FIRST NATIONAL CORP /VA/
Form 10-Q
May 15, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2015

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number: 0-23976

(Exact name of registrant as specified in its charter)

Virginia	**54-1232965**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
112 West King Street, Strasburg, Virginia	**22657**
(Address of principal executive offices)	**(Zip Code)**

(540) 465-9121

(Registrant s telephone number, including area code)

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 x No ¨

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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of May 15, 2015, 4,909,714 shares of common stock, par value $1.25 per share, of the registrant were outstanding.

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PART I   FINANCIAL INFORMATION

Item 1.   Financial Statements
FIRST NATIONAL CORPORATION

Consolidated Balance Sheets

(in thousands, except share and per share data)

	(unaudited) March 31, 2015	December 31, 2014
Assets		
Cash and due from banks	$ 7,529	$ 6,043
Interest-bearing deposits in banks	1,645	18,802
Securities available for sale, at fair value	90,855	83,292
Restricted securities, at cost	1,999	1,366
Loans held for sale		328
Loans, net of allowance for loan losses, 2015, $6,771; 2014, $6,718	391,746	371,692
Other real estate owned, net of valuation allowance, 2015, $125; 2014, $375	1,949	1,888
Premises and equipment, net	16,298	16,126
Accrued interest receivable	1,256	1,261
Bank owned life insurance	11,431	11,357
Other assets	5,701	6,010
Total assets	$ 530,409	$ 518,165

Liabilities and Shareholders   Equity

Liabilities		
Deposits:		
Noninterest-bearing demand deposits	$ 109,927	$ 104,986
Savings and interest-bearing demand deposits	231,885	237,618
Time deposits	96,974	101,734
Total deposits	$ 438,786	$ 444,338
Federal funds purchased	1,955	52
Other borrowings	15,020	26
Trust preferred capital notes	9,279	9,279
Accrued interest payable and other liabilities	5,057	4,906

Total liabilities	$	470,097	$	458,601
Shareholders Equity				
Preferred stock, $1,000 per share liquidation preference; authorized 1,000,000 shares; 14,595 shares issued and outstanding, net of discount	$	14,595	$	14,595
Common stock, par value $1.25 per share; authorized 8,000,000 shares; issued and outstanding, 2015, 4,909,714 shares; 2014, 4,904,577 shares		6,137		6,131
Surplus		6,881		6,835
Retained earnings		33,649		33,557
Accumulated other comprehensive loss, net		(950)		(1,554)
Total shareholders equity	$	60,312	$	59,564
Total liabilities and shareholders equity	$	530,409	$	518,165

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

Three months ended March 31, 2015 and 2014

(in thousands, except per share data)

	(unaudited) March 31, 2015	(unaudited) March 31, 2014
Interest and Dividend Income		
Interest and fees on loans	$ 4,540	$ 4,215
Interest on deposits in banks	5	16
Interest and dividends on securities available for sale:		
Taxable interest	358	562
Tax-exempt interest	64	95
Dividends	21	21
Total interest and dividend income	$ 4,988	$ 4,909
Interest Expense		
Interest on deposits	$ 300	$ 400
Interest on federal funds purchased	1	
Interest on trust preferred capital notes	54	54
Interest on other borrowings	1	29
Total interest expense	$ 356	$ 483
Net interest income	$ 4,632	$ 4,426
Recovery of loan losses		(200)
Net interest income after recovery of loan losses	$ 4,632	$ 4,626
Noninterest Income		
Service charges on deposit accounts	$ 547	$ 630
ATM and check card fees	349	335
Wealth management fees	503	484
Fees for other customer services	107	87
Income from bank owned life insurance	74	74

Net (losses) on sale of securities available for sale	(52)	
Net gains on sale of loans	55	
Other operating income	8	6
Total noninterest income	$ 1,591	$ 1,616
Noninterest Expense		
Salaries and employee benefits	$ 3,125	$ 2,509
Occupancy	317	315
Equipment	281	304
Marketing	97	109
Stationery and supplies	345	80
Legal and professional fees	212	202
ATM and check card fees	155	163
FDIC assessment	67	172
Bank franchise tax	122	94
Telecommunications expense	85	71
Data processing expense	187	115
Postage expense	117	39
Other real estate owned (income) expense, net	(36)	31
Net loss on disposal of premises and equipment		2
Other operating expense	413	407
Total noninterest expense	$ 5,487	$ 4,613

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

(Continued)

Three months ended March 31, 2015 and 2014

(in thousands, except per share data)

	(unaudited) March 31, 2015	(unaudited) March 31, 2014
Income before income taxes	$ 736	$ 1,629
Income tax expense	192	483
Net income	$ 544	$ 1,146
Effective dividend and accretion on preferred stock	329	220
Net income available to common shareholders	$ 215	$ 926
Earnings per common share		
Basic	$ 0.04	$ 0.19
Diluted	$ 0.04	$ 0.19

