined by $693,000 primarily as a result of a decline in average interest bearing liabilities of $34,310,000, with average interest bearing deposits declining by $27,436,000 and average Federal Home Loan Bank of Atlanta (“FHLB”) advances declining by $6,441,000.

The decline in net interest income of $2,171,000 in 2014 was also a result of declines in interest income and interest expense. Interest income declined by $3,036,000 in 2014 primarily as a result of a decline in average interest earning assets of $39,123,000 combined with a decline in the yield on those assets of 0.31% (31 basis points). The primary driver of the declines in average interest earning assets and their associated yields were continued reductions in problem loans and a competitive lending environment for new loans which resulted in a decrease in average portfolio loans of $41,214,000 and their yields by 0.21% (21 basis points). Interest expense declined by $865,000 in 2014 primarily as a result of a decline in average interest bearing liabilities of $39,856,000, with average interest bearing deposits declining by $31,579,000 and average FHLB advances declining by $7,960,000.

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

	Year Ended December 31, 2015			Year Ended December 31, 2014			Year Ended December 31, 2013		
	Average Balance	Interest Income/ Expense	Yield Rate	Average Balance	Interest Income/ Expense	Yield Rate	Average Balance	Interest Income/ Expense	Yield Rate
Loans									
Commercial	$ 21,291	$ 1,096	5.15 %	$ 23,991	$ 1,321	5.51 %	$ 29,792	$ 1,678	5.63 %
Real estate - residential	87,767	4,756	5.42 %	94,482	5,275	5.58 %	107,116	5,827	5.44 %
Real estate - commercial	113,132	5,650	4.99 %	115,541	6,350	5.50 %	139,468	8,203	5.88 %
Real estate - construction	30,828	1,609	5.22 %	30,577	1,728	5.65 %	36,808	2,050	5.57 %
Student loans	42,610	1,204	2.83 %	8,145	204	2.50 %	-	-	-
Consumer	1,795	72	4.01 %	1,692	84	4.96 %	2,458	122	4.96 %
Gross loans	297,423	14,387	4.84 %	274,428	14,962	5.45 %	315,642	17,880	5.66 %
Investment securities	38,246	616	1.61 %	54,566	1,182	2.17 %	47,943	1,083	2.26 %
Loans held for sale	11,487	446	3.88 %	8,204	347	4.23 %	13,772	564	4.10 %
Federal funds and other	24,242	55	0.23 %	38,805	87	0.22 %	37,769	87	0.23 %
Total interest earning assets	371,398	15,504	4.17 %	376,003	16,578	4.41 %	415,126	19,614	4.72 %
Allowance for loan losses	(5,678)			(6,218)			(9,502)		
Cash and due from banks	9,765			12,376			12,280		
Premises and equipment, net	14,210			13,204			24,150		
Other assets	36,906			43,107			36,417		
Total assets	$ 426,601			$ 438,472			$ 478,471		
Interest bearing deposits									
Interest checking	43,450	79	0.18 %	42,311	78	0.18 %	42,655	102	0.24 %
Money market	67,796	251	0.37 %	66,866	251	0.38 %	64,831	203	0.31 %
Savings	20,282	37	0.18 %	20,555	37	0.18 %	20,649	59	0.29 %
Certificates	163,956	2,114	1.29 %	193,188	2,640	1.37 %	226,364	3,302	1.46 %
Total deposits	295,484	2,481	0.84 %	322,920	3,006	0.93 %	354,499	3,666	1.03 %
Borrowings									
Long-tern debt - trust preferred securities	9,922	213	2.15 %	9,714	215	2.21 %	8,764	238	2.72 %
FHLB advances	9,027	170	1.88 %	15,468	334	2.16 %	23,428	513	2.19 %
Other borrowings	1,390	3	0.22 %	2,031	5	0.25 %	3,298	8	0.24 %
Total interest bearing liabilities	315,823	2,867	0.91 %	350,133	3,560	1.02 %	389,989	4,425	1.13 %

Noninterest bearing deposits	75,127		62,612		57,955	
Other liabilities	7,480		6,639		7,197	
Total liabilities	398,430		419,384		455,141	
Equity capital	28,171		19,088		23,330	
Total liabilities and capital	$ 426,601		$ 438,472		$ 478,471	
Net interest income before provision for loan losses		$ 12,637		$ 13,018		$ 15,189
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities		3.26 %		3.39 %		3.59 %
Net interest margin (net interest income expressed as a percentage of average earning assets)		3.40 %		3.46 %		3.66 %

