

Virginia National Bankshares Corp  
Form 10-K  
March 30, 2015

**Table of Contents**

**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, 2014**

**Commission File Number: 000-55117**

**VIRGINIA NATIONAL BANKSHARES CORPORATION**

(Exact name of registrant as specified in its charter)

**Virginia**

(State or other jurisdiction of  
incorporation or organization)

**46-2331578**

(I.R.S. Employer  
Identification Number)

**404 People Place, Charlottesville, Virginia**

(Address of principal executive offices)

**22911**

(Zip Code)

**(434) 817-8621**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act: None**

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

**Common Stock, \$2.50 par value**

(Title of class)

**OTC Markets Group's OTCQX Marketplace**

(Name of exchange on which registered)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes**  **No**

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 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**  **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 the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

On June 30, 2014, the aggregate market value of the common equity held by non-affiliates of the registrant was \$58,831,849.

**The registrant has one class of common stock, of which 2,688,781 shares were outstanding as of close of business March 14, 2015.**

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are hereby incorporated into Part I and Part III of this Form 10-K by reference: the Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2015.

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**Table of Contents****INDEX**

	<b>Page</b>
<b>Part I</b>	
<u>Item 1</u>	<u>Business</u> 3
<u>Item 1A</u>	<u>Risk Factors</u> 14
<u>Item 1B</u>	<u>Unresolved Staff Comments</u> 14
<u>Item 2</u>	<u>Properties</u> 14
<u>Item 3</u>	<u>Legal Proceedings</u> 15
<u>Item 4</u>	<u>Mine Safety Disclosures</u> 15
<b>Part II</b>	
<u>Item 5</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> 16
<u>Item 6</u>	<u>Selected Financial Data</u> 17
<u>Item 7</u>	<u>Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations</u> 17
<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 42
<u>Item 8</u>	<u>Consolidated Financial Statements and Supplementary Data</u> 43
<u>Item 9</u>	<u>Changes In and Disagreements with Accountants on Accounting and Financial Disclosure</u> 88
<u>Item 9A</u>	<u>Controls and Procedures</u> 88
<u>Item 9B</u>	<u>Other Information</u> 88
<b>Part III</b>	
<u>Item 10</u>	<u>Directors, Executive Officers and Corporate Governance</u> 89
<u>Item 11</u>	<u>Executive Compensation</u> 89
<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> 89
<u>Item 13</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u> 89
<u>Item 14</u>	<u>Principal Accounting Fees and Services</u> 89
<b>Part IV</b>	
<u>Item 15</u>	<u>Exhibits, Financial Statement Schedules</u> 90



## Table of Contents

### **FORWARD-LOOKING STATEMENTS AND FACTORS THAT COULD AFFECT FUTURE RESULTS**

Certain statements contained or incorporated by reference in this annual report on Form 10-K, including but not limited to, statements concerning future results of operations or financial position, borrowing capacity and future liquidity, future investment results, future credit exposure, future loan losses and plans and objectives for future operations, change in laws and regulations applicable to the Company and its subsidiaries, adequacy of funding sources, actuarial expected benefit payment, valuation of foreclosed assets, regulatory requirements, economic environment and other statements contained herein regarding matters that are not historical facts, are forward-looking statements as defined in the Securities Exchange Act of 1934. Such statements are often characterized by use of qualified words such as expect, believe, estimate, project, anticipate, intend, will, or words of similar meaning or other statements concerning opinions or judgment of the Company and its management about future events. These statements are not historical facts but instead are subject to numerous assumptions, risks and uncertainties, and represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and outside our control. Any forward-looking statements made by the Company speak only as of the date on which such statements are made. Our actual results and financial position may differ materially from the anticipated results and financial condition indicated in or implied by these forward-looking statements. The Company makes no commitment to update or revise forward-looking statements in order to reflect new information or subsequent events or changes in expectations.

Factors that could cause our actual results to differ materially from those in the forward-looking statements include, but are not limited to, the following: inflation, interest rates, market and monetary fluctuations; geopolitical developments including acts of war and terrorism and their impact on economic conditions; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board; changes, particularly declines, in general economic conditions and in the local economies in which the Company operates; the financial condition of the Company's borrowers; competitive pressures on loan and deposit pricing and demand; changes in technology and their impact on the marketing of new products and services and the acceptance of these products and services by new and existing customers; the willingness of customers to substitute competitors' products and services for the Company's products and services; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); changes in accounting principles, policies and guidelines; other risks and uncertainties described from time to time in press releases and other public filings; and the Company's performance in managing the risks involved in any of the foregoing. The foregoing list of important factors is not exclusive, and the Company will not update any forward-looking statement, whether written or oral, that may be made from time to time.

## Part I

### Item 1. BUSINESS.

#### **General**

Virginia National Bankshares Corporation (the Company) was incorporated under the laws of the Commonwealth of Virginia on February 21, 2013 at the direction of the Board of Directors of Virginia National Bank (the Bank) for the purpose of acquiring all of the outstanding shares of the Bank and becoming the holding company of the Bank. On June 19, 2013, the shareholders of the Bank approved the Reorganization Agreement and Plan of Share Exchange, dated March 6, 2013, whereby the Bank would reorganize into a holding company structure (the Reorganization).

On December 16, 2013, when the Reorganization became effective, the Bank became a wholly-owned subsidiary of the Company, and each share of the Bank's common stock was exchanged for one share of the Company's common stock. The Company is regulated under the Bank Holding Company Act of 1956, as amended (BHC Act), and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve Board or Federal Reserve). The Company is also under the jurisdiction of the Securities and Exchange Commission (SEC) and is subject to the disclosure and regulatory requirements of the Securities Exchange Act of 1934, as amended, (the Exchange Act) as administered by the SEC. Virginia National Bankshares Corporation is headquartered at 404 People Place, Charlottesville, Virginia.

## **Table of Contents**

Virginia National Bank, the principal operating subsidiary of the Company, was organized in 1998 under federal law as a national banking association to engage in a general commercial and retail banking business. The Bank received its charter from the Office of the Comptroller of the Currency (the OCC) and commenced operations on July 29, 1998. The Bank is headquartered in Charlottesville, Virginia. The Bank's deposits are insured up to the maximum amount provided by the Federal Deposit Insurance Act by the Federal Deposit Insurance Corporation (FDIC). The Bank is subject to the supervision, examination and regulation of the OCC.

The Bank serves the Virginia communities in and around the City of Charlottesville, Albemarle County, Orange County and the City of Winchester. The Bank offers a full range of banking and related financial services, including checking accounts, NOW accounts, money market deposit accounts, certificates of deposit, individual retirement accounts and other depository services. The Bank actively solicits such accounts from individuals, businesses, associations and other organizations within its trade area. The Bank also offers short-to-long term commercial, real estate and consumer loans. The Bank is committed to being a reliable and consistent source of credit, with loans that are priced based upon an overall banking relationship, easy access to the Bank's local decision makers who possess strong local market knowledge, local delivery, fast response, and continuity in the banking relationship. Other services offered by the Bank include automated teller machines (ATMs), Internet banking, safe deposit boxes, merchant card services, cash management services and direct deposit of payroll and federal recurring payments. In addition, the Bank is affiliated with Visa® which is accepted worldwide and offers debit cards to consumer and business customers.

Late in the second quarter of 2014, the Company hired a secondary market mortgage originator. The Company now originates and sells residential mortgage loans sold on the secondary market which the Company does not wish to retain for its own loan portfolio due to the interest rate risks that are inherent with long-term fixed rate loans.

Since late 2012, the Company has offered annuity, insurance and brokerage services to the public at its banking offices, under the title of VNB Investment Strategies. The Bank entered into an agreement with LPL Financial LLC, which provides broker/dealer and advisory services through registered representatives. The goal of the program is to offer customers opportunities to access additional financial products and services beyond the traditional banking products.

Investment management, trust, estate administration and financial planning services are offered through the Bank's wholly-owned subsidiary, VNBTrust, National Association, which now does business under the trade name VNB Wealth Management (VNBTrust, VNB Wealth or VNB Wealth Management). The flagship product for managed accounts employs a value-based, catalyst-driven investment strategy. The financial instruments used include common and preferred stock, corporate bonds, bank loans and other debt securities, convertible securities, Exchange Traded Funds (ETFs), options, warrants and cash equivalents.

On January 1, 2014, VNBTrust began doing business under the trade name of VNB Wealth Management. While the trade name is new, clients will continue to receive community-based trust and investment services. More information on VNB Wealth Management is available at [www.vnbwealth.com](http://www.vnbwealth.com).

Prior to July 18, 2013, VNBTrust was the sole owner of an operating subsidiary, Swift Run Capital Management, LLC (SRCM), formerly known as VNB Investment Management Company, LLC, a Delaware limited liability corporation. SRCM operates as the general partner of Swift Run Capital L.P. (Fund), a hedge fund. On July 18, 2013 (the Closing Date), VNBTrust completed the sale of all of the membership interests of SRCM to SRCM Holdings LLC (SRCM Holdings) pursuant to a purchase and sale agreement dated June 27, 2013 among SRCM Holdings, VNBTrust, SRCM and the Bank (the Sale Agreement). The Fund managed by SRCM represented less than 7 percent of the total assets managed by VNBTrust and SRCM at the Closing Date. A former officer of VNBTrust is the principal owner of SRCM Holdings. Additional details on this transaction are available in Note 1, in the notes to the consolidated financial statements, contained in Item 8 Consolidated Financial Statements and Supplementary Data.

References to the Company's subsidiaries in this document include both the Bank and the Bank's subsidiary, VNBTrust.

## **Table of Contents**

As of March 31, 2015, the Company and its subsidiaries occupied the following seven full-service banking facilities in the cities of Charlottesville and Winchester, as well as the counties of Albemarle and Orange in Virginia:

### Location

222 East Main Street, Charlottesville, Virginia  
1580 Seminole Trail, Charlottesville, Virginia  
1900 Arlington Boulevard, Charlottesville, Virginia  
102 East Main Street, Orange, Virginia  
186 North Loudoun Street, Winchester, Virginia  
3119 Valley Avenue in Winchester, Virginia  
404 People Place, Charlottesville, Virginia

Additionally, the multi-story office building at 404 People Place also serves as the Company's corporate headquarters and operations center, as well as the principal offices of VNB Wealth Management. The Bank also has a loan production office in Warrenton, Virginia and a business development office in Culpeper, Virginia.

## **Market Area**

The population in the market area served by the Company continues to grow. According to the U.S. Census Bureau, the total market area served by the Company grew 21.7 percent between 2000 and 2010, as compared to 13.0 percent for the Commonwealth of Virginia as a whole. The Virginia State Demographer (the VSD) estimates that, by 2014, the population of the Commonwealth had grown by 4.1%, while the Company's current markets had grown by 4.8 percent.

The combined populations of the City of Charlottesville and Albemarle County stood at 142,445 persons as of April 1, 2010, an increase of approximately 14.6 percent between April 1, 2000 and April 1, 2010. The VSD estimates that the two municipalities have grown by an additional 6.4 percent to a population of 151,490 as of 2014 and projects these municipalities will continue to grow to a population of 161,278 by 2020. Charlottesville and Albemarle County support a diverse, well-rounded economy. Stability in the local economy stems from the significant number of persons employed by a wide variety of employers including the University of Virginia, large medical and research facilities such as Martha Jefferson and UVA Health Services, insurance and technology industries, large number of national retail chains and Federal government-based facilities.

The combined populations of the City of Winchester and Frederick County increased approximately 26.2 percent between April 1, 2000 and April 1, 2010, to a population of 104,508 persons in 2010. The VSD estimates that the combined populations for these two areas have already grown to 109,259 by 2014, a 4.6 percent increase, and expects these populations to be 125,159 by 2020, an increase of 19.8 percent over the 2010 census figure.

Orange and Culpeper Counties had a combined population of approximately 80,170 persons as of 2010. Between April 1, 2000 and April 1, 2010, its population grew 33.3 percent. 2014 VSD estimates show the population at 83,045, a 3.6 percent increase over the 2010 population.

The Company's newest market area of Warrenton and Fauquier County is estimated by VSD to have a population of 67,512 as of 2014 and is projected to grow to 74,118 persons by 2020.

Over the next decade, Virginia is expected to have only a 10.1 percent growth, where the Company's current market area is projected by VSD to be 15.5 percent higher by 2020 than reported by the 2010 Census.

## **Competition**

The Company engages in highly competitive activities. Each activity involves competition with other banks, as well as with non-banking enterprises that offer financial products and services that compete directly with the Company's product and service offerings. The Company actively competes with other banks in its efforts to obtain deposits and make loans, in the scope and types of services offered, in interest rates paid on time deposits and charged on loans, and in other aspects of banking.

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In addition to competing with other commercial banks within and outside its primary service areas, the Company competes with other financial institutions engaged in the business of making loans or accepting deposits, such as credit unions, insurance companies, small loan companies, finance companies, mortgage companies, certain governmental agencies and other enterprises. Competition for funds from securities brokers and mutual funds for money market accounts is strong. Additional competition for deposits comes from government and private issues of debt obligations and other investment alternatives for depositors such as money market funds.



## **Table of Contents**

The market areas served by the Company are highly competitive with respect to banking. Competition for loans to small businesses and professionals is intense, and pricing is important. Many of the Company's competitors have substantially greater resources and lending limits than the Company and offer certain services such as extensive and established branch networks that the Company does not expect to match. Deposit competition is also very strong. Management believes, however, that a market exists for the personal and customized financial services an independent, locally owned bank can offer.

## **Supervision and Regulation**

Bank holding companies and banks are extensively regulated under both federal and state laws. The following description briefly addresses certain historic and current provisions of federal and state laws and certain regulations, proposed regulations and the potential impacts on the Company and the Bank. To the extent statutory or regulatory provisions or proposals are described in this Report, the description is qualified in its entirety by reference to the particular statutory or regulatory provisions or proposals.

### ***The Company***

***General.*** As a bank holding company registered under the BHC Act, the Company is subject to supervision, regulation, and examination by the Federal Reserve. The Company is also registered under the bank holding company laws of Virginia and is subject to supervision, regulation, and examination by the Virginia State Corporation Commission (the SCC).

***Permitted Activities.*** A bank holding company is limited to managing or controlling banks, furnishing services to or performing services for its subsidiaries, and engaging in other activities that the Federal Reserve determines by regulation or order to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is permissible, the Federal Reserve must consider whether the performance of such an activity reasonably can be expected to produce benefits to the public that outweigh possible adverse effects. Possible benefits include greater convenience, increased competition, and gains in efficiency. Possible adverse effects include undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices. Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any activity or to terminate ownership or control of any subsidiary when the Federal Reserve has reasonable cause to believe that a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company may result from such an activity.

***Banking Acquisitions; Changes in Control.*** The BHC Act requires, among other things, the prior approval of the Federal Reserve in any case where a bank holding company proposes to (i) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank or bank holding company (unless it already owns a majority of such voting shares), (ii) acquire all or substantially all of the assets of another bank or bank holding company, or (iii) merge or consolidate with any other bank holding company. In determining whether to approve a proposed bank acquisition, the Federal Reserve will consider, among other factors, the effect of the acquisition on competition, the public benefits expected to be received from the acquisition, the projected capital ratios and levels on a post-acquisition basis, and the acquiring institution's performance under the Community Reinvestment Act of 1977 and its compliance with fair housing and other consumer protection laws.

Subject to certain exceptions, the BHC Act and the Change in Bank Control Act, together with the applicable regulations, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company's acquiring control of a bank or bank holding company. A conclusive presumption of control exists if an individual or company acquires the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25% or more of any class of voting securities of any insured depository institution. A rebuttable presumption of control exists if a person or company acquires 10% or more but less than 25% of any class of voting securities of an insured depository institution and either the institution has registered its securities with the SEC under Section 12 of the Exchange Act or no other person will own a greater percentage of that class of voting securities immediately after the acquisition. The Company's common stock is registered under Section 12 of the Exchange Act.

## **Table of Contents**

In addition, Virginia law requires the prior approval of the SCC for (i) any Virginia bank or Virginia bank holding company to acquire more than 5% of the voting shares of a Virginia bank or any holding company that controls a Virginia bank, or (ii) the acquisition by a Virginia bank holding company of a bank or its holding company domiciled outside Virginia.

**Source of Strength.** Federal Reserve policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Wall Street Reform and Consumer Protection Act ( Dodd-Frank Act ) codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to depositors and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

**Safety and Soundness.** There are a number of obligations and restrictions imposed on bank holding companies and their subsidiary banks by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance fund in the event of a depository institution default. For example, under the Federal Deposit Insurance Company Improvement Act of 1991, to avoid receivership of an insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any subsidiary bank that may become undercapitalized with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal bank regulatory agency up to the lesser of (i) an amount equal to 5% of the institution's total assets at the time the institution became undercapitalized, or (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan.

Under the Federal Deposit Insurance Act ( FDIA ), the federal bank regulatory agencies have adopted guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines.

**Capital Requirements.** The Federal Reserve imposes certain capital requirements on bank holding companies under the BHC Act, including a minimum leverage ratio and a minimum ratio of qualifying capital to risk-weighted assets. These requirements are described below under The Bank's Capital Requirements.

**Limits on Dividends and Other Payments.** The Company is a legal entity, separate and distinct from its subsidiaries. A significant portion of the revenues of the Company result from dividends paid to it by the Bank. There are various legal limitations applicable to the payment of dividends by the Bank to the Company and to the payment of dividends by the Company to its shareholders. The Bank is subject to various restrictions on its ability to pay dividends to the Company. The OCC has advised that a national bank should generally pay dividends only out of current operating earnings. Under current regulations, prior approval from the Federal Reserve is required if cash dividends declared in any given year exceed net income for that year, plus retained net profits of the two preceding years. The payment of dividends by the Bank or the Company may be limited by other factors, such as requirements to maintain capital above regulatory guidelines. Bank regulatory agencies have the authority to prohibit the Bank or the Company from engaging in an unsafe or unsound practice in conducting their business. The payment of dividends, depending on the financial condition of the Bank, or the Company, could be deemed to constitute such an unsafe or unsound practice.

Under the FDIA, insured depository institutions such as the Bank, are prohibited from making capital distributions, including the payment of dividends, if, after making such distributions, the institution would become undercapitalized (as such term is used in the statute). Based on the Bank's current financial condition, the Company does not expect this provision will have any impact on its ability to receive dividends from the Bank.

## **Table of Contents**

### ***The Bank***

***General.*** The Bank is supervised and regularly examined by the OCC. The various laws and regulations administered by the bank regulatory agencies affect corporate practices, such as the payment of dividends, incurrence of debt and acquisition of financial institutions and other companies; they also affect business practices, such as the payment of interest on deposits, the charging of interest on loans, types of business conducted and location of offices. Certain of these law and regulations are referenced above under The Company.

### ***Capital Requirements:***

***2014 Capital Requirements.*** The OCC and the other federal banking agencies have issued risk-based and leverage capital guidelines applicable to U.S. banking organizations. In addition, those regulatory agencies may from time to time require that a banking organization maintain capital above the minimum levels because of its financial condition or actual or anticipated growth. Under the risk-based capital requirements of the Federal Reserve and the OCC that were effective through December 31, 2014, the Company and the Bank were required to maintain a minimum ratio of total capital (which is defined as core capital and supplementary capital less certain specified deductions from total capital such as reciprocal holdings of depository institution capital instruments and equity investments) to risk-weighted assets of at least 8.0%. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet activities, recourse obligations, residual interests and direct credit substitutes, were multiplied by a risk-weight factor assigned by the capital regulation based on the risks believed inherent in the type of asset. At least half of the total capital was required to be Tier 1 capital, which consisted principally of common and certain qualifying preferred shareholders equity (including grandfathered trust preferred securities), less certain intangibles and other adjustments. The remainder ( Tier 2 capital ) consisted of cumulative preferred stock, long-term perpetual preferred stock, a limited amount of subordinated and other qualifying debt (including certain hybrid capital instruments), and a limited amount of the general loan loss allowance. The Tier 1 and total capital to risk-weighted asset ratios of the Company were 16.98% and 17.87%, respectively, as of December 31, 2014, thus exceeding the minimum requirements. The Tier 1 and total capital to risk-weighted asset ratios of the Bank were 14.74% and 15.63%, respectively, as of December 31, 2014, also exceeding the minimum requirements.

Each of the federal bank regulatory agencies also established a minimum leverage capital ratio of Tier 1 capital to average adjusted assets ( Tier 1 leverage ratio ) that was effective through December 31, 2014. The guidelines required a minimum Tier 1 leverage ratio of 3.0% for bank holding companies and banking organizations with the highest supervisory rating. All other banking organizations were required to maintain a minimum Tier 1 leverage ratio of 4% unless a different minimum was specified by an appropriate regulatory authority. In addition, for a depository institution to have been considered well capitalized under the regulatory framework for prompt corrective action, its Tier 1 leverage ratio must have been at least 5.0%. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. The Federal Reserve and the OCC have not advised the Company or the Bank of any specific minimum leverage ratio applicable to either entity. As of December 31, 2014, the Tier 1 leverage ratio of the Company and the Bank were 11.38% and 9.86%, respectively, well above the minimum requirements.

***Basel III Capital Requirements Effective January 1, 2015.*** In June 2012, the federal bank regulatory agencies issued a series of proposed rules intended to revise and strengthen its risk-based and leverage capital requirements and its method for calculating risk-weighted assets. The rules were proposed to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. In July 2013, the federal bank regulatory agencies approved certain revisions to the proposals and finalized new capital requirements for banking organizations.

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 common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6% of risk-weighted assets (increased from the prior requirement of 4%); (iii) a total capital ratio of 8% of risk-weighted assets (unchanged from the prior requirement); and (iv) a leverage ratio of 4% of total assets (unchanged from the prior requirement). These are the initial capital requirements, which will be phased in over a four-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% capital conservation buffer (which is added to the 4.5% common equity Tier 1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of common equity Tier 1 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 2.5% 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 2.5% capital conservation

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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%, calculated as the ratio of Tier 1 capital to average assets.

## **Table of Contents**

The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing by the same amount each year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

With respect to the Bank, the rules also revised the prompt corrective action regulations pursuant to Section 38 of the FDIA by (i) introducing a common equity Tier 1 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% (as compared to the prior ratio of 6.0%); and (iii) eliminating the current 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.

The new capital requirements also include changes in the risk weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and nonresidential mortgage loans that are 90 days past due or otherwise on non-accrual status, a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital, and increased risk-weights (from 0% to up to 600%) for equity exposures.

Based on management's understanding and interpretation of the new capital rules, it believes that, as of December 31, 2014, the Company and the Bank would meet all capital adequacy requirements under such rules on a fully phased-in basis as if such requirements were in effect as of such date.

**Deposit Insurance.** The deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund ( DIF ) of the FDIC and are subject to deposit insurance assessments to maintain the DIF. On April 1, 2011, the deposit insurance assessment base changed from total deposits to average total assets minus average tangible equity, pursuant to a rule issued by the FDIC as required by the Dodd-Frank Act.

The Federal Deposit Insurance Act (the FDIA ), as amended by the Federal Deposit Insurance Reform Act and the Dodd-Frank Act, requires the FDIC to set a ratio of deposit insurance reserves to estimated insured deposits of at least 1.35%. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory rating. On February 27, 2009, the FDIC introduced three possible adjustments to an institution's initial base assessment rate: (i) a decrease of up to five basis points for long-term unsecured debt, including senior unsecured debt (other than debt guaranteed under the Temporary Liquidity Guarantee Program) and subordinated debt and, for small institutions, a portion of Tier 1 capital; (ii) an increase not to exceed 50% of an institution's assessment rate before the increase for secured liabilities in excess of 25% of domestic deposits; and (iii) for non-Risk Category I institutions, an increase not to exceed 10 basis points for brokered deposits in excess of 10% of domestic deposits. In 2014 and 2013, the Company expensed only the base assessment rate for well-capitalized institutions, which totaled \$240 thousand and \$220 thousand, respectively, in regular deposit insurance assessments.

## **Table of Contents**

On May 22, 2009, the FDIC issued a final rule that levied a special assessment applicable to all insured depository institutions totaling 5 basis points of each institution's total assets less Tier 1 capital as of June 30, 2009, not to exceed 10 basis points of domestic deposits. The special assessment was part of the FDIC's efforts to rebuild the DIF. Deposit insurance expense during 2009 for the Company included an additional \$184 thousand related to the special assessment.