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income

Three months ended March 31, 2015 and 2014

(in thousands)

	(unaudited) March 31, 2015	(unaudited) March 31, 2014
Net income	$ 544	$ 1,146
Other comprehensive income, net of tax,		
Unrealized holding gains on available for sale securities, net of tax $294 and $232, respectively	570	450
Reclassification adjustment for losses included in net income, net of tax $18 and $0, respectively	34	
Total other comprehensive income	604	450
Total comprehensive income	$ 1,148	$ 1,596

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

Three months ended March 31, 2015 and 2014

(in thousands)

	(unaudited) March 31, 2015	(unaudited) March 31, 2014
Cash Flows from Operating Activities		
Net income	$ 544	$ 1,146
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	238	248
Origination of loans held for sale	(2,210)	
Proceeds from sale of loans held for sale	2,593	
Net gains on sales of loans held for sale	(55)	
Recovery of loan losses		(200)
Provision for other real estate owned		23
Net losses on sale of securities available for sale	52	
Net gains on sale of other real estate owned	(57)	(1)
Losses on disposal of premises and equipment		2
Income from bank owned life insurance	(74)	(74)
Accretion of discounts and amortization of premiums on securities, net	148	160
Stock-based compensation	43	
Changes in assets and liabilities:		
(Increase) decrease in interest receivable	5	(3)
(Increase) decrease in other assets	(3)	437
Increase (decrease) in other liabilities	151	(674)
Net cash provided by operating activities	$ 1,375	$ 1,064
Cash Flows from Investing Activities		
Proceeds from maturities, calls, and principal payments of securities available for sale	3,668	3,052
Purchase of securities available for sale	(10,515)	(9,790)
Proceeds from redemption of restricted securities		168
Purchase of restricted securities	(633)	
Purchase of premises and equipment	(410)	(77)
Proceeds from sale of other real estate owned	224	16
Net increase in loans	(20,282)	(2,601)

Net cash used in investing activities	$ (27,948)	$ (9,232)
Cash Flows from Financing Activities		
Net increase (decrease) in demand deposits and savings accounts	$ (792)	$ 14,583
Net decrease in time deposits	(4,760)	(3,605)
Proceeds from other borrowings	15,000	
Principal payments on other borrowings	(6)	(6)
Net proceeds from issuance of common stock	1	
Cash dividends paid on preferred stock	(329)	(189)
Cash dividends paid on common stock, net of reinvestment	(115)	
Increase in federal funds purchased	1,903	
Net cash provided by financing activities	$ 10,902	$ 10,783
Increase (decrease) in cash and cash equivalents	$ (15,671)	$ 2,615
Cash and Cash Equivalents		
Beginning	$ 24,845	$ 31,508
Ending	$ 9,174	$ 34,123

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

(Continued)

Three months ended March 31, 2015 and 2014

(in thousands)

	(unaudited) March 31, 2015		(unaudited) March 31, 2014	
Supplemental Disclosures of Cash Flow Information				
Cash payments for:				
Interest	$	371	$	500
Income Taxes	$	363	$	
Supplemental Disclosures of Noncash Investing and Financing Activities				
Unrealized gains on securities available for sale	$	916	$	682
Transfer from loans to other real estate owned	$	228	$	
Issuance of common stock, dividend reinvestment plan	$	8	$	

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FIRST NATIONAL CORPORATION

Consolidated Statements of Changes in Shareholders Equity

Three months ended March 31, 2015 and 2014

(in thousands)

(unaudited)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2013	$ 14,564	$ 6,127	$ 6,813	$ 27,360	$ (1,304)	$ 53,560
Net income				1,146		1,146
Other comprehensive income					450	450
Cash dividends on preferred stock				(189)		(189)
Accretion of preferred stock discount	31			(31)		
Balance, March 31, 2014	$ 14,595	$ 6,127	$ 6,813	$ 28,286	$ (854)	$ 54,967

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2014	$ 14,595	$ 6,131	$ 6,835	$ 33,557	$ (1,554)	$ 59,564
Net income				544		544
Other comprehensive income					604	604
Cash dividends on common stock ($0.025 per share)				(123)		(123)
Stock-based compensation			43			43
Issuance of 955 shares common stock, dividend reinvestment plan		1	8			9
Issuance of 4,182 shares common stock, stock incentive plan		5	(5)			
Cash dividends on preferred stock				(329)		(329)
Balance, March 31, 2015	$ 14,595	$ 6,137	$ 6,881	$ 33,649	$ (950)	$ 60,312

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Notes to Consolidated Financial Statements

(unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of First National Corporation (the Company) and its subsidiaries, including First Bank (the Bank), have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at March 31, 2015 and December 31, 2014, the results of operations and comprehensive income for the three months ended March 31, 2015 and 2014 and the cash flows and changes in shareholders equity for the three months ended March 31, 2015 and 2014. The statements should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2014. Operating results for the three month period ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

Recent Accounting Pronouncements

In January 2014, the FASB issued ASU 2014-01, Investments Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force). The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The adoption of ASU 2014-01 did not have an impact on the Company s consolidated financial statements.