24

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

	2015 vs. 2014 Increase (Decrease) Due to Changes in			2014 vs. 2013 Increase (Decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income						
Loans	$450	$(926)	$(476)	$(2,979)	$(156)	$(3,135)
Investment securities	(305)	(261)	(566)	141	(42)	99
Fed funds sold and other	(32)	(1)	(33)	-	-	-
Total interest income	113	(1,188)	(1,075)	(2,838)	(198)	(3,036)
Interest expense						
Deposits						
Interest checking	2	(1)	1	(1)	(23)	(24)
Money market accounts	-	-	-	7	41	48
Savings accounts	-	-	-	-	(22)	(22)
Certificates of deposit	(383)	(144)	(527)	(463)	(199)	(662)
Total deposits	(381)	(145)	(526)	(457)	(203)	(660)
Borrowings						
Long-term debt	(0)	(2)	(2)	(2)	(21)	(23)
FHLB Advances	(125)	(39)	(164)	(172)	(7)	(179)
Other borrowings	(2)	-	(2)	(3)	-	(3)
Total interest expense	(508)	(186)	(694)	(634)	(231)	(865)
Net interest income	$621	$(1,002)	$(381)	$(2,204)	$33	$(2,171)

Note: the combined effect on interest due to changes in both volume and rate, which cannot be separately identified, has been allocated proportionately to the change due to volume and the change due to rate.

Provision for (recovery of) loan losses

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

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

The provision for (recovery of) loan losses by loan category is presented following (in thousands):

	2015		2014		2013	
	Provision (Recovery)	Loans Outstanding	Provision (Recovery)	Loans Outstanding	Provision (Recovery)	Loans Outstanding
Construction and land development	$286	$ 31,150	$(1,119)	$ 29,467	$(3,944)	$ 31,110
Commercial real estate	(866)	116,218	1,645	109,568	1,933	130,475
Consumer real estate	(1,143)	83,594	(159)	89,773	3,014	96,794
Commercial and industrial	(350)	20,086	(447)	22,165	145	26,254
Student	13	53,989	217	33,562	-	-
Consumer	60	1,734	(37)	1,611	25	1,930
	$(2,000)	$ 306,771	$100	$ 286,146	$1,173	$ 286,563

Overall the recovery of loan losses recorded for the year ended December 31, 2015 was due primarily to credit quality improvements and an enhanced model for evaluating inherent losses in the Bank's loan portfolio. Improvements in credit quality are provided in the following schedule:

	December 31,		
	2015	2014	2013
Classified assets	$15,375	$30,684	$61,690
Nonaccrual loans	3,718	7,478	18,647
Foreclosed real estate	6,249	12,638	16,742

During the fourth quarter of 2015, we adopted a software solution for the analysis of the allowance for loan losses. While our methodology of evaluating the adequacy of the allowance for loan losses generally did not change, the software is more robust in that it:

- allows us to take a more measureable approach to our evaluation of qualitative factors such as economic conditions that may affect loss experience; and
- is widely used by community banks which provides peer data that can be used as a benchmark for comparison to our analysis.

In addition to the adoption of the software solution for our analysis, we reviewed the last twenty years of historical loss data for peer banks in Virginia to assist us in our evaluation of environmental factors and other conditions that could affect the loan portfolio and the overall adequacy of the allowance for loan losses.

The allowance for loan losses at each of the periods presented includes an amount that could not be identified to individual types of loans referred to as the unallocated portion of the allowance. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. We concluded that the unallocated portion of the allowance was acceptable given the continued higher level of classified assets and was within a reasonable range around the estimate of losses. At December 31, 2015 the allowance for loan losses included an unallocated portion of approximately $59,000.

Discussion of the recovery of loan losses related to specific loan types are provided following:

- The recovery of loan losses totaling $1,119,000 and $3,944,000 for the construction and land development loan portfolio during the years 2014 and 2013, respectively, was attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. In both years the general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 7.81% at December 31, 2012 to 4.82% at December 31, 2013 and to a net recovery of 0.27% at December 31, 2014. Also contributing to the declines in the general component were declines of approximately $1,643,000 and $12,945,000 in the outstanding loan balance of this portfolio at December 31, 2014 and 2013, respectively.

