

NEW PEOPLES BANKSHARES INC  
Form 10-Q  
August 15, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2016

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-33411

**NEW PEOPLES BANKSHARES, INC.**

(Exact name of registrant as specified in its charter)

**Virginia**

(State or other jurisdiction of  
incorporation or organization)

**31-1804543**

(I.R.S. Employer

Identification No.)

**67 Commerce Drive**

**Honaker, Virginia**

**24260**

(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code) **(276) 873-7000**

**n/a**

(Former name, former address and former fiscal year, if changed since last report)

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  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. (Check one):

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date:

| Class                          | Outstanding at August 12, 2016 |
|--------------------------------|--------------------------------|
| Common Stock, \$2.00 par value | 23,354,082                     |

**NEW PEOPLES BANKSHARES, INC.**

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## Part I Financial Information

## Item 1 Financial Statements

**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME****FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

|   |          |          |
|---|----------|----------|
| INTEREST AND DIVIDEND INCOME                        | 2016     | 2015     |
| Loans including fees                                | \$11,178 | \$11,706 |
| Federal funds sold                                  | —        | 2        |
| Interest-earning deposits with banks                | 44       | 55       |
| Investments   | 827      | 849      |
| Dividends on equity securities (restricted)         | 64       | 66       |
| Total Interest and Dividend Income                  | 12,113   | 12,678   |
| INTEREST EXPENSE                                    |          |          |
| Deposits  |          |          |
| Demand  | 24       | 18       |
| Savings   | 78       | 85       |
| Time deposits below \$100,000                       | 535      | 747      |
| Time deposits above \$100,000                       | 312      | 522      |
| FHLB advances                                       | 64       | 78       |
| Federal funds purchased                             | 2        | —        |
| Trust preferred securities                          | 245      | 217      |
| Total Interest Expense                              | 1,260    | 1,667    |
| NET INTEREST INCOME                                 | 10,853   | 11,011   |
| PROVISION FOR LOAN LOSSES                           | (500 )   | —        |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 11,353   | 11,011   |
| NONINTEREST INCOME                                  |          |          |
| Service charges                                     | 1,072    | 1,088    |
| Fees, commissions and other income                  | 1,663    | 1,537    |
| Insurance and investment fees                       | 301      | 256      |
| Net realized gains on sale of investment securities | 240      | 35       |
| Life insurance investment income                    | 63       | 69       |
| Total Noninterest Income                            | 3,339    | 2,985    |

NONINTEREST EXPENSES

|   |        |        |
|---|--------|--------|
| Salaries and employee benefits                        | 6,549  | 5,824  |
| Occupancy and equipment expense                       | 1,921  | 1,862  |
| Advertising and public relations                      | 233    | 129    |
| Data processing and telecommunications                | 1,157  | 1,002  |
| FDIC insurance premiums                               | 270    | 439    |
| Other real estate owned and repossessed vehicles, net | 252    | 1,066  |
| Other operating expenses                              | 2,731  | 2,587  |
| Total Noninterest Expenses                            | 13,113 | 12,909 |

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|   |            |            |
|---|------------|------------|
| INCOME BEFORE INCOME TAXES              | 1,579      | 1,087      |
| INCOME TAX EXPENSE (BENEFIT)            | (1         | ) 3        |
| NET INCOME                              | \$1,580    | \$1,084    |
| Income Per Share                        |            |            |
| Basic                                   | \$0.07     | \$0.05     |
| Fully Diluted                           | \$0.07     | \$0.05     |
| Average Weighted Shares of Common Stock |            |            |
| Basic                                   | 23,354,082 | 22,878,654 |
| Fully Diluted                           | 23,354,082 | 22,878,654 |

The accompanying notes are an integral part of this statement.

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**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED JUNE 30, 2016 AND 2015**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

|  |         |         |
|--|---------|---------|
| INTEREST AND DIVIDEND INCOME                           | 2016    | 2015    |
| Loans including fees                                   | \$5,613 | \$5,925 |
| Federal funds sold                                     | —       | 1       |
| Interest-earning deposits with banks                   | 23      | 29      |
| Investments  | 363     | 423     |
| Dividends on equity securities (restricted)            | 32      | 34      |
| Total Interest and Dividend Income                     | 6,031   | 6,412   |
| INTEREST EXPENSE                                       |         |         |
| Deposits   |         |         |
| Demand   | 13      | 9       |
| Savings  | 37      | 44      |
| Time deposits below \$100,000                          | 270     | 360     |
| Time deposits above \$100,000                          | 158     | 251     |
| FHLB Advances  | 28      | 38      |
| Federal funds purchased                                | —       | —       |
| Trust Preferred Securities                             | 123     | 109     |
| Total Interest Expense                                 | 629     | 811     |
| NET INTEREST INCOME                                    | 5,402   | 5,601   |
| PROVISION FOR LOAN LOSSES                              | (500 )  | —       |
| NET INTEREST INCOME AFTER<br>PROVISION FOR LOAN LOSSES | 5,902   | 5,601   |
| NONINTEREST INCOME                                     |         |         |
| Service charges  | 584     | 552     |
| Fees, commissions and other income                     | 858     | 823     |
| Insurance and investment fees                          | 143     | 132     |
| Net realized gains on sale of investment securities    | 135     | —       |
| Life insurance investment income                       | 33      | 34      |
| Total Noninterest Income                               | 1,753   | 1,541   |

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|   |            |            |
|---|------------|------------|
| NONINTEREST EXPENSES                                  |            |            |
| Salaries and employee benefits                        | 3,339      | 2,882      |
| Occupancy and equipment expense                       | 1,068      | 920        |
| Advertising and public relations                      | 129        | 72         |
| Data processing and telecommunications                | 576        | 503        |
| FDIC insurance premiums                               | 136        | 221        |
| Other real estate owned and repossessed vehicles, net | 89         | 707        |
| Other operating expenses                              | 1,439      | 1,375      |
| Total Noninterest Expenses                            | 6,776      | 6,680      |
| <br>  |            |            |
| INCOME BEFORE INCOME TAXES                            | 879        | 462        |
| <br>  |            |            |
| INCOME TAX EXPENSE (BENEFIT)                          | (3         | ) —        |
| <br>  |            |            |
| NET INCOME  | \$882      | \$462      |
| <br>  |            |            |
| Income Per Share                                      |            |            |
| Basic   | \$0.04     | \$0.02     |
| Fully Diluted   | \$0.04     | \$0.02     |
| <br>  |            |            |
| Weighted Average Shares of Common Stock               |            |            |
| Basic   | 23,354,082 | 22,878,654 |
| Fully Diluted   | 23,354,082 | 22,878,654 |

The accompanying notes are an integral part of this statement.

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**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

(IN THOUSANDS)

(UNAUDITED)

|  | <b>For the three<br/>months ended</b> |                | <b>For the six<br/>months ended</b> |               |
|--|---------------------------------------|----------------|-------------------------------------|---------------|
|  | <b>June 30,</b>                       |                | <b>June 30,</b>                     |               |
|  | <b>2016</b>                           | <b>2015</b>    | <b>2016</b>                         | <b>2015</b>   |
| NET INCOME   | \$882                                 | \$462          | \$1,580                             | \$1,084       |
| Other comprehensive income (loss):                   |                                       |                |                                     |               |
| Investment Securities Activity                       |                                       |                |                                     |               |
| Unrealized gains (losses) arising during the period  | 694                                   | (893)          | 1,479                               | (267 )        |
| Tax related to unrealized gains (losses)             | (236 )                                | 304            | (503 )                              | 91            |
| Reclassification of realized gains during the period | (135 )                                | —              | (240 )                              | (35 )         |
| Tax related to realized gains                        | 46                                    | —              | 82                                  | 12            |
| <b>TOTAL OTHER COMPREHENSIVE INCOME (LOSS)</b>       | <b>369</b>                            | <b>(589)</b>   | <b>818</b>                          | <b>(199 )</b> |
| <b>TOTAL COMPREHENSIVE INCOME (LOSS)</b>             | <b>\$1,251</b>                        | <b>\$(127)</b> | <b>\$2,398</b>                      | <b>\$885</b>  |

The accompanying notes are an integral part of this statement.