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. The adoption of ASU 2014-04 did not have a material impact on the Company s consolidated financial statements.

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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. 2014-11, 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. Early adoption is not permitted. The adoption of ASU 2014-11 did not have an impact on the Company s 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 does not expect the adoption of ASU 2014-12 to have an impact 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 an impact on its consolidated financial statements.

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In November 2014, the FASB issued ASU No. 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity. The amendments in this ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. The Company does not expect the adoption of ASU 2014-16 to have an impact on its consolidated financial statements.

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 an impact on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Company does not expect the adoption of ASU 2015-02 to have an impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of ASU 2015-03 to have an impact on its consolidated financial statements.

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(unaudited)

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer s Accounting for Fees Paid in a Cloud Computing Arrangement. The amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer s accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. The amendments in this ASU are effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Company is currently assessing the impact that ASU 2015-05 will have on its consolidated financial statements.

Note 2. Securities

The Company invests in U.S. agency and mortgage-backed securities, obligations of state and political subdivisions and corporate equity securities. Amortized costs and fair values of securities available for sale at March 31, 2015 and December 31, 2014 were as follows (in thousands):

	March 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. agency and mortgage-backed securities	$ 74,540	$ 650	$ (354)	$ 74,836
Obligations of states and political subdivisions	15,600	435	(22)	16,013
Corporate equity securities	1	5		6
	$ 90,141	$ 1,090	$ (376)	$ 90,855

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value

U.S. agency and mortgage-backed securities	$ 67,462	$ 374	$ (807)	$ 67,029
Obligations of states and political subdivisions	16,031	325	(99)	16,257
Corporate equity securities	1	5		6
	$ 83,494	$ 704	$ (906)	$ 83,292

At March 31, 2015 and December 31, 2014, investments in an unrealized loss position that were temporarily impaired were as follows (in thousands):

	March 31, 2015					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
U.S. agency and mortgage-backed securities	$ 7,438	$ (18)	$ 21,024	$ (336)	$ 28,462	$ (354)
Obligations of states and political subdivisions			1,079	(22)	1,079	(22)
	$ 7,438	$ (18)	$ 22,103	$ (358)	$ 29,541	$ (376)

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Notes to Consolidated Financial Statements

(unaudited)

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
U.S. agency and mortgage-backed securities	$ 8,677	$ (60)	$ 32,527	$ (747)	$ 41,204	$ (807)
Obligations of states and political subdivisions	715	(1)	2,841	(98)	3,556	(99)
	$ 9,392	$ (61)	$ 35,368	$ (845)	$ 44,760	$ (906)

The tables above provide information about securities that have been in an unrealized loss position for less than twelve consecutive months and securities that have been in an unrealized loss position for twelve consecutive months or more. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Impairment is considered to be other-than-temporary if the Company (1) intends to sell the security, (2) more likely than not will be required to sell the security before recovering its cost, or (3) does not expect to recover the security s entire amortized cost basis. Presently, the Company does not intend to sell any of these securities, does not expect to be required to sell these securities, and expects to recover the entire amortized cost of all the securities.

At March 31, 2015, there were nineteen U.S. agency and mortgage-backed securities and two obligations of state and political subdivisions in an unrealized loss position. One hundred percent of the Company s investment portfolio is considered investment grade. The weighted-average re-pricing term of the portfolio was 3.7 years at March 31, 2015. At December 31, 2014, there were twenty-nine U.S. agency and mortgage-backed securities and seven obligations of states and political subdivisions in an unrealized loss position. One hundred percent of the Company s investment portfolio was considered investment grade at December 31, 2014. The weighted-average re-pricing term of the portfolio was 3.9 years at December 31, 2014. The unrealized losses at March 31, 2015 in the U.S. agency and mortgage-backed securities portfolio and the obligation of states and political subdivisions portfolio were related to changes in market interest rates and not credit concerns of the issuers.

The amortized cost and fair value of securities available for sale at March 31, 2015 by contractual maturity are shown below (in thousands). Expected maturities of mortgage-backed securities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties. Corporate equity securities are not included in the maturity categories in the following maturity summary because they do not have a stated maturity date.

	Amortized	**Fair**

	Cost	Value
Due within one year	$	$
Due after one year through five years	6,661	6,717
Due after five years through ten years	21,289	21,457
Due after ten years	62,190	62,675
Corporate equity securities	1	6
	$ 90,141	$ 90,855

Federal Home Loan Bank, Federal Reserve Bank and Community Bankers Bank stock are generally viewed as long-term investments and as restricted securities, which are carried at cost, because there is a minimal market for the stock. Therefore, when evaluating restricted securities for impairment, their value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2015, and no impairment has been recognized. Restricted securities are not part of the available for sale securities portfolio.