- The recovery of loan losses totaling $866,000 for the commercial real estate portfolio in 2015 was also attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 0.96% in 2014 to 0.57% in 2015. In addition, net charge-offs on this portfolio decreased from $1,220,000 in 2014 to $90,000 in 2015. Also contributing to the declines in the general component were declines of approximately $6,179,000 and $7,021,000 in the outstanding loan balance of this portfolio at December 31, 2015 and 2014, respectively.

- The recovery of loan losses totaling $1,143,000 for the consumer real estate portfolio in 2015 was also attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 1.36% in 2014 to 0.24% in 2015. In addition, net charge-offs on this portfolio decreased from $562,000 in 2014 to a recovery of $215,000 in 2015.

Noninterest income

Noninterest income includes service charges and fees on deposit accounts, fee income related to loan origination, gains and losses on sale of mortgage loans and securities held for sale, and rental income primarily on our previous headquarters building. Over the last three years the most significant noninterest income item has been gain on loan sales generated by the mortgage company, representing 60% in 2015, 56% in 2014, and 63% in 2013 of total noninterest income. Noninterest income amounted to $10,058,000 in 2015, $7,889,000 in 2014, and $12,255,000 in 2013.

Noninterest income increased by $2,169,000 in 2015 and is primarily attributable to an increase in the gain on sale of loans of $1,627,000, an increase in the gain on sale of investments of $216,000 and an increase in rental income of $140,000. In 2014 noninterest income decreased by $4,366,000 and is primarily attributable to a decrease in the gain on sale of loans of $3,295,000, decrease in gain on sale of investments of $427,000 and a decrease in the gain on sale of assets of $595,000, offset by an increase in service charges and fees on deposit accounts of $184,000.

The changes in the gains on sale of loans were due to changes in the mortgage lending market. Our mortgage subsidiary originated mortgage loans totaling $262 million in 2013, $160 million in 2014 and $207 million in 2015. The mortgage loan market declined overall in 2014 even though interest rates were at historic lows and had a negative impact on our mortgage loan production in that year. While the mortgage loan market improved in 2015, it was not as robust as in 2013.

The decrease in gain on sale of assets was a result of a branch sale completed in the first quarter of 2013, and the decrease in gain on sale of investments resulted from the sale of investments at a loss during 2014 as we positioned our securities portfolio for rising interest rates.

Noninterest expense

Noninterest expense includes all expenses of the Company with the exception of interest expense on deposits and borrowings, provision for loan losses and income taxes. Some of the primary components of noninterest expense are salaries and benefits, occupancy and equipment costs and expenses related to foreclosed real estate. Over the last three years, the most significant noninterest expense item has been salaries and benefits including commissions, representing 52%, 54% and 46% of noninterest expense in 2015, 2014 and 2013, respectively. Noninterest expense decreased from $30,278,000 in 2013 to $21,844,000 in 2014 while increasing to $24,049,000 in 2015.

The increase in noninterest expense of $2,205,000 in 2015 resulted primarily from the write down of assets held for sale of $2,649,000, increased salaries and benefits of $161,000, and increased commissions of $390,000, offset by declines in expense related to foreclosed assets of $1,091,000 and other noninterest expense of $267,000.

The write down of assets held for sale of $2,649,000 primarily relates to our previous headquarters building. We evaluate the net realizable value of this asset each quarter normally based on appraised value less selling costs. However, this write down results in a carrying value below appraised value net of selling costs because we believe that it is more representative of its net realizable value in the current commercial real estate market.

The decline in expenses related to foreclosed real estate was aided by gains of $862,000 offset by write downs of $690,000 on the sale of these properties.

The decrease in noninterest expense of $8,434,000 in 2014 resulted primarily from decreases in expenses related to foreclosed real estate of $5,838,000, salaries and benefits of $2,058,000, and occupancy expense of $374,000.

Income taxes

Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

We did not recognize any income tax in 2015, 2014 and 2013 based on our valuation allowance.