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**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED BALANCE SHEETS**

(IN THOUSANDS EXCEPT PER SHARE AND SHARE DATA)

| ASSETS                                   | June 30,<br>2016<br>(Unaudited) | December<br>31,<br>2015<br>(Audited) |
|--|---------------------------------|--------------------------------------|
| Cash and due from banks                  | \$ 18,412                       | \$ 15,087                            |
| Interest-bearing deposits with banks     | 13,821                          | 11,251                               |
| Total Cash and Cash Equivalents          | 32,233                          | 26,338                               |
| Investment securities available-for-sale | 76,626                          | 101,642                              |
| Loans receivable                         | 459,613                         | 441,169                              |
| Allowance for loan losses                | (6,649 )                        | (7,493 )                             |
| Net Loans                                | 452,964                         | 433,676                              |
| Bank premises and equipment, net         | 31,228                          | 28,148                               |
| Equity securities (restricted)           | 2,613                           | 2,441                                |
| Other real estate owned                  | 14,134                          | 12,398                               |
| Accrued interest receivable              | 1,886                           | 1,816                                |
| Life insurance investments               | 12,168                          | 12,105                               |
| Deferred taxes, net                      | 4,770                           | 5,121                                |
| Other assets                             | 3,689                           | 2,213                                |
| Total Assets                             | \$ 632,311                      | \$ 625,898                           |

**LIABILITIES**

## Deposits:

## Demand deposits:

|                     |            |            |
|---------------------|------------|------------|
| Noninterest bearing | \$ 148,729 | \$ 149,714 |
| Interest-bearing    | 42,720     | 30,251     |
| Savings deposits    | 112,037    | 121,076    |
| Time deposits       | 251,598    | 256,978    |
| Total Deposits      | 555,084    | 558,019    |

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|  |                  |                  |
|--|------------------|------------------|
| Federal Home Loan Bank advances  | 9,358            | 2,958            |
| Accrued interest payable   | 292              | 288              |
| Accrued expenses and other liabilities   | 2,596            | 2,050            |
| Trust preferred securities   | 16,496           | 16,496           |
| <b>Total Liabilities</b>   | <b>583,826</b>   | <b>579,811</b>   |
| Commitments and contingencies  | —                | —                |
| <b>STOCKHOLDERS' EQUITY</b>  |                  |                  |
| Common stock - \$2.00 par value; 50,000,000 shares authorized;<br>23,354,082 shares issued and outstanding | 46,708           | 46,708           |
| Common stock warrants  | 764              | 764              |
| Additional paid-in-capital   | 13,965           | 13,965           |
| Retained deficit   | (13,443 )        | (15,023 )        |
| Accumulated other comprehensive income (loss)  | 491              | (327 )           |
| <b>Total Stockholders' Equity</b>  | <b>48,485</b>    | <b>46,087</b>    |
| <b>Total Liabilities and Stockholders' Equity</b>  | <b>\$632,311</b> | <b>\$625,898</b> |

The accompanying notes are an integral part of this statement.

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**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY****FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

(IN THOUSANDS INCLUDING SHARE DATA)

(UNAUDITED)

|  | Shares of<br>Common<br>Stock | Common<br>Stock | Common<br>Stock<br>Warrants | Additional<br>Paid-in-<br>Capital | Retained<br>Deficit | Accum-ulated<br>Other<br>Compre-hensive<br>Income (Loss) | Total<br>Stockholders'<br>Equity |
|--|------------------------------|-----------------|-----------------------------|-----------------------------------|---------------------|--|----------------------------------|
| Balance, December 31,<br>2014                | 22,878                       | \$45,757        | \$ 1,176                    | \$ 13,672                         | \$ (17,685          | ) \$ (69   | ) \$ 42,851                      |
| Net income                                   | —                            | —               | —                           | —                                 | 1,084               | —  | 1,084                            |
| Other comprehensive loss,<br>net of tax      | —                            | —               | —                           | —                                 | —                   | (199   | ) (199                           |
| Balance, June 30, 2015                       | 22,878                       | \$45,757        | \$ 1,176                    | \$ 13,672                         | \$ (16,601          | ) \$ (268  | ) \$ 43,736                      |
| Balance, December 31,<br>2015                | 23,354                       | \$46,708        | \$ 764                      | \$ 13,965                         | \$ (15,023          | ) \$ (327  | ) \$ 46,087                      |
| Net income                                   | —                            | —               | —                           | —                                 | 1,580               | —  | 1,580                            |
| Other comprehensive<br>income,<br>net of tax | —                            | —               | —                           | —                                 | —                   | 818  | 818                              |
| Balance, June 30, 2016                       | 23,354                       | \$46,708        | \$ 764                      | \$ 13,965                         | \$ (13,443          | ) \$ 491   | \$ 48,485                        |

The accompanying notes are an integral part of this statement.

NEW PEOPLES BANKSHARES, INC.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(IN THOUSANDS)

(UNAUDITED)

|   | 2016     | 2015     |
|---|----------|----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |          |          |
| Net income  | \$ 1,580 | \$ 1,084 |
| Adjustments to reconcile net income to net cash provided by operating activities: |          |          |
| Depreciation  | 1,175    | 1,055    |
| Provision for loan losses   | (500 )   | —        |
| Income on life insurance  | (63 )    | (69 )    |
| Gain on sale of securities available-for-sale                                     | (240 )   | (35 )    |
| Gain on sale of premises and equipment  | —        | (66 )    |
| Gain on sale of foreclosed assets   | (185 )   | (15 )    |
| Adjustment of carrying value of foreclosed real estate                            | (28 )    | 639      |
| Accretion of bond premiums/discounts  | 482      | 573      |
| Deferred tax benefit  | (70 )    | —        |
| Net change in:  |          |          |
| Interest receivable   | (70 )    | 104      |
| Other assets  | (1,476 ) | (26 )    |
| Accrued interest payable  | 4        | 56       |
| Accrued expenses and other liabilities  | 546      | (56 )    |
| Net Cash Provided by Operating Activities   | 1,155    | 3,244    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |          |          |
| Net (increase) decrease in loans  | (21,383) | 10,865   |
| Purchase of securities available-for-sale   | (7,631 ) | (25,202) |
| Proceeds from sales and maturities of securities available-for-sale               | 33,644   | 16,690   |
| Sale (Purchase) of Federal Home Loan Bank stock                                   | (172 )   | 30       |
| Purchase of Federal Reserve Bank stock  | —        | (37 )    |
| Payments for the purchase of premises and equipment                               | (4,130 ) | (723 )   |
| Payments for the purchase of other real estate owned                              | —        | (5 )     |
| Payments for premiums on life insurance investments                               | —        | (65 )    |
| Proceeds from sales of premises and equipment                                     | —        | 179      |
| Proceeds from insurance on other real estate owned                                | —        | 53       |
| Proceeds from sales of other real estate owned                                    | 947      | 760      |
| Net Cash Provided by Investing Activities   | 1,275    | 2,545    |



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**CASH FLOWS FROM FINANCING ACTIVITIES**

|  |          |          |
|--|----------|----------|
| Net increase (decrease) in Federal Home Loan Bank advances | 6,400    | (600 )   |
| Net change in:   |          |          |
| Demand deposits  | 11,484   | 7,964    |
| Savings deposits   | (9,039 ) | 7,512    |
| Time deposits  | (5,380 ) | (24,071) |
| Net Cash Provided by (Used in) Financing Activities        | 3,465    | (9,195 ) |
| <br>   |          |          |
| Net increase (decrease) in cash and cash equivalents       | 5,895    | (3,406 ) |
| Cash and Cash Equivalents, Beginning of Period             | 26,338   | 35,560   |
| Cash and Cash Equivalents, End of Period                   | \$32,233 | \$32,154 |

Supplemental Disclosure of Cash Paid During the Period for:

|          |         |         |
|----------|---------|---------|
| Interest | \$1,256 | \$1,611 |
| Taxes    | \$70    | \$—     |

Supplemental Disclosure of Non Cash Transactions:

|  |         |          |
|--|---------|----------|
| Other real estate acquired in settlement of foreclosed loans         | \$3,098 | \$1,869  |
| Loans made to finance sale of foreclosed real estate                 | \$503   | \$148    |
| Transfer of other real estate to premises and equipment              | \$125   | \$—      |
| Change in unrealized gains (losses) on securities available-for-sale | \$1,239 | \$(302 ) |

The accompanying notes are an integral part of this statement.