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The composition of restricted securities at March 31, 2015 and December 31, 2014 was as follows (in thousands):

	March 31, 2015	December 31, 2014
Federal Home Loan Bank stock	$ 1,103	$ 470
Federal Reserve Bank stock	846	846
Community Bankers Bank stock	50	50
	$ 1,999	$ 1,366

Note 3. Loans

Loans at March 31, 2015 and December 31, 2014 are summarized as follows (in thousands):

	March 31, 2015	December 31, 2014
Real estate loans:		
Construction and land development	$ 33,344	$ 29,475
Secured by 1-4 family residential	172,874	163,727
Other real estate loans	158,896	151,802
Commercial and industrial loans	21,420	21,166
Consumer and other loans	11,983	12,240
Total loans	$ 398,517	$ 378,410
Allowance for loan losses	(6,771)	(6,718)
Loans, net	$ 391,746	$ 371,692

Net deferred loan costs included in the above loan categories were $145 thousand and $130 thousand at March 31, 2015 and December 31, 2014, respectively. Consumer and other loans included $194 thousand and $285 thousand of demand deposit overdrafts at March 31, 2015 and December 31, 2014, respectively.

Risk characteristics of each loan portfolio class that are considered by the Company include:

1-4 family residential mortgage loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.

Real estate construction and land development loans carry risks that the project may not be finished according to schedule, the project may not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may be unable to finish the construction project as planned because of financial pressure or other factors unrelated to the project.

Other real estate loans and commercial and industrial loans carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because repayment of these loans may be dependent upon the profitability and cash flows of the business or project. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much reliability.

Consumer and other loans carry risk associated with the continued creditworthiness of the borrower and the value of the collateral, i.e. rapidly depreciating assets such as automobiles, or lack thereof. Consumer loans are likely to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy, or other changes in circumstances.

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The following table provides a summary of loan classes and an aging of past due loans as of March 31, 2015 and December 31, 2014 (in thousands):

	March 31, 2015							
	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual Loans	90 Days or More Past Due and Accruing
Real estate loans:								
Construction and land development	$ 443	$	$ 71	$ 514	$ 32,830	$ 33,344	$ 1,653	$ 71
1-4 family residential	535	76	349	960	171,914	172,874	685	
Other real estate loans	498		3,304	3,802	155,094	158,896	4,722	
Commercial and industrial	283	92		375	21,045	21,420	110	
Consumer and other loans	16			16	11,967	11,983		
Total	$ 1,775	$ 168	$ 3,724	$ 5,667	$ 392,850	$ 398,517	$ 7,170	$ 71

	December 31, 2014							
	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual Loans	90 Days or More Past Due and Accruing
Real estate loans:								
Construction and land development	$ 2,441	$ 71	$	$ 2,512	$ 26,963	$ 29,475	$ 1,787	$

1-4 family residential	504	323	754	1,581	162,146	163,727	1,342	
Other real estate loans	554	800	2,519	3,873	147,929	151,802	4,756	
Commercial and industrial	10	106		116	21,050	21,166	115	
Consumer and other loans	14			14	12,226	12,240		
Total	$ 3,523	$ 1,300	$ 3,273	$ 8,096	$ 370,314	$ 378,410	$ 8,000	$

Credit Quality Indicators

As part of the ongoing monitoring of the credit quality of the Company s loan portfolio, management tracks certain credit quality indicators including trends related to the risk grading of specified classes of loans. The Company utilizes a risk grading matrix to assign a rating to each of its loans. The loan ratings are summarized into the following categories: pass, special mention, substandard, doubtful and loss. Pass rated loans include all risk rated credits other than those included in special mention, substandard or doubtful. Loans classified as loss are charged-off. Loan officers assign risk grades to loans at origination and as renewals arise. The Bank s Credit Administration department reviews risk grades for accuracy on a quarterly basis and as credit issues arise. In addition, a certain amount of loans are reviewed each year through the Company s internal and external loan review process. A description of the general characteristics of the loan grading categories is as follows:

Pass Loans classified as pass exhibit acceptable operating trends, balance sheet trends, and liquidity. Sufficient cash flow exists to service the loan. All obligations have been paid by the borrower as agreed.

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

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

Doubtful Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The Company considers all doubtful loans to be impaired and places the loan on non-accrual status.

Loss Loans classified as loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted.