On November 12, 2009, the FDIC issued a rule that required all insured depository institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. In the fourth quarter of 2009, the Company paid \$1.939 million in prepaid risk-based assessments, most of which has been expensed in the appropriate periods through December 31, 2012. On June 28, 2013, \$582 thousand was refunded to the Company from the FDIC. Beginning September 30, 2013, payments are being assessed and charged to financial institutions on a quarterly basis, rather than being applied against the prepaid balance.

In addition, all FDIC insured institutions are required to pay assessments to the FDIC at an annual rate of approximately one basis point of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019. In both 2014 and 2013, the Company paid a Financing Corporation assessment of \$28 thousand.

**Transactions with Affiliates.** Pursuant to Sections 23A and 23B of the Federal Reserve Act and Regulation W, the authority of the Bank to engage in transactions with related parties or affiliates or to make loans to insiders is limited. Loan transactions with an affiliate generally must be collateralized and certain transactions between the Bank and its affiliates, including the sale of assets, the payment of money or the provision of services, must be on terms and conditions that are substantially the same, or at least as favorable to the Bank, as those prevailing for comparable nonaffiliated transactions. In addition, the Bank generally may not purchase securities issued or underwritten by affiliates.

Loans to executive officers, directors or to any person who directly or indirectly, or acting through or in concert with one or more persons, owns, controls or has the power to vote more than 10% of any class of voting securities of a bank (a 10% Shareholder), are subject to Sections 22(g) and 22(h) of the Federal Reserve Act and their corresponding regulations (Regulation O) and Section 13(k) of the Exchange Act relating to the prohibition on personal loans to executives (which exempts financial institutions in compliance with the insider lending restrictions of Section 22(h) of the Federal Reserve Act). Among other things, these loans must be made on terms substantially the same as those prevailing on transactions made to unaffiliated individuals and certain extensions of credit to those persons must first be approved in advance by a disinterested majority of the entire board of directors. Section 22(h) of the Federal Reserve Act prohibits loans to any of those individuals where the aggregate amount exceeds an amount equal to 15% of an institution's unimpaired capital and surplus plus an additional 10% of unimpaired capital and surplus in the case of loans that are fully secured by readily marketable collateral, or when the aggregate amount on all of the extensions of credit outstanding to all of these persons would exceed the Bank's unimpaired capital and unimpaired surplus. Section 22(g) of the Federal Reserve Act identifies limited circumstances in which the Bank is permitted to extend credit to executive officers.

**Prompt Corrective Action.** Federal banking regulators are authorized and, under certain circumstances, required to take certain actions against banks that fail to meet their capital requirements. The federal bank regulatory agencies have additional enforcement authority with respect to undercapitalized depository institutions. Well capitalized institutions may generally operate without supervisory restriction. With respect to adequately capitalized institutions, such banks cannot normally pay dividends or make any capital contributions that would leave it undercapitalized; they cannot pay a management fee to a controlling person if, after paying the fee, it would be undercapitalized; and they cannot accept, renew or roll over any brokered deposit unless the bank has applied for and been granted a waiver by the FDIC.

Immediately upon becoming undercapitalized, a depository institution becomes subject to the provisions of Section 38 of the FDIA, which: (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution's assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the DIF, subject in certain cases to specified procedures. These discretionary supervisory actions include: (i) requiring the institution to raise additional capital; (ii) restricting transactions with affiliates; (iii) requiring divestiture of the institution or the sale of the institution to a willing purchaser; and (iv) any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically

undercapitalized institutions. The Bank meets the definition of being well capitalized as of December 31, 2014.

## **Table of Contents**

As described above in The Bank Capital Requirements Basel III Capital Requirements Effective January 1, 2015, the new capital requirement rules issued by the OCC incorporate new requirements into the prompt corrective action framework.

**Community Reinvestment Act.** The Bank is subject to the requirements of the Community Reinvestment Act of 1977 (the CRA). The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of the local communities they serve, including low and moderate income neighborhoods. The CRA requires the appropriate federal banking agency, in connection with its examination of a bank, to assess the bank's record in meeting such credit needs. Furthermore, such assessment is also required of banks that have applied, among other things, to merge or consolidate with or acquire the assets or assume the liabilities of an insured depository institution, or to open or relocate a branch. In the case of a bank holding company applying for approval to acquire a bank or another bank holding company, the record of each subsidiary bank of the applicant bank holding company is subject to assessment in considering the application. Under the CRA, institutions are assigned a rating of outstanding, satisfactory, needs to improve, or substantial non-compliance. The Bank received a satisfactory CRA rating in its most recent examination.

**Privacy Legislation.** Several recent laws, including the Right to Financial Privacy Act, and related regulations issued by the federal bank regulatory agencies, provide new protections against the transfer and use of customer information by financial institutions. A financial institution must provide to its customers information regarding its policies and procedures with respect to the handling of customers' personal information. Each institution must conduct an internal risk assessment of its ability to protect customer information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated parties without prior notice and approval from the customer.

**USA Patriot Act of 2001.** In October 2001, the USA Patriot Act of 2001 (Patriot Act) was enacted in response to the September 11, 2001 terrorist attacks in New York, Pennsylvania, and Northern Virginia. The Patriot Act is intended to strengthen U.S. law enforcement and the intelligence communities' abilities to work cohesively to combat terrorism. The continuing impact on financial institutions of the Patriot Act and related regulations and policies is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws, and imposes various regulations, including standards for verifying customer identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities to identify persons who may be involved in terrorism or money laundering.

**Volcker Rule.** The Dodd-Frank Act prohibits insured depository institutions and their holding companies from engaging in proprietary trading except in limited circumstances, and prohibits them from owning equity interests in excess of 3% of Tier 1 capital in private equity and hedge funds (known as the Volcker Rule). On December 10, 2013, the federal bank regulatory agencies adopted final rules implementing the Volcker Rule. These final rules prohibit banking entities from (i) engaging in short-term proprietary trading for their own accounts, and (ii) having certain ownership interests in and relationships with hedge funds or private equity funds. The final rules are 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 also require each regulated entity to establish an internal compliance program that is consistent with the extent to which it engages in activities covered by the Volcker Rule, which must include (for the largest entities) making regular reports about those activities to regulators. Although the final rules provide some tiering of compliance and reporting obligations based on size, the fundamental prohibitions of the Volcker Rule apply to banking entities of any size, including the Company and the Bank. The final rules were effective April 1, 2014, with full compliance being phased in over a period which will end on July 21, 2016. The Company has evaluated the implications of the final rules on its investments and does not expect any material financial implications.

Under the rules implementing the Volcker Rule, banking entities would have been prohibited from owning certain collateralized debt obligations (CDOs) backed by trust preferred securities (TruPS) as of July 21, 2015, which could have forced banking entities to recognize unrealized market losses based on the inability to hold any such investments to maturity. However, on January 14, 2014, the federal bank regulatory agencies issued an interim rule, effective April 1, 2014, exempting TruPS CDOs from the Volcker Rule if (i) the CDO was established prior to May 19, 2010, (ii) the banking entity reasonably believes that the offering proceeds of the CDO were used to invest primarily in TruPS issued by banks with less than \$15 billion in assets, and (iii) the banking entity acquired the CDO on or before December 10, 2013. The regulators solicited comments on the interim final rule, and this exemption could change prior to its effective date. The Company currently does not have any impermissible holdings of TruPS CDOs under the interim final rule and, therefore, will not be required to divest of any such investments or change their accounting treatment. The Company is continuously reviewing its investments to ensure compliance as the various provisions of the Volcker Rule regulations become effective.





## **Table of Contents**

**Consumer Financial Protection.** The Bank is subject to a number of federal and state consumer protection laws that extensively govern its relationship with its customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, Secure and Fair Enforcement for Mortgage Licensing Act, laws governing flood insurance, federal and state laws prohibiting unfair and deceptive business practices, foreclosure laws, and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans and providing other services. If the Bank fails to comply with these laws and regulations, it may be subject to various penalties. Failure to comply with consumer protection requirements may also result in failure to obtain any required bank regulatory approval for merger or acquisition transactions the Bank may wish to pursue or being prohibited from engaging in such transactions even if approval is not required.

The Dodd-Frank Act centralized responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the CFPB), and giving it responsibility for implementing, examining, and enforcing compliance with federal consumer protection laws. The CFPB focuses on (i) risks to consumers and compliance with the federal consumer financial laws, (ii) the markets in which firms operate and risks to consumers posed by activities in those markets., (iii) depository institutions that offer a wide variety of consumer financial products and services, and (iv) non-depository companies that offer one or more consumer financial products or services.

The CFPB has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks, including, among other things, the authority to prohibit unfair, deceptive or abusive acts and practices. Abusive acts or practices are defined as those that materially interfere with a consumer's ability to understand a term or condition of a consumer financial product or service or take unreasonable advantage of a consumer's (i) lack of financial savvy, (ii) inability to protect himself in the selection or use of consumer financial products or services, or (iii) reasonable reliance on a covered entity to act in the consumer's interests. The CFPB can issue cease-and-desist orders against banks and other entities that violate consumer financial laws. The CFPB may also institute a civil action against an entity in violation of federal consumer financial law in order to impose a civil penalty or injunction.

**Ability-to-Repay and Qualified Mortgage Rule.** Pursuant to the Dodd-Frank Act, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) the monthly payment on the covered transaction; (iv) the monthly payment on any simultaneous loan; (v) the monthly payment for mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) the monthly debt-to-income ratio or residual income; and (viii) credit history. Alternatively, the mortgage lender can originate qualified mortgages, which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount and the consumer's debt-to-income (DTI) must be below the prescribed threshold. Qualified mortgages that are higher-priced (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not higher-priced (e.g. prime loans) are given a safe harbor of compliance. Small creditors, those financial institutions that meet the following requirements: (i) have assets below \$2 billion (adjustable annually by CFPB); (ii) originated no more than 500 first-lien, closed-end residential mortgages subject to the ability-to-repay requirements in the preceding calendar year; and (iii) holds the qualified mortgage loan in its portfolio after origination, may originate qualified mortgages that are not restricted by the specific DTI threshold (however, the DTI must still be considered) and may make balloon loans that will still be considered a qualified mortgage. The Company, as a small creditor, does comply with the qualified mortgage rules and the other applicable Truth in Lending requirements.

## **Table of Contents**

**Incentive Compensation.** In June 2010, the federal bank regulatory agencies issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of financial institutions do not undermine the safety and soundness of such institutions by encouraging excessive risk-taking. The Interagency Guidance on Sound Incentive Compensation Policies, which covers all employees that have the ability to materially affect the risk profile of financial institutions, either individually or as part of a group, is based upon the key principles that a financial institution's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the institution's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the financial institution's board of directors.

The Federal Reserve and the OCC will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of financial institutions, such as the Company and the Bank, that are not large, complex banking organizations. These reviews will be tailored to each financial institution based on the scope and complexity of the institution's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the institution's supervisory ratings, which can affect the institution's ability to make acquisitions and take other actions. Enforcement actions may be taken against a financial institution if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the institution's safety and soundness and the financial institution is not taking prompt and effective measures to correct the deficiencies. At December 31, 2014, the Company and the Bank have not been made aware of any instances of non-compliance with the final guidance.

## ***Effect of Governmental Monetary Policies***

The Company's operations are affected not only by general economic conditions but also by the policies of various regulatory authorities. In particular, the Federal Reserve regulates money and credit conditions and interest rates to influence general economic conditions. These policies have a significant impact on overall growth and distribution of loans, investments and deposits; they affect interest rates charged on loans or paid for time and savings deposits. Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks, including the Company, in the past and are expected to do so in the future.

## ***Reporting Obligations under Securities Laws***

The Company is subject to the periodic and other reporting requirements of the Exchange Act, including the filing of annual, quarterly and other reports with the SEC. The Company provides access to its SEC filings through the Investor Relations section of the Bank's website at [www.vnb.com](http://www.vnb.com) and at [www.vnbcorp.com](http://www.vnbcorp.com). The Company's SEC filings are posted and available at no cost on the website as soon as reasonably practicable after the reports are filed electronically with the SEC. The information on the website is not incorporated into this report or any other filing the Company makes with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov).

## **Employees**

At December 31, 2014, the Company had 101 full time equivalent employees. None of its employees are represented by any collective bargaining unit. The Company considers relations with its employees to be good.

The Company owns Bank Owned Life Insurance ( BOLI ) policies on executives and key personnel of the Company. BOLI is a bank-eligible asset designed to recover costs of providing pre- and post-retirement benefits and/or to finance general employee benefit expenses. Under BOLI policies, the executives and other key personnel are the insured, and the Company is the owner and beneficiary of the policies. The insured has no claim to the insurance policy or to the policy's cash value. Under separate split dollar agreements, a portion of any death benefit may be paid to the beneficiaries of the insured employees, subject to the terms and restrictions of the split dollar endorsement agreement between the officer and the Company.

## **Table of Contents**

### **Availability of Information**

Prior to the Reorganization, the Bank filed its periodic and annual reports with the OCC. Beginning with the Reorganization on December 16, 2013, the Company files annual, quarterly, and other reports under the Exchange Act with the SEC. The Company's filings are available through the SEC's website at [www.sec.gov](http://www.sec.gov). In addition, our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, plus any amendments to these reports, are available, free of charge, at [www.vnbcorp.com](http://www.vnbcorp.com). These reports are available as soon as reasonably practical after they are filed with the SEC. The information on the Bank's Internet website is not incorporated into this Annual Report on Form 10-K or any other filing the Company makes with the SEC.

### **Item 1A. RISK FACTORS.**

Not required

### **Item 1B. UNRESOLVED STAFF COMMENTS.**

None

### **Item 2. PROPERTIES.**

The Company and its subsidiaries currently occupy seven full-service banking facilities in Charlottesville, Winchester, and Albemarle and Orange Counties. The Company's main office and a full-service banking facility are located at 404 People Place, Charlottesville, Virginia. Full-service banking facilities are also located at 222 East Main Street, Charlottesville, Virginia; 1580 Seminole Trail, Charlottesville, Virginia; 1900 Arlington Boulevard, Charlottesville, Virginia; 102 East Main Street, Orange, Virginia; 186 North Loudoun Street, Winchester, Virginia; and 3119 Valley Avenue, #102, Winchester, Virginia. In addition, an administrative office was opened in 2013 at 402 South Main Street, Culpeper, Virginia and a loan production office was opened in 2014 at 92 Main Street, Suite 202-6, in Warrenton, Virginia.

The five-story building located at 404 People Place, Charlottesville, Virginia, just east of the Charlottesville city limits on Pantops Mountain, was constructed by the Bank on a pad site leased in 2005 from Pantops Park, LLC for a term of twenty years, with seven five-year renewal options. William D. Dittmar, Jr., a director of the Company, is the sole managing member of Pantops Park, LLC. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal. The building, consisting of approximately 43,000 square feet, was completed in early 2008, and the Bank opened this full-service office in April, 2008. Additionally, the office building serves as the corporate headquarters for the Company and its operations center, as well as the principal offices of VNB Wealth Management. A portion of the additional space not occupied by the Company and its subsidiaries is leased to tenants.

The property located at 1580 Seminole Trail, Charlottesville, Virginia has been fully owned by the Company since 2012. As of December 31, 2014, all of the other locations were leased from parties other than related parties. The banking facility located at 1900 Arlington Boulevard, Charlottesville, Virginia, was constructed by the Bank on a pad site which is leased by the Company. This space has additional space not occupied by the banking facility that has been leased to tenants.

Previously, VNBTrust leased space at 310 4<sup>th</sup> Street, NE, Suite 102, Charlottesville, Virginia. As of January 1, 2014, this property was subleased to SRCM Holdings LLC, as part of the Sale Agreement described in Note 1 of the notes to the consolidated financial statements contained in Item 8 Consolidated Financial Statements and Supplementary Data. Effective August 1, 2014, VNBTrust assigned its interest in the lease to SRCM Holdings, and the landlord released VNBTrust from all further liability on the lease. VNBTrust main office is now located at 404 People Place, Charlottesville, Virginia.

**Table of Contents**

See Note 6 Premises and Equipment in the notes to the consolidated financial statements in Item 8 Consolidated Financial Statements and Supplementary Data for information with respect to the amounts at which the Company's premises and equipment are carried and commitments under long-term leases.

**Item 3. LEGAL PROCEEDINGS.**

In the ordinary course of its operations, the Company's subsidiaries are parties to various legal proceedings. Based on the information presently available, management believes that the ultimate outcome of such proceedings will not have an adverse effect on the business or financial condition of the Company and its subsidiaries.

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable

**Table of Contents****Part II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.****Common Stock Performance and Dividends**

Virginia National Bankshares Corporation's Common Stock is quoted on the OTC Markets Group's OTCQX tier (OTCQX) under the symbol VABK. As of December 31, 2014, the Company had issued and outstanding 2,688,336 shares of Common Stock. These shares were held by approximately 556 shareholders of record and others who held shares at brokerage firms.

Prior to the second quarter of 2013, the Company had not paid a cash dividend. On June 18, 2013, the Board of Directors declared a quarterly cash dividend of \$0.05 per share, payable on July 19, 2013 to shareholders of record as of July 8, 2013. Subsequently, quarterly dividends of \$0.05 per share were declared as of September 19, 2013, December 17, 2013, and March 18, 2014 and quarterly dividends of \$0.075 per share were declared May 20, 2014, September 18, 2014, and December 16, 2014. The payment of dividends is at the discretion of the Company's Board of Directors and is subject to various federal and state regulatory limitations. As a bank holding company, the ability to pay dividends is dependent upon the overall performance and capital requirements of the subsidiary Bank.

For the years ended December 31, 2014 and December 31, 2013, the data in the table below represents the high bid and low bid quotations that occurred for the periods shown as reported by the OTCQX. These over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. Additionally, the table shows the dividends declared per quarter in 2014 and 2013.

	Bid Quotations				Dividends Declared	
	2014		2013		2014	2013
	High	Low	High	Low		
First Quarter	\$ 21.89	\$ 18.05	\$ 15.85	\$ 13.52	\$ 0.050	\$ -
Second Quarter	\$ 23.45	\$ 21.57	\$ 16.75	\$ 15.70	\$ 0.075	\$ 0.050
Third Quarter	\$ 23.60	\$ 22.65	\$ 17.10	\$ 16.50	\$ 0.075	\$ 0.050
Fourth Quarter	\$ 23.50	\$ 22.67	\$ 18.25	\$ 17.00	\$ 0.075	\$ 0.050
Total					\$ 0.275	\$ 0.150

American Stock Transfer and Trust Company is the Company's stock transfer agent and registrar.

**Stock Repurchase Program**

On September 22, 2014, the Company issued a press release and filed a Form 8-K with the Securities and Exchange Commission to announce the approval by its Board of Directors of a stock repurchase program authorizing repurchase of up to 400,000 shares of the Company's common shares through the open market or in privately negotiated transactions. The repurchase program is authorized through September 18, 2015.

**Table of Contents**

The table below represents the number of shares repurchased by quarter since the Plan's inception on September 22, 2014 through December 31, 2014.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced Plan	Maximum number of shares that may yet be purchased under the Plan
September 22, 2014 to September 30, 2014	-	\$ -	-	400,000
October 1, 2014 to December 31, 2014	11,500	\$ 22.75	11,500	388,500
<b>Total</b>	<b>11,500</b>	<b>\$ 22.75</b>	<b>11,500</b>	<b>388,500</b>

**Item 6. SELECTED FINANCIAL DATA.**

Not required.

**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion provides information about the major components of the results of consolidated operations and financial condition, liquidity and capital resources of Virginia National Bankshares Corporation. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements.

**Application of Critical Accounting Policies and Critical Accounting Critical Estimates**

The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States ( GAAP ) and to general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Company considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Company's financial statements. The Company's accounting policies are fundamental to understanding management's discussion and analysis of financial condition and results of operations.

Following are the accounting policies and estimates that the Company considers as critical:

**Allowance for loan losses** is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. Accounting policies related to the allowance for loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with Accounting Standards Codification ( ASC ) Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio, as well as trends in the

foregoing. 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. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion and Note 3 - Loans and Note 4 - Allowance for Loan Loss in the notes to consolidated financial statements, included in Item 8. Consolidated Financial Statements and Supplementary Data, elsewhere in this report for further details of the risk factors considered by management in estimating the necessary level of the allowance for loan losses.



## **Table of Contents**

**Impaired loans** are loans so designated when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. Additional information on impaired loans, which includes both Troubled Debt Restructurings ( TDRs ) and non-accrual loans, is included in Note 3 Loans and Note 4 Allowance for Loan Losses in the notes to consolidated financial statements.

**Fair value measurements** are used by the Company to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realized value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Additional discussion of valuation methodologies is presented in Note 14 Fair Value Measurements in the notes to consolidated financial statements.

**Other-than-temporary impairment of securities** accounting policies require a periodic review by management to determine if the decline in the fair value of any security appears to be other-than-temporary. Factors considered in determining whether the decline is other-than-temporary include, but are not limited to: the length of time and the extent to which fair value has been below cost; the financial condition and near-term prospects of the issuer; and the Company's intent to sell. See Note 1 Summary of Significant Accounting Policies and Note 2 Securities, in the notes to consolidated financial statements, for further details on the accounting policies for other-than-temporary impairment of securities and the methodology used by management to make this evaluation.

**Other real estate owned ( OREO )** represents assets acquired through, or in lieu of, loan foreclosures and are held for sale. Initially the OREO is recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less cost to sell. More information regarding the valuation methods used as well as the accounting for OREO is presented in Note 5 Other Real Estate Owned and Note 14 Fair Value Measurements in the notes to consolidated financial statements.

## **Non-GAAP Presentations**

The Company, in referring to its net income, is referring to income computed under GAAP. Management's Discussion and Analysis of Financial Condition and Results of Operations also refer to various calculations that are non-GAAP presentations. They include:

**Fully taxable-equivalent ( FTE ) adjustments** are the result of increasing income from tax-free investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 34% Federal income tax rate, thus making tax-exempt yields comparable to taxable asset yields.

**Efficiency ratio** is computed as a percentage of noninterest expense divided by the sum of net interest income (on an FTE basis) and noninterest income. This is a financial measure which may provide important information concerning the Company's operational efficiency. Comparison of the Company's efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently.

## **Table of Contents**

### **Results of Operations**

The Company reported net income totaled \$1.898 million, or \$0.70 diluted per common share in 2014 compared to \$6.896 million, or \$2.56 diluted per common share in 2013. The decrease was primarily the result of a \$12.257 million decrease in noninterest income and an increase in provision for loan losses of \$146 thousand. Positively affecting net income for 2014 compared to 2013 was a decrease of \$4.644 million in noninterest expense, an increase of \$5 thousand in net interest income, and a decrease in provision for income taxes of \$2.756 million.

The Company has two reportable segments, the Bank and VNB Wealth. Commercial banking involves making loans and generating deposits from individuals and businesses. Loan fee income, service charges from deposit accounts, and other non-interest-related fees such as fees for debit cards and ATM usage and fees for treasury management services generate additional income for this segment. VNB Wealth services include investment management, trust and estate administration, custody services, and financial planning. Fees for these services are charged on a fixed basis and a performance basis.

The Bank earned net income of \$1.771 million in 2014, \$278 thousand less than the \$2.049 million earned in 2013. VNB Wealth earned net income of \$127 thousand in 2014, compared to net income of \$4.847 million in 2013.

The decrease in noninterest income of \$12.257 million and the decrease of \$4.644 million in noninterest expense resulted primarily from the sale of Swift Run Capital Management, LLC ( SRCM ) in July, 2013 and the subsequent transfer of other assets under management to SRCM (together, SRCM Transfers ) contemplated by the Sale Agreement previously discussed. Both performance fees earned and the related incentive compensation payable decreased significantly from 2013 to 2014 as a result of the SRCM Transfers. VNBTrust earned \$523 thousand in performance fees in 2014 and earned \$12.267 million in performance fees in 2013. This amount for 2013 included 100% of the fees earned on assets under management on which performance fees are earned ( Incentive AUMs ) that were sold or transferred to SRCM (the Transferred Assets ) during 2013, as well as on Incentive AUMs remaining at VNBTrust. Likewise, the incentive compensation was accrued on all performance fees earned by VNBTrust in 2013, including the fees earned on the Transferred Assets. At December 31, 2013, the Incentive AUMs related to the Transferred Assets had an aggregate market value of \$99.6 million, which represented 38.7% of the total Incentive AUMs on which VNBTrust earned performance fees in 2013. As provided in the Sales Agreement, starting in 2014, VNBTrust received only 20 percent of the performance fees earned on the Transferred Assets. A further discussion of the changes in Noninterest Income and Noninterest Expense can be found under these respective headings later in this report.