The net deferred tax asset is included in other assets on the balance sheet. Accounting Standards Codification Topic 740, *Income Taxes*, requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard. Management considers both positive and negative evidence and analyzes changes in near-term market conditions as well as other factors which may impact future operating results. In making such judgments, significant weight is given to evidence that can be objectively verified. The deferred tax assets are analyzed quarterly for changes affecting realization. Management determined that as of December 31, 2014, the objective negative evidence represented by the Company’s recent losses outweighed the more subjective positive evidence and, as a result, recognized a valuation allowance for all of the net deferred tax asset that is dependent on future earnings of the Company of approximately

$12,274,000. At December 31, 2015, management continues to believe that the objective negative evidence represented by the Company's prior losses outweighed the more subjective positive evidence and, as a result, maintains a valuation allowance at December 31, 2015 of $11,997,000. The net operating losses available to offset future taxable income amounted to $23,563,000 at December 31, 2015 and begin expiring in 2028; $1,257,000 of such amount is subject to a limitation by Section 382 of the Internal Revenue Code of 1986, as amended, to $908,000 per year.

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. Due to the Company's adjusted capital level we were not subject to franchise tax expense for the years ended December 31, 2015, 2014 and 2013.

The Company is currently under an Internal Revenue Service ("IRS") examination of its federal tax return for the year ended December 31, 2013. The outcome of this audit is currently unknown, but we do not believe it will have a material impact on the Company's financial condition or results of operations.

Balance Sheet Analysis

Investment securities

At December 31, 2015 and 2014, all of our investment securities were classified as available for sale. Investment securities classified as available for sale may be sold in the future, prior to maturity. These securities are carried at fair value. Net aggregate unrealized gains or losses on these securities are included, net of taxes, as a component of shareholders' equity. Given the generally high credit quality of the portfolio, management expects to realize all of its investment upon market recovery or, the maturity of such instruments, and thus believes that any impairment in value is interest rate related and therefore temporary. Available for sale securities included net unrealized losses of $665,000 and $976,000 at December 31, 2015 and 2014, respectively. As of December 31, 2015, management does not have the intent to sell any of the securities classified as available for sale and which have unrealized losses, and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost.

The Company sold approximately $8 million and $22 million of investment securities available for sale at a gain of $6,000 and loss of $210,000 in 2015 and 2014, respectively. The sale of these securities, which had fixed interest rates, allowed the Company to decrease its exposure to the anticipated upward movement in interest rates that would result in unrealized losses being recognized in shareholders' equity. In 2014, approximately $15 million of the proceeds from the sale of these securities were used to purchase rehabilitated student loans that have variable interest rates that will increase as interest rates in general increase.

The following table presents the composition of our investment portfolio at the dates indicated (in thousands).

	Par Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Average Yield
December 31, 2015						
US Government Agencies						
One to five years	$11,000	$ 11,270	$ -	$ (157)	$ 11,113	0.91 %
Five to ten years	18,500	19,697	-	(403)	19,294	2.32 %
More than ten years	3,312	3,319	-	(13)	3,306	0.85 %
	32,812	34,286	-	(573)	33,713	1.51 %
Mortgage-backed securities						
One to five years	1,794	1,841	-	(28)	1,813	1.30 %
More than ten years	1,149	1,202	1	(15)	1,188	1.34 %
	2,943	3,043	1	(43)	3,001	1.35 %
Municipals						
More than ten years	1,130	1,255	-	(50)	1,205	3.72 %
	1,130	1,255	-	(50)	1,205	3.72 %
Total investment securities	$36,885	$ 38,584	$ 1	$ (666)	$ 37,919	1.57 %
December 31, 2014						
US Government Agencies						
One to Five years	$10,000	$ 10,324	$ -	$ (225)	$ 10,099	1.10 %
Five to ten years	22,500	23,895	-	(647)	23,248	1.98 %
	32,500	34,219	-	(872)	33,347	1.71 %
Mortgage-backed securities						
More than ten years	471	484	2	(2)	484	0.31 %
Municipals						
Five to ten years	1,000	1,131	-	(20)	1,111	2.50 %
More than ten years	4,130	4,684	2	(86)	4,600	2.89 %
	5,130	5,815	2	(106)	5,711	2.82 %
Total investment securities	$38,101	$ 40,518	$ 4	$ (980)	$ 39,542	1.85 %

Loans

One of management's objectives is to improve the quality of the loan portfolio. The Company seeks to achieve this objective by maintaining rigorous underwriting standards coupled with regular evaluation of the creditworthiness of and the designation of lending limits for each borrower. The portfolio strategies include seeking industry, loan type and loan size diversification in order to minimize credit concentration risk. Management also focuses on originating loans in markets with which the Company is familiar. Additionally, as a significant amount of the loan losses we have experienced in the past is attributable to construction and land development loans, our strategy has shifted from reducing this type of lending to closely manage the quality and concentration in these loan types.