The following tables provide an analysis of the credit risk profile of each loan class as of March 31, 2015 and December 31, 2014 (in thousands):

	March 31, 2015				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	$ 24,129	$ 3,250	$ 5,965	$	$ 33,344
Secured by 1-4 family residential	162,248	4,652	5,974		172,874
Other real estate loans	134,037	14,196	10,663		158,896
Commercial and industrial	20,660	452	308		21,420
Consumer and other loans	11,983				11,983
Total	$ 353,057	$ 22,550	$ 22,910	$	$ 398,517

	December 31, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	$ 20,476	$ 2,962	$ 6,037	$	$ 29,475
Secured by 1-4 family residential	152,004	5,058	6,665		163,727

Other real estate loans	126,211	14,776	10,815		151,802
Commercial and industrial	20,428	463	275		21,166
Consumer and other loans	12,240				12,240
Total	$ 331,359	$ 23,259	$ 23,792	$	$ 378,410

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Note 4. Allowance for Loan Losses

The following tables present, as of March 31, 2015, December 31, 2014 and March 31, 2014, the total allowance for loan losses, the allowance by impairment methodology and loans by impairment methodology (in thousands):

	March 31, 2015					
	Construction and Land Development	Secured by 1-4 Family Residential	Other Real Estate	Commercial and Industrial	Consumer and Other Loans	Total
Allowance for loan losses:						
Beginning Balance, December 31, 2014	$ 1,403	$ 1,204	$ 3,658	$ 310	$ 143	$ 6,718
Charge-offs		(47)			(65)	(112)
Recoveries	1	34	1	60	69	165
Provision for (recovery of) loan losses	197	(239)	137	(82)	(13)	
Ending Balance, March 31, 2015	$ 1,601	$ 952	$ 3,796	$ 288	$ 134	$ 6,771
Ending Balance:						
Individually evaluated for impairment	341	85	1,447	28		1,901
Collectively evaluated for impairment	1,260	867	2,349	260	134	4,870
Loans:						
Ending Balance	33,344	172,874	158,896	21,420	11,983	398,517
Individually evaluated for impairment	3,071	2,747	7,103	113		13,034
Collectively evaluated for impairment	30,273	170,127	151,793	21,307	11,983	385,483

	December 31, 2014					
	Construction and Land Development	Secured by 1-4 Family Residential	Other Real Estate	Commercial and Industrial	Consumer and Other Loans	Total
Allowance for loan losses:						

Beginning Balance, December 31, 2013	$ 2,710	$ 2,975	$ 4,418	$ 442	$ 99	$ 10,644
Charge-offs	(91)	(272)	(203)	(43)	(318)	(927)
Recoveries	80	15	509	18	229	851
Provision for (recovery of) loan losses	(1,296)	(1,514)	(1,066)	(107)	133	(3,850)
Ending Balance, December 31, 2014	$ 1,403	$ 1,204	$ 3,658	$ 310	$ 143	$ 6,718
Ending Balance:						
Individually evaluated for impairment	245	173	1,456	33		1,907
Collectively evaluated for impairment	1,158	1,031	2,202	277	143	4,811
Loans:						
Ending Balance	29,475	163,727	151,802	21,166	12,240	378,410
Individually evaluated for impairment	3,205	3,414	7,183	120		13,922
Collectively evaluated for impairment	26,270	160,313	144,619	21,046	12,240	364,488

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	March 31, 2014					
	Construction and Land Development	Secured by 1-4 Family Residential	Other Real Estate	Commercial and Industrial	Consumer and Other Loans	Total
Allowance for loan losses:						
Beginning Balance, December 31, 2013	$ 2,710	$ 2,975	$ 4,418	$ 442	$ 99	$ 10,644
Charge-offs		(71)		(36)	(132)	(239)
Recoveries		4	1	1	72	78
Provision for (recovery of) loan losses	(458)	42	89	36	91	(200)
Ending Balance, March 31, 2014	$ 2,252	$ 2,950	$ 4,508	$ 443	$ 130	$ 10,283
Ending Balance:						
Individually evaluated for impairment	862	126	505	45		1,538
Collectively evaluated for impairment	1,390	2,824	4,003	398	130	8,745
Loans:						
Ending Balance	33,876	147,541	142,719	23,381	12,016	359,533
Individually evaluated for impairment	6,568	3,468	11,030	172		21,238
Collectively evaluated for impairment	27,308	144,073	131,689	23,209	12,016	338,295

Impaired loans and the related allowance at March 31, 2015, December 31, 2014 and March 31, 2014, were as follows (in thousands):

	March 31, 2015						
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real estate loans:							
Construction and land development	$ 3,198	$ 2,196	$ 875	$ 3,071	$ 341	$ 3,171	$ 16
Secured by 1-4 family	3,672	2,509	238	2,747	85	3,149	29
Other real estate loans	7,559	4,119	2,984	7,103	1,447	7,149	34
Commercial and industrial	122	3	110	113	28	118	

Consumer and other loans							
Total	$ 14,551	$ 8,827	$ 4,207	$ 13,034	$ 1,901	$ 13,587	$ 79

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	December 31, 2014						
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real estate loans:							
Construction and land development	$ 3,299	$ 2,800	$ 405	$ 3,205	$ 245	$ 5,532	$ 40
Secured by 1-4 family	4,327	2,526	888	3,414	173	3,433	138
Other real estate loans	7,623	3,708	3,475	7,183	1,456	10,115	206
Commercial and industrial	127	5	115	120	33	159	1
Consumer and other loans							
Total	$ 15,376	$ 9,039	$ 4,883	$ 13,922	$ 1,907	$ 19,239	$ 385