**Table of Contents**

Details of the changes in the various components of net income are further discussed below.

**Consolidated Return on Equity and Assets**

The annualized ratio of net income to average total assets and average shareholders' equity and certain other ratios for the periods indicated are as follows:

	2014	2013	2012
Return on average assets	0.37%	1.40%	1.11%
Return on average equity	3.16%	12.70%	10.90%
Average equity to average assets	11.62%	11.04%	10.21%
Cash dividend payout ratio	39.09%	5.86%	0.00%

One of the ratios the Company examines in its evaluation of net income is the efficiency ratio, which measures the cost to produce one dollar of revenue. A lower ratio, computed by dividing noninterest expense by the sum of net interest income (on an FTE basis) and noninterest income, is an indicator of increased efficiency. The efficiency ratio for 2014 was negatively impacted as a result of a revenue decrease of \$12.236 million as compared to 2013 and despite a decrease in noninterest expense of \$4.644 million in 2014 over 2013. The contraction in revenue and expense in 2014 from 2013 were primarily attributable to a decrease in Trust performance fee revenue and the associated incentive compensation expense. This is a result of the restructuring of VNBTrust (now operating under the trade name VNB Wealth Management) and the transactions related to Swift Run Capital Management, LLC discussed earlier under Item 1: Business.

The efficiency ratio for 2013 improved from 2012 as a result of the increased revenue of \$4.810 million that came primarily from VNBTrust performance fee revenue as discussed above. Noninterest expense for 2013 was \$2.385 million greater than 2012 due mainly to the increase in VNBTrust's incentive compensation that was associated with 2013's higher performance fee revenue.

The efficiency ratio for the years ended December 31, 2014, 2013, and 2012 is shown below.

	2014	2013	2012
Efficiency Ratio	85.7%	67.9%	70.9%

**Net Interest Income**

Net interest income is computed as the difference between the interest income on earning assets and the interest expense on deposits and other interest bearing liabilities. Net interest income represents the principal source of revenue for the Company and accounted for 72.1% of the total revenue in 2014. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

During 2014, net interest income, on a tax equivalent basis, totaled \$14.700 million and was fairly level with the 2013 total of \$14.679 million. Despite average earning assets for 2014 being \$23.845 million higher compared to 2013, lower interest rates and the mix of earning asset balances for 2014 versus 2013 offset the benefits from the increased volume. The average balance for loans as a percentage of earnings assets for 2014 was 61.8% while average loan balances during 2013 were 64.5% of earning assets. The decrease in average loans as a percentage of earning assets was offset by increases in average balances as a percentage of earning assets for lower yielding investment securities and Federal Funds Sold. Investment securities balances were 29.2% of earning assets in 2014; up from 27.8% in 2013. Similarly, Federal Funds average balances were 8.6% of earning assets in 2014, up from 7.4% in 2013. The tax equivalent yield on investment securities was 2.13% for 2014, or 211 basis points less than the yield of 4.24% for the loan portfolio. This illustrates the impact that the mix of investments and loans had not only on the earning asset yield but on the related interest income.

**Table of Contents**

The net interest margin declined 16 basis points to 3.07% for the year ended December 31, 2014 from 3.23% reported for 2013. Further, the decrease in the net interest margin for 2013 was 19 basis points from the 3.42% net interest margin reported for the year ended December 31, 2012.

Total interest income, on a tax equivalent basis, aggregated \$15.628 million for 2014, down \$48 thousand from 2013, primarily as a result of a decline in loan interest income of \$450 thousand. The decline from loan interest income was partially offset by an increase of \$380 thousand in tax equivalent interest income from the investment portfolio when comparing 2014 to 2013. In comparing 2013 to 2012, total interest income, on a tax equivalent basis, declined \$1.318 million to \$15.676 million in 2013 from \$16.994 million in 2012. The tax-equivalent yield on interest-earning assets was 3.27% for 2014, compared to 3.45% for 2013 and 3.70% for 2012.

The \$450 thousand decrease in interest income earned on the loan portfolio for 2014, from \$12.998 million in 2013, was mainly attributable to lower yields realized on new production and loans with rate adjustments in the protracted low interest rate environment combined with payoffs of higher interest loans. The yield on the loan portfolio decreased to 4.24% for 2014 from 4.43% for 2013, resulting in a decrease of \$550 thousand in loan interest income solely attributable to yields. Partially offsetting the decline in yields on loans was a \$100 thousand increase in loan interest income that is solely attributable to higher average loan balances of \$295.9 million in 2014 compared to \$293.5 million for 2013.

The decline in interest income earned on the loan portfolio during 2014 was a continuation of the yield compression experienced over the past few years and intense competition for loans. Loan interest income had decreased \$1.722 million for 2013 from \$14.720 million in 2012. The yield on the loan portfolio decreased 56 basis points in 2013 from 4.99% for 2012.

Interest earned on the securities portfolio, on a tax-equivalent basis, increased to \$2.971 million for 2014 from \$2.591 million in 2013 and \$2.154 million in 2012. Average securities balances increased to \$139.650 million (29.2% of average earning assets) for 2014 from \$126.157 million (27.7% of average earning assets) and \$104.800 million (22.8% of average earning assets) in 2013 and 2012, respectively. The average yield on investment securities increased 8 basis points in 2014 from 2.05% in the corresponding 2013 period. In 2012, the average yield on the investment portfolio was 2.06%.

Management's asset/liability strategy for the investment portfolio is to maintain diversity within the investment portfolio by adding mortgage-backed securities, bank-qualified municipal bonds, and corporate bonds. The average duration of the investment portfolio continues to be relatively short. Adding mortgage-backed securities has resulted in providing a consistent stream of cash flow that can be diverted to loan growth or re-invested in higher yielding securities if interest rates rise. The level of bank-qualified municipal bonds has favorably contributed to reducing the Company's effective income tax rate.

Total interest expense decreased slightly by \$69 thousand for 2014 to \$928 thousand from \$997 thousand for 2013, mainly due to a decline in the rates paid for interest-bearing liabilities from 0.32% for 2013 to 0.30% for 2014. Average balances of interest-bearing liabilities of \$309.1 million for 2014 was virtually unchanged from 2013. Total interest expense decreased by \$284 thousand for 2013 from \$1.281 million for 2012. Further, rates paid for interest-bearing liabilities declined from 0.43% for 2012 to 0.32% for 2013.

A continuing primary driver of the Company's low cost of funds compared to peers is the Company's level of non-interest bearing demand deposits and low-cost deposit accounts. Below is a table illustrating the average balances of these accounts as a percentage of total deposit account balances.

**Non-interest and low-cost deposit account analysis**

(dollars in thousands)	2014		2013		2012	
	Average Balance	% of Total Deposits	Average Balance	% of Total Deposits	Average Balance	% of Total Deposits
Non-interest demand deposits	\$ 144,964	33.0%	\$ 127,480	29.7%	\$ 139,741	31.9%
Interest checking accounts	81,881	18.7%	77,954	18.2%	67,898	15.5%
Money market deposit accounts	89,061	20.3%	94,369	22.0%	93,690	21.4%
Total non-interest and low-cost deposit accounts	\$ 315,906	72.0%	\$ 299,803	69.9%	\$ 301,329	68.8%

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Total deposit account balances	\$ 438,565	\$ 428,619	\$ 438,161
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**Table of Contents****Consolidated Average Balance Sheet And Analysis of Net Interest Income**

(dollars in thousands)	Year Ended December 31, 2014			Year Ended December 31, 2013			Year Ended December 31, 2012		
	Average Balance	Interest Income Expense	Average Yield/ Cost	Average Balance	Interest Income Expense	Average Yield/ Cost	Average Balance	Interest Income Expense	Average Yield/ Cost
<b>ASSETS</b>									
Interest earning assets:									
Securities									
Taxable securities	\$ 119,774	\$ 2,248	1.88%	\$ 106,842	\$ 1,914	1.79%	\$ 96,776	\$ 1,890	1.95%
Tax exempt securities <sup>1</sup>	19,876	723	3.64%	19,315	677	3.51%	8,024	264	3.29%
Total securities <sup>1</sup>	139,650	2,971	2.13%	126,157	2,591	2.05%	104,800	2,154	2.05%
Loans:									
Real estate	231,310	10,253	4.43%	230,320	10,651	4.62%	238,958	12,481	5.23%
Commercial	51,799	1,871	3.61%	50,382	1,910	3.79%	42,876	1,765	4.12%
Consumer	12,811	424	3.31%	12,769	437	3.42%	12,996	474	3.65%
Total Loans	295,920	12,548	4.24%	293,471	12,998	4.43%	294,830	14,720	5.00%
Fed funds sold	41,156	90	0.22%	33,770	74	0.22%	58,420	112	0.19%
Other interest bearing deposits	1,767	19	1.08%	1,250	13	1.04%	751	8	1.06%
Total earning assets	478,493	15,628	3.27%	454,648	15,676	3.45%	458,801	16,994	3.70%
Less: Allowance for loan losses	(3,240)			(3,439)			(3,704)		
Total non-earning assets	41,044			40,728			37,031		
Total assets	\$ 516,297			\$ 491,937			\$ 492,128		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
Interest bearing liabilities:									
Interest bearing deposits:									
Interest checking	\$ 81,881	\$ 41	0.05%	\$ 77,954	\$ 39	0.05%	\$ 67,898	\$ 34	0.05%
Money market deposits	89,061	164	0.18%	94,369	183	0.19%	93,690	194	0.21%
Time deposits	122,659	686	0.56%	128,816	758	0.59%	136,832	1,049	0.76%
Total interest-bearing deposits	293,601	891	0.30%	301,139	980	0.33%	298,420	1,277	0.42%
Securities sold under agreement to repurchase	15,480	37	0.24%	7,941	17	0.21%	2,973	4	0.13%
Total interest-bearing liabilities	309,081	928	0.30%	309,080	997	0.32%	301,393	1,281	0.42%
Non-interest-bearing liabilities:									
Demand deposits	144,964			127,480			139,741		
Other liabilities	2,277			1,067			730		
Total liabilities	456,322			437,627			441,864		
Shareholders' equity	59,975			54,310			50,264		
Total liabilities & shareholders' equity	\$ 516,297			\$ 491,937			\$ 492,128		
Net interest income (tax equivalent)		\$ 14,700			\$ 14,679			\$ 15,713	
Interest rate spread <sup>2</sup>			2.97%			3.13%			3.28%
Interest expense as a percentage of average earning assets			0.19%			0.22%			0.25%
Net interest margin <sup>3</sup>			3.07%			3.23%			3.78%

<sup>1</sup> Tax-exempt income for investment securities has been adjusted to a tax-equivalent basis (FTE), using a Federal income tax rate of 34%.

<sup>2</sup> Interest Rate Spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.

<sup>3</sup> Net Interest Margin is net interest income expressed as a percentage of average earning assets.



**Table of Contents****Volume and Rate Analysis**

The following table describes the impact on the net interest income of the Company resulting from changes in average balances and average rates for the periods indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each. Interest income is reported on a tax-equivalent basis.

**2014 compared to 2013  
(dollars in thousands)**

	Change due to:		Increase/ (Decrease)
	Volume	Rate	
<b>Assets:</b>			
Securities	\$ 261	\$ 119	\$ 380
<b>Loans:</b>			
Real estate	46	(444)	(398)
Commercial	53	(92)	(39)
Consumer	1	(14)	(13)
Total loans	100	(550)	(450)
Federal funds sold	16	-	16
Other interest bearing deposits	6	-	6
Total earning assets	\$ 383	\$ (431)	\$ (48)
<b>Liabilities and Shareholders' equity:</b>			
Interest-bearing deposits:			
Interest checking	\$ 2	\$ -	\$ 2
Money market	(10)	(9)	(19)
Time deposits	(35)	(37)	(72)
Total interest-bearing deposits	(43)	(46)	(89)
Securities sold under agreements to repurchase	18	2	20
Total interest-bearing liabilities	(25)	(44)	(69)
Change in net interest income	\$ 408	\$ (387)	\$ 21

**2013 compared to 2012  
(dollars in thousands)**

	Change due to:		Increase/ (Decrease)
	Volume	Rate	
<b>Assets:</b>			
Securities	\$ 439	\$ (2)	\$ 437
<b>Loans:</b>			
Real estate	(439)	(1,391)	(1,830)
Commercial	292	(147)	145
Consumer	(8)	(29)	(37)
Total loans	(155)	(1,567)	(1,722)
Federal funds sold	(52)	14	(38)
Other interest bearing deposits	5	-	5
Total earning assets	\$ 237	\$ (1,555)	\$ (1,318)
<b>Liabilities and Shareholders' equity:</b>			
Interest-bearing deposits:			
Interest checking	\$ 5	\$ -	\$ 5
Money market	1	(12)	(11)
Time deposits	(58)	(233)	(291)
Total interest-bearing deposits	(52)	(245)	(297)
Securities sold under agreements to repurchase	10	3	13
Total interest-bearing liabilities	(42)	(242)	(284)
Change in net interest income	\$ 279	\$ (1,313)	\$ (1,034)





## **Table of Contents**

### **Provision for Loan Losses**

The level of the allowance reflects changes in the size of the portfolio or in any of its components as well as management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality and 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. Additional information concerning management's methodology in determining the adequacy of the allowance for loan losses is contained in Note 1 and Note 4 of the notes to consolidated financial statements, found in Item 8 Consolidated Financial Statements and Supplementary Data, later in this report.

Based on management's continuing evaluation of the loan portfolio in 2014, the Company recorded a provision for loan losses of \$306 thousand, compared to 2013 when the Company recorded a provision for loan losses of \$160 thousand. One of the major factors in driving the \$146 thousand increase in the provision for loan loss between 2014 and 2013 was the net increase in loan balances of \$13.22 million as of December 31, 2014 from December 31, 2013. The other major factor that influenced an increase in the provision expense was the higher level of net charge-offs in 2014 compared to 2013.

There were \$551 thousand in loan balances charged off during 2014, with a total of \$49 thousand in recoveries of previously charged-off balances. This resulted in net charge-offs of \$502 thousand during 2014. There were \$161 thousand in loan balances charged off during 2013, with a total of \$94 thousand in recoveries of previously charged-off balances, resulting in net charge-offs of \$67 thousand during 2013. The ratio of net charge-offs to average loans remained strong at 0.17% for 2014 compared to 0.02% for 2013 and 0.13% for 2012.

As of December 31, 2014, the allowance for loan losses was \$3.164 million, a decrease of \$196 thousand from \$3.360 million at December 31, 2013. Factors positively affecting the provision for the years 2014 compared to 2013 included a continuing improved economic climate and an overall improvement in asset quality. Management's estimates for the allowance for loan losses resulted in the Company's allowance to total loans outstanding ratio to be 1.01% at December 31, 2014, compared to the 1.12% reported at December 31, 2013 and the 1.15% at December 31, 2012. See the section captioned Allowance for Loan Losses later in this report and Note 3 Loans and Note 4 Allowance for Loan Losses in the notes to consolidated financial statements, included in Item 8 Consolidated Financial Statements and Supplementary Data, later this report for further details of the risk factors considered by management in estimating the necessary level of the allowance for loan losses.

### **Noninterest Income**

Noninterest income decreased from \$17.854 million for 2013 to \$5.597 million in 2014. The decrease of \$12.257 million principally resulted from fee revenues from VNB Wealth, which were down \$12.614 million in 2014 compared to 2013. Noninterest income, exclusive of trust fees, totaled \$3.230 million in 2014, an increase of \$357 thousand as compared to \$2.873 million in 2013.

Late in the third quarter of 2014, a new fee structure for the Bank was implemented as part of management's revenue enhancement strategy. Many of the Bank's fees had not been increased in several years, and the reassessment of the fees allowed the Bank to increase revenue while remaining at the same level or lower than its competition.

In addition, in mid-2014, the Company initiated a new source of revenue by hiring a secondary market mortgage loan originator. Since the new business line and new fee schedules were not completely implemented until the fourth quarter of 2014, the Company has not yet fully realized the impact that these changes would have on a full-year basis.

**Table of Contents**

The major components of noninterest income are detailed below. Year-to-year variances are shown for trust income and for other noninterest income categories.

(dollars in thousands)	Years ended December 31,		Variance
	2014	2013	
<b>Trust income from VNB Wealth</b>			
Performance fees	\$ 523	\$ 12,267	\$ (11,744)
Management fees	1,844	2,714	(870)
Total Trust Income	2,367	14,981	(12,614)
<b>Noninterest income, excluding trust income:</b>			
Customer service fees	894	921	(27)
Debit/credit card and ATM fees	742	729	13
Earnings/increase in value of bank owned life insurance	439	445	(6)
Gains on sales of assets	44	304	(260)
Gains on sales of securities	24	50	(26)
Royalty income	593	-	593
Other	494	424	70
Total noninterest income, excluding trust income	3,230	2,873	357
Total	\$ 5,597	\$ 17,854	\$ (12,257)

**Trust income** is primarily derived from two forms of fee income: management fees and performance fees. Management fees will vary depending on the type of account, investment authority and assets under management ( AUMs ). During 2014, VNB Wealth recognized \$1.844 million in management fees, a decrease of \$870 thousand compared to 2013. The decrease in management fees is attributed in large part to the net decrease in AUMs from \$583.6 million at December 31, 2013 to \$484.7 million at December 31, 2014.

Performance fees are based on the year-over-year increase in the market value (both realized and unrealized gains) of managed Incentive AUMs. Performance fees are assessed based upon the appreciation in the market value of Incentive AUMs at December 31<sup>st</sup> compared to the preceding January 1<sup>st</sup>. As discussed in the Results of Operations section earlier in this report, the decrease in performance fees resulted primarily from the sale of SRCM and SRCM Transfers under the Sale Agreement. VNBTrust earned 100% of the performance fees earned on the Incentive AUMs of \$99.6 million which were managed by SRCM as of December 31, 2013. The performance fees earned in 2013 by VNBTrust on Incentive AUMs transferred to SRCM and to other investment managers totaled \$5.548 million, representing 45.2% of the total performance fees of \$12.267 million earned by VNBTrust. As of December 31, 2014, Incentive AUMs on which VNBTrust received performance fees were \$55.1 million compared to \$257.2 million at December 31, 2013. The remaining decrease in performance fees in 2014 resulted from lower level of market appreciation of Incentive AUMs in 2014 compared to 2013.

Starting in 2014, VNBTrust received 20% of the management and performance fee revenue from AUMs that transferred to SRCM as contemplated under Sale Agreement, which VNBTrust recorded as royalty income rather than as performance fees or management fees of VNBTrust. VNBTrust recorded royalty revenue of \$593 thousand for the twelve months ended December 31, 2014 on Incentive AUMs that transferred to SRCM. Additional information on royalty income is discussed below.

**Royalty income** of \$593 thousand was recorded in 2014 in accordance with the first year of the Sale Agreement with SRCM Holdings. Beginning in 2014 for a ten-year period, ongoing royalty payments will be paid to VNBTrust. Performance fee royalty income is recognized in the same manner and timeframe as the performance fees earned by VNB Wealth and totaled \$426 thousand for 2014, with the remaining \$167 thousand representing fixed fee royalty income. Additional details on this Sale Agreement with SRCM Holdings, LLC are discussed in Note 1 of the notes to the consolidated financial statements and are found under Item 8 Consolidated Financial Statements and Supplementary Data, later in this report.

**Table of Contents**

**Gains on sales of assets** decreased \$260 thousand in the year-over-year comparison. The \$304 thousand gain in 2013 was the result of the sale of the former fund management business to SRCM Holdings, LLC. Additional details on this transaction are found in Note 1, of the notes to the consolidated financial statements, under Item 8 Consolidated Financial Statements and Supplementary Data, later in this report. The \$44 thousand gain in 2014 was the result of the sale of stock and a Company-owned automobile.

**Other noninterest income** increased \$70 thousand in 2014 to \$494 thousand from \$424 thousand. Approximately \$59 thousand of the increase in other noninterest income for 2014 can be associated with the Bank's new deposit account fee schedule implemented in late 2014, as discussed above. In addition, in mid-2014, the Company hired a secondary market mortgage loan originator; income of \$76 thousand was generated from this new line of business. These increases were partially offset by contractions in brokerage fees of \$47 thousand and miscellaneous other fees of \$32 thousand.

**Noninterest Expense**

Total noninterest expense for the year ended December 31, 2014 was \$17.391 million, or \$4.644 million lower than the \$22.035 million reported for the year ended December 31, 2013. The decrease was almost entirely due to the decrease of \$4.995 million in VNB Wealth incentive compensation. In 2013, incentive compensation paid by VNB Wealth was based entirely on the performance fee revenue earned by VNBTrust through December 31, 2013, including 100% of the revenue earned on assets associated with the sale of SRCM under the Sale Agreement, as explained earlier in the Results of Operations and Noninterest Income sections of the management's discussion and analysis. Following the sale of SRCM, changes were made to VNB Wealth's compensation agreements for 2014 to separate incentive compensation paid by VNB Wealth from the amount of performance fees earned by VNB Wealth. Noninterest expense, excluding the VNB Wealth incentive compensation cost, was \$16.842 million for 2014, \$351 thousand higher than the \$16.491 million recorded in 2013 as noninterest expense.

The major components of noninterest expense are detailed below for the years ended December 31, 2014 and December 31, 2013. The personnel expenses related to the VNB Wealth incentive compensation have been separated from the remaining noninterest expense categories to allow a more meaningful year-to-year comparison.

(dollars in thousands)	Years ended December 31,		Variance
	2014	2013	
<b>Noninterest expense, excluding VNB Wealth incentive compensation:</b>			
Salaries and employee benefits	\$ 8,756	\$ 8,202	\$ 554
Net occupancy	1,954	2,104	(150)
Equipment	531	686	(155)
ATM, debit and credit card	349	297	52
Bank franchise tax	328	253	75
Computer software	330	319	11
Data processing	1,025	949	76
FDIC deposit insurance assessment	268	248	20
Marketing, advertising and promotion	774	721	53
Net OREO write downs and expenses	345	285	60
Professional fees	696	744	(48)
Other	1,486	1,683	(197)
Total noninterest expense, excluding incentive compensation	\$ 16,842	\$ 16,491	\$ 351
<b>Noninterest Expense for VNB Wealth Incentive Compensation:</b>			
Incentive compensation-related expense	549	5,544	(4,995)
<b>Total Noninterest Expense</b>	<b>\$ 17,391</b>	<b>\$ 22,035</b>	<b>\$ (4,644)</b>

**Total Salaries and employee benefits** were lower in 2014, by \$4.441 million compared to 2013. The primary reason was a decrease of \$4.995 million in the total booked as VNB Wealth incentive compensation as discussed previously. Incentive compensation expenses of \$5.544 million were recorded for 2013, compared to \$549 thousand recorded for 2014. Higher incentive compensation costs, calculated in accordance with pre-established formulas, were related to the increased performance fee revenue for VNB Wealth in 2013. Excluding the VNB Wealth incentive compensation cost for both years, personnel expense was \$8.756 million for 2014 or \$554 thousand higher than the \$8.202 million recorded for 2013. In 2014 VNB Wealth made key hires to

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augment operational improvements, trading and financial planning and changed the method of calculating incentive compensation. The increase in salaries and employee benefits is directly related to these hires, as well as the Bank's hiring of experienced lenders to increase loan production. In addition, benefits expenses were higher due to an increase in the rate of the 401(k) employer match for contributions for all eligible Company employees.