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**NEW PEOPLES BANKSHARES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 NATURE OF OPERATIONS:**

New Peoples Bankshares, Inc. (“The Company”) is a financial holding company whose principal activity is the ownership and management of a community bank. New Peoples Bank, Inc. (“Bank”) was organized and incorporated under the laws of the Commonwealth of Virginia on December 9, 1997. The Bank commenced operations on October 28, 1998, after receiving regulatory approval. As a state-chartered member bank, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve Bank. The Bank provides general banking services to individuals, small and medium size businesses and the professional community of southwestern Virginia, southern West Virginia, and eastern Tennessee. On June 9, 2003, the Company formed two wholly-owned subsidiaries; NPB Financial Services, Inc. and NPB Web Services, Inc. On July 7, 2004 the Company established NPB Capital Trust I for the purpose of issuing trust preferred securities. On September 27, 2006, the Company established NPB Capital Trust 2 for the purpose of issuing additional trust preferred securities. NPB Financial Services, Inc. was a subsidiary of the Company until January 1, 2009 when it became a subsidiary of the Bank. In June 2012 the name of NPB Financial Services, Inc. was changed to NPB Insurance Services, Inc. which operates solely as an insurance agency. On March 4, 2016 the Federal Reserve Bank of Richmond approved the Company’s election to become a financial holding company.

**NOTE 2 ACCOUNTING PRINCIPLES:**

These consolidated financial statements conform to U. S. generally accepted accounting principles and to general industry practices. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the Company’s financial position at June 30, 2016 and December 31, 2015, and the results of operations for the three and six month periods ended June 30, 2016 and 2015. The notes included herein should be read in conjunction with the notes to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. The results of operations for the three and six month periods ended June 30, 2016 and 2015 are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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. The determination of the adequacy of the allowance for loan losses and the determination of the deferred tax asset and related valuation allowance are based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions.

**NOTE 3 FORMAL WRITTEN AGREEMENT:**

The Company and the Bank had previously entered into the Written Agreement with the Federal Reserve Bank of Richmond and the Virginia State Corporation Commission Bureau of Financial Institutions. On February 2, 2016, the Company and the Bank announced that they had successfully complied with all of the requirements of the Written Agreement and accordingly, effective January 20, 2016, the agreement had been terminated.

Under the terms of the Written Agreement, the Bank developed and submitted for approval, within specified time periods, written plans related to board oversight; the Bank's management and governance, including management of the Bank's operations, credit risk management, lending and credit risk administration, management of commercial real estate concentrations; the review and grading of the Bank's loan portfolio; the improvement of Bank problem assets in excess of \$1 million; the maintenance of an adequate allowance for loan and lease losses; the enhanced management of the Bank's liquidity position and funds management practices; the revision of the Bank's contingency funding and strategic plans; and the enhancement of the Bank's anti-money laundering activities. The Written Agreement also imposed limitations on actions taken on criticized credits and credits classified as "loss". The Written Agreement required the submission of capital plans and the maintenance of adequate capital and restricted the payment of dividends and other distributions, the redemption of stock and the incurrence of debt.

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**NOTE 4 CAPITAL:****Capital Requirements and Ratios**

The Bank is subject to various capital requirements administered by 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 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.

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 and Tier 1 capital (as defined) to risk-weighted assets (as defined), Tier 1 capital (as defined) to average assets (as defined), and Common Equity Tier 1 capital (as defined) to risk-weighted assets (as defined). As of June 30, 2016, the Bank meets all capital adequacy requirements to which it is subject.

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board's Small Bank Holding Company Policy Statement issued in February 2015, and is no longer obligated to report consolidated regulatory capital. The Bank continues to be subject to various capital requirements administered by banking agencies. The Bank's actual capital amounts and ratios are presented in the following table as of June 30, 2016 and December 31, 2015, respectively. These ratios comply with Federal Reserve rules to align with the Basel III Capital requirements effective January 1, 2015.

|   | Actual   | Minimum Capital Requirement |          | Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions |                |
|---|----------|-----------------------------|----------|--|----------------|
| (Dollars are in thousands)              | Amount   | Ratio                       | Amount   | Ratio  | Amount         |
| June 30, 2016:                          |          |                             |          |  |                |
| Total Capital to Risk Weighted Assets:  |          |                             |          |  |                |
| New Peoples Bank, Inc.                  | \$67,951 | 16.95%                      | \$32,069 | 8.0%   | \$40,086 10.0% |
| Tier 1 Capital to Risk Weighted Assets: |          |                             |          |  |                |
| New Peoples Bank, Inc.                  | 62,920   | 15.70%                      | 24,051   | N.0%   | 32,069 8.0%    |
| Tier 1 Capital to Average Assets:       |          |                             |          |  |                |
| New Peoples Bank, Inc.                  | 62,920   | 9.98%                       | 25,212   | 4.0%   | 31,515 5.0%    |

Common Equity Tier 1 Capital

to Risk Weighted Assets:

|                        |        |        |        |      |        |      |
|------------------------|--------|--------|--------|------|--------|------|
| New Peoples Bank, Inc. | 62,920 | 15.70% | 18,039 | 4.5% | 26,056 | 6.5% |
|------------------------|--------|--------|--------|------|--------|------|

December 31, 2015:

Total Capital to Risk Weighted Assets:

|                        |          |        |          |      |          |       |
|------------------------|----------|--------|----------|------|----------|-------|
| New Peoples Bank, Inc. | \$65,713 | 17.55% | \$29,954 | 8.0% | \$37,443 | 10.0% |
|------------------------|----------|--------|----------|------|----------|-------|

Tier 1 Capital to Risk Weighted Assets:

|                        |        |        |        |      |        |      |
|------------------------|--------|--------|--------|------|--------|------|
| New Peoples Bank, Inc. | 60,998 | 16.29% | 22,466 | 6.0% | 29,954 | 8.0% |
|------------------------|--------|--------|--------|------|--------|------|

Tier 1 Capital to Average Assets:

|                        |        |       |        |      |        |      |
|------------------------|--------|-------|--------|------|--------|------|
| New Peoples Bank, Inc. | 60,998 | 9.67% | 25,239 | 4.0% | 31,549 | 5.0% |
|------------------------|--------|-------|--------|------|--------|------|

Common Equity Tier 1 Capital

to Risk Weighted Assets:

|                        |        |        |        |      |        |      |
|------------------------|--------|--------|--------|------|--------|------|
| New Peoples Bank, Inc. | 60,998 | 16.29% | 16,849 | 4.5% | 24,338 | 6.5% |
|------------------------|--------|--------|--------|------|--------|------|

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As of June 30, 2016, the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage, and Common Equity Tier 1 ratios as set forth in the above tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

Beginning January 1, 2016, a capital conservation buffer of 0.625% became effective. The capital conservation buffer will be gradually increased through January 1, 2019 to 2.5%. Banks will be required to maintain levels that meet the required minimum plus the capital conservation buffer in order to make distributions or discretionary bonus payments.

#### NOTE 5 INVESTMENT SECURITIES:

The amortized cost and estimated fair value of securities (all available-for-sale ("AFS")) are as follows:

| (Dollars are in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Approximate Fair Value |
|----------------------------|----------------|------------------------|-------------------------|------------------------|
| June 30, 2016              |                |                        |                         |                        |
| U.S. Government Agencies   | \$28,133       | \$344                  | \$52                    | \$28,425               |
| Taxable municipals         | 2,411          | 72                     | -                       | 2,483                  |
| Corporate bonds            | 3,101          | 137                    | 6                       | 3,232                  |
| Mortgage backed securities | 42,238         | 302                    | 54                      | 42,486                 |
| Total Securities AFS       | \$75,883       | \$855                  | \$112                   | \$76,626               |
| December 31, 2015          |                |                        |                         |                        |
| U.S. Government Agencies   | \$41,488       | \$244                  | \$209                   | \$41,523               |
| Taxable municipals         | 3,337          | 5                      | 61                      | 3,281                  |
| Corporate bonds            | 1,944          | 15                     | 20                      | 1,939                  |
| Mortgage backed securities | 55,369         | 41                     | 511                     | 54,899                 |
| Total Securities AFS       | \$102,138      | \$305                  | \$801                   | \$101,642              |

The following table details unrealized losses and related fair values in the available-for-sale portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2016 and December 31, 2015.

| (Dollars are in thousands) | Less than 12 Months<br>Unrealized<br>Fair Value<br>Losses | 12 Months or More<br>Fair Value<br>Losses | Total<br>Fair Value<br>Losses |
|----------------------------|---|---|-------------------------------|
|                            |   |   |                               |