	March 31, 2014						
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real estate loans:							
Construction and land development	$ 8,864	$ 4,018	$ 2,550	$ 6,568	$ 862	$ 6,684	$ 11
Secured by 1-4 family	4,391	2,932	536	3,468	126	3,313	31
Other real estate loans	12,346	9,139	1,891	11,030	505	11,082	79
Commercial and industrial	176	13	159	172	45	200	
Consumer and other loans							
Total	$ 25,777	$ 16,102	$ 5,136	$ 21,238	$ 1,538	$ 21,279	$ 121

The Recorded Investment amounts in the table above represent the outstanding principal balance on each loan represented in the table. The Unpaid Principal Balance represents the outstanding principal balance on each loan represented in the table plus any amounts that have been charged off on each loan and/or payments that have been applied towards principal on non-accrual loans.

As of March 31, 2015, loans classified as troubled debt restructurings (TDRs) and included in impaired loans in the disclosure above totaled $1.8 million. At March 31, 2015, $782 thousand of the loans classified as TDRs were performing under the restructured terms and were not considered non-performing assets. There were $1.9 million in

TDRs at December 31, 2014, $790 thousand of which were performing under the restructured terms. Modified terms under TDRs may include rate reductions, extension of terms that are considered to be below market, conversion to interest only, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. There were no loans modified under TDRs during the three month period ended March 31, 2015. There was one other real estate loan classified as a TDR during the three month period ended March 31, 2014 because the loan term was extended at a below market rate of interest. The recorded investment for this loan prior to the modification totaled $283 thousand and the recorded investment after the modification totaled $344 thousand.

For the three months ended March 31, 2015 and 2014, there were no troubled debt restructurings that subsequently defaulted within twelve months of the loan modification. Management defines default as over ninety days past due or the foreclosure and repossession of the collateral and charge-off of the loan during the twelve month period subsequent to the modification.

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Note 5. Other Real Estate Owned (OREO)

At March 31, 2015 and December 31, 2014, OREO totaled $1.9 million. OREO is primarily comprised of residential lots, raw land, non-residential properties and residential properties, and are located primarily in the Commonwealth of Virginia. Changes in the balance for OREO are as follows (in thousands):

	For the three months ended March 31, 2015	For the year ended December 31, 2014
Balance at the beginning of year, gross	$ 2,263	$ 4,695
Transfers in	228	139
Charge-offs	(250)	(1,302)
Sales proceeds	(224)	(1,502)
Gain on disposition	57	307
Deferred gain recognized		(73)
Depreciation		(1)
Balance at the end of period, gross	$ 2,074	$ 2,263
Less: valuation allowance	(125)	(375)
Balance at the end of period, net	$ 1,949	$ 1,888

At March 31, 2015, the carrying amount of residential real estate properties included in OREO was $228 thousand. There were no residential real estate properties included in OREO at December 31, 2014. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process was $87 thousand as of March 31, 2015.

Changes in the valuation allowance are as follows (in thousands):

	For the three months ended	For the year ended

	March 31, 2015	March 31, 2014	December 31, 2014
Balance at beginning of year	$ 375	$ 1,665	$ 1,665
Provision for losses		23	12
Charge-offs, net	(250)	(2)	(1,302)
Balance at end of period	$ 125	$ 1,686	$ 375

Net expenses applicable to OREO, other than the provision for losses, were $21 thousand and $9 thousand for the three months ended March 31, 2015 and 2014, respectively and $81 thousand for the year ended December 31, 2014.

Note 6. Other Borrowings

The Bank had unused lines of credit totaling $106.1 million and $121.1 million available with non-affiliated banks at March 31, 2015 and December 31, 2014, respectively. These amounts primarily consist of a blanket floating lien agreement with the Federal Home Loan Bank of Atlanta in which the Bank can borrow up to 19% of its total assets. The unused line of credit with FHLB totaled $62.7 million at March 31, 2015.

At March 31, 2015, the Bank had borrowings from the Federal Home Loan Bank (FHLB) system totaling $15.0 million which matured April 6, 2015. The interest rate on this note payable was 0.22%. At December 31, 2014, the Bank did not have borrowings from the FHLB system. The Bank had a letter of credit from the FHLB totaling $23.0 million at March 31, 2015 and December 31, 2014. The Bank had collateral pledged on the borrowing line and the letter of credit at March 31, 2015 and December 31, 2014 including real estate loans totaling $103.0 million and $101.9 million, respectively, and Federal Home Loan Bank stock with a book value of $1.1 million and $470 thousand, respectively.