## **Table of Contents**

**Net occupancy and equipment expenses** were reduced by \$150 thousand and \$155 thousand, respectively, in 2014 from the 2013 levels. The decrease in occupancy expense is largely attributable to the reduction in rent expense as a result of relocating VNB Wealth offices from formerly leased space into available space at the Company's Pantops Office building in Charlottesville. Equipment expense was lower primarily due to a decline in depreciation cost of \$107 thousand, as various equipment became fully depreciated in 2014.

**Bank franchise tax** increased \$75 thousand in 2014 to \$328 thousand as compared to \$253 thousand for 2013. In 2013, the Bank was able to take advantage of available Neighborhood Assistance Credits that directly reduced the tax liability.

**Data processing expense** of \$1.025 million during 2014 were \$76 thousand higher than the \$949 thousand recognized in 2013. The increase was mainly attributable to deconversion costs associated with the VNB Wealth's core system conversion in the fourth quarter of 2014. This change was planned and implemented to improve portfolio reporting and portfolio management capabilities to provide better service to VNB Wealth clients.

**Professional fees and other expenses** decreased by \$245 thousand in 2014 as compared to 2013 when the Company paid legal and consulting fees associated with the formation of the bank holding company and the sale of Swift Run Capital Management, LLC.

## **Provision for Income Taxes**

In 2014, the Company provided \$456 thousand for Federal income taxes, resulting in an effective income tax rate of 19.4%. For 2013, the Company provided \$3.212 million for Federal income taxes, resulting in an effective income tax rate of 31.8%. The effective income tax rates differed from the U.S. statutory rate of 34% during the comparable periods primarily due to the effect of tax-exempt income from municipal bonds and life insurance policies. The lower effective tax rate during 2014 was related to the relative level of the income from these tax-exempt instruments to other taxable income. The significantly high level of trust performance fee income in 2013 caused the effective tax rate to be higher for that year. More information on income taxes, including net deferred taxes can be found in Note 8 of the notes to the consolidated financial statements which is found in Item 8 Consolidated Financial Statements and Supplementary Data, later in this report.

## **BALANCE SHEET ANALYSIS**

### **Securities**

The investment securities portfolio has a primary role in the management of the Company's liquidity requirements, interest rate sensitivity and in generating substantial interest income. Investment securities play a key role in diversifying the Company's balance sheet. In addition, a portion of the investment securities portfolio is pledged as collateral for public fund deposits and for commercial customers utilizing the Bank's overnight repurchase program. Changes in deposit and other funding balances and in loan production will impact the overall level of the investment portfolio.

As of December 31, 2014, the Company's investment portfolio totaled \$143.381 million, of which obligations of U.S. government corporations and government-sponsored enterprises amounted to \$98.354 million which is approximately 68.6% of the total. The investment portfolio as of December 31, 2013 totaled \$134.672 million. The year over year growth of 6.5% was primarily a result of management's focus on maximizing the earning capacity of the Company's excess liquidity by moving funds from overnight federal funds and into investment securities.

In accordance with ASC 320, Investments - Debt and Equity Securities, the Company has categorized its unrestricted securities portfolio as Available for Sale (AFS). Securities classified as AFS may be sold in the future, prior to maturity. Any decision to sell a security classified as AFS would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. AFS 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. All of the Company's securities were investment grade or better as of December 31, 2014. 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. AFS securities included gross unrealized gains of \$870 thousand and gross unrealized losses of \$803 thousand as of December 31, 2014.



**Table of Contents**

During the third quarter of 2013, the Company reclassified its held to maturity ( HTM ) securities as AFS. Management determined that it no longer had the positive intent to hold the securities classified as HTM for an indefinite period of time because of management's desire to have more flexibility in managing the investment portfolio. As of June 30, 2013, the Company had three corporate and municipal securities designated as HTM recorded at an amortized cost of \$2.699 million. The fair value of these securities was \$2.733 million, reflecting an unrealized gross gain of \$34 thousand. The unrealized gross gain of \$34 thousand, net of income taxes, was recorded as other comprehensive income at the time of the transfer. As a result of this transfer, there were no securities classified as held to maturity as of December 31, 2014 or December 31, 2013.

For the year ended December 31, 2014, proceeds from the sales of securities amounted to \$7.498 million and realized gains on these securities were \$24 thousand. For the year ended December 31, 2013, proceeds from the sales of securities amounted to \$16.854 million and realized gains on these securities were \$50 thousand.

**Securities Held to Maturity and Available for Sale**  
**(dollars in thousands)**
**Carrying Value of Securities**

	2014	As of December 31, 2013	2012
<b>Securities Available for Sale</b>			
Fair Value:			
U.S. Government-Sponsored Agencies	\$ 31,528	\$ 44,005	\$ 63,497
Corporate Bonds	21,276	9,053	4,023
Asset-Backed Securities	2,105	2,100	1,144
Mortgage-Backed Securities/CMOs	63,220	55,597	25,166
Municipal Bonds	23,687	22,272	17,023
	\$ 141,816	\$ 133,027	\$ 110,853
<b>Securities Held to Maturity</b>			
Amortized Cost:			
Corporate Bonds	\$ -	\$ -	\$ 4,024
Municipal Bonds	-	-	1,967
	\$ -	\$ -	\$ 5,991
<b>Restricted Securities</b>			
Cost:			
Federal Reserve Bank Stock	\$ 1,039	\$ 1,036	\$ 1,033
Community Bankers Bank Stock	64	-	-
Federal Home Loan Bank Stock	462	609	696
	\$ 1,565	\$ 1,645	\$ 1,729

All mortgage-backed securities included in the tables above were issued by U.S. government agencies and corporations. At December 31, 2014, the securities issued by political subdivisions or agencies ( municipal bonds ) were highly rated, with 83% of the municipal bonds having credit ratings from nationally recognized statistical rating organizations of AA or higher. Approximately 79% of the municipal bonds are general obligation bonds with issuers that are geographically diverse.



**Table of Contents**

The Company does not hold any derivative instruments. The Company held no issues that exceeded 10% of Shareholders' Equity at December 31, 2014.

The Company's holdings of restricted securities totaled \$1.565 million at December 31, 2014 and \$1.645 million at December 31, 2013 and consisted of Federal Reserve Bank of Richmond, Federal Home Loan Bank of Atlanta, and for December 31, 2014, stock of CBB Financial Corporation, the holding company for Community Bankers Bank. The Bank is required to hold stock in the Federal Reserve Bank of Richmond and the Federal Home Loan Bank of Atlanta as a condition of membership with each of these correspondent banks. The amount of stock required to be held by the Bank is periodically assessed by each bank, and the Bank may be subject to purchase or put back stock held in these banks, as determined by their respective calculations. Stock ownership in the bank holding company for Community Bankers Bank provides the Bank with several benefits that are not available to non-shareholder correspondent banks. None of these stock issues are traded on the open market and can only be redeemed by the respective issuer. Restricted stock holdings are recorded at cost.

The table shown below details the amortized cost and fair value of available for sale securities at December 31, 2014 based upon contractual maturities, by major investment categories. Expected maturities may differ from contractual maturities because issuers have the right to call or prepay obligations. The tax-equivalent yield is based upon a federal tax rate of 34%.

**Maturity Distribution and Average Yields**  
(dollars in thousands)

**Contractual Maturities of Securities at December 31, 2014**

	Amortized Cost	Fair Value	Tax Equivalent (T/E) Yield	% of AFS Portfolio
<b>U.S. Government-Sponsored Agencies:</b>				
One year or less	\$ 13,090	\$ 13,218	2.21%	
After one year to five years	8,941	9,089	2.25%	
After five years to ten years	8,172	8,220	2.30%	
After ten years	986	1,001	2.58%	
	\$ 31,189	\$ 31,528	2.26%	22.0%
<b>Mortgage-Backed Securities/CMOs</b>				
After five years to ten years	\$ 18,933	\$ 18,985	1.53%	
After ten years	44,394	44,235	1.75%	
	\$ 63,327	\$ 63,220	1.68%	44.7%
<b>Asset-Backed Securities</b>				
After five years to ten years	\$ 975	\$ 952	1.50%	
After ten years	1,158	1,153	0.65%	
	\$ 2,133	\$ 2,105	1.03%	1.5%
<b>Corporate Bonds</b>				
After one year to five years	\$ 9,077	\$ 9,049	1.48%	
After five years to ten years	12,296	12,227	2.38%	
	\$ 21,373	\$ 21,276	2.00%	15.1%
<b>Municipal Bonds</b>				
After one year to five years	\$ 1,700	\$ 1,704	1.96%	
After five years to ten years	9,852	9,882	3.19%	
After ten years	12,175	12,101	3.63%	
	\$ 23,727	\$ 23,687	3.33%	16.7%
<b>Total Securities Available for Sale</b>	<b>\$ 141,749</b>	<b>\$ 141,816</b>		

## **Table of Contents**

The above table reflects the distribution of the contractual maturities of investment portfolio at December 31, 2014. Management's investment portfolio strategy is to structure the portfolio so that it is a constant source of liquidity for the balance sheet. In order to achieve greater liquidity in the portfolio, securities that have a monthly flow of principal repayments become a key component. To illustrate the difference between contractual maturity and average life, consider the difference for the fixed rate mortgage-backed securities (MBS) component of this portfolio. At December 31, 2014, the weighted average maturity (WAM) of the fixed rate MBS sector was 10.75 years, and the projected average life for this group of securities is 3.8 years.

Another indication of the investment portfolio's liquidity potential is shown by the projected annual principal cash flow from maturities, callable bonds, and monthly principal repayments. For the next three years, the principal cash flows are estimated to be \$30.4 million for 2015, \$19.3 million for 2016, and \$21.1 million for 2017, based upon rates remaining at current levels. This represents nearly 50% of the investment portfolio's balance at December 31, 2014 that will be available to support the future liquidity needs of the Company. Cash flow projections are subject to change based upon changes to market interest rates.

## **Loan Portfolio**

The Company's loan portfolio totaled \$313.254 million as of December 31, 2014 or 58.3% of total assets. Loan balances increased \$13.22 million, or 4.4% from the balance of \$300.034 million as of December 31, 2013.

The Company's objective is to maintain the historically strong credit quality of the loan portfolio by maintaining rigorous underwriting standards. These standards coupled with regular evaluation of the creditworthiness of and the designation of lending limits for each borrower has helped to Company achieve this objective. The primary portfolio strategy includes seeking industry and loan size diversification in order to minimize credit exposure and originating loans in markets with which the Company is familiar. The predominant market area for loans is Charlottesville, Albemarle County, Orange County, Winchester, Frederick County and adjacent counties.

The Company also purchases commercial and industrial loans from the syndicated loan market. The same underwriting standards applied to the organic loan portfolio are applied to purchased syndicated loans. Additionally, the Company has developed policies to limit overall credit exposure to the syndicated market as a whole and to each borrower. The purchase of syndicated loans is considered a secondary strategy, which allows the Company to supplement organic loan growth and enhance earnings until sufficient loan demand returns to the Company's market area.

The Company's commercial and industrial loan portfolio totaled \$60.940 million and represented approximately 19.5% of all loans as of December 31, 2014. This category includes loans made to individuals and small and medium-sized businesses, as well as loans purchased on the syndicated market. Syndicated loans totaled \$14.815 million of the commercial loan total.

The Company's real estate loan portfolio increased by \$7.093 million, from the balance of \$219.909 million at December 31, 2013, to \$227.002 million at December 31, 2014. This category represented approximately 72.5% of all loans, and these loans are secured by mortgages on real property located principally in Virginia. Of this amount, approximately \$85.660 million represented loans on residential properties. Commercial real estate loans totaled \$141.342 million as of December 31, 2014. Sources of repayment are from the borrower's operating profits, cash flows and liquidation of pledged collateral.

Loans for construction and land development totaled \$11.912 million and represented 3.8% of all loans as of December 31, 2014. Loans to consumers, included revolving credit and other fixed payment loans, totaled \$13.400 million as of December 31, 2014 or 4.3% of all loans.

Based on underwriting standards, loans and leases 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.

**Table of Contents****Loan Portfolio**

(dollars in thousands)

	<b>As of December 31,</b>				
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Commercial loans	\$ 60,940	\$ 48,060	\$ 45,370	\$ 42,157	\$ 40,737
Real estate construction	11,912	18,461	14,193	17,475	26,645
Real estate mortgage:					
Residential	60,162	54,300	56,820	59,995	58,107
Commercial	141,342	135,997	125,089	128,611	128,746
Home equity loans	25,498	29,612	31,433	32,802	31,330
Total real estate mortgage	227,002	219,909	213,342	221,408	218,183
Consumer	13,400	13,604	11,955	11,492	13,066
Total loans	313,254	300,034	284,860	292,532	298,631
Less: Allowance for loan losses	(3,164)	(3,360)	(3,267)	(3,741)	(3,730)
Net loans	\$ 310,090	\$ 296,674	\$ 281,593	\$ 288,791	\$ 294,901

**Table of Contents**

**Maturities and Sensitivities of Loans to Changes in Interest Rates.** The following table presents the maturity distribution of the Company's loans at December 31, 2014. The table also presents the portion of loans that have fixed interest rates or variable/floating interest rates that fluctuate over the life of the loans in accordance with changes in an interest rate index such as the prime rate or U.S. Treasury bond indices.

(dollars in thousands)

	As of December 31, 2014			
	Due in One Year or Less	After One, to under Five Years	After Five Years	Total
Commercial loans	\$ 16,268	\$ 16,776	\$ 27,896	\$ 60,940
Real estate construction	2,226	4,304	5,382	11,912
Real estate mortgage:				
Residential	2,062	5,421	52,679	60,162
Commercial	3,796	10,442	127,104	141,342
Home equity loans	1,208	1,079	23,211	25,498
Consumer and other	2,444	9,268	1,688	13,400
Total	\$ 28,004	\$ 47,290	\$ 237,960	\$ 313,254
Loans with fixed interest rates	\$ 4,245	\$ 26,089	\$ 20,626	\$ 50,960
Loans with floating interest rates	23,758	21,202	217,334	262,294
Total	\$ 28,003	\$ 47,291	\$ 237,960	\$ 313,254

**Loan Asset Quality**

Intrinsic to the lending process is the possibility of loss. In times of economic slowdown, the risk of loss inherent in the Company's loan portfolio may increase. While management endeavors to minimize this risk, it recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio, which in turn depend on current and future economic conditions, the financial condition of borrowers, the realization of collateral, and the credit management process.

The Company places a loan on non-accrual status when management believes, after considering economic and business conditions and collections efforts, that it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement, or when the loan is past due for 90 days or more, unless the debt is both well-secured and in the process of collection.

Troubled debt restructurings ( TDRs ) occur when the Company agrees to modify the original terms of a loan by granting a concession that it would not otherwise consider due to the deterioration in the financial condition of the borrower. These concessions are done in an attempt to improve the paying capacity of the borrower, and in some cases to avoid foreclosure, and are made with the intent to restore the loan to a performing status once sufficient payment history can be demonstrated. These concessions could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs that are considered to be performing continue to accrue interest under the terms of the restructuring agreement. TDRs that have been placed in non-accrual status are considered to be nonperforming.

**Table of Contents**

At December 31, 2014, the Company had three loans with balances of \$218 thousand classified as non-accrual. This compares favorably to December 31, 2013, when the Company had five loans with balances of \$367 thousand classified as non-accrual and to December 31, 2012 when the Company had seven loans with balances of \$1.403 million in this category. Troubled Debt Restructurings that are still performing have remained fairly constant over the three years shown and ended December 31, 2014 with three loans totaling \$1.479 million classified as TDRs. The Company ended the year with no loans over 90 days past due that were still accruing interest. Below is a summary of loans identified with these risk elements:

**Non-Accrual Loans**

	As of December 31,		
(dollars in thousands)	2014	2013	2012
<b>Total</b>	\$ 218	\$ 367	\$ 1,403
<b>Number of Loans</b>	3	5	7

**Loans Past Due 90 Days or More and Still Accruing**

	As of December 31,		
(dollars in thousands)	2014	2013	2012
<b>Total</b>	\$ -	\$ 178	\$ 35
<b>Number of Loans</b>	0	2	1

**Troubled Debt Restructurings, Performing**

	As of December 31,		
(dollars in thousands)	2014	2013	2012
<b>Total</b>	\$ 1,479	\$ 1,369	\$ 1,413
<b>Number of Loans</b>	3	2	2

See Note 3 Loans and Note 4 Allowance for Loan Losses in the accompanying notes to consolidated financial statements included in Item 8 Consolidated Financial Statements and Supplementary Data for further details regarding the Company's loan asset quality measurements.

**Allowance for Loan Losses**

The Company is committed to determining, on an ongoing basis, the adequacy of its allowance for loan losses. The Company applies historical loss rates to various pools of loans. Thereafter, the adequacy of the allowance is evaluated through reference to the following qualitative factors: national and local economic trends; underlying collateral values; loan delinquency status and trends; loan risk classifications; industry concentrations; lending policies; experience, ability and depth of lending staff; and levels of policy exceptions.

At December 31, 2014, the allowance was \$3.164 million and represented 1.01% of outstanding loans. The allowance for loan losses at December 31, 2013, was \$3.360 million and represented 1.12% of outstanding loans. The purpose of the allowance is to provide for probable losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate.

**Table of Contents**

Activity for the allowance for loan losses is provided in the following table.

**Summary of the Allowance for Loan Losses**

(dollars in thousands)

	2014	2013	2012	2011	2010
Balance, beginning of period	\$ 3,360	\$ 3,267	\$ 3,741	\$ 3,730	\$ 3,732
Loans charged off					
Real estate	262	139	458	549	233
Commercial	286	22	132	-	160
Consumer	3	-	18	11	42
Total	551	161	608	560	435
Recoveries					
Real estate	10	48	176	3	13
Commercial	32	22	7	11	86
Consumer	7	24	30	22	20
Total	49	94	213	36	119
Provision for (recovery of) loan losses	306	160	(79)	535	314
Balance, December 31,	\$ 3,164	\$ 3,360	\$ 3,267	\$ 3,741	\$ 3,730
Net charge-offs to average loans	0.17%	0.02%	0.13%	0.18%	0.10%
Allowance for loan losses as a percentage of period-end total loans	1.01%	1.12%	1.15%	1.28%	1.25%

Please refer to Note 4 Allowance for Loan Losses in the accompanying notes to consolidated financial statements for additional details into management's approach and methodology in estimating the allowance for loan losses.

**Table of Contents**

The table below provides an allocation of year-end allowance for loan losses by loan type; however, allocation of a portion of the allowance to one loan category does not preclude its availability to absorb losses in other categories.

**Allocation of the Allowance for Loan Losses**

(dollars in thousands)

	December 31, 2014	
	Allowance	Percentage of loans in each category to total loans
Commercial loans	\$ 674	19.45%
Real estate construction	102	3.80%
Real estate mortgages	2,360	72.47%
Consumer	28	4.28%
Total	\$ 3,164	100.00%

	December 31, 2013	
	Allowance	Percentage of loans in each category to total loans
Commercial loans	\$ 340	16.03%
Real estate construction	198	6.14%
Real estate mortgages	2,788	73.30%
Consumer	34	4.53%
Total	\$ 3,360	100.00%

	December 31, 2012	
	Allowance	Percentage of loans in each category to total loans
Commercial loans	\$ 303	15.93%
Real estate construction	168	4.98%
Real estate mortgages	2,750	74.89%
Consumer	46	4.20%
Total	\$ 3,267	100.00%

	December 31, 2011	
	Allowance	Percentage of loans in each category to total loans
Commercial loans	\$ 397	14.41%
Real estate construction	319	5.97%
Real estate mortgages	2,954	75.69%
Consumer	68	3.93 %
Total	\$ 3,741	100.00%

	December 31, 2010	
	Allowance	Percentage of loans in each category to total loans
Commercial loans	\$ 476	13.64%
Real estate construction	488	8.92%
Real estate mortgages	2,644	73.06%
Consumer	122	4.38%
Total	\$ 3,730	100.00%





## **Table of Contents**

### **Accrued Interest Receivable and Other Assets**

As of December 31, 2014, accrued interest receivable and other assets totaled \$5.799 million, a decrease of \$10.986 million from the balance of \$16.785 million at December 31, 2013. This significant decrease year over year was mainly due to receivables of \$11.297 million due from VNBTrust and SRCM Holdings clients for performance fees at the end of 2013, compared to \$1.005 million due at the end of 2014 from VNBTrust and certain SRCM Holdings clients. As previously discussed under Noninterest Income in this same section, performance fees are based on the year over year increase in value (both realized and unrealized gains) in AUMs, and these fees are normally collected on applicable accounts as of the end of the year. As the performance fees are computed and recognized based on the relative performance of these accounts as of close of markets on December 31<sup>st</sup> of each year, the offset is recorded as a receivable until the cash due for these fees is collected from VNBTrust's clients or from SRCM Holdings, which normally occurs early in the next calendar quarter. Performance fees recognized as non-interest income as of December 31, 2013 was \$10.292 million higher than the amount recognized as of December 31, 2014; therefore, the receivable asset was lower as of December 31, 2014 by this same amount.

### **Deposits**

Depository accounts represent the Company's primary source of funding and are comprised of demand deposits, interest-bearing checking accounts, money market deposit accounts and time deposits. These deposits have been provided predominantly by individuals, professionals and small businesses in the Charlottesville/Albemarle area, the Orange County area, and the Winchester area.

Depository accounts held by the Company as of December 31, 2014, totaled \$456.719 million, an increase of \$26.259 million or 6.1% as compared to the December 31, 2013 total of \$430.460 million.

At December 31, 2014, the balances of non-interest bearing demand deposits were 33.3% of total deposits, increasing to \$152.107 million from \$140.911 million, or 32.7% of total deposits at December 31, 2013. Interest-bearing transaction and money market accounts totaled \$187.518 million and \$165.387 million at December 31, 2014 and December 31, 2013, respectively. The Company's low-cost deposit accounts, which include both non-interest and interest bearing checking accounts as well as money market accounts, represented 74.4% of total deposit account balances at December 31, 2014 and compares favorably to the 71.2% of total deposit account balances at December 31, 2013.

Certificates of deposit and other time deposit balances decreased \$7.068 million to \$117.094 million at December 31, 2014 from the balance of \$124.162 million at December 31, 2013. Included in this deposit total were brokered deposits totaling \$18.693 million and \$25.045 million at December 31, 2014 and 2013, respectively, which were reciprocal relationships under the Certificate of Deposit Account Registry Service (CDARS), whereby depositors can obtain FDIC insurance on deposits up to \$50 million.

The aggregate amount of total certificates of deposit with a minimum balance of \$100 thousand was \$85.8 million at December 31, 2014. Approximately 85.3% of this total is scheduled to mature within the next twelve months. Included in this total are deposits of \$38.959 million with balances of \$250 thousand or more.

**Table of Contents****Deposits****Average Balances and Rates Paid**

(dollars in thousands)	Years Ended December 31					
	2014		2013		2012	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Non-interest-bearing demand deposits	\$ 144,964		\$ 127,480		\$ 139,741	
Interest-bearing deposits:						
Interest checking	81,881	0.05%	77,954	0.05%	67,898	0.05%
Money market deposits	89,061	0.18%	94,369	0.19%	93,690	0.21%
Time deposits	122,659	0.56%	128,816	0.59%	136,832	0.77%
Total interest-bearing deposits	\$ 293,601	0.30%	\$ 301,139	0.33%	\$ 298,420	0.43%
Total deposits	\$ 438,565		\$ 428,619		\$ 438,161	

**Maturities of CD's of \$100,000 and Over**

(dollars in thousands)	December 31, 2014	
	Amount	Percentage
Three months or less	\$ 61,865	72.11%
Over three months to six months	11,335	13.21%
Over six months to one year	7,806	9.10%
Over one year	4,784	5.58%
Totals	\$ 85,790	100.00%

**Securities Sold Under Agreements to Repurchase**

The Company offers commercial customers the opportunity to invest excess deposit balances into overnight repurchase agreements. Under the agreements to repurchase, invested funds are fully collateralized by Federal government or agency bonds that are pledged on behalf of customers utilizing this product.