Approximately 75% of all loans are secured by mortgages on real property located principally in the Commonwealth of Virginia. The composition of this real estate secured exposure is very different in 2015 than it was in 2011. Specifically, construction and land development accounted for 19% of loans in 2011 vs. 10% in 2015. Sources of repayment are from the borrower's operating profits, cash flows and liquidation of pledged collateral. Approximately 18% of the loan portfolio consists of rehabilitated student loans purchased by the Bank in 2015 and 2014 (see discussion following). Commercial and industrial loans plus owner-occupied commercial real estate loans represented $89 million, or 29%, of the portfolio at December 31, 2015. Loans in this category are typically made to individuals, small and medium-sized businesses and range between $250,000 and $2.5 million. Based on underwriting standards, these loans may be secured in whole or in part by collateral such as liquid assets, accounts receivable, equipment, inventory, and real property. The collateral securing any loan may depend on the type of loan and may vary in value based on market conditions. The remainder of our loan portfolio is in consumer loans which represent less than 1% of the total.

The Bank purchased two portfolios of rehabilitated student loans guaranteed by the DOE totaling approximately $15 million on June 10, 2015 and approximately $8 million on October 23, 2015. The Bank had previously purchased two portfolios of approximately $19 million on July 29, 2014 and approximately $14 million on December 30, 2014. The guarantee covers approximately 98% of principal and accrued interest. The loans are serviced by a third-party servicer that specializes in handling the special needs of the DOE student loan programs. The Bank used excess liquidity to purchase the loans.

The following tables present the composition of our loan portfolio at the dates indicated and maturities of selected loans at December 31, 2015 (in thousands).

	December 31,				
	2015	2014	2013	2012	2011
Construction and land development					
Residential	$5,202	$4,315	$2,931	$2,845	$7,906
Commercial	25,948	25,152	28,179	41,210	72,621
Total construction and land development	31,150	29,467	31,110	44,055	80,527
Commercial real estate					
Owner occupied	69,256	58,804	73,585	92,773	105,592
Non-owner occupied	38,037	38,892	43,868	54,551	54,059
Multifamily	8,537	11,438	11,560	7,979	6,680
Farmland	388	434	1,463	2,581	2,465
Total commercial real estate	116,218	109,568	130,476	157,884	168,796
Consumer real estate					
Home equity lines	20,333	20,082	21,246	25,521	30,687
Secured by 1-4 family residential					
First deeds of trust	56,776	61,837	66,872	80,788	93,219
Second deeds of trust	6,485	7,854	8,675	9,517	12,042
Total consumer real estate	83,594	89,773	96,793	115,826	135,948
Commercial and industrial loans (except those secured by real estate)	20,086	22,165	26,254	34,384	37,734
Guaranteed student loans	53,989	33,562			
Consumer and other	1,734	1,611	1,930	2,761	4,865
Total loans	306,771	286,146	286,563	354,910	427,870
Deferred loan cost, net	670	722	683	788	768
Less: allowance for loan losses	(3,562)	(5,729)	(7,239)	(10,808)	(16,071)
Total loans, net	$303,879	$281,139	$280,007	$344,890	$412,567

	Fixed Rate				Variable Rate			
	Within 1 Year	1 to 5 Years	After 5 Years	Total	1 to 5 Years	After 5 Years	Total	Total Maturities
Construction and land development								
Residential	$5,176	$26	$-	$26	$-	$-	$-	$5,202
Commercial	11,142	4,753	-	4,753	4,974	5,079	10,053	25,948
Total construction and land development	16,318	4,779	-	4,779	4,974	5,079	10,053	31,150
Commercial real estate								
Owner occupied	5,185	17,404	24,902	42,306	276	21,489	21,765	69,256
Non-owner occupied	1,678	10,785	5,222	16,007	486	19,866	20,352	38,037
Multifamily	40	1,341	1,213	2,554	-	5,943	5,943	8,537
Farmland	125	154	-	154	-	109	109	388
Total commercial real estate	7,028	29,684	31,337	61,021	762	47,407	48,169	116,218
Consumer real estate								