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June 30, 2016

|                          |         |      |         |      |          |       |
|--------------------------|---------|------|---------|------|----------|-------|
| U.S. Government Agencies | \$4,747 | \$45 | \$1,849 | \$7  | \$6,596  | \$52  |
| Taxable municipals       | -       | -    | 276     | -    | 276      | -     |
| Corporate bonds          | 941     | 6    | -       | -    | 941      | 6     |
| Mtg. backed securities   | 2,607   | 15   | 6,276   | 39   | 8,883    | 54    |
| Total Securities AFS     | \$8,295 | \$66 | \$8,401 | \$46 | \$16,696 | \$112 |

December 31, 2015

|                          |          |       |          |       |          |       |
|--------------------------|----------|-------|----------|-------|----------|-------|
| U.S. Government Agencies | \$14,995 | \$81  | \$7,708  | \$128 | \$22,073 | \$209 |
| Taxable municipals       | 2,136    | 57    | 278      | 4     | 2,414    | 61    |
| Corporate bonds          | 923      | 20    | -        | -     | 923      | 20    |
| Mtg. backed securities   | 38,945   | 354   | 8,719    | 157   | 47,664   | 511   |
| Total Securities AFS     | \$56,999 | \$512 | \$16,705 | \$289 | \$73,074 | \$801 |

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At June 30, 2016, the available-for-sale portfolio included thirty eight investments for which the fair market value was less than amortized cost. At December 31, 2015, the available-for-sale portfolio included one hundred and thirty four investments for which the fair market value was less than amortized cost. 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. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial conditions and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Based on the Company's analysis, the Company concluded that no securities had an other-than-temporary impairment.

Investment securities with a carrying value of \$12.5 million and \$15.4 million at June 30, 2016 and December 31, 2015, respectively, were pledged as collateral to secure public deposits and for other purposes required by law.

Gross proceeds on the sale of investment securities were \$24.8 million and \$7.1 million, respectively, for the six months ended June 30, 2016 and 2015. Gross realized gains and losses pertaining to the sale of investment securities available for sale are detailed as follows:

|                            | For the<br>three<br>months<br><br>ended June<br>30, |      | For the six<br>months<br><br>ended June<br>30, |      |
|----------------------------|---|------|--|------|
| (Dollars are in thousands) | 2016  | 2015 | 2016   | 2015 |
| Gross gains realized       | \$156   | \$-  | \$275  | \$62 |
| Gross losses realized      | (21)  | -    | (35)   | (27) |
| Net realized gains         | \$135   | \$-  | \$240  | \$35 |

The amortized cost and fair value of investment securities at June 30, 2016, by contractual maturity, are shown in the following schedule. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollars are in thousands)             | Amortized<br>Cost | Fair<br>Value | Weighted<br>Average<br>Yield |
|--|-------------------|---------------|------------------------------|
| <u>Securities Available-for-Sale</u>   |                   |               |                              |
| Due in one year or less                | \$1,232           | \$1,236       | 0.91%                        |
| Due after one year through five years  | 742               | 743           | 1.79%                        |
| Due after five years through ten years | 13,068            | 13,287        | 2.46%                        |

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|                     |          |          |       |
|---------------------|----------|----------|-------|
| Due after ten years | 60,841   | 61,360   | 1.85% |
| Total               | \$75,883 | \$76,626 | 1.94% |

The Bank, as a member of the Federal Reserve Bank and the Federal Home Loan Bank, is required to hold stock in each. The Bank also owns stock in CBB Financial Corp., which is a correspondent of the Bank. These equity securities are restricted from trading and are recorded at a cost of \$2.6 million and \$2.4 million as of June 30, 2016 and December 31, 2015, respectively.

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**NOTE 6 LOANS:**

Loans receivable outstanding are summarized as follows:

| (Dollars are in thousands)        | June 30, 2016 | December 31, 2015 |
|-----------------------------------|---------------|-------------------|
| Real estate secured:              |               |                   |
| Commercial                        | \$ 103,531    | \$ 98,569         |
| Construction and land development | 19,289        | 14,672            |
| Residential 1-4 family            | 246,084       | 242,916           |
| Multifamily                       | 13,273        | 12,954            |
| Farmland                          | 23,474        | 22,174            |
| Total real estate loans           | 405,651       | 391,285           |
| Commercial                        | 24,863        | 21,469            |
| Agriculture                       | 4,346         | 3,793             |
| Consumer installment loans        | 24,724        | 24,568            |
| All other loans                   | 29            | 54                |
| Total loans                       | \$ 459,613    | \$ 441,169        |

Loans receivable on nonaccrual status are summarized as follows:

| (Dollars are in thousands)                  | June 30, 2016 | December 31, 2015 |
|---|---------------|-------------------|
| Real estate secured:                        |               |                   |
| Commercial                                  | \$ 2,851      | \$ 4,358          |
| Construction and land development           | 424           | 436               |
| Residential 1-4 family                      | 7,685         | 8,338             |
| Multifamily                                 | 270           | 430               |
| Farmland                                    | 969           | 1,170             |
| Total real estate loans                     | 12,199        | 14,732            |
| Commercial                                  | 75            | 65                |
| Agriculture                                 | 178           | 9                 |
| Consumer installment loans                  | 69            | 41                |
| All other loans                             | -             | -                 |
| Total loans receivable on nonaccrual status | \$ 12,521     | \$ 14,847         |

Total interest income not recognized on nonaccrual loans for the six months ended June 30, 2016 and 2015 was \$158 thousand and \$238 thousand, respectively.

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The following table presents information concerning the Company's investment in loans considered impaired as of June 30, 2016 and December 31, 2015:

| <b>As of June 30, 2016</b>          | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
|-------------------------------------|-----------------------------------|----------------------------------|------------------------|--------------------------------|----------------------|
| (Dollars are in thousands)          |                                   |                                  |                        |                                |                      |
| With no related allowance recorded: |                                   |                                  |                        |                                |                      |
| Real estate secured:                |                                   |                                  |                        |                                |                      |
| Commercial                          | \$ 4,451                          | \$ 73                            | \$ 4,396               | \$4,818                        | \$ —                 |
| Construction and land development   | 116                               | —                                | 7                      | 7                              | —                    |
| Residential 1-4 family              | 3,758                             | 103                              | 4,075                  | 4,391                          | —                    |
| Multifamily                         | 282                               | 11                               | 308                    | 349                            | —                    |
| Farmland                            | 4,162                             | 102                              | 4,189                  | 4,869                          | —                    |
| Commercial                          | —                                 | —                                | —                      | —                              | —                    |
| Agriculture                         | 33                                | 2                                | 26                     | 26                             | —                    |
| Consumer installment loans          | 32                                | 2                                | 43                     | 43                             | —                    |
| All other loans                     | —                                 | —                                | —                      | —                              | —                    |
| With an allowance recorded:         |                                   |                                  |                        |                                |                      |
| Real estate secured:                |                                   |                                  |                        |                                |                      |
| Commercial                          | 1,522                             | —                                | 1,029                  | 1,102                          | 158                  |
| Construction and land development   | 277                               | —                                | 265                    | 485                            | 131                  |
| Residential 1-4 family              | 1,037                             | 11                               | 568                    | 574                            | 69                   |
| Multifamily                         | 133                               | 4                                | 165                    | 165                            | 30                   |
| Farmland                            | 595                               | 12                               | 505                    | 513                            | 296                  |
| Commercial                          | 72                                | 2                                | 68                     | 68                             | 23                   |
| Agriculture                         | 139                               | (2 )                             | 185                    | 185                            | 185                  |
| Consumer installment loans          | 22                                | —                                | 10                     | 10                             | 3                    |
| All other loans                     | —                                 | —                                | —                      | —                              | —                    |
| <b>Total</b>                        | <b>\$ 16,631</b>                  | <b>\$ 320</b>                    | <b>\$ 15,839</b>       | <b>\$ 17,605</b>               | <b>\$ 895</b>        |