(dollars in thousands)	2014	2013	2012
Period-end balance	\$ 17,995	\$ 16,297	\$ 4,000
Maximum amount at any month-end during the year	\$ 17,995	\$ 16,297	\$ 4,000
Annual average balance outstanding	\$ 15,480	\$ 7,941	\$ 2,973
Annual average interest rate paid	0.24%	0.21%	0.13%

**Accrued Interest Payable and Other Liabilities**

As of December 31, 2014, accrued interest payable and other liabilities totaled \$1.707 million, a decrease of \$6.499 million from the balance of \$8.206 million at December 31, 2013. The decrease year over year was mainly due to payables of \$4.885 million due to VNBTrust staff in accordance with pre-established agreements for 2013 under which VNBTrust staff was eligible for incentive compensation based on the level of performance fees earned. There is a correlated decrease in salaries and benefits expense for 2014 compared to 2013 that is discussed previously under Noninterest Expense.

In addition, due to the lower level of noninterest income recognized in 2014 compared to 2013, federal taxes payable as of December 31, 2014 was \$305 thousand, or \$1.768 million less than \$2.073 million due as of December 31, 2013.

**Table of Contents**

**ASSET/LIABILITY MANAGEMENT**

The Company's primary earnings source is its net interest income; therefore, the Company devotes significant time and resources to assist in the management of interest rate risk and asset quality. The Company's net interest income is affected by changes in market interest rates and by the level and composition of interest-earning assets and interest-bearing liabilities. The Company's objectives in its asset/liability management are to utilize its capital effectively, to provide adequate liquidity and to enhance net interest income, without taking undue risks or subjecting the Company unduly to interest rate fluctuations. The Company takes a coordinated approach to the management of its liquidity, capital and interest rate risk. This risk management process is governed by policies and limits established by the Bank's Asset/Liability Committee, which are reviewed and approved by the Bank's Board of Directors. This committee, which is comprised of directors and members of management, meets to review, among other things, economic conditions, interest rates, yield curves, cash flow projections, expected customer actions, liquidity levels, capital ratios and repricing characteristics of assets, liabilities and financial instruments.

*Market Risk*

Market risk is the risk of loss in a financial instrument arising from adverse changes in market indices such as interest rates. The Company's principal market risk exposure is interest rate risk. Interest rate risk is the exposure to changes in market interest rates. Interest rate sensitivity is the relationship between market interest rates and net interest income due to the repricing characteristics of assets and liabilities. The Company monitors the interest rate sensitivity of its balance sheet positions by examining its near-term sensitivity and its longer-term gap position. In its management of interest rate risk, the Company utilizes several financial and statistical tools including traditional gap analysis and sophisticated income simulation models.

A traditional gap analysis is prepared based on the maturity and repricing characteristics of interest-earning assets and interest-bearing liabilities for selected time bands. The mismatch between repricings or maturities within a time band is commonly referred to as the "gap" for that period. A positive gap (asset sensitive) where interest rate sensitive assets exceed interest rate sensitive liabilities generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite result on the net interest margin. The Company's balance sheet structure is primarily short-term in nature with a substantial portion of rate-sensitive assets and rate-sensitive liabilities repricing or maturing within one year, as shown in the Interest Sensitivity Analysis table below.

**Table of Contents****Gap Interest Sensitivity Analysis****As of December 31, 2014**

(dollars in thousands)

	Within 90 days	90 to 365 days	1 to 4 years	Over 4 years	Nonrate Sensitive	Total
<b>Assets</b>						
Loans	\$ 116,576	\$ 54,103	\$ 113,494	\$ 28,051	\$ 1,030	\$ 313,254
Investment securities	30,306	17,641	37,402	57,962	70	143,381
Interest bearing deposits	-	1,250	1,247	-	-	2,497
Federal funds sold	41,273	-	-	-	-	41,273
Non-interest-earning assets and allowance for loan losses	-	-	-	-	36,648	36,648
<b>Total assets</b>	<b>\$ 188,155</b>	<b>\$ 72,994</b>	<b>\$ 152,143</b>	<b>\$ 86,013</b>	<b>\$ 37,748</b>	<b>\$ 537,053</b>
<b>Liabilities and Shareholders' Equity</b>						
Interest checking	\$ 3,290	\$ 9,869	\$ 39,477	\$ 40,572	\$ -	\$ 93,208
Money market deposits	7,859	23,577	62,874	-	-	94,310
Time deposits	78,963	22,709	14,582	840	-	117,094
Repurchase agreements	17,995	-	-	-	-	17,995
Non-interest bearing liabilities and shareholders' equity	-	-	-	-	214,446	214,446
<b>Total liabilities and shareholders' equity</b>	<b>\$ 108,107</b>	<b>\$ 56,155</b>	<b>\$ 116,933</b>	<b>\$ 41,412</b>	<b>\$ 214,446</b>	<b>\$ 537,053</b>
Period gap	\$ 80,048	\$ 16,839	\$ 35,210	\$ 44,601	\$ (176,698)	\$ -
Cumulative gap	\$ 80,048	\$ 96,887	\$ 132,097	\$ 176,698	\$ -	\$ -
Ratio of cumulative gap to cumulative earning assets	42.54%	37.10%	31.96%	35.39%		

The Company utilizes the gap analysis to complement its income simulations modeling. However, the traditional gap analysis does not assess the relative sensitivity of assets and liabilities to changes in interest rates and other factors that could have an impact on interest rate sensitivity or net interest income.

The Asset/Liability Committee routinely monitors simulated net interest income sensitivity over a rolling two-year horizon. It also utilizes additional tools to monitor potential longer-term interest rate risk. The income simulation models measure the Company's net interest income volatility or sensitivity to interest rate changes utilizing statistical techniques that allow the Company to consider various factors which impact net interest income. These factors include actual maturities, estimated cash flows, repricing characteristics, deposit growth/retention and, most importantly, the relative sensitivity of the Company's assets and liabilities to changes in market interest rates. This relative sensitivity is important to consider as the Company's core deposit base has not been subject to the same degree of interest rate sensitivity as its assets. The core deposit costs are internally managed and tend to exhibit less sensitivity to changes in interest rates than the Company's adjustable rate assets whose yields are based on external indices and generally change in concert with market interest rates. The Company's interest rate sensitivity is determined by identifying the probable impact of changes in market interest rates on the yields on the Company's assets and the rates that would be paid on its liabilities. This modeling technique involves a degree of estimation based on certain assumptions that management believes to be reasonable. Utilizing this process, management projects the impact of changes in interest rates on net interest margin. The Company has established certain policy limits for the potential volatility of its net interest margin assuming certain levels of changes in market interest rates with the objective of maintaining a stable net interest margin under various probable rate scenarios. Management generally has maintained a risk position well within the policy limits.

**Table of Contents**

As market conditions vary from those assumed in the income simulation models, actual results will also differ due to: prepayment/refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other variables. Furthermore, this sensitivity analysis does not reflect actions that the Asset/Liability Committee might take in responding to or anticipating changes in interest rates.

In simulating the effects of upward and downward changes in market rates to net interest income over a rolling two-year horizon, the model utilizes a static balance sheet approach where balance sheet composition or mix as of the measurement date is maintained over the two-year horizon. Similarly, the base case simulation performed assumes interest rates on the measurement date are unchanged for the next 24 months. Then the simulation assumes all rate indices are instantaneously shocked upward and downward by 100 basis points to 400 basis points, in 100 basis point increments. Due to the low level of interest rates, the shock down analysis where the rates fall 200 basis points or more are not considered meaningful and are therefore not shown in the results below as of December 31, 2014.

(dollars in thousands)	Change in Net Interest Income	
	Percentage	Amount
<b>Change in Yield Curve</b>		
+400 basis points	29.95%	\$ 8,819
+300 basis points	24.88%	7,328
+200 basis points	19.30%	5,684
+100 basis points	10.98%	3,235
Base case	0.00%	-
-100 basis points	-5.61%	(1,652)

The shape of the yield curve can cause downward pressure on net interest income. In general, if and to the extent that the yield curve is flatter (i.e., the differences between interest rates for different maturities are relatively smaller) than previously anticipated, then the yield on the Company's interest earning assets and its cash flows will tend to be lower. Management believes that a relatively flat yield curve could continue to affect adversely the Company's results in 2015.

**Liquidity**

Liquidity represents the Company's ability to provide funds to meet customer demand for loan and deposit withdrawals without impairing profitability. Effective management of balance sheet liquidity is necessary to fund growth in earning assets and to pay liability maturities and depository customers' withdrawal requirements. The Company maintains a Liquidity Management Policy that is approved annually by the Board of Directors. The policy sets limits on a number of areas, including limits on the amount of non-core liabilities, and funding long-term assets with non-core liabilities.

The Bank's customer base has provided a stable and steadily increasing source of funds and liquidity. Limits contained within the Bank's Investment Policy also provides for appropriate levels of liquidity through maturities and cash flows within the securities portfolio. Other sources of balance sheet liquidity are obtained from the repayment of loan proceeds and overnight investments. The Bank has numerous secondary sources of liquidity including access to borrowing arrangements from a number of correspondent banks. Available borrowing arrangements maintained by the Bank include formal federal funds lines with three major regional correspondent banks, access to advances from the Federal Home Loan Bank of Atlanta and access to the discount window at the Federal Reserve Bank of Richmond.

**Table of Contents****Borrowing Lines****As of December 31, 2014****(dollars in thousands)**

Correspondent Banks	\$ 31,000
Federal Home Loan Bank of Atlanta	42,500
<b>Total Available</b>	<b>\$ 73,500</b>

As of December 31, 2014, there were no outstanding balances for any borrowing lines.

Any excess funds are sold on a daily basis in the federal funds market. The Company maintained an average of \$41.156 million outstanding in federal funds sold during 2014. On December 31, 2014, the Company sold \$41.273 million in the overnight federal funds market. The Company intends to maintain sufficient liquidity at all times to meet its funding commitments.

**Capital**

The Company is subject to risk-based capital regulations which quantitatively measure capital against risk-weighted assets, including certain off-balance-sheet items. These regulations define the elements of the Tier 1 and Tier 2 components of total capital and currently establish minimum ratios of 4% for Tier 1 capital and 8% for total capital for capital adequacy purposes. Supplementing these regulations is a leverage requirement. This requirement establishes a minimum leverage ratio (at least 3% or 4%, depending upon an institution's regulatory status), which is calculated by dividing Tier 1 capital by adjusted quarterly average assets (after deducting goodwill). Information regarding the Company's risk-based capital at December 31, 2014 and December 31, 2013 is presented in Note 12 Capital Requirements of the notes to consolidated financial statements, contained in Item 8 Consolidated Financial Statements and Supplementary Data.

The banking regulatory agencies have encouraged banking organizations, including healthy, well-run banking organizations, to operate with capital ratios substantially in excess of the stated ratios required to maintain well capitalized status. This is a result of, among other things, current economic conditions, the global financial crisis and increased formal capital requirements for banking organizations. In light of the foregoing, the Company expects to maintain capital ratios substantially in excess of these ratios due to the new Basel III capital regulations.

The elements currently comprising Tier 1 capital and Tier 2 capital, the minimum Tier 1 capital and total capital ratios and the minimum leverage ratio may in the future be subject to change, as discussed in greater detail under the caption Supervision and Regulation, found earlier in this report under Item 1 - Business.

**Impact of Inflation and Changing Prices**

The Company's financial statements included herein have been prepared in accordance with GAAP, which require the Company to measure financial position and operating results primarily in terms of historical dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than do changes in the inflation rate.

While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions, and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things, as further discussed under the caption Asset/Liability Management, found earlier in this section.

**Table of Contents****Off-Balance Sheet Arrangements**

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. Additional information concerning the Company's off-balance sheet arrangements is contained in Note 10 of the notes to consolidated financial statements, found in Item 8 Consolidated Financial Statements and Supplementary Data.

**Contractual Commitments**

In the normal course of business, the Company and its subsidiaries enter into contractual obligations, including obligations on lease arrangements, contractual commitments for capital expenditures, and service contracts. The significant contractual obligations include the leasing of certain of its banking and operations offices under operating lease agreements on terms ranging from 1 to 20 years with renewal options.

Following is a schedule of future minimum rental payments under non-cancelable operating leases that have initial or remaining terms in excess of one year as of December 31, 2014:

(dollars in thousands)	1 year or less	1-3 years	3-5 years	After 5 years	Total
Operating lease obligations	\$ 834	\$ 1,477	\$ 1,044	\$ 2,626	\$ 5,981

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Not required for smaller reporting company.

**Table of Contents**

**Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders  
Virginia National Bankshares Corporation  
Charlottesville, Virginia

We have audited the accompanying consolidated balance sheets of Virginia National Bankshares Corporation and subsidiaries (the Company ) as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Virginia National Bankshares Corporation and subsidiaries as of December 31, 2014 and 2013 and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

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

Winchester, Virginia  
March 30, 2015



**Table of Contents****VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except per share data)

	December 31, 2014	December 31, 2013
<b>ASSETS</b>		
Cash and due from banks	\$ 12,834	\$ 12,871
Federal funds sold	41,273	27,201
Securities:		
Available for sale, at fair value	141,816	133,027
Restricted securities, at cost	1,565	1,645
Total securities	143,381	134,672
Total loans	313,254	300,034
Allowance for loan losses	(3,164)	(3,360)
Total loans, net	310,090	296,674
Premises and equipment, net	9,465	9,824
Other real estate owned, net of valuation allowance	1,177	2,372
Bank owned life insurance	13,034	12,595
Accrued interest receivable and other assets	5,799	16,785
Total assets	\$ 537,053	\$ 512,994
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Demand deposits:		
Noninterest-bearing	\$ 152,107	\$ 140,911
Interest-bearing	93,208	80,832
Money market deposit accounts	94,310	84,555
Certificates of deposit and other time deposits	117,094	124,162
Total deposits	456,719	430,460
Securities sold under agreements to repurchase	17,995	16,297
Accrued interest payable and other liabilities	1,707	8,206
Total liabilities	476,421	454,963
Shareholders' equity:		
Preferred stock, \$2.50 par value, 2,000,000 shares authorized, no shares outstanding	-	-
Common stock, \$2.50 par value, 10,000,000 shares authorized; 2,688,336 and 2,690,320 shares issued and outstanding in 2014 and 2013 (including 288 non-vested shares at December 31, 2013)	6,721	6,725
Capital surplus	27,889	27,915
Retained earnings	25,978	24,822
Accumulated other comprehensive income (loss)	44	(1,431)
Total shareholders' equity	60,632	58,031
Total liabilities and shareholders' equity	\$ 537,053	\$ 512,994

See Notes to Consolidated Financial Statements

**Table of Contents****VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME**

(dollars in thousands, except per share data)

	For the years ended	
	December 31, 2014	December 31, 2013
<b>Interest and dividend income:</b>		
Loans, including fees	\$ 12,548	\$ 12,998
Federal funds sold	90	74
<b>Investment securities:</b>		
Taxable	2,165	1,836
Tax exempt	477	447
Dividends	83	78
Other	19	13
<b>Total interest and dividend income</b>	<b>15,382</b>	<b>15,446</b>
<b>Interest expense:</b>		
Demand and savings deposits	205	222
Certificates and other time deposits	686	758
Federal funds purchased and securities sold under agreements to repurchase	37	17
<b>Total interest expense</b>	<b>928</b>	<b>997</b>
<b>Net interest income</b>	<b>14,454</b>	<b>14,449</b>
Provision for loan losses	306	160
<b>Net interest income after provision for loan losses</b>	<b>14,148</b>	<b>14,289</b>
<b>Noninterest income:</b>		
Trust income	2,367	14,981
Customer service fees	894	921
Debit/credit card and ATM fees	742	729
Earnings/increase in value of bank owned life insurance	439	445
Gains on sales of assets	44	304
Gains on sales of securities	24	50
Royalty income	593	-
Other	494	424
<b>Total noninterest income</b>	<b>5,597</b>	<b>17,854</b>
<b>Noninterest expense:</b>		
Salaries and employee benefits	9,305	13,746
Net occupancy	1,954	2,104
Equipment	531	686
Other	5,601	5,499
<b>Total noninterest expense</b>	<b>17,391</b>	<b>22,035</b>
<b>Income before income taxes</b>	<b>2,354</b>	<b>10,108</b>
Provision for income taxes	456	3,212
<b>Net income</b>	<b>\$ 1,898</b>	<b>\$ 6,896</b>
<b>Net income per share, basic</b>	<b>\$ 0.70</b>	<b>\$ 2.56</b>
<b>Net income per share, diluted</b>	<b>\$ 0.70</b>	<b>\$ 2.56</b>

See Notes to the Consolidated Financial Statements



**Table of Contents****VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(dollars in thousands)

	<b>For the years ended</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>
Net income	\$ 1,898	\$ 6,896
Other comprehensive income (loss)		
Unrealized gains (losses) on securities, net of tax of \$769 and (\$1,326) for the years ended December 31, 2014 and December 31, 2013	1,491	(2,572)
Adjustment to unrealized income on securities due to the transfer of held-to-maturity securities to available-for-sale, net of tax of \$12 for year ended December 31, 2013	-	22
Reclassification adjustment net of tax of (\$8) and (\$17) for the years ended December 31, 2014 and December 31, 2013	(16)	(33)
Total other comprehensive income (loss)	1,475	(2,583)
Total comprehensive income	\$ 3,373	\$ 4,313

See Notes to Consolidated Financial Statements

**Table of Contents****VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

(dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance, December 31, 2012, as previously reported</b>	\$ 6,724	\$ 27,809	\$ 18,254	\$ 1,152	\$ 53,939
Adjustment to retained earnings for prior years due to change in accounting method	-	-	75	-	75
<b>Balance, December 31, 2012, as adjusted</b>	\$ 6,724	\$ 27,809	\$ 18,329	\$ 1,152	\$ 54,014
Stock options exercised	-	1	-	-	1
Vested stock grants	1	(1)	-	-	-
Stock option/grant expense	-	106	-	-	106
Cash dividend (\$0.15 per share)	-	-	(403)	-	(403)
Net income	-	-	6,896	-	6,896
Other comprehensive loss	-	-	-	(2,583)	(2,583)
<b>Balance, December 31, 2013</b>	\$ 6,725	\$ 27,915	\$ 24,822	\$ (1,431)	\$ 58,031
Stock options exercised or expired	24	156	-	-	180
Vested stock grants	1	(1)	-	-	-
Stock purchased under stock repurchase plan	(29)	(233)	-	-	(262)
Stock option/grant expense	-	52	-	-	52
Cash dividend (\$0.275 per share)	-	-	(742)	-	(742)
Net income	-	-	1,898	-	1,898
Other comprehensive income	-	-	-	1,475	1,475
<b>Balance, December 31, 2014</b>	\$ 6,721	\$ 27,889	\$ 25,978	\$ 44	\$ 60,632

See Notes to Consolidated Financial Statements

**Table of Contents****VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(dollars in thousands)

	For the years ended	
	December 31, 2014	December 31, 2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 1,898	\$ 6,896
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	306	160
Net amortization and accretion of securities	739	815
Gains on sales of securities	(24)	(50)
Earnings/increase in value of bank owned life insurance	(439)	(445)
Depreciation and amortization	1,151	1,274
Net gain on sale of assets	(44)	(304)
Deferred tax benefit	(61)	(292)
Stock option/stock grant expense	52	106
Writedown of other real estate owned	277	178
Losses on sale of other real estate owned	27	-
Decrease (increase) in accrued interest receivable and other assets	10,330	(3,748)
(Decrease) increase in accrued interest payable and other liabilities	(6,499)	4,036
Net cash provided by operating activities	7,713	8,626
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of held to maturity securities		
Purchases of available for sale securities	(44,278)	(66,610)
Net decrease in restricted investments	80	84
Proceeds from maturities, calls and principal payments of held to maturity securities	-	1,275
Proceeds from maturities, calls and principal payments of available for sale securities	29,512	27,619
Proceeds from sale of held to maturity securities	-	2,012
Proceeds from sale of available for sale securities	7,498	14,842
Net increase in loans	(13,966)	(16,045)
Proceeds from sale of other real estate owned	1,135	-
Proceeds from sale of bank premises and equipment	11	20
Purchase of bank premises and equipment	(803)	(462)
Net cash used in investing activities	(20,811)	(37,265)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase (decrease) in demand deposits, NOW accounts, and money market accounts	33,327	(8,981)
Net decrease in certificates of deposit and other time deposits	(7,068)	(5,981)
Net increase in securities sold under agreements to repurchase	1,698	12,297
Common stock repurchased	(262)	-
Proceeds from stock options exercised	180	1
Cash dividends	(742)	(403)
Net cash provided by (used in) financing activities	27,133	(3,067)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>\$ 14,035</b>	<b>\$ (31,706)</b>
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	\$ 40,072	\$ 71,778
End of period	\$ 54,107	\$ 40,072
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$ 936	\$ 1,026
Taxes	\$ 2,488	\$ 2,778

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES

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Unrealized gain (loss) on available for sale securities	\$	2,236	\$	(3,914)
Transfer of held-to-maturity securities to available-for-sale	\$	-	\$	2,699
Transfer of loans to other real estate owned	\$	244	\$	804

See Notes to Consolidated Financial Statements

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Note 1 Summary of Significant Accounting Policies:**

**Organization and Principles of Consolidation**

Virginia National Bankshares Corporation (the Company) is a bank holding company incorporated under the laws of the Commonwealth of Virginia. On June 19, 2013, the shareholders of Virginia National Bank (the Bank) approved a Reorganization Agreement and Plan of Share Exchange (Reorganization) whereby the Bank would reorganize into a holding company structure. The Plan of Share Exchange called for each outstanding share of Bank common stock to be automatically converted into and exchanged for one share of the Company common stock, and the common shareholders of the Bank would become the common shareholders of the Company on the effective date of the Reorganization. The Company is authorized to issue 10,000,000 shares of common stock with a par value of \$2.50 per share. Additionally, the Company is authorized to issue 2,000,000 shares of preferred stock at a par value \$2.50 per share. There is currently no preferred stock outstanding. There are no plans currently nor does the Board of Directors of the Company anticipate any need in the foreseeable future to issue shares of preferred stock.

On December 16, 2013, the Reorganization became effective, and the Bank became a wholly-owned subsidiary of the Company. The holding company is regulated under the Bank Holding Company Act of 1956, as amended (BHC Act) and is subject to inspection, examination, and supervision by the Federal Reserve Board.

On September 22, 2014, the Company issued a press release and filed a Form 8-K with the Securities and Exchange Commission to announce the approval by its Board of Directors of a stock repurchase program authorizing repurchase of up to 400,000 shares of the Company's common shares through the open market or in privately negotiated transactions. The repurchase program is authorized through September 18, 2015.

Virginia National Bank was organized in 1998 under federal law as a national banking association to engage in a general commercial and retail banking business. The Bank is headquartered in Charlottesville, Virginia and serves the Virginia communities in and around the City of Charlottesville, Albemarle County, Orange County and the City of Winchester. The Bank continues to be subject to the supervision, examination and regulation of the Office of the Comptroller of the Currency (OCC) following the Reorganization.

On May 1, 2007, the OCC granted conditional approval to the Bank's application to establish a new national trust bank with the title VNBTrust, National Association which now trades under the name VNB Wealth Management (VNBTrust, VNB Wealth or VNB Wealth Management). VNBTrust operates as a wholly-owned subsidiary of the Bank. Additionally, the OCC approved the Bank's application for VNBTrust to create a wholly owned operating subsidiary, VNB Investment Management Company, LLC, a Delaware limited liability corporation. In January, 2010, VNB Investment Management Company changed its name to Swift Run Capital Management, LLC (SRCM). SRCM served as the general partner of Swift Run Capital, L.P. (the Fund), a private investment fund.

The consolidated financial statements include the accounts of the Company, its subsidiary the Bank, and the Bank's subsidiary, VNBTrust (together, subsidiaries). All significant intercompany balances and transactions have been eliminated in consolidation.