At March 31, 2015 and December 31, 2014, the Bank had a note payable totaling $20 and $26 thousand, respectively, secured by a deed of trust, for land purchased to construct a banking office, which requires monthly payments of $2 thousand and matures January 3, 2016. The fixed interest rate on this loan was 4.00%.

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Note 7. Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their 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 Bank to maintain minimum amounts and ratios (set forth in the following table) of total (as defined in the regulations), Tier 1 (as defined), and common equity Tier 1 capital (as defined) to risk-weighted assets (as defined), and of Tier 1 capital to average assets. Management believes, as of March 31, 2015 and December 31, 2014, that the Bank met all capital adequacy requirements to which it is subject.

As of March 31, 2015, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum risk-based capital and leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank s category.

A comparison of the capital of the Bank at March 31, 2015 and December 31, 2014 with the minimum regulatory guidelines were as follows (dollars in thousands):

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2015:						
Total Capital (to Risk-Weighted Assets)	$ 72,764	18.86%	$ 30,859	8.00%	$ 38,573	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	$ 67,918	17.61%	$ 23,144	6.00%	$ 30,859	8.00%
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	$ 67,918	17.61%	$ 17,358	4.50%	$ 25,073	6.50%
Tier 1 Capital (to Average Assets)	$ 67,918	13.17%	$ 20,628	4.00%	$ 25,785	5.00%

December 31, 2014:

Total Capital (to Risk-Weighted Assets)	$ 71,941	19.14%	$ 30,077	8.00%	$ 37,596	10.00%
Tier 1 Capital (to Risk-Weighted Assets)	$ 67,217	17.88%	$ 15,038	4.00%	$ 22,557	6.00%
Tier 1 Capital (to Average Assets)	$ 67,217	12.90%	$ 20,841	4.00%	$ 26,051	5.00%

Note 8. Trust Preferred Capital Notes

On June 8, 2004, First National (VA) Statutory Trust II (Trust II), a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable capital securities, commonly known as trust preferred securities. On June 17, 2004, $5.0 million of trust preferred securities were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest. The interest rate at March 31, 2015 and December 31, 2014 was 2.87% and 2.84%, respectively. The securities have a mandatory redemption date of June 17, 2034, and were subject to varying call provisions that began September 17, 2009. The principal asset of Trust II is $5.2 million of the Company s junior subordinated debt securities with maturities and interest rates comparable to the trust preferred securities. The Trust s obligations under the trust preferred securities are fully and unconditionally guaranteed by the Company. The Company is current on its interest payments on the trust preferred securities.

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On July 24, 2006, First National (VA) Statutory Trust III (Trust III), a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable capital securities. On July 31, 2006, $4.0 million of trust preferred securities were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest. The interest rate at March 31, 2015 and December 31, 2014 was 1.86% and 1.84%, respectively. The securities have a mandatory redemption date of October 1, 2036, and were subject to varying call provisions that began October 1, 2011. The principal asset of Trust III is $4.1 million of the Company s junior subordinated debt securities with maturities and interest rates comparable to the trust preferred securities. The Trust s obligations under the trust preferred securities are fully and unconditionally guaranteed by the Company. The Company is current on its interest payments on the trust preferred securities.

While these securities are debt obligations of the Company, they are included in capital for regulatory capital ratio calculations. Under present regulations, the trust preferred securities may be included in Tier 1 capital for regulatory capital adequacy purposes as long as their amount does not exceed 25% of Tier 1 capital, including total trust preferred securities. The portion of the trust preferred securities not considered as Tier 1 capital, if any, may be included in Tier 2 capital. At March 31, 2015 and December 31, 2014, the total amount of trust preferred securities issued by the Trusts was included in the Company s Tier 1 capital.

Note 9. Benefit Plans

The Bank has a noncontributory, defined benefit pension plan for all full-time employees over 21 years of age with at least one year of credited service and hired prior to May 1, 2011. Effective May 1, 2011, the plan was frozen to new participants. Only individuals employed on or before April 30, 2011 were eligible to become participants in the plan upon satisfaction of the eligibility requirements. Benefits are generally based upon years of service and average compensation for the five highest-paid consecutive years of service. The Bank s funding practice has been to make at least the minimum required annual contribution permitted by the Employee Retirement Income Security Act of 1974, as amended, and the Internal Revenue Code of 1986, as amended.

Components of the net periodic benefit cost of the plan for the three months ended March 31, 2015 and 2014 were as follows (in thousands):

	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Service cost	$ 111	$ 87
Interest cost	76	67

Expected return on plan assets	(79)	(79)
Amortization of net loss	22	
Net periodic benefit cost	$ 130	$ 75

The Company previously disclosed in its consolidated financial statements in its Annual Report on Form 10-K for the year ended December 31, 2014, that it expected to make no contribution to its pension plan during the year ended December 31, 2015. There was no minimum annual contribution required.

In addition to the defined benefit pension plan, the Company maintains a 401(k) plan and an employee stock ownership plan (ESOP) for eligible employees. See Note 12 of the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2014 for additional information about the Company s benefit plans.