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| <b>As of December 31, 2015</b>      | Average<br>Recorded | Interest<br>Income | Recorded        | Unpaid Principal<br>Balance | Related      |
|-------------------------------------|---------------------|--------------------|-----------------|-----------------------------|--------------|
| (Dollars are in thousands)          | Investment          | Recognized         | Investment      |                             | Allowance    |
| With no related allowance recorded: |                     |                    |                 |                             |              |
| Real estate secured:                |                     |                    |                 |                             |              |
| Commercial                          | \$4,534             | \$163              | \$4,212         | \$5,173                     | \$—          |
| Construction and land development   | 12                  | 1                  | 10              | 10                          | —            |
| Residential 1-4 family              | 3,506               | 161                | 3,037           | 3,150                       | —            |
| Multifamily                         | 520                 | 9                  | 430             | 471                         | —            |
| Farmland                            | 5,073               | 213                | 3,983           | 4,620                       | —            |
| Commercial                          | 267                 | —                  | —               | —                           | —            |
| Agriculture                         | 42                  | 4                  | 36              | 36                          | —            |
| Consumer installment loans          | 31                  | 1                  | 11              | 11                          | —            |
| All other loans                     | —                   | —                  | —               | —                           | —            |
| With an allowance recorded:         |                     |                    |                 |                             |              |
| Real estate secured:                |                     |                    |                 |                             |              |
| Commercial                          | 2,935               | 37                 | 2,503           | 2,849                       | 288          |
| Construction and land development   | 373                 | —                  | 289             | 499                         | 155          |
| Residential 1-4 family              | 2,219               | 99                 | 1,920           | 2,121                       | 168          |
| Multifamily                         | 23                  | —                  | —               | —                           | —            |
| Farmland                            | 906                 | 38                 | 761             | 778                         | 328          |
| Commercial                          | 80                  | 3                  | 69              | 69                          | 24           |
| Agriculture                         | 24                  | 2                  | 18              | 18                          | 18           |
| Consumer installment loans          | 19                  | 4                  | 45              | 45                          | 2            |
| All other loans                     | —                   | —                  | —               | —                           | —            |
| <b>Total</b>                        | <b>\$20,564</b>     | <b>\$735</b>       | <b>\$17,324</b> | <b>\$19,850</b>             | <b>\$983</b> |

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An age analysis of past due loans receivable was as follows:

|                                      | Loans<br>30-59<br>Days<br>Past<br>Due | Loans<br>60-89<br>Days<br>Past<br>Due | Loans<br>90 or<br>More<br>Days<br>Past<br>Due | Total<br>Past<br>Due<br>Loans | Current<br>Loans | Total<br>Loans | Accruing<br>Loans<br>90 or<br>More<br>Days<br>Past<br>Due |
|--------------------------------------|---------------------------------------|---------------------------------------|---|-------------------------------|------------------|----------------|---|
| <b>As of June 30, 2016</b>           |                                       |                                       |   |                               |                  |                |   |
| (Dollars are in thousands)           |                                       |                                       |   |                               |                  |                |   |
| Real estate secured:                 |                                       |                                       |   |                               |                  |                |   |
| Commercial                           | \$534                                 | \$1,255                               | \$1,552                                       | \$3,341                       | \$100,190        | \$103,531      | \$ —  |
| Construction and land<br>development | 100                                   | —                                     | 71  | 171                           | 19,118           | 19,289         | —   |
| Residential 1-4 family               | 6,199                                 | 2,054                                 | 2,075   | 10,328                        | 235,756          | 246,084        | —   |
| Multifamily                          | 446                                   | 67                                    | 165   | 678                           | 12,595           | 13,273         | —   |
| Farmland                             | 365                                   | 164                                   | —   | 529                           | 22,945           | 23,474         | —   |
| Total real estate loans              | 7,644                                 | 3,540                                 | 3,863   | 15,047                        | 390,604          | 405,651        | —   |
| Commercial                           | 36                                    | 15                                    | 75  | 126                           | 24,737           | 24,863         | —   |
| Agriculture                          | 29                                    | —                                     | 173   | 202                           | 4,144            | 4,346          | —   |
| Consumer installment<br>Loans        | 161                                   | 49                                    | 37  | 247                           | 24,477           | 24,724         | —   |
| All other loans                      | 22                                    | —                                     | —   | 22                            | 7                | 29             | —   |
| Total loans                          | \$7,892                               | \$3,604                               | \$4,148                                       | \$15,644                      | \$443,969        | \$459,613      | \$ —  |

|                                | Loans<br>30-59<br>Days<br>Past<br>Due | Loans<br>60-89<br>Days<br>Past<br>Due | Loans<br>90 or<br>More<br>Days<br>Past<br>Due | Total<br>Past<br>Due<br>Loans | Current<br>Loans | Total<br>Loans | Accruing<br>Loans<br>90 or<br>More<br>Days<br>Past<br>Due |
|--------------------------------|---------------------------------------|---------------------------------------|---|-------------------------------|------------------|----------------|---|
| <b>As of December 31, 2015</b> |                                       |                                       |   |                               |                  |                |   |
| (Dollars are in thousands)     |                                       |                                       |   |                               |                  |                |   |
| Real estate secured:           |                                       |                                       |   |                               |                  |                |   |
| Commercial                     | \$311                                 | \$105                                 | \$2,534                                       | \$2,950                       | \$95,619         | \$98,569       | \$ —  |

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|                                   |         |         |         |          |           |           |      |
|-----------------------------------|---------|---------|---------|----------|-----------|-----------|------|
| Construction and land development | 144     | —       | 17      | 161      | 14,511    | 14,672    | —    |
| Residential 1-4 family            | 4,694   | 1,487   | 2,891   | 9,072    | 233,844   | 242,916   | —    |
| Multifamily                       | 47      | —       | 320     | 367      | 12,587    | 12,954    | —    |
| Farmland                          | 363     | —       | 251     | 614      | 21,560    | 22,174    | —    |
| Total real estate loans           | 5,559   | 1,592   | 6,013   | 13,164   | 378,121   | 391,285   | —    |
| Commercial                        | 18      | 1       | 64      | 83       | 21,386    | 21,469    | —    |
| Agriculture                       | —       | —       | —       | —        | 3,793     | 3,793     | —    |
| Consumer installment Loans        | 113     | 1       | 27      | 141      | 24,427    | 24,568    | —    |
| All other loans                   | 6       | —       | —       | 6        | 48        | 54        | —    |
| Total loans                       | \$5,696 | \$1,594 | \$6,104 | \$13,394 | \$427,775 | \$441,169 | \$ — |

The Company categorizes loans receivable into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans receivable as to credit risk. The Company uses the following definitions for risk ratings:

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**Pass** - Loans in this category are considered to have a low likelihood of loss based on relevant information analyzed about the ability of the borrowers to service their debt and other factors.

**Special Mention** - Loans in this category are currently protected but are potentially weak, including adverse trends in borrower's operations, credit quality or financial strength. Those loans constitute an undue and unwarranted credit risk but not to the point of justifying a substandard classification. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances. Special mention loans have potential weaknesses which may, if not checked or corrected, weaken the loan or inadequately protect the Company's credit position at some future date.

**Substandard** - A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must 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 Doubtful have all the weaknesses inherent in loans classified as Substandard, plus 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.

Based on the most recent analysis performed, the risk category of loans receivable was as follows:

| <b>As of June 30, 2016</b>        | <b>Pass</b>      | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Total</b>     |
|-----------------------------------|------------------|----------------------------|--------------------|-----------------|------------------|
| (Dollars are in thousands)        |                  |                            |                    |                 |                  |
| Real estate secured:              |                  |                            |                    |                 |                  |
| Commercial                        | \$91,667         | \$7,378                    | \$4,486            | \$—             | \$103,531        |
| Construction and land development | 17,267           | 1,598                      | 424                | —               | 19,289           |
| Residential 1-4 family            | 235,604          | 1,843                      | 8,637              | —               | 246,084          |
| Multifamily                       | 12,730           | —                          | 543                | —               | 13,273           |
| Farmland                          | 17,703           | 3,473                      | 2,298              | —               | 23,474           |
| Total real estate loans           | 374,971          | 14,292                     | 16,388             | —               | 405,651          |
| Commercial                        | 24,070           | 706                        | 87                 | —               | 24,863           |
| Agriculture                       | 4,157            | —                          | 189                | —               | 4,346            |
| Consumer installment loans        | 24,574           | —                          | 150                | —               | 24,724           |
| All other loans                   | 29               | —                          | —                  | —               | 29               |
| <b>Total</b>                      | <b>\$427,801</b> | <b>\$14,998</b>            | <b>\$16,814</b>    | <b>\$—</b>      | <b>\$459,613</b> |