On July 18, 2013 (the Closing Date), VNBTrust completed the sale of all of the membership interests of SRCM to SRCM Holdings LLC (SRCM Holdings) pursuant to a purchase and sale agreement dated June 27, 2013 among SRCM Holdings, VNBTrust, SRCM and the Bank (the Sale Agreement). A former officer of VNBTrust is the principal owner of SRCM Holdings. Swift Run Capital LP (the Fund), for which SRCM acted as general partner, represented less than 7 percent of the total assets managed by VNBTrust and its subsidiary on the Closing Date. Under the terms of the Sale Agreement, SRCM Holdings agreed to pay VNBTrust, quarterly during the ten-year period beginning January 1, 2014 and ending December 31, 2023 (the Term), (a) ongoing acquisition royalty payments equal to (i) 20% of the management and performance fee revenue received by SRCM from limited partners of the Fund as of the Closing Date and (ii) 20% of the management and performance fee revenue received by SRCM from VNBTrust clients that opened accounts with SRCM within 30 days of the Closing Date, and (b) ongoing referral payments equal to 20% of the management and performance fee revenue received by SRCM from clients referred by the Company and its affiliates to SRCM during the Term. The Company recognized \$302 thousand as gain from the sale of SRCM in 2013, which amount included an estimate of the present value of the portion of the acquisition royalty payments to be received from management fees during the Term. Each quarter, as the Company receives royalty payments from SRCM, a portion of the payment is applied to write down the



contingent asset established for this estimated value. The remaining amount of the payment is applied to noninterest income as royalty income.

## Table of Contents

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** **(Dollar amounts in thousands, except share and per share data)**

#### **Summary of Significant Accounting Policies**

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to the reporting guidelines prescribed by regulatory authorities. The following is a description of the more significant of those policies and practices.

**Principles of consolidation** The consolidated financial statements include the accounts of the Company, the Bank, and VNBTrust. All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred tax assets, valuation of other real estate owned, and fair value measurements.

**Cash flow reporting** For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents consist of cash on hand, funds due from banks, and federal funds sold.

**Securities sold under agreements to repurchase** The Company sells certain securities under agreements to repurchase. The agreements are treated as collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying consolidated balance sheets. The dollar amount of the securities underlying the agreements remains in the asset accounts.

**Securities** Unrestricted investments are to be classified in two categories as described below.

**Securities held to maturity** Securities classified as held to maturity are those debt and equity securities the Company has both the positive intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. During the third quarter of 2013, the Company reclassified held to maturity securities as available for sale. Management determined that it no longer had the positive intent to hold the securities classified as held to maturity for an indefinite period of time because of Management's desire to have more flexibility in managing the investment portfolio.

**Securities available for sale** Securities classified as available for sale are those debt and equity securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported as a separate component of other comprehensive income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities or to call dates, whichever occurs first. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the Company intends to sell the security or (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. If, however, the Company does not intend to sell the security and it is not more-than-likely that the Company will be required to sell the security before recovery, the Company must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be

recognized in other comprehensive income.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Restricted securities** As members of the Federal Reserve Bank of Richmond ( FRB ) and the Federal Home Loan Bank of Atlanta ( FHLB ), the Company is required to maintain certain minimum investments in the common stock of the FRB and FHLB. Required levels of investments are based upon the Bank's capital and a percentage of qualifying assets. Additionally, the Company has purchased common stock in CBB Financial Corp. ( CBBFC ), the holding company for Community Bankers Bank. Common Stock from the FRB, FHLB, and CBB are classified as restricted securities which are carried at cost

**Loans** Loans are reported at the principal balance outstanding net of unearned discounts and of the allowance for loan losses. Interest income on loans is reported on the level-yield method and includes amortization of deferred loan fees and costs over the loan term. Further information regarding the Company's accounting policies related to past due loans, non-accrual loans, impaired loans and troubled-debt restructurings is presented in Note 3 - Loans.

**Allowance for loan losses** The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing loan portfolio. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with Financial Accounting Standards Board ( FASB ) ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Further information regarding the Company's policies and methodology used to estimate the allowance for loan losses is presented in Note 4 Allowance for Loan Losses.

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

**Premises and equipment** Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method based on the estimated useful lives of assets, which range from 3 to 20 years. Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, the asset and related accumulated depreciation are removed from the books and any resulting gain or loss is charged to income. More information regarding premises and equipment is presented in Note 6 Premises and Equipment.

**Other real estate owned** Assets acquired through, or in lieu of, loan foreclosures are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses for foreclosed assets. More information regarding other real estate owned is presented in Note 5 Other Real Estate Owned.

**Bank owned life insurance** The Company has purchased life insurance on certain key employees. These policies are recorded at their cash surrender value on the Consolidated Balance Sheets. Income generated from policies is recorded as noninterest income.

**Fair value measurements** ASC Topic 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair values of financial instruments are based upon internally developed models that primarily use, as inputs, observable market-based parameters. Any such valuation adjustments are applied consistently over time. Additional information on fair value measurements is presented in Note 14 Fair Value Measurements.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Stock-based compensation** The Company accounts for all plans under recognition and measurement accounting principles which require that the compensation cost relating to stock-based payment transactions be recognized in the financial statements. Stock-based compensation arrangements include stock options and restricted stock. Stock-based compensation is estimated at the date of grant, using the Black-Scholes option valuation model for determining fair value. The model employs the following assumptions:

**Dividend yield** - calculated as the ratio of historical cash dividends paid per share of common stock to the stock price on the date of grant;

**Expected life (term of the option)** - based on the average of the contractual life and vesting schedule for the respective option;

**Expected volatility** - based on the monthly historical volatility of the Company's stock price over the expected life of the options;

**Risk-free interest rate** - based upon the U.S. Treasury bill yield curve, for periods within the contractual life of the option, in effect at the time of grant.

The Company is required to estimate forfeitures when recognizing compensation expense and that this estimate of forfeitures be adjusted over the requisite service period or vesting schedule based on the extent to which actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment, which is recognized in the period of change, and also will impact the amount of estimated unamortized compensation expense to be recognized in future periods. Further information on stock-based compensation is presented in Note 17 - Stock Incentive Plans.

**Earnings per common share** Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. Additional information on earnings per share is presented in Note 18 - Earnings per Share.

**Comprehensive income** Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. Further information on the Company's other comprehensive income is presented in Note 19 - Other Comprehensive Income.

**Advertising costs** The Company follows the policy of charging the costs of advertising to expense as they are incurred.

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

When tax returns are filed, it is highly probable that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more

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than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

## **Table of Contents**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollar amounts in thousands, except share and per share data)**

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statements of income. Further information on the Company's accounting policies for income taxes is presented in Note 8 Income Taxes.

**VNBTrust** Securities and other property held by VNBTrust in a fiduciary or agency capacity are not assets of the Company and are not included in the accompanying consolidated financial statements.

**Reclassifications** Certain reclassifications have been made to prior periods to conform to current year presentation. The results of the reclassifications are not considered material.

In 2014, the Company elected to change its method for recording audit fees. Prior to 2014, the Bank accrued, in the current year, costs related to audit engagements for the current year, even if the remaining audit work was performed the following year. Management decided to change to an equally acceptable methodology that calls for recording audit expenses in the year the services are performed. The retrospective application of this change in methodology is reflected in the consolidated financial statements. The change in accounting method required a \$75 thousand increase to retained earnings as of January 1, 2013. The offsetting decrease to other liabilities for the years ended December 31, 2013 and December 31, 2014 consisted of a decrease of approximately \$113 thousand in reserve for accrued and unpaid expenses, netted against an increase in income tax payable of \$38 thousand. The new method is preferable to the old method as audit fee expense would be recognized in the period in which the expense was incurred.

#### **Adoption of New Accounting Standards**

##### **Recent accounting pronouncements**

In January 2014, the FASB issued ASU 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure* (a consensus of the FASB Emerging Issues Task Force). The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Management does not expect the adoption of ASU 2014-04 to have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. The Company is currently assessing the impact that ASU 2014-11 will have on its consolidated financial statements.

## **Table of Contents**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollar amounts in thousands, except share and per share data)**

In August 2014, the FASB issued ASU No. 2014-14, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure*. The amendments in this ASU apply to creditors that hold government-guaranteed mortgage loans and are intended to eliminate the diversity in practice related to the classification of these guaranteed loans upon foreclosure. The new guidance stipulates that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if (1) the loan has a government guarantee that is not separable from the loan prior to foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the other receivable should be measured on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. Entities may adopt the amendments on a prospective basis or modified retrospective basis as of the beginning of the annual period of adoption; however, the entity must apply the same method of transition as elected under ASU 2014-04. Early adoption is permitted provided the entity has already adopted ASU 2014-04. The Company is currently assessing the impact that ASU 2014-14 will have on its consolidated financial statements.

#### **Newly issued not yet effective standards**

In June 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers: Topic 606*. This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, most industry-specific guidance, and some cost guidance included in Subtopic 605-35, *Revenue Recognition - Construction-Type and Production-Type Contracts*. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, *Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in *Compensation - Stock Compensation (Topic 718)* should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company is currently assessing the impact that ASU 2014-12 will have on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. This update is intended to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management is required under the new guidance to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued when preparing financial statements for each interim and annual reporting period. If conditions or events are identified, the ASU specifies the process that must be followed by management and also clarifies the timing and content of going concern footnote disclosures in order to reduce diversity in practice. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December



15, 2016. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on its consolidated financial statements.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

In January 2015, the FASB issued ASU No. 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. The amendments in this ASU eliminate from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of ASU 2015-01 to have a material impact on its consolidated financial statements.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Note 2 Securities**

The amortized cost and fair values of securities available for sale as of December 31, 2014 and December 31, 2013 are as follows:

<b>December 31, 2014</b>		<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
U.S. Government agencies	\$	31,189	\$ 395	\$ (56)	\$ 31,528
Corporate bonds		21,373	21	(118)	21,276
Asset-backed securities		2,133	-	(28)	2,105
Mortgage-backed securities/CMOs		63,327	297	(404)	63,220
Municipal bonds		23,727	157	(197)	23,687
	\$	141,749	\$ 870	\$ (803)	\$ 141,816

<b>December 31, 2013</b>		<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
U.S. Government agencies	\$	43,268	\$ 828	\$ (91)	\$ 44,005
Corporate bonds		9,066	37	(50)	9,053
Asset-backed securities		2,151	-	(51)	2,100
Mortgage-backed securities/CMOs		56,815	34	(1,252)	55,597
Municipal bonds		23,896	5	(1,629)	22,272
	\$	135,196	\$ 904	\$ (3,073)	\$ 133,027

All mortgage-backed securities included in the above tables were issued by U.S. government agencies and corporations. At December 31, 2014, the securities issued by political subdivisions or agencies were highly rated with 83% of the municipal bonds having AA or higher ratings. Approximately 79% of the municipal bonds are general obligation bonds with issuers that are geographically diverse.

Restricted securities are securities with limited marketability and consist of stock in the FRB, FHLB and CBBFC totaling \$1.565 million as of December 31, 2014 and \$1.645 million as of December 31, 2013. These restricted securities are carried at cost as they are not permitted to be traded.

For the year ended December 31, 2014, proceeds from the sales of securities amounted to \$7.498 million and gross net realized gains on these securities were \$24 thousand. For the year ended December 31, 2013, proceeds from the sales of securities amounted to \$16.854 million and gross net realized gains on these securities were \$50 thousand.

During the third quarter of 2013, the Company reclassified held to maturity securities as available for sale. Management determined that it no longer had the positive intent to hold the securities classified as held to maturity for an indefinite period of time because of management's desire to have more flexibility in managing the investment portfolio. As of June 30, 2013, the Company had three corporate and municipal securities designated as held to maturity recorded at an amortized cost of \$2.699 million. The fair value of these securities was \$2.733 million, reflecting an unrealized gross gain of \$34 thousand. The unrealized gross gain of \$34 thousand, net of taxes, was recorded as other comprehensive income at the time of the transfer. As a result of this transfer, there were no securities classified as held to maturity as of December 31, 2014 or December 31, 2013.

Securities pledged to secure deposits, and for other purposes required by law, had carrying values of \$23.799 million at December 31, 2014 and \$17.547 million at December 31, 2013. The increase in the amount of pledged securities during 2013 resulted from increased customer participation in the overnight repurchase agreement program.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

Year-end securities with unrealized losses, segregated by length of time in a continuous unrealized loss position, were as follows:

**2014**

	Less than 12 Months		12 Months or more		Total	
	Estimated Fair Value	Unrealized (Losses)	Estimated Fair Value	Unrealized (Losses)	Estimated Fair Value	Unrealized (Losses)
U.S. Government agencies	\$ 6,375	\$ (21)	\$ 966	\$ (35)	\$ 7,341	\$ (56)
Corporate bonds	13,213	(102)	3,032	(16)	16,245	(118)
Asset-backed securities	98	-	2,007	(28)	2,105	(28)
Mortgage-backed/CMOs	6,276	(35)	25,081	(369)	31,357	(404)
Municipal bonds	1,769	(19)	10,330	(178)	12,099	(197)
	\$ 27,731	\$ (177)	\$ 41,416	\$ (626)	\$ 69,147	\$ (803)

**2013**

	Less than 12 Months		12 Months or more		Total	
	Estimated Fair Value	Unrealized (Losses)	Estimated Fair Value	Unrealized (Losses)	Estimated Fair Value	Unrealized (Losses)
U.S. Government agencies	\$ 2,889	\$ (39)	\$ 948	\$ (52)	\$ 3,837	\$ (91)
Corporate bonds	5,016	(50)	-	-	5,016	(50)
Asset-backed securities	960	(36)	1,140	(15)	2,100	(51)
Mortgage-backed/CMOs	39,061	(1,079)	8,609	(173)	47,670	(1,252)
Municipal bonds	18,433	(1,451)	2,280	(178)	20,713	(1,629)
	\$ 66,359	\$ (2,655)	\$ 12,977	\$ (418)	\$ 79,336	\$ (3,073)

As of December 31, 2014, management does not have the intent to sell any of the securities classified as available for sale in the table above 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. As of December 31, 2014, there were \$69.1 million, or 74 issues, of individual securities in a loss position. These securities have an unrealized loss of \$803 thousand and consisted of 26 mortgage-backed/CMOs, 25 municipal bonds, 15 corporate bonds, and 8 other security issues.

The Company's securities portfolio is primarily made up of fixed rate bonds, whose prices move inversely with interest rates. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. At the end of any accounting period, the portfolio may have both unrealized gains and losses. Management does not believe any of the securities in an unrealized loss position are impaired due to credit quality. Accordingly, as of December 31, 2014, management believes the impairments detailed in the table above are temporary, and no impairment loss has been realized in the Company's consolidated income statement.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

The amortized cost and fair value of available for sale securities at December 31, 2014 are presented below based upon contractual maturities, by major investment categories. Expected maturities may differ from contractual maturities because issuers have the right to call or prepay obligations.

	Amortized Cost	Fair Value
<b>U.S. Government agencies</b>		
One year or less	\$ 13,090	\$ 13,218
After one year to five years	8,941	9,089
After five years to ten years	8,172	8,220
After ten years	986	1,001
	\$ 31,189	\$ 31,528
<b>Corporate bonds</b>		
After one year to five years	\$ 9,077	\$ 9,049
After five years to ten years	12,296	12,227
	\$ 21,373	\$ 21,276
<b>Asset-backed securities</b>		
After five years to ten years	\$ 975	\$ 952
Ten years or more	1,158	1,153
	\$ 2,133	\$ 2,105
<b>Mortgage-backed securities/CMOs</b>		
After five years to ten years	\$ 18,933	\$ 18,985
Ten years or more	44,394	44,235
	\$ 63,327	\$ 63,220
<b>Municipal bonds</b>		
After one year to five years	\$ 1,700	\$ 1,704
After five years to ten years	9,852	9,882
Ten years or more	12,175	12,101
	\$ 23,727	\$ 23,687
<b>Total Securities Available for Sale</b>	<b>\$ 141,749</b>	<b>\$ 141,816</b>

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Note 3 Loans**

The composition of the loan portfolio by loan classification year-end appears below.

	<b>December 31</b>	
	<b>2014</b>	<b>2013</b>
<b>Commercial</b>		
Commercial and industrial - organic	\$ 46,125	\$ 48,060
Commercial and industrial - syndicated	14,815	-
Total commercial and industrial	60,940	48,060
<b>Real estate construction and land</b>		
Residential construction	337	794
Other construction and land	11,575	17,667
Total construction and land	11,912	18,461
<b>Real estate mortgages</b>		
1-4 family residential	60,162	54,300
Home equity lines of credit	25,498	29,612
Multifamily	26,462	22,560
Commercial owner occupied	60,868	58,802
Commercial non-owner occupied	54,012	54,635
Total real estate mortgage	227,002	219,909
<b>Consumer</b>		
Consumer revolving credit	3,428	2,254
Consumer all other credit	9,972	11,350
Total consumer	13,400	13,604
Total loans	313,254	300,034
Less: Allowance for loan losses	(3,164)	(3,360)
Net loans	\$ 310,090	\$ 296,674

**Loan origination/risk management.** The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and the Board of Directors approve lending policies on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. Underwriting standards are designed to promote relationship banking rather than transactional banking.

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

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The Company identifies commercial and industrial loans by classifying them into two classes. Organic loans are originated by the Bank's commercial lenders. Syndicated loans are purchased from national lending correspondents. Both organic and syndicated loans are underwritten according to the Bank's loan policy.

**Commercial real estate loans** are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. At December 31, 2014, commercial real estate loans, including multifamily mortgages, totaled \$141.3 million or 62.2% of the Company's outstanding balances of real estate loans. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. Of the \$141.3 million in commercial real estate loans outstanding at December 31, 2014, \$60.9 million or 43.1% were owner-occupied properties.

**Residential mortgages** for 1-to-4 family properties and home equity loans have underwriting standards that are heavily influenced by statutory requirements, which include, but are not limited to, documentation requirements, limits on maximum loan-to-value percentages, and collection remedies. The Company typically originates residential mortgages with the intention of retaining in its portfolio shorter-term, fixed-rate loans and adjustable-rate mortgages. The Company also originates longer-term, fixed rates loans, which are sold to secondary mortgage market correspondents. At December 31, 2014, residential and home equity loans outstanding totaled \$85.7 million or 37.8% of real estate mortgage loans.

**Real estate construction and land loans** consist primarily of loans for the purchase or refinance of unimproved lots or raw land. Additionally, the Company finances the construction of real estate projects typically where the permanent mortgage will remain with the Company. Specific underwriting guidelines are delineated in the loan policy. At December 31, 2014, real estate construction and land loans totaled \$11.9 million, or 3.8% of total loans.

**Consumer loans** are generally small loans spread across many borrowers and are underwritten after determining the ability of the consumer borrower to repay their obligations as agreed. The underwriting standards are heavily influenced by statutory requirements, which include, but are not limited to, documentation requirements and collection remedies. Consumer loans may be secured or unsecured and are comprised of revolving lines, installment loans and other consumer loans. At December 31, 2014, consumer loans totaled \$13.4 million, or 4.3% of total loans. Deposit account overdrafts are included in the consumer loan balances and totaled \$53 thousand and \$51 thousand at December 31, 2014 and 2013, respectively.

**Independent loan review** is performed by an independent loan review firm that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management and the Audit and Compliance Committee of the Board. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

**Concentrations of credit.** Most of the Company's lending activity occurs within the Commonwealth of Virginia, primarily in the Company's primary markets and surrounding areas. The majority of the Company's loan portfolio consists of commercial and industrial and commercial real estate loans. As of December 31, 2014, there were no concentrations of loans related to any single industry in excess of 20% of total loans.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Related party loans.** In the ordinary course of business, the Company has granted loans to certain directors, executive officers and their affiliates (collectively referred to as related parties ). Activity in related party loans during 2014 and 2013 is presented in the following table.

	2014	2013
Balance outstanding at beginning of year	\$ 6,526	\$ 6,401
Principal additions	8,043	4,574
Principal reductions	(3,728)	(4,449)
Balance outstanding at end of year	\$ 10,841	\$ 6,526

**Past due, non-accrual and charged-off loans.** Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Smaller, unsecured consumer loans are typically charged-off when management judges the loan to be uncollectable or the borrower files for bankruptcy and are generally not placed in non-accrual status prior to charge-off. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Company considers the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Company's collateral position.

Regulatory provisions would typically require a loan to be charged-off or placed on non-accrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on non-accrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

Non-accrual loans are shown below by class:

	December 31, 2014	December 31, 2013
Other construction and land	\$ 69	\$ 77
1-4 family residential mortgages	149	60
Commercial non-owner occupied real estate	-	230
Total nonaccrual loans	\$ 218	\$ 367

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

The following tables show the aging of past due loans as of December 31, 2014 and December 31, 2013. Also included are loans that are 90 or more days past due but still accruing, because they are well secured and in the process of collection. As of December 31, 2014, the Company had no loans that were 90 days or more past due. As of December 31, 2013, the Company had two loans that were 90 or more days past due but still accruing for a balance of \$178 thousand.

**Past Due Aging as of  
December 31, 2014**

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due and Still Accruing
<b>Commercial loans</b>							
Commercial and industrial - organic	\$ 6	\$ -	\$ -	\$ 6	\$ 46,119	\$ 46,125	\$ -
Commercial and industrial - syndicated	-	-	-	-	14,815	14,815	-
<b>Real estate construction and land</b>							
Residential construction	-	-	-	-	337	337	-
Other construction and land	-	-	-	-	11,575	11,575	-
<b>Real estate mortgages</b>							
1-4 family residential	-	24	-	24	60,138	60,162	-
Home equity lines of credit	-	-	-	-	25,498	25,498	-
Multifamily	-	-	-	-	26,462	26,462	-
Commercial owner occupied	-	-	-	-	60,868	60,868	-
Commercial non-owner occupied	-	-	-	-	54,012	54,012	-
<b>Consumer loans</b>							
Consumer revolving credit	1	-	-	1	3,427	3,428	-
Consumer all other credit	12	30	-	42	9,930	9,972	-
<b>Total Loans</b>	<b>\$ 19</b>	<b>\$ 54</b>	<b>\$ -</b>	<b>\$ 73</b>	<b>\$ 313,181</b>	<b>\$ 313,254</b>	<b>\$ -</b>

**Past Due Aging as of  
December 31, 2013**

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due and Still Accruing
<b>Commercial and industrial - organic</b>	<b>\$ 123</b>	<b>\$ 35</b>	<b>\$ -</b>	<b>\$ 158</b>	<b>\$ 47,902</b>	<b>\$ 48,060</b>	<b>\$ -</b>
<b>Real estate construction and land</b>							
Residential construction	-	-	-	-	794	794	-
Other construction and land	34	-	29	63	17,604	17,667	29
<b>Real estate mortgages</b>							
1-4 family residential	60	26	149	235	54,065	54,300	149
Home equity lines of credit	-	-	-	-	29,612	29,612	-
Multifamily	-	-	-	-	22,560	22,560	-
Commercial owner occupied	-	-	-	-	58,802	58,802	-
Commercial non-owner occupied	-	139	91	230	54,405	54,635	-
<b>Consumer loans</b>							
Consumer revolving credit	-	-	-	-	2,254	2,254	-
Consumer all other credit	93	30	-	123	11,227	11,350	-
<b>Total Loans</b>	<b>\$ 310</b>	<b>\$ 230</b>	<b>\$ 269</b>	<b>\$ 809</b>	<b>\$ 299,225</b>	<b>\$ 300,034</b>	<b>\$ 178</b>

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Impaired loans.** Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts when due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Regulatory guidelines require the Company to reevaluate the fair value of collateral supporting impaired collateral dependent loans on at least an annual basis. While the Company's policy is to comply with the regulatory guidelines, the Company's general practice is to reevaluate the fair value of collateral supporting impaired collateral dependent loans on a quarterly basis.

The following tables provide a breakdown by class of the loans classified as impaired loans as of December 31, 2014 and December 31, 2013. These loans are reported at their recorded investment, which is the carrying amount of the loan as reflected on the Company's balance sheet, net of charge-offs and other amounts applied to reduce the net book balance. Average recorded investment in impaired loans is computed using an average of month-end balances for these loans for the twelve months ended December 31, 2014 and December 31, 2013. Interest income recognized is for the years ended December 31, 2014 and December 31, 2013.