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Note 10. Earnings per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflects 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.

The following table presents the computation of basic and diluted earnings per share for the three months ended March 31, 2015 and 2014 (dollars in thousands, except per share data):

	For the three months ended	
	March 31, 2015	March 31, 2014
(Numerator):		
Net income	$ 544	$ 1,146
Effective dividend and accretion on preferred stock	329	220
Net income available to common shareholders	$ 215	$ 926
(Denominator):		
Weighted average shares outstanding basic	4,906,981	4,901,464
Potentially dilutive common shares restricted stock units	4,063	
Weighted average shares outstanding diluted	4,911,044	4,901,464
Income per common share		
Basic	$ 0.04	$ 0.19
Diluted	$ 0.04	$ 0.19

Note 11. Fair Value Measurements

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 Measurement and Disclosures topic of FASB ASC, the fair value of an 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 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.

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Fair Value Hierarchy

In accordance with this guidance, the Company groups its assets and 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 or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
Level 2	Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.
Level 3	Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires a significant management judgment or estimation.

An instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following describes the valuation techniques used by the Company to measure certain assets 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).

The following tables present the balances of assets measured at fair value on a recurring basis as of March 31, 2015 and December 31, 2014 (in thousands).

			Fair Value Measurements at March 31, 2015					
Description		Balance as of March 31, 2015		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
Securities available for sale								
U.S. agency and mortgage-backed securities	$	74,836	$		$	74,836	$	
Obligations of states and political subdivisions		16,013				16,013		
Corporate equity securities		6		6				
	$	90,855	$	6	$	90,849	$	

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	Fair Value Measurements at December 31, 2014			
Description	Balance as of December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale				
U.S. agency and mortgage-backed securities	$ 67,029	$	$ 67,029	$
Obligations of states and political subdivisions	16,257		16,257	
Corporate equity securities	6	6		
	$ 83,292	$ 6	$ 83,286	$

Certain 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 assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans held for sale

Loans held for sale are carried at the lower of cost or market value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during three months ended March 31, 2015 and the year ended December 31, 2014.

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 agreements will not be collected. The measurement of loss associated with impaired loans can be based on the present value of expected future cash flows discounted at the loan s effective interest rate, 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 Company s collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal conducted by an independent, licensed appraiser using observable market data (Level 2) within the last twelve months. However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business s financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other real estate owned

Loans are transferred to other real estate owned when the collateral securing them is foreclosed on or acquired through a deed in lieu of foreclosure. The measurement of loss associated with other real estate owned is based on the appraisal documents and assessed the same way as impaired loans described above.

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The following tables summarize the Company s assets that were measured at fair value on a nonrecurring basis during the periods (dollars in thousands):

		Fair Value Measurements at March 31, 2015		
Description	Balance as of March 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans, net	$ 2,306	$	$	$ 2,306
Other real estate owned, net	1,949			1,949

		Fair Value Measurements at December 31, 2014		
Description	Balance as of December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans, net	$ 2,976	$	$	$ 2,976
Other real estate owned, net	1,888			1,888

Quantitative information about Level 3 Fair Value Measurements for March 31, 2015				
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted-Average)

Impaired loans, net	$ 2,306	Property appraisals	Selling cost	10%
Other real estate owned, net	$ 1,949	Property appraisals	Selling cost	7%

	Quantitative information about Level 3 Fair Value Measurements for December 31, 2014			
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted-Average)
Impaired loans, net	$ 2,976	Property appraisals	Selling cost	10%
Other real estate owned, net	$ 1,888	Property appraisals	Selling cost	7%

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Accounting guidance requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below:

Cash and Cash Equivalents and Federal Funds Sold

The carrying amounts of cash and short-term instruments approximate fair values.

Restricted Securities

The carrying value of restricted securities approximates fair value based on redemption.

Loans

For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for all other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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 using the rates currently offered for deposits of similar remaining maturities.

Accrued Interest

Accrued interest receivable and payable were estimated to equal the carrying value due to the short-term nature of these financial instruments.

Borrowings and Federal Funds Purchased

The carrying amounts of federal funds purchased and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of all other borrowings are estimated using discounted cash flow analyses based on the Company s current incremental borrowing rates for similar types of borrowing arrangements.

Bank Owned Life Insurance

Bank owned life insurance represents insurance policies on officers, directors, and past directors of the Company. The cash values of these policies are estimates using information provided by insurance carriers. These policies are carried at their cash surrender value, which approximates the fair value.

Commitments and Unfunded Credits

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The fair value of stand-by letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At March 31, 2015 and December 31, 2014, fair value of loan commitments and standby letters of credit was immaterial.

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The carrying values and estimated fair values of the Company s financial instruments at March 31, 2015 and December 31, 2014 are as follows (in thousands):

		Fair Value Measurements at March 31, 2015 Using			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Fair Value
Financial A					