**As of December 31, 2015** Special

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| (Dollars are in thousands)        | Pass      | Mention  | Substandard | Doubtful | Total     |
|-----------------------------------|-----------|----------|-------------|----------|-----------|
| Real estate secured:              |           |          |             |          |           |
| Commercial                        | \$85,255  | \$7,543  | \$5,771     | \$—      | \$98,569  |
| Construction and land development | 12,262    | 1,974    | 436         | —        | 14,672    |
| Residential 1-4 family            | 229,182   | 3,572    | 10,162      | —        | 242,916   |
| Multifamily                       | 12,264    | 187      | 503         | —        | 12,954    |
| Farmland                          | 16,663    | 2,923    | 2,588       | —        | 22,174    |
| Total real estate loans           | 355,626   | 16,199   | 19,460      | —        | 391,285   |
| Commercial                        | 20,641    | 724      | 104         | —        | 21,469    |
| Agriculture                       | 3,767     | —        | 26          | —        | 3,793     |
| Consumer installment loans        | 24,478    | —        | 90          | —        | 24,568    |
| All other loans                   | 54        | —        | —           | —        | 54        |
| Total                             | \$404,566 | \$16,923 | 19,680      | \$—      | \$441,169 |

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**NOTE 7 ALLOWANCE FOR LOAN LOSSES:**

The following table details activity in the allowance for loan losses by portfolio segment for the period ended June 30, 2016. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

**As of June 30, 2016**

| (Dollars are in thousands)        | Beginning Balance | Charge Offs | Recoveries | Advances | Provisions | Ending Balance |
|-----------------------------------|-------------------|-------------|------------|----------|------------|----------------|
| Real estate secured:              |                   |             |            |          |            |                |
| Commercial                        | \$ 2,384          | \$(327)     | \$ 185     | \$ —     | \$ (320)   | \$ 1,922       |
| Construction and land development | 332               | (5)         | 18         | —        | (18)       | 327            |
| Residential 1-4 family            | 2,437             | (411)       | 65         | —        | 96         | 2,187          |
| Multifamily                       | 232               | (10)        | —          | —        | 36         | 258            |
| Farmland                          | 675               | (2)         | 101        | —        | (139)      | 635            |
| Total real estate loans           | 6,060             | (755)       | 369        | —        | (345)      | 5,329          |
| Commercial                        | 266               | (5)         | 48         | —        | (110)      | 199            |
| Agriculture                       | 124               | —           | 4          | —        | 91         | 219            |
| Consumer installment loans        | 128               | (18)        | 13         | —        | (3)        | 120            |
| All other loans                   | 1                 | —           | —          | —        | (1)        | —              |
| Unallocated                       | 914               | —           | —          | —        | (132)      | 782            |
| Total                             | \$ 7,493          | \$(778)     | \$ 434     | \$ —     | \$ (500)   | \$ 6,649       |

| As of June 30, 2016               | Allowance for Loan Losses             |                                       | Recorded Investment in Loans          |                                       | Total     | Total      |
|-----------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|-----------|------------|
|                                   | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Individually Evaluated for Impairment | Collectively Evaluated for Impairment |           |            |
| (Dollars are in thousands)        |                                       |                                       |                                       |                                       |           |            |
| Real estate secured:              |                                       |                                       |                                       |                                       |           |            |
| Commercial                        | \$ 158                                | \$ 1,764                              | \$ 1,922                              | \$ 5,425                              | \$ 98,106 | \$ 103,531 |
| Construction and land development | 131                                   | 196                                   | 327                                   | 272                                   | 19,017    | 19,289     |

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|                            |       |         |         |          |           |           |
|----------------------------|-------|---------|---------|----------|-----------|-----------|
| Residential 1-4 family     | 69    | 2,118   | 2,187   | 4,643    | 241,441   | 246,084   |
| Multifamily                | 30    | 228     | 258     | 473      | 12,800    | 13,273    |
| Farmland                   | 296   | 339     | 635     | 4,694    | 18,780    | 23,474    |
| Total real estate loans    | 684   | 4,645   | 5,329   | 15,507   | 390,144   | 405,651   |
| Commercial                 | 23    | 176     | 199     | 68       | 24,795    | 24,863    |
| Agriculture                | 185   | 34      | 219     | 211      | 4,135     | 4,346     |
| Consumer installment loans | 3     | 117     | 120     | 53       | 24,671    | 24,724    |
| All other loans            | —     | —       | —       | —        | 29        | 29        |
| Unallocated                | —     | 782     | 782     | —        | —         | —         |
| Total                      | \$895 | \$5,754 | \$6,649 | \$15,839 | \$443,774 | \$459,613 |

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The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

**As of December 31, 2015**

| (Dollars are in thousands)        | Beginning Balance | Charge Offs | Recoveries | Advances | Provisions | Ending Balance |
|-----------------------------------|-------------------|-------------|------------|----------|------------|----------------|
| Real estate secured:              |                   |             |            |          |            |                |
| Commercial                        | \$ 4,418          | \$(724 )    | \$ 147     | \$ —     | \$(1,457 ) | \$ 2,384       |
| Construction and land development | 199               | (226 )      | 215        | —        | 144        | 332            |
| Residential 1-4 family            | 2,572             | (743 )      | 93         | —        | 515        | 2,437          |
| Multifamily                       | 154               | (384 )      | 6          | —        | 456        | 232            |
| Farmland                          | 913               | (90 )       | 214        | —        | (362 )     | 675            |
| Total real estate loans           | 8,256             | (2,167)     | 675        | —        | (704 )     | 6,060          |
| Commercial                        | 457               | (92 )       | 1,412      | —        | (1,511 )   | 266            |
| Agriculture                       | 125               | —           | 3          | —        | (4 )       | 124            |
| Consumer installment loans        | 171               | (101 )      | 41         | —        | 17         | 128            |
| All other loans                   | 1                 | —           | —          | —        | —          | 1              |
| Unallocated                       | 912               | —           | —          | —        | 2          | 914            |
| Total                             | \$ 9,922          | \$(2,360)   | \$ 2,131   | \$ —     | \$(2,200 ) | \$ 7,493       |

| As of December 31, 2015           | Allowance for Loan Losses             |                                       | Recorded Investment in Loans          |                                       | Total    | Total    |
|-----------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|----------|----------|
|                                   | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Individually Evaluated for Impairment | Collectively Evaluated for Impairment |          |          |
| (Dollars are in thousands)        |                                       |                                       |                                       |                                       |          |          |
| Real estate secured:              |                                       |                                       |                                       |                                       |          |          |
| Commercial                        | \$288                                 | \$2,096                               | \$2,384                               | \$6,715                               | \$91,854 | \$98,569 |
| Construction and land development | 155                                   | 177                                   | 332                                   | 299                                   | 14,373   | 14,672   |
| Residential 1-4 family            | 168                                   | 2,269                                 | 2,437                                 | 4,957                                 | 237,959  | 242,916  |
| Multifamily                       | —                                     | 232                                   | 232                                   | 430                                   | 12,524   | 12,954   |

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|                            |       |         |       |          |           |           |
|----------------------------|-------|---------|-------|----------|-----------|-----------|
| Farmland                   | 328   | 347     | 675   | 4,744    | 17,430    | 22,174    |
| Total real estate loans    | 939   | 5,121   | 6,060 | 17,145   | 374,140   | 391,285   |
| Commercial                 | 24    | 242     | 266   | 69       | 21,400    | 21,469    |
| Agriculture                | 18    | 106     | 124   | 54       | 3,739     | 3,793     |
| Consumer installment loans | 2     | 126     | 128   | 56       | 24,512    | 24,568    |
| All other loans            | —     | 1       | 1     | —        | 54        | 54        |
| Unallocated                | —     | 914     | 914   | —        | —         | —         |
| Total                      | \$983 | \$6,510 | 7,493 | \$17,324 | \$423,845 | \$441,169 |

In determining the amount of our allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions, as well as the requirements of the written agreement and other regulatory input. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover future loan losses and we may experience significant increases to our provision.