**December 31, 2014**

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
<b>Impaired loans without a valuation allowance:</b>					
Other construction and land	\$ 69	\$ 109	\$ -	\$ 79	\$ 1
1-4 family residential mortgages	525	545	-	437	16
Home equity lines of credits	-	-	-	50	3
Commercial owner occupied real estate	1,103	1,103	-	1,124	60
Commercial non-owner occupied real estate	-	-	-	46	-
<b>Impaired loans with a valuation allowance</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total impaired loans</b>	<b>\$ 1,697</b>	<b>\$ 1,757</b>	<b>\$ -</b>	<b>\$ 1,736</b>	<b>\$ 80</b>

**December 31, 2013**

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
<b>Impaired loans without a valuation allowance:</b>					
Other construction and land	\$ 77	\$ 110	\$ -	\$ 81	\$ -
1-4 family residential mortgages	285	380	-	293	11
Commercial owner occupied real estate	1,144	1,144	-	1,414	50
Commercial non-owner occupied real estate	230	274	-	202	-
<b>Impaired loans with a valuation allowance</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total impaired loans</b>	<b>\$ 1,736</b>	<b>\$ 1,908</b>	<b>\$ -</b>	<b>\$ 1,990</b>	<b>\$ 61</b>

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Troubled debt restructurings ( TDRs )** are also considered impaired loans. TDRs occur when the Bank agrees to modify the original terms of a loan by granting a concession that it would not otherwise consider due to the deterioration in the financial condition of the borrower. These concessions are done in an attempt to improve the paying capacity of the borrower, and in some cases to avoid foreclosure, and are made with the intent to restore the loan to a performing status once sufficient payment history can be demonstrated. These concessions could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions.

The following provides a summary, by class, of modified loans that continue to accrue interest under the terms of the restructuring agreement, which are considered to be performing, and modified loans that have been placed in non-accrual status, which are considered to be nonperforming.

Troubled debt restructuring (TDRs)	December 31, 2014		December 31, 2013	
	No. of Loans	Recorded Investment	No. of Loans	Recorded Investment
<b>Performing TDRs</b>				
1-4 family residential mortgages	2	\$ 376	1	\$ 225
Commercial owner occupied real estate	1	1,103	1	1,144
Total performing TDRs	3	\$ 1,479	2	\$ 1,369
<b>Nonperforming TDRs</b>				
Other construction and land	1	\$ 39	-	\$ -
<b>Total TDRs</b>	<b>4</b>	<b>\$ 1,518</b>	<b>2</b>	<b>\$ 1,369</b>

A summary of loans that were modified as TDRs during the years ended December 31, 2014 and 2013 is shown below by class. The Post-Modification Recorded Balance reflects any interest or fees from the original loan which may have been added to the principal balance on the new note as a condition of the TDR. Additionally, the Post-Modification Recorded Balance is reported below at the period end balances, inclusive of all partial principal pay downs and principal charge-offs since the modification date. Loans modified as TDRs that were fully paid down, charged-off, or foreclosed upon by period end are not reported.

Loans modified at below market rates	During year ended December 31, 2014			During year ended December 31, 2013		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Other construction and land	1	\$ 40	\$ 39	-	\$ -	\$ -
1-4 family residential mortgage	1	156	155	-	-	-
Total loans modified during the period	2	\$ 196	\$ 194	-	\$ -	\$ -

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The following tables present, by class of loans, information related to loans modified as TDRs that subsequently defaulted during the years ended December 31, 2014 and 2013 and were modified as TDRs during the twelve months prior to default:

	2014		2013	
	No. of Loans	Recorded Investment	No. of Loans	Recorded Investment
1-4 family residential mortgages	-	\$ -	1	\$ 65
Commercial owner occupied real estate	-	-	1	183
<b>Total</b>	<b>-</b>	<b>\$ -</b>	<b>2</b>	<b>\$ 248</b>

**Note 4 Allowance for Loan Losses**

A summary of the transactions in the allowance for loan losses for the years ended December 31, 2014 and 2013 appears below:

	2014	2013
Balance, beginning of period	\$ 3,360	\$ 3,267
Loans charged off	(551)	(161)
Recoveries	49	94
Net charge-offs	(502)	(67)
Provision for loan losses	306	160
Balance, December 31	\$ 3,164	\$ 3,360

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Within these segments, the Company has sub-segmented its portfolio by classes, based on the associated risks within these classes.

**LOAN CLASSES BY SEGMENTS**

Commercial loan segment:

- Commercial and industrial - organic
- Commercial and industrial - syndicated

Real estate construction and land loan segment:

- Residential construction
- Other construction and land

Real estate mortgage loan segment:

- 1-4 family residential
- Home equity lines of credit
- Multifamily
- Commercial owner occupied
- Commercial non-owner occupied

Consumer loan segment:

- Consumer revolving credit
- Consumer all other credit



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

Based upon the internal risk ratings assigned to each credit, a historical loss factor is assigned to the principal balances for each loan class. The historical loss factor is calculated by averaging the actual loan losses, for each loan class, from the previous twelve quarters.

The Company's internal creditworthiness grading system is based on experiences with similarly graded loans. Category ratings are reviewed quarterly by experienced senior lenders based on each borrower's situation. Additionally, internal and external monitoring and review of credits are conducted on an annual basis.

Loans that trend upward toward more positive risk ratings generally have a lower risk factor associated. Conversely, loans that migrate toward more negative ratings generally will result in a higher risk factor being applied to those related loan balances.

**Risk Ratings And Historical Loss Factor Applied**

**Excellent**

0% applied, as these loans are secured by cash and represent a minimal risk. The Company has never experienced a loss for this category.

**Good**

0% applied, as these loans are secured by marketable securities within margin and represent a low risk. The Company has never experienced a loss for this category.

**Pass**

Historical loss factor for loans rated **pass** is applied to current balances of like-rated loans, pooled by class. Loans with the following risk ratings are pooled by class and considered together as **pass** :

**Satisfactory** - modest risk loans where the borrower has strong and liquid financial statement and more than adequate cash flow

**Average** average risk loans where the borrower has reasonable debt service capacity

**Marginal** acceptable risk loans where the borrower has an acceptable financial statement but is leveraged

**Watch** acceptable risk loans which require more attention than normal servicing

**Special Mention**

These potential problem loans are currently protected but are potentially weak. Historical loss factor for loans rated **special mention** is applied to current balances of like-rated loans pooled by class.

**Substandard**

These problem loans are inadequately protected by the sound worth and paying capacity of the borrower and/or the value of any collateral pledged. These loans may be considered impaired and evaluated on an individual basis. Otherwise, an historical loss factor for loans rated **substandard** is applied to current balances of all other **substandard** loans pooled by class.

**Doubtful**

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Loans with this rating have significant deterioration in the sound worth and paying capacity of the borrower and/or the value of any collateral pledged, making collection or liquidation of the loan in full highly questionable. These loans would be considered impaired and evaluated on an individual basis.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The following represents the loan portfolio designated by the internal risk ratings assigned to each credit at year-end:

**Internal Risk Rating Grades**

<b>December 31, 2014</b>	Excellent	Good	Pass	Special Mention	Sub- standard	Doubtful	TOTAL
<b>Commercial</b>							
Commercial and industrial - organic	\$ 3,579	\$ 23,261	\$ 18,487	\$ 64	\$ 734	\$ -	\$ 46,125
Commercial and industrial - syndicated	-	-	14,815	-	-	-	14,815
<b>Real estate construction</b>							
Residential construction	-	-	337	-	-	-	337
Other construction and land	-	-	10,903	507	165	-	11,575
<b>Real estate mortgages</b>							
1-4 family residential	-	1,910	56,968	455	829	-	60,162
Home equity lines of credit	-	-	25,411	-	87	-	25,498
Multifamily	-	-	26,462	-	-	-	26,462
Commercial owner occupied	-	-	58,890	-	1,978	-	60,868
Commercial non-owner occupied	-	-	54,012	-	-	-	54,012
<b>Consumer</b>							
Consumer revolving credit	34	3,054	332	-	8	-	3,428
Consumer all other credit	200	7,856	1,867	-	49	-	9,972
<b>Total Loans</b>	<b>\$ 3,813</b>	<b>\$ 36,081</b>	<b>\$ 268,484</b>	<b>\$ 1,026</b>	<b>\$ 3,850</b>	<b>\$ -</b>	<b>\$ 313,254</b>

**Internal Risk Rating Grades**

<b>December 31, 2013</b>	Excellent	Good	Pass	Special Mention	Sub- standard	Doubtful	TOTAL
<b>Commercial and industrial - organic</b>	<b>\$ 4,056</b>	<b>\$ 19,464</b>	<b>\$ 24,015</b>	<b>\$ 5</b>	<b>\$ 520</b>	<b>\$ -</b>	<b>\$ 48,060</b>
<b>Real estate construction</b>							
Residential construction	-	-	794	-	-	-	794
Other construction and land	-	-	17,031	530	106	-	17,667
<b>Real estate mortgages</b>							
1-4 family residential	-	1,934	50,945	593	828	-	54,300
Home equity lines of credit	-	-	29,367	-	245	-	29,612
Multifamily	-	-	22,560	-	-	-	22,560
Commercial owner occupied	-	-	56,668	-	2,134	-	58,802
Commercial non-owner occupied	-	-	51,884	567	2,184	-	54,635
<b>Consumer</b>							
Consumer revolving credit	-	1,926	319	-	9	-	2,254
Consumer all other credit	371	8,772	2,153	-	54	-	11,350
<b>Total Loans</b>	<b>\$ 4,427</b>	<b>\$ 32,096</b>	<b>\$ 255,736</b>	<b>\$ 1,695</b>	<b>\$ 6,080</b>	<b>\$ -</b>	<b>\$ 300,034</b>

In addition to the historical factors, the adequacy of the Company's allowance for loan losses is evaluated through reference to eight qualitative factors, listed below and ranked in order of importance:

- 1) Changes in national and local economic conditions, including the condition of various market segments
- 2) Changes in the value of underlying collateral
- 3) Changes in volume of classified assets, measured as a percentage of capital
- 4) Changes in volume of delinquent loans
- 5) The existence and effect of any concentrations of credit and changes in the level of such concentrations
- 6) Changes in lending policies and procedures, including underwriting standards
- 7) Changes in the experience, ability and depth of lending management and staff
- 8) Changes in the level of policy exceptions

It has been the Company's experience that the first four factors drive losses to a much greater extent than the last four factors; therefore, the first four factors are weighted more heavily.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

Historical factors and qualitative factors are not assessed against loans rated excellent or rated good, since these are fully collateralized by cash or readily marketable securities.

For each segment and class of loans, management must exercise significant judgment to determine the estimation method that fits the credit risk characteristics of its various segments. Although this evaluation is inherently subjective, qualified management utilizes its significant knowledge and experience related to both the market and history of the Company's loan losses.

During these evaluations, particular characteristics associated with a segment of the loan portfolio are also considered. These characteristics are detailed below:

Commercial loans not secured by real estate carry risks associated with the successful operation of a business, and the repayments of these loans depend on the profitability and cash flows of the business. Additional risk relates to the value of collateral where depreciation occurs and the valuation is less precise.

Commercial loans purchased from the syndicated loan market generally represent shared national credits, which are participations in loans or loan commitments that are shared by three or more banks. Included in the Company's shared national credit portfolio are purchased participations and assignments in leveraged lending transactions. Leveraged lending transactions are generally used to support a merger- or acquisition-related transaction, to back a recapitalization of a company's balance sheet or to refinance debt. When considering a participation in the leveraged lending market, the Company participates only in first lien senior secured term loans. To further minimize risk, the Company has developed policies to limit overall credit exposure to the syndicated market as a whole and to each borrower.

Loans secured by commercial real estate also carry risks associated with the success of the business and the ability to generate a positive cash flow sufficient to service debts. Real estate security diminishes risks only to the extent that a market exists for the subject collateral.

Consumer loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral, such as automobiles which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. Consumer loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy. Consumer loans are further segmented into consumer revolving lines and all other consumer loans.

Real estate secured construction loans carry risks that a project will not be completed as scheduled and budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan. Additional risks may occur if the general contractor, who may not be a loan customer, is unable to finish the project as planned due to financial pressures unrelated to the project.

Residential real estate loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.

Impaired loans are individually evaluated and, if deemed appropriate, a specific allocation is made for these loans. In reviewing the six loans in the amount of \$1.697 million classified as impaired loans at December 31, 2014, there was no valuation allowance on any of these loans after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Allowance for Loan Losses Rollforward by Portfolio Segment**  
For the year ended December 31, 2014

	Commercial Loans	Real Estate Construction and Land	Real Estate Mortgages	Consumer Loans	Total
<b>Allowance for Loan Losses:</b>					
Balance as of January 1, 2014	\$ 340	\$ 198	\$ 2,788	\$ 34	\$ 3,360
Charge-offs	(286)	-	(262)	(3)	(551)
Recoveries	32	-	10	7	49
Provision for (recovery of) loan losses	588	(96)	(176)	(10)	306
Ending Balance	\$ 674	\$ 102	\$ 2,360	\$ 28	\$ 3,164
<b>Ending Balance:</b>					
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	674	102	2,360	28	3,164
<b>Loans:</b>					
Individually evaluated for impairment	\$ -	\$ 69	\$ 1,628	\$ -	\$ 1,697
Collectively evaluated for impairment	60,940	11,843	225,374	13,400	311,557
Ending Balance	\$ 60,940	\$ 11,912	\$ 227,002	\$ 13,400	\$ 313,254

**Allowance for Loan Losses Rollforward by Portfolio Segment**  
For the year ended December 31, 2013

	Commercial Loans	Real Estate Construction and Land	Real Estate Mortgages	Consumer Loans	Total
<b>Allowance for Loan Losses:</b>					
Balance as of January 1, 2013	\$ 303	\$ 168	\$ 2,750	\$ 46	\$ 3,267
Charge-offs	(22)	-	(139)	-	(161)
Recoveries	22	-	48	24	94
Provision for (recovery of) loan losses	37	30	129	(36)	160
Ending Balance	\$ 340	\$ 198	\$ 2,788	\$ 34	\$ 3,360
<b>Ending Balance:</b>					
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	340	198	2,788	34	3,360
<b>Loans:</b>					
Individually evaluated for impairment	\$ -	\$ 77	\$ 1,659	\$ -	\$ 1,736
Collectively evaluated for impairment	48,060	18,384	218,250	13,604	298,298
Ending Balance	\$ 48,060	\$ 18,461	\$ 219,909	\$ 13,604	\$ 300,034

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Note 5 Other Real Estate Owned (OREO)**

At December 31, 2014, OREO was carried at \$1.177 million and was comprised of one residential property. At December 31, 2013, OREO was carried at \$2.372 million.

Changes in the balance for OREO are as follows:

	December 31, 2014	December 31, 2013
Balance at beginning of year, gross	\$ 3,133	\$ 2,329
Transfer from loans	244	804
Previously recognized impairment losses on disposition	(101)	-
Net loss on sale of property	(27)	-
Sales proceeds	(1,135)	-
Balance at end of year, gross	\$ 2,114	\$ 3,133
Less: valuation allowance	(937)	(761)
Balance at end of year, net	\$ 1,177	\$ 2,372

Changes in the valuation allowance for OREO are as follows:

	December 31, 2014	December 31, 2013
Balance at beginning of year	\$ 761	\$ 583
Valuation allowance	277	178
Charge-offs	(101)	-
Balance at end of year	\$ 937	\$ 761

Expenses applicable to OREO, other than the valuation allowance and net losses on sale, were \$59 thousand for the year ended December 31, 2014 and \$107 thousand for the year ended December 31, 2013.

**Note 6 Premises and Equipment**

Premises and equipment are summarized as follows:

	December 31, 2014	December 31, 2013
Leasehold improvements	\$ 15,703	\$ 15,439
Building and land	1,215	1,207
Construction and fixed assets in progress	110	3
Furniture and equipment	5,683	5,368
Computer software	1,875	1,848
	\$ 24,586	\$ 23,865
Less: accumulated depreciation and amortization	15,121	14,041
	\$ 9,465	\$ 9,824

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At December 31, 2014, the Company had leased certain of its banking and operations offices under operating lease agreements on terms ranging from 1 to 20 years with renewal options. Rent expense charged to operations under operating lease agreements totaled \$940 thousand in 2014 and \$1.010 million in 2013.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The following is a schedule of future minimum rental payments required under non-cancelable operating leases that have initial or remaining terms in excess of one year as of December 31, 2014:

2015	\$	834
2016		772
2017		705
2018		619
2019		425
Thereafter		2,626
	\$	5,981

**Note 7 Deposits**

The aggregate amount of time deposits with a minimum balance of \$250 thousand was \$38.959 million at December 31, 2014 and \$32.738 million at December 31, 2013.

Brokered deposits totaled \$18.693 million and \$25.045 million at December 31, 2014 and 2013, respectively. These brokered deposits represent reciprocal relationships established under the Certificate of Deposit Account Registry Service (CDARS), whereby depositors can obtain FDIC insurance on deposits up to at least \$50 million or more.

At December 31, 2014, the scheduled maturities of time deposits are as follows:

2015	\$	107,199
2016		5,341
2017		2,787
2018		927
2019		840
	\$	117,094

Deposit account overdrafts reported as loans totaled \$53 thousand and \$51 thousand at December 31, 2014 and December 31, 2013, respectively.

**Note 8 Income Taxes**

The Company files tax returns in the U.S. federal jurisdiction. With few exceptions, the Company is no longer subject to U.S. federal tax examinations by tax authorities for years prior to 2011.

The Commonwealth of Virginia assesses a Bank Franchise Tax on banks instead of a state income tax. The Bank Franchise Tax expense is reported in noninterest expense and the tax's calculation is unrelated to taxable income.

For the tax year 2013, the Company and the Bank filed separate federal income tax returns. The Company will file a consolidated federal income tax return beginning in 2014 and for the foreseeable future. The tax provision and liability shown below reflects the tax position of the Company on a consolidated basis.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

Net deferred tax assets consist of the following components as of year-end:

	2014	2013
<b>Deferred tax assets:</b>		
Allowance for loan losses	\$ 970	\$ 1,025
Non-accrual loan interest	5	7
Stock option/grant expense	316	337
Start-up expenses	60	1
Home equity closing costs	66	63
OREO valuation allowance	319	315
Deferred compensation expense	14	12
Securities available for sale unrealized losses	-	737
Depreciation	696	585
	\$ 2,446	\$ 3,082
<b>Deferred tax liabilities:</b>		
Securities available for sale unrealized gains	\$ 23	\$ -
Deferred loan costs	57	17
	80	17
<b>Net deferred tax assets</b>	<b>\$ 2,366</b>	<b>\$ 3,065</b>

The provision for income taxes charged to operations for years ended December 31, 2014 and 2013 consists of the following:

	2014	2013
Current tax expense	\$ 517	\$ 3,504
Deferred tax benefit	(61)	(292)
<b>Provision for income taxes</b>	<b>\$ 456</b>	<b>\$ 3,212</b>

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income for the years ended December 31, 2014 and 2013 due to the following:

	2014	2013
Federal statutory rate	34%	34%
Computed statutory tax expense	\$ 800	\$ 3,501
<b>Increase (decrease) in tax resulting from:</b>		
Tax-exempt interest income	(169)	(169)
Tax-exempt income from Bank Owned Life Insurance (BOLI)	(149)	(151)
Stock option expense	14	14
Other	(40)	17
<b>Provision for income taxes</b>	<b>\$ 456</b>	<b>\$ 3,212</b>



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Note 9 Commitments and Contingent Liabilities**

In the normal course of business, there are various outstanding commitments and contingent liabilities, which are not reflected in the accompanying consolidated financial statements. The Company does not anticipate any material loss as a result of these transactions.

As a member of the Federal Reserve System, the Company is required to maintain certain average clearing balances. Those balances include amounts on deposit with the Federal Reserve. For the final weekly reporting period in the years ended December 31, 2014 and December 31, 2013, no daily average required balances were required for either year.

**Note 10 Financial Instruments with Off-Balance Sheet Risk and Credit Risk**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. In addition to the amounts shown below, the Company has extended commitment letters at December 31, 2014 in the amount of \$23.280 million to various borrowers. At December 31, 2013, commitment letters totaled \$12.364 million. Commitment letters are done in the normal course of business and typically expire after 120 days. All of these off-balance-sheet instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet, although material losses are not anticipated. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The totals for financial instruments whose contract amount represents credit risk are shown below:

	Notional Amount	
	December 31, 2014	December 31, 2013
Unfunded lines-of-credit	\$ 80,589	\$ 79,519
ACH	16,316	14,287
Letters of credit	5,034	5,364
Total	\$ 101,939	\$ 99,170

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral normally consists of real property.

Standby letters of credit are conditional commitments by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds real estate and bank deposits as collateral supporting those commitments for which collateral is deemed necessary.

The Company has approximately \$100 thousand in deposits in other financial institutions in excess of amounts insured by the FDIC at December 31, 2014.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

**Note 11 Related Party Transactions**

From time to time, the Company and its subsidiaries have business dealings with companies owned by directors and beneficial shareholders of the Company. Payments made to these companies that exceeded the disclosure threshold of \$120 thousand in 2014 are reported below.

In 2014, rental expenditures of \$453 thousand (including reimbursements for taxes, insurance, and other expenses) were paid to an entity owned by a director of the Company. Additionally, the Bank paid \$318,000 for assistance with the Bank's marketing and advertising programs to a marketing and advertising agency of which a Bank director is an owner. Some portion of the payments to this agency was used, in turn, to pay third parties for legitimate business expenses incurred on behalf of the Bank.

SRCM Holdings LLC ( SRCM Holdings ) and Swift Run Capital Management, LLC ( SRCM ) are part of a group (collectively, the SRCM Group ) that have shared voting and shared dispositive power over 9% of the outstanding Company common stock as of March 6, 2014. As discussed in the section titled Organization and Principles of Consolidation in Note 1 – Summary of Significant Accounting Policies, the Sale Agreement entered into on June 27, 2013 provides for VNBTrust to receive ongoing royalty payments from SRCM Holdings and/or SRCM. A former officer of VNBTrust is the principal owner of SRCM Holdings. From March 6, 2014 through December 31, 2014, the Company and its affiliates received cash payments from SRCM Holdings and/or SRCM of \$651 thousand, of which \$593 thousand was recorded as royalty income.

**Note 12 Capital Requirements**

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2014 and 2013, that the Company and the Bank met all capital adequacy requirements to which they are subject.

The Bank's capital ratios remain above the levels designated by bank regulators as well capitalized at December 31, 2014. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's category.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The Company's and the Bank's actual capital amounts and ratios are presented in the following tables:

**December 31, 2014**

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Total Capital</b>						
(To Risk Weighted Assets)						
Consolidated	\$ 63,752	17.87%	\$ 28,538	8.00%	N/A	N/A
Bank	\$ 52,505	15.63%	\$ 28,490	8.00%	\$ 35,612	10.00%
<b>Tier 1 Capital</b>						
(To Risk Weighted Assets)						
Consolidated	\$ 60,588	16.98%	\$ 14,269	4.00%	N/A	N/A
Bank	\$ 55,669	14.74%	\$ 14,245	4.00%	\$ 21,367	6.00%
<b>Tier 1 Capital</b>						
(To Average Assets)						
Consolidated	\$ 60,588	11.38%	\$ 21,305	4.00%	N/A	N/A
Bank	\$ 55,669	9.86%	\$ 21,296	4.00%	\$ 26,620	5.00%

**December 31, 2013**

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Total Capital</b>						
(To Risk Weighted Assets)						
Consolidated	\$ 62,747	18.00%	\$ 27,889	8.00%	N/A	N/A
Bank	\$ 54,434	15.62%	\$ 27,886	8.00%	\$ 34,857	10.00%
<b>Tier 1 Capital</b>						
(To Risk Weighted Assets)						
Consolidated	\$ 59,387	17.03%	\$ 13,945	4.00%	N/A	N/A
Bank	\$ 51,074	14.65%	\$ 13,943	4.00%	\$ 20,914	6.00%
<b>Tier 1 Capital</b>						
(To Average Assets)						
Consolidated	\$ 59,387	11.86%	\$ 20,026	4.00%	N/A	N/A
Bank	\$ 51,074	10.20%	\$ 20,026	4.00%	\$ 25,033	5.00%

**Note 13 Dividend Restrictions**

The primary source of funds for the dividends paid by the Company to shareholders is dividends received from the Bank. Federal regulations limit the amount of dividends which the Bank can pay to the Company without obtaining prior approval. The amount of cash dividends that the Bank may pay is limited to current year earnings plus retained net profits for the two preceding years. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. Notwithstanding the regulatory limitations on cash dividends, the Bank's Board of Directors approved a cash dividend payment policy that, once combined with any previous cash dividends paid within the last 12 months, the total of which will not exceed 50% of the Bank's after-tax earnings, excluding any extraordinary items, for the preceding

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12 months. If the previous 3 quarterly dividends are not within the preceding 12 months, then only the amounts of dividends paid in the previous 12 months, plus the proposed dividend, in total will not exceed 60% of the Bank's after-tax earnings.