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**NOTE 8 TROUBLED DEBT RESTRUCTURINGS:**

At June 30, 2016 there were \$9.7 million in loans that are classified as troubled debt restructurings compared to \$9.5 million at December 31, 2015. The following table presents information related to loans modified as troubled debt restructurings during the six and three months ended June 30, 2016 and 2015.

| Troubled Debt Restructurings (Dollars are in thousands) | For the six months ended June 30, 2016 |                              |                               | For the six months ended June 30, 2015 |                              |                               |
|---|--|------------------------------|-------------------------------|--|------------------------------|-------------------------------|
|   | # of Loans                             | Pre-Mod. Recorded Investment | Post-Mod. Recorded Investment | # of Loans                             | Pre-Mod. Recorded Investment | Post-Mod. Recorded Investment |
| Real estate secured:                                    |  |                              |                               |  |                              |                               |
| Commercial  | 1                                      | \$341                        | \$339                         | —                                      | \$—                          | \$—                           |
| Construction and land                                   | —                                      | —                            | —                             | 1                                      | 551                          | 314                           |
| Development   |  |                              |                               |  |                              |                               |
| Residential 1-4 family                                  | —                                      | —                            | —                             | —                                      | —                            | —                             |
| Multifamily   | —                                      | —                            | —                             | —                                      | —                            | —                             |
| Farmland  | 1                                      | 291                          | 291                           | —                                      | —                            | —                             |
| Total real estate loans                                 | 2                                      | 632                          | 630                           | 1                                      | 551                          | 314                           |
| Commercial  | —                                      | —                            | —                             | —                                      | —                            | —                             |
| Agriculture   | —                                      | —                            | —                             | —                                      | —                            | —                             |
| Consumer installment loans                              | —                                      | —                            | —                             | —                                      | —                            | —                             |
| All other loans   | —                                      | —                            | —                             | —                                      | —                            | —                             |
| Total   | 2                                      | \$632                        | \$630                         | 1                                      | \$551                        | \$314                         |

| Troubled Debt Restructurings (Dollars are in thousands) | For the three months ended |                              |                               | For the three months ended |                              |                               |
|---|----------------------------|------------------------------|-------------------------------|----------------------------|------------------------------|-------------------------------|
|   | # of Loans                 | Pre-Mod. Recorded Investment | Post-Mod. Recorded Investment | # of Loans                 | Pre-Mod. Recorded Investment | Post-Mod. Recorded Investment |
| Real estate secured:                                    |                            |                              |                               |                            |                              |                               |
| Commercial  |                            |                              |                               |                            |                              |                               |
| Construction and land                                   |                            |                              |                               |                            |                              |                               |
| Development   |                            |                              |                               |                            |                              |                               |
| Residential 1-4 family                                  |                            |                              |                               |                            |                              |                               |
| Multifamily   |                            |                              |                               |                            |                              |                               |
| Farmland  |                            |                              |                               |                            |                              |                               |
| Total real estate loans                                 |                            |                              |                               |                            |                              |                               |
| Commercial  |                            |                              |                               |                            |                              |                               |
| Agriculture   |                            |                              |                               |                            |                              |                               |
| Consumer installment loans                              |                            |                              |                               |                            |                              |                               |
| All other loans   |                            |                              |                               |                            |                              |                               |
| Total   |                            |                              |                               |                            |                              |                               |

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|                            |   |       |       |   |     |     |
|----------------------------|---|-------|-------|---|-----|-----|
| Commercial                 | — | \$—   | \$—   | — | \$— | \$— |
| Construction and<br>land   | — | —     | —     | — | —   | —   |
| Development                |   |       |       |   |     |     |
| Residential 1-4<br>family  | — | —     | —     | — | —   | —   |
| Multifamily                | — | —     | —     | — | —   | —   |
| Farmland                   | 1 | 291   | 291   | — | —   | —   |
| Total real estate<br>loans | 1 | 291   | 291   | — | —   | —   |
| Commercial                 | — | —     | —     | — | —   | —   |
| Agriculture                | — | —     | —     | — | —   | —   |
| Consumer                   |   |       |       |   |     |     |
| installment loans          | — | —     | —     | — | —   | —   |
| All other loans            | — | —     | —     | — | —   | —   |
| Total                      | 1 | \$291 | \$291 | — | \$— | \$— |

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During the six months ended June 30, 2016, the Company modified the terms of two loans for which the modification was considered to be a troubled debt restructuring. On one loan the interest rate and maturity date were not modified; however, the payment terms were changed. On one loan the interest rate was lowered and the payment terms and maturity date were changed. During the six months ended June 30, 2015, the Company modified the terms of one loan for which the modification was considered to be a troubled debt restructuring. The interest rate was not modified on the loan; however, the maturity date was extended.

During the three months ended June 30, 2016, the Company modified the terms of one loan for which the modification was considered to be a troubled debt restructuring. The interest rate was lowered and the payment terms and maturity date were changed. During the three months ended June 30, 2015, the Company modified no loans that were considered to be troubled debt restructurings.

There was one commercial real estate loan with a recorded investment of \$308 thousand that had been modified as a troubled debt restructuring that defaulted during the six months ended June 30, 2016, which was within twelve months of the loan's modification date. No loans modified as troubled debt restructurings defaulted during the six months ended June 30, 2015. There were no loans modified as troubled debt restructurings that defaulted during the three months ended June 30, 2016 and 2015, which were within twelve months of their modification date. Generally, a troubled debt restructuring is considered to be in default once it becomes 90 days or more past due following a modification.

In determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings in its estimate. The Company evaluates all troubled debt restructurings for possible further impairment. As a result, the allowance may be increased, adjustments may be made in the allocation of the allowance, or charge-offs may be taken to further writedown the carrying value of the loan.

**NOTE 9 OTHER REAL ESTATE OWNED:**

The following table summarizes the activity in other real estate owned for the six months ended June 30, 2016 and the year ended December 31, 2015:

| (Dollars are in thousands)           | June 30,<br>2016 | December<br>31, 2015 |
|--------------------------------------|------------------|----------------------|
| Balance, beginning of period         | \$ 12,398        | \$ 15,049            |
| Additions                            | 3,098            | 3,277                |
| Purchases of other real estate owned | —                | 12                   |
| Transfers of other real estate owned | (125 )           | —                    |
| Donation of other real estate owned  | —                | (33 )                |
| Proceeds from sales                  | (947 )           | (1,831 )             |

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|                                |           |           |
|--------------------------------|-----------|-----------|
| Loans made to finance sales    | (503 )    | (878 )    |
| Proceeds from insurance claims | —         | (101 )    |
| Adjustment of carrying value   | 28        | (3,246 )  |
| Deferred gain from sales       | —         | 50        |
| Gain from sales                | 185       | 99        |
| Balance, end of period         | \$ 14,134 | \$ 12,398 |

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**NOTE 10 EARNINGS PER SHARE:**

Basic earnings per share computations are based on the weighted average number of shares outstanding during each period. Dilutive earnings per share reflect the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate to outstanding options and common stock warrants are determined by the Treasury method. For the three and six months ended June 30, 2016 and 2015, potential common shares of 882,353 and 1,539,877, respectively, were anti-dilutive and were not included in the calculation. Basic and diluted net income per common share calculations follows:

| (Amounts in Thousands, Except<br>Share and Per Share Data) | For the three months<br>ended June 30, |            | For the six months<br>ended June 30, |            |
|--|--|------------|--------------------------------------|------------|
|  | 2016                                   | 2015       | 2016                                 | 2015       |
| Net income   | \$882                                  | \$462      | \$1,580                              | \$1,084    |
| Weighted average shares outstanding                        | 23,354,082                             | 22,878,654 | 23,354,082                           | 22,878,654 |
| Dilutive shares for stock options and warrants             | —                                      | —          | —                                    | —          |
| Weighted average dilutive shares outstanding               | 23,354,082                             | 22,878,654 | 23,354,082                           | 22,878,654 |
| Basic income per share                                     | \$0.04                                 | \$0.02     | \$0.07                               | \$0.05     |
| Diluted income per share                                   | \$0.04                                 | \$0.02     | \$0.07                               | \$0.05     |

**NOTE 11 TRUST PREFERRED SECURITIES AND DEFERRAL OF INTEREST PAYMENTS:**

On July 7, 2004, the Company completed the issuance of \$11.3 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust I. The proceeds of the funds were used for general corporate purposes which included capital management for affiliates, retirement of indebtedness and other investments. The securities have a floating rate of 3 month LIBOR plus 260 basis points, which resets quarterly, with a current rate at June 30, 2016 of 3.23%.

On September 27, 2006, the Company completed the issuance of \$5.2 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust 2. The proceeds of the funds were used for general corporate purposes, which include capital management for affiliates and the acquisition of two branch banks. The securities have a floating rate of 3 month LIBOR plus 177 basis points, which resets quarterly, with a current rate at June 30, 2016 of 2.40%.