## **Table of Contents**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollar amounts in thousands, except share and per share data)**

At December 31, 2014, the maximum amount of retained earnings available to the Bank for cash dividends to the Company was \$4.584 million.

#### **Note 14 Fair Value Measurements**

##### **Determination of Fair Value**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic of FASB ASC 825, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

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

##### **Fair Value Hierarchy**

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

Level 1	Valuation is based on quoted prices in active markets for identical assets and liabilities.
Level 2	Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.
Level 3	Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

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

##### **Securities available for sale**

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



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

The following tables present the balances measured at fair value on a recurring basis:

**Fair Value Measurements at December 31, 2014 Using:**

Description	Balance	Quoted	Significant	Significant
		Prices in Active Markets for Identical Assets (Level 1)	Other  Observable  Inputs (Level 2)	Unobservable  Inputs (Level 3)
<b>Assets:</b>				
U.S. Government agencies	\$ 31,528	\$ -	\$ 31,528	\$ -
Corporate bonds	21,276	-	21,276	-
Asset-backed securities	2,105	-	2,105	-
Mortgage-backed securities/CMOs	63,220	-	63,220	-
Municipal bonds	23,687	-	23,687	-
Total securities available for sale	\$ 141,816	\$ -	\$ 141,816	\$ -

**Fair Value Measurements at December 31, 2013 Using:**

Description	Balance	Quoted	Significant	Significant
		Prices in Active Markets for Identical Assets (Level 1)	Other  Observable  Inputs (Level 2)	Unobservable  Inputs (Level 3)
<b>Assets:</b>				
U.S. Government agencies	\$ 44,005	\$ -	\$ 44,005	\$ -
Corporate bonds	9,053	-	9,053	-
Asset-backed securities	2,100	-	2,100	-
Mortgage-backed securities/CMOs	55,597	-	55,597	-
Municipal bonds	22,272	-	22,272	-
Total securities available for sale	\$ 133,027	\$ -	\$ 133,027	\$ -

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

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

**Other real estate owned**



Other real estate owned is measured at fair value less cost to sell, based on an appraisal conducted by an independent, licensed appraiser outside of the Company. If the collateral value is significantly adjusted due to differences in the comparable properties, or is discounted by the Company because of marketability, then the fair value is considered Level 3. OREO is measured at fair value on a nonrecurring basis. Any initial fair value adjustment is charged against the Allowance for Loan Losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest expense on the Consolidated Statements of Income.

#### **Impaired loans**

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral value is significantly adjusted due to differences in the comparable properties, or is discounted by the Company because of marketability, then the fair value is considered Level 3.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollar amounts in thousands, except share and per share data)**

The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business financial statements if not considered significant. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3).

Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses in the Consolidated Statements of Income. The Company had \$1.697 million and \$1.736 million in impaired loans as of December 31, 2014 and December 31, 2013, respectively. None of these impaired loans required a valuation allowance after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

The following tables present the Company's assets that were measured at fair value on a nonrecurring basis:

Description	<b>Fair Value Measurements at December 31, 2014 Using:</b>			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Other Real Estate Owned	\$ 1,177	\$ -	\$ -	\$ 1,177

Description	<b>Fair Value Measurements at December 31, 2013 Using:</b>			
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Other Real Estate Owned	\$ 2,372	\$ -	\$ -	\$ 2,372

For the assets measured at fair value on a nonrecurring basis as of December 31, 2014, the following table displays quantitative information about Level 3 Fair Value Measurements:

Description	Fair Value	Valuation Technique	Unobservable Inputs	Weighted Average
Assets:				
Other Real Estate Owned	\$ 1,177	Market comparables	Discount applied to market comparables *	6.0%

\* A discount percentage is applied based on age of independent appraisals, current market conditions, and cost to sell.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollar amounts in thousands, except share and per share data)**

The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments:

**Cash and short-term investments**

For those short-term instruments, including cash, due from banks and federal funds sold, the carrying amount is a reasonable estimate of fair value.

**Interest bearing deposits**

The carrying amounts of interest bearing deposits maturing within ninety days approximate their fair value.

**Securities**

Fair values for securities, excluding restricted securities, are based on third party vendor pricing models. The carrying value of restricted FRB and FHLB stock approximates fair value based on the redemption provisions of each entity and is therefore excluded from the following table.

**Loans**

The fair value of performing loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar remaining maturities. This calculation ignores loan fees and certain factors affecting the interest rates charged on various loans such as the borrower's creditworthiness and compensating balances and dissimilar types of real estate held as collateral. The fair value of impaired loans is measured as described within the Impaired Loans section of this note.

**Bank owned life insurance**

The carrying amounts of Bank owned life insurance approximate fair value.

**Accrued interest**

The carrying amounts of accrued interest approximate fair value.

**Deposit liabilities**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

**Short-term borrowings**

The carrying amounts of securities sold under agreements to repurchase approximate fair value.

**Off-balance sheet financial instruments**

The fair values of loan commitments and standby letters of credit are immaterial. Therefore, they have not been included in the following table.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

The carrying values and estimated fair values of the Company's financial instruments are as follows:

	Carrying value	Fair Value Measurement at December 31, 2014 using:			Fair Value
		Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	
<b>Assets</b>					
Cash and cash equivalent	\$ 54,107	\$ 54,107	\$ -	\$ -	\$ 54,107
Securities	141,816	-	141,816	-	141,816
Loans, net	310,090	-	-	310,806	310,806
Bank owned life insurance	13,034	-	13,034	-	13,034
Accrued interest receivable	1,296	-	566	730	1,296
<b>Liabilities</b>					
Demand deposits and interest-bearing transaction and money market accounts	\$ 339,625	\$ -	\$ 339,625	\$ -	\$ 339,625
Certificates of deposit	117,094	-	117,189	-	117,189
Securities sold under agreements to repurchase	17,995	-	17,995	-	17,995
Accrued interest payable	117	-	117	-	117

	Carrying value	Fair Value Measurement at December 31, 2013 using:			Fair Value
		Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	
<b>Assets</b>					
Cash and cash equivalent	\$ 40,072	\$ 40,072	\$ -	\$ -	\$ 40,072
Securities	133,027	-	133,027	-	133,027
Loans, net	296,674	-	-	297,765	297,765
Bank owned life insurance	12,595	-	12,595	-	12,595
Accrued interest receivable	1,247	-	566	681	1,247
<b>Liabilities</b>					
Demand deposits and interest-bearing transaction and money market accounts	\$ 306,298	\$ -	\$ 306,298	\$ -	\$ 306,298
Certificates of deposit	124,162	-	124,391	-	124,391
Securities sold under agreements to repurchase	16,297	-	16,297	-	16,297
Accrued interest payable	125	-	125	-	125



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk; however, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

**Note 15 Other Expenses**

The Company had the following other expenses as of the dates indicated:

	December 31, 2014	December 31, 2013
ATM, debit and credit card	\$ 349	\$ 297
Bank franchise tax	328	253
Computer software	330	319
Data processing	1,025	949
FDIC deposit insurance assessment	268	248
Marketing, advertising and promotion	774	721
Net OREO write downs and expenses	345	285
Professional fees	696	744
Other	1,486	1,683
	\$ 5,601	\$ 5,499

**Note 16 Employee Benefit Plans**

The Company has a 401(k) plan available to all employees who are at least 18 years of age. Employees are able to elect the amount to contribute, not to exceed a maximum amount as determined by Internal Revenue Service regulation. Effective January 1, 2013, the Bank matched 100% of the first 3% of employee contributions and 50% for the next 2% of employee contributions. Effective January 1, 2014, the company matched 100% of the first 6% of employee contributions.

Vesting refers to the rights of ownership to the assets in the 401(k) accounts. Effective January 1, 2013, matching contributions were fully vested immediately. Employee contributions to the plan have always been 100% vested.

The Company contributed \$327 thousand to the plan in 2014 and \$277 thousand in 2013.

**Note 17 Stock Incentive Plans**

At the Annual Shareholders Meeting on May 21, 2014, shareholders approved the Virginia National Bankshares Corporation 2014 Stock Incentive Plan ( 2014 Plan ). The 2014 Plan makes available up to 250,000 shares of the Company's common stock to be issued to plan participants. Similar to the Virginia National Bank 1998 Stock Incentive Plan ( 1998 Plan ), 2003 Stock Incentive Plan ( 2003 Plan ), and 2005 Stock Incentive Plan ( 2005 Plan ), the 2014 Plan provides for granting of both incentive and nonqualified stock options, as well as restricted stock and other stock based awards. The 2005 Plan expired on December 20, 2014. No new grants will be issued under the 1998 Plan, the 2003 Plan, or the 2005 Plan as all three plans have expired.

For all Plans, the option price of incentive options will not be less than the fair market value of the stock at the time an option is granted. Nonqualified options may be granted at a price established by the Board of Directors, including prices less than the fair market value on the date of grant. Outstanding options generally expire in ten years from the grant date. Stock options generally vest by the fourth or fifth anniversary of the date of the grant.





**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

A summary of the shares issued and available under each of the Company's stock incentive plans (the Plans) is shown below as of December 31, 2014. Although the 2003 Plan and 2005 Plan have expired and no new grants will be issued under these plans, there were shares issued before the plans expired which are still outstanding as shown below.

	1998 Plan	2003 Plan	2005 Plan	2014 Plan
Aggregate shares issuable	430,100	128,369	230,000	250,000
Options issued, net of forfeited and expired options	(381,089)	(110,278)	(149,751)	-
Cancelled due to Plan expiration	(49,011)	(18,091)	(80,249)	-
Remaining available for grant	-	-	-	250,000
<b>Grants issued and outstanding:</b>				
Total vested and unvested shares	-	32,438	148,358	-
Fully vested shares	-	32,438	138,025	-
Exercise price range	N/A	\$15.65 to \$18.26	\$11.74 to \$36.74	N/A

The Company accounts for all of its stock incentive plans under recognition and measurement accounting principles which require that the compensation cost relating to stock-based payment transactions be recognized in financial statements. Stock-based compensation arrangements include stock options and restricted stock. All stock-based payments to employees are required to be valued using a fair value method on the date of grant and expensed based on that fair value over the applicable vesting period. For the years ended December 31, 2014 and December 31, 2013, the Company recognized \$52 thousand and \$106 thousand, respectively, in compensation expense for stock options and restricted stock grants. As of December 31, 2014, there was \$65 thousand in unamortized compensation expense remaining to be recognized in future reporting periods through 2017.

**Stock Options**

Changes in the stock options outstanding related to the Plans are summarized as follows:

	Number of Options	December 31, 2014 Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at January 1, 2014	226,424	\$ 26.35	\$ 44
Granted	5,000	18.10	
Exercised	(9,516)	19.90	
Expired	(10,350)	22.27	
Forfeited	(30,762)	31.30	
Outstanding at December 31, 2014	180,796	\$ 25.86	\$ 271
Options exercisable at December 31, 2014	170,463	\$ 26.41	\$ 209

The total intrinsic value of options exercised during the year ended December 31, 2014 was \$18 thousand.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollar amounts in thousands, except share and per share data)**

The fair value of any grant is estimated at the grant date using the Black-Scholes pricing model. During both the first quarter of 2014 and 2013, there were stock option grants of 5,000 shares each. No other stock option grant has been issued during the years ended December 31, 2014 and 2013. The fair value on the grant issued in 2014 was estimated based on the assumptions noted in the following table:

	For the year ended December 31, 2014
Expected volatility <sup>1</sup>	29.20%
Expected dividends <sup>2</sup>	1.10%
Expected term (in years) <sup>3</sup>	6.25
Risk-free rate <sup>4</sup>	2.15%

1 Based on the monthly historical volatility of the Company's stock price over the expected life of the options.

2 Calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant.

3 Based on the average of the contractual life and vesting period for the respective option.

4 Based upon an interpolated US Treasury yield curve interest rate that corresponds to the contractual life of the option, in effect at the time of the grant.

Summary information pertaining to options outstanding at December 31, 2014 is as follows:

Exercise Price	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable	Weighted- Average Exercise Price
\$11.74 to 20.00	49,238	5.5 Years	\$ 17.25	38,905	\$ 17.40
\$20.01 to 30.00	63,018	3.2 Years	24.73	63,018	24.73
\$30.01 to 36.74	68,540	1.4 Years	33.08	68,540	33.08
Total	180,796	3.2 Years	\$ 25.86	170,463	\$ 26.41

**Restricted Stock**

The 288 shares of restricted stock that were outstanding as of December 31, 2013 fully vested in November 2014. Changes in the restricted stock activity as of December 31, 2014 are summarized as follows:

	Number of Shares	Grant Date Fair Value
Outstanding at January 1, 2014	288	\$ 12.18
Issued	-	-
Vested	(288)	12.18
Non-vested at December 31, 2014	-	\$ -

No restricted stock grants were awarded during 2014 or 2013.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Note 18 Earnings per Share**

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

	December 31, 2014			December 31, 2013		
	Net Income	Weighted Average Shares	Per Share Amount	Net Income	Weighted Average Shares	Per Share Amount
Basic earnings per share	\$ 1,898	2,695,426	\$ 0.70	\$ 6,896	2,690,237	\$ 2.56
Effect of dilutive stock options		11,533	-		255	-
Diluted earnings per share	\$ 1,898	2,706,959	\$ 0.70	\$ 6,896	2,690,492	\$ 2.56

In 2014, stock options representing 130,677 average shares were not included in the calculation of earnings per share, as their effect would have been antidilutive. Stock options representing 225,062 average shares were similarly not included in 2013.

**Note 19 Other Comprehensive Income**

A component of the Company's comprehensive income, in addition to net income from operations, is the recognition of the unrealized gains and losses on AFS securities, net of income taxes. Reclassifications of unrealized gains and losses on AFS securities are reported in the income statement as Gain on sale of securities with the corresponding income tax effect reflected as a component of income tax expense. Amounts reclassified out of accumulated other comprehensive income (loss) are presented below:

	December 31, 2014	December 31, 2013
Available-for-sale securities		
Realized gains on sale of securities	\$ 24	\$ 50
Tax effect	(8)	(17)
Realized gains, net of tax	\$ 16	\$ 33

**Note 20 Segment Reporting**

Virginia National Bankshares Corporation has two reportable segments, the Bank and VNB Wealth.

Commercial banking involves making loans and generating deposits from individuals and businesses. Loan fee income, service charges from deposit accounts, and other non-interest-related fees such as fees for debit cards and ATM usage and fees for treasury management services generate additional income for this segment.

VNB Wealth services include investment management, trust and estate administration, custody services, and financial planning. Fees for these services are charged on a fixed basis and a performance basis. A management fee for administrative and technology support services provided by the Bank is charged to VNB Wealth. For the years ended December 31, 2014 and December 31, 2013, management fees of \$250 thousand were charged to VNB Wealth and eliminated in consolidated totals. The VNB Wealth total assets as shown in the following tables represent the assets of VNB Wealth and should not be confused with client assets under management.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies provided earlier in this report. Each reportable segment is a strategic business unit that offers different products and services. They are managed separately, because each segment appeals to different markets and, accordingly, require different technology and marketing strategies.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

Segment information as of, and for the years ended, December 31, 2014 and 2013, is shown in the following tables:

	Bank	VNB Wealth	Consolidated
<b>2014</b>			
Net interest income	\$ 14,422	\$ 32	\$ 14,454
Provision for loan losses	306	-	306
Non-interest income	2,614	2,983	5,597
Non-interest expense	14,576	2,815	17,391
Income before income taxes	2,154	200	2,354
Provision for income taxes	383	73	456
Net income	\$ 1,771	\$ 127	\$ 1,898
Total assets	\$ 526,458	\$ 10,595	\$ 537,053
<b>2013</b>			
Net interest income	\$ 14,421	\$ 28	\$ 14,449
Provision for loan losses	160	-	160
Non-interest income	2,571	15,283	17,854
Non-interest expense	14,072	7,963	22,035
Income before income taxes	2,760	7,348	10,108
Provision for income taxes	711	2,501	3,212
Net income	\$ 2,049	\$ 4,847	\$ 6,896
Total assets	\$ 490,564	\$ 22,430	\$ 512,994

**Note 21 Condensed Parent Company Financial Statements**

Condensed financial statements pertaining only to the Parent Company are presented below. The investment in subsidiary is accounted for using the equity method of accounting.

The Bank paid the Parent Company a cash dividend of \$8.5 million on December 18, 2013, after the Reorganization became effective, in order to capitalize the bank holding company. A quarterly cash dividend payment of \$135 thousand was authorized by the Bank's Board of Directors and paid to the Parent Company on December 17, 2013. Each quarter in 2014 a cash dividend was paid by the Bank to the Parent Company for a total of \$788 thousand.

The payment of dividends by the subsidiary is restricted by various regulatory limitations. Banking regulations also prohibit extensions of credit to the parent company unless appropriately secured by assets. For more detail on dividends, see Note 13 Dividend Restrictions.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Condensed Parent Company Only**

**BALANCE SHEETS**

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 7,713	\$ 8,436
Investment securities	64	-
Investments in subsidiary	52,549	49,717
Other assets	541	45
Total assets	\$ 60,867	\$ 58,198
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Other liabilities	\$ 235	\$ 167
Stockholders' equity	60,632	58,031
Total liabilities and stockholders' equity	\$ 60,867	\$ 58,198

**STATEMENTS OF INCOME**

	<b>For the years ended</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>
Dividends from subsidiary	\$ 788	\$ 8,635
Noninterest expense	449	187
Income before income taxes	\$ 339	\$ 8,448
Income tax (benefit)	(202)	-
Income before equity in undistributed earnings of subsidiary	\$ 541	\$ 8,448
Equity (deficit) in undistributed earnings of subsidiary	1,357	(1,552)
Net income	\$ 1,898	\$ 6,896

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except share and per share data)

**Condensed Parent Company Only**

**STATEMENTS OF CASH FLOWS**

	<b>For the years ended</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 1,898	\$ 6,896
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity (deficit) in undistributed earnings of subsidiary	(1,357)	1,552
Deferred tax benefit	(375)	-
Stock option & stock grant expense	52	-
Increase in other assets	(122)	(45)
Increase in other liabilities	69	167
Net cash provided from operating activities	165	8,570
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of restricted securities	(64)	-
Net cash used in investing activities	(64)	-
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Stock options exercised	180	-
Stock purchased under stock repurchase plan	(262)	-
Dividends paid	(742)	(134)
Net cash used in financing activities	(824)	(134)
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(723)</b>	<b>8,436</b>
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of period	8,436	-
End of period	\$ 7,713	\$ 8,436



**Table of Contents**

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

None

**Item 9A. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures.** The Company maintains disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC's rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In designing and evaluating its disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective at the reasonable assurance level.

**Management's Report on Internal Control over Financial Reporting.** Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2014. This assessment was based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on May 14, 2013. The revised version of the Framework superseded the original Framework and became effective at the end of 2014. The Company does not anticipate any change in internal control effectiveness during the complete transition to the new framework during 2015.

Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective at the reasonable assurance level. This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the SEC that permit the Company to provide only management's report in this annual report.

**Changes in Internal Control over Financial Reporting.** There was no change in the internal control over financial reporting that occurred during the quarter ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, the internal control over financial reporting.

**Item 9B. OTHER INFORMATION.**

None

**Table of Contents****Part III****Item 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE.**

Information is incorporated by reference to the information that appears under the headings Proposal 1 Election of Directors , Executive Compensation Executive Officers , Section 16(a) Beneficial Ownership Reporting Compliance , Code of Ethics Information about the Board of Directors and Board Committees and Audit and Compliance Committee Report contained in the Company s 2015 Definitive Proxy Statement ( Definitive Proxy Statement ) to be filed by April 30, 2015.

**Item 11. EXECUTIVE COMPENSATION.**

This information is incorporated by reference from the Executive Compensation section of the Company s Definitive Proxy Statement to be filed by April 30, 2015.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

Other than as set forth below, this information is incorporated by reference from Note 17, Stock Incentive Plans, in the notes to consolidated financial statements contained in Item 8 Consolidated Financial Statements and Supplementary Data of this Form 10-K and from the Beneficial Ownership of Company Common Stock section of the Company s Definitive Proxy Statement to be filed by April 30, 2015.

The following table summarizes information, as of December 31, 2014, relating to the Company s Stock Incentive Plans:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	180,796	\$ 25.86	250,000
Equity compensation plans not approved by security holders	--	--	--
<b>Total</b>	<b>180,796</b>	<b>\$ 25.86</b>	<b>250,000</b>

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.**

This information is incorporated by reference from the Information about the Board of Directors and Board Committees and Transactions with Related Persons sections of the Company s Definitive Proxy Statement to be filed by April 30, 2015. For further information, see Note 11 of the notes to consolidated financial statements contained in Item 8 Consolidated Financial Statements and Supplementary Data in this Form 10-K.

**Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

This information is incorporated by reference from the Independent Auditors section of the Company s Definitive Proxy Statement to be filed by April 30, 2015.



**Table of Contents****Part IV****Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

The following documents are files as part of this report:

(a)(1) Financial Statements

The following consolidated financial statements and reports of independent registered public accountants of the Company are in Part II, Item 8 Consolidated Financial Statements and Supplementary Data:

- (i) Consolidated Balance Sheets December 31, 2014 and December 31, 2013
  - (ii) Consolidated Statements of Income Years ended December 31, 2014 and December 31, 2013
  - (iii) Consolidated Statements of Comprehensive Income (Loss) Years ended December 31, 2014 and December 31, 2013
  - (iv) Consolidated Statements of Changes in Shareholders' Equity Years ended December 31, 2014 and December 31, 2013
  - (v) Consolidated Statements of Cash Flows Years ended December 31, 2014 and December 31, 2013
  - (vi) Notes to the Consolidated Financial Statements
- (a)(2) Financial Statement Schedules

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

(a)(3) Exhibit Index:

**Exhibit**

<b>Number</b>	<b>Description of Exhibit</b>
2.0	Reorganization Agreement and Plan of Share Exchange, dated as of March 6, 2013, between Virginia National Bank and Virginia National Bankshares Corporation <sup>a</sup>
3.1	Articles of Incorporation of Virginia National Bankshares Corporation, as amended and restated <sup>b</sup>
3.2	Bylaws of Virginia National Bankshares Corporation <sup>c</sup>
10.1	Virginia National Bank 1998 Stock Incentive Plan <sup>d</sup>
10.2	Virginia National Bank 2003 Stock Incentive Plan <sup>e</sup>
10.3	Virginia National Bank Amended and Restated 2005 Stock Incentive Plan <sup>f</sup>
10.4	Virginia National Bankshares Corporation 2014 Stock Incentive Plan <sup>g</sup>
21.0	Subsidiaries of the Registrant <sup>h</sup>
31.1	302 Certification of Principal Executive Officer
31.2	302 Certification of Principal Financial Officer
32.1	906 Certification
101.0	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of December 31, 2014 and December 31, 2013, (ii) the Consolidated Statements of Income for the years ended December 31, 2014 and December 31, 2013, (iii) the Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2014 and December 31, 2013, (iv) the Consolidated Statements of Changes in Shareholders' Equity for years ended December 31, 2014 and December 31, 2013, (v) the Consolidated Statements of Cash Flows for the years ended December 31, 2014 and December 31, 2013, and (vi) the Notes to the Consolidated Financial Statements (furnished herewith).

**Table of Contents**

<sup>a, b, c</sup> Incorporated herein by reference to Virginia National Bankshares Corporation's Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 18, 2013.

<sup>d</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on or around April 16, 1999.

<sup>e</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 24, 2003.

<sup>f</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on March 30, 2006.

<sup>g</sup> Incorporated herein by reference to Virginia National Bankshares Corporation's Definitive Proxy Statement, filed with the Securities and Exchange Commission on April 10, 2014.

<sup>h</sup> Refer to Item 1, Business, beginning on page 3 of this Form 10-K Report for a discussion of Virginia National Bankshares Corporation's direct and indirect subsidiaries.