Under the terms of the subordinated debt transactions, the securities mature in 30 years from the date of issuance and are redeemable, in whole or in part, without penalty, at the option of the Company after five years. Due to the ability to defer interest and principal payments for 60 months without being considered in default, the regulatory agencies consider the trust preferred securities as Tier 1 capital up to certain limits.

In October 2009, a restriction to pay dividends from the Bank to the Company was issued by the Federal Reserve Bank of Richmond. In July 2010 the Company and the Bank entered into the Written Agreement discussed in Note 3. The Written Agreement prohibited the payment of interest on the trust preferred securities without prior regulatory approval. As a result, interest on trust preferred securities was deferred. This deferral was for a period of 60 months, and was set to expire on January 7, 2015. In the fourth quarter of 2014, the Company requested and received regulatory approval to pay the cumulative deferred interest on the trust preferred securities due on January 7, 2015 totaling \$2.5 million, which the Company paid on December 10, 2014. As a result of this payment there has been no interest in arrears on the trust preferred securities since that date.

The Company is currently not deferring the quarterly interest payments on the trust preferred securities. However, as discussed above, regulatory approval was needed to pay the interest while the Company was under the formal Written Agreement. In March 2015 the Company requested and received regulatory approval to pay the \$107 thousand in interest on the trust preferred securities due on April 7, 2015, which the Company paid on April 3, 2015. In June 2015 the Company requested and received regulatory approval to pay the \$109 thousand in interest on the trust preferred securities due on July 7, 2015, which the Company paid on July 2, 2015. In September 2015 the Company requested and received regulatory approval to pay the \$111 thousand in interest on the trust preferred securities due on October 7, 2015, which the Company paid on October 5, 2015. In December 2015 the Company requested and received regulatory approval to pay the \$112 thousand in interest on the trust preferred securities due on January 7, 2016, which the Company paid on January 5, 2016.

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The restriction requiring regulatory approval before the payment of interest on the trust preferred securities was lifted when the Written Agreement was terminated effective January 20, 2016. On April 4, 2016, the Company paid \$124 thousand in interest on the trust preferred securities, which was due on April 7, 2016. On July 6, 2016 the Company paid \$124 thousand in interest on the trust preferred securities, which was due on July 7, 2016.

**NOTE 12 FAIR VALUES:**

The financial reporting standard, "Fair Value Measurements and Disclosures" provides a framework for measuring fair value under generally accepted accounting principles and requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans and other real estate acquired through foreclosure).

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair Value Measurements and Disclosures also establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an exchange market, as well as U. S. Treasury, other U. S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2: Observable inputs other than Level 1 prices such as 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 assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and 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 the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential

mortgage servicing rights, and highly structured or long-term derivative contracts.

*Investment Securities Available-for-Sale* – Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices. The Company’s available-for-sale securities, totaling \$76.6 million and \$101.6 million at June 30, 2016 and December 31, 2015, respectively, are the only assets whose fair values are measured on a recurring basis using Level 2 inputs from an independent pricing service.

*Loans* - The Company does not record loans at fair value on a recurring basis. Real estate serves as collateral on a substantial majority of the Company’s loans. When a loan is considered impaired a specific reserve may be established. Loans which are deemed to be impaired and require a reserve are primarily valued on a non-recurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which management evaluates and determines whether or not the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or whether or not an appraised value does not include estimated costs of disposition. The Company records impaired loans as nonrecurring Level 3 assets. The aggregate carrying amounts of impaired loans carried at fair value were \$14.9 million and \$16.3 million at June 30, 2016 and December 31, 2015, respectively.

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*Foreclosed Assets* – Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Foreclosed assets are carried at the lower of the carrying value or fair value. Fair value is based upon independent observable market prices or appraised values of the collateral with a third party less an estimate of disposition costs, which the Company considers to be level 2 inputs. When the appraised value is not available, management determines the fair value of the collateral if further impaired below the appraised value and there is no observable market price, or an appraised value does not include estimated costs of disposition and management must make an estimate, the Company records the foreclosed asset as nonrecurring Level 3. The aggregate carrying amounts of foreclosed assets were \$14.1 million and \$12.4 million at June 30, 2016 and December 31, 2015, respectively.

Assets and liabilities measured at fair value are as follows as of June 30, 2016 (for purpose of this table the impaired loans are shown net of the related allowance):

| (Dollars are in thousands)        | Quoted<br>market<br>price in<br>active<br>markets<br>(Level<br>1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|-----------------------------------|---|---|--|
| (On a recurring basis)            |   |   |  |
| Available-for-sale investments    |   |   |  |
| U.S. Government Agencies          | \$ —  | \$ 28,425   | \$ —   |
| Taxable municipals                | —   | 2,483   | —  |
| Corporate bonds                   | —   | 3,232   | —  |
| Mortgage backed securities        | —   | 42,486  | —  |
| (On a non-recurring basis)        |   |   |  |
| Other real estate owned           | —   | —   | 14,134   |
| Impaired loans:                   |   |   |  |
| Real estate secured:              |   |   |  |
| Commercial                        | —   | —   | 5,267  |
| Construction and land development | —   | —   | 141  |
| Residential 1-4 family            | —   | —   | 4,574  |
| Multifamily                       | —   | —   | 443  |
| Farmland                          | —   | —   | 4,398  |
| Commercial                        | —   | —   | 45   |
| Agriculture                       | —   | —   | 26   |
| Consumer installment loans        | —   | —   | 50   |
| All other loans                   | —   | —   | —  |
| Total                             | \$ —  | \$ 76,626   | \$ 29,078  |

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Assets and liabilities measured at fair value are as follows as of December 31, 2015 (for purpose of this table the impaired loans are shown net of the related allowance):

| (Dollars are in thousands)        | Quoted<br>market<br>price in<br>active<br>markets<br>(Level<br>1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|-----------------------------------|---|---|--|
| (On a recurring basis)            |   |   |  |
| Available-for-sale investments    |   |   |  |
| U.S. Government Agencies          | \$ —  | \$ 41,523   | \$ —   |
| Taxable municipals                | —   | 3,281   | —  |
| Corporate bonds                   | —   | 1,939   | —  |
| Mortgage backed securities        | —   | 54,899  | —  |
| (On a non-recurring basis)        |   |   |  |
| Other real estate owned           | —   | —   | 12,398   |
| Impaired loans:                   |   |   |  |
| Real estate secured:              |   |   |  |
| Commercial                        | —   | —   | 6,427  |
| Construction and land development | —   | —   | 144  |
| Residential 1-4 family            | —   | —   | 4,789  |
| Multifamily                       | —   | —   | 430  |
| Farmland                          | —   | —   | 4,416  |
| Commercial                        | —   | —   | 45   |
| Agriculture                       | —   | —   | 36   |
| Consumer installment loans        | —   | —   | 54   |
| All other loans                   | —   | —   | —  |
| Total                             | \$ —  | \$ 101,642  | \$ 28,739  |

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of June 30, 2016, the significant unobservable inputs used in the fair value measurements were as follows:

| (Dollars in thousands)  | Fair Value at June 30, 2016 | Valuation Technique  | Significant Unobservable Inputs  | General Range of Significant Unobservable Input Values |
|-------------------------|-----------------------------|--|--|--|
| Impaired Loans          | \$ 14,944                   | Appraised Value/Discounted Cash Flows/Market Value of Note | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell | 0 – 18%  |
| Other Real Estate Owned | \$ 14,134                   | Appraised Value/Comparable Sales/Other Estimates from      | Discounts to reflect current market conditions and estimated   | 0 – 18%  |



Independent Sources

costs to sell

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## Fair Value of Financial Instruments

Fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practical to estimate the value is based upon the characteristics of the instruments and relevant market information. Financial instruments include cash, evidence of ownership in an entity, or contracts that convey or impose on an entity that contractual right or obligation to either receive or deliver cash for another financial instrument.

The following summary presents the methodologies and assumptions used to estimate the fair value of the Company's financial instruments presented below. The information used to determine fair value is highly subjective and judgmental in nature and, therefore, the results may not be precise. Subjective factors include, among other things, estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of the balance sheet date, the amounts that will actually be realized or paid upon settlement or maturity on these various instruments could be significantly different.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of June 30, 2016 and December 31, 2015. This table excludes financial instruments for which the carrying amount approximates fair value. The carrying value of cash and due from banks, federal funds sold, interest-bearing deposits, deposits with no stated maturities, trust preferred securities and accrued interest approximates fair value. The remaining financial instruments were valued based on the present value of estimated future cash flows, discounted at various rates in effect for similar instruments as of June 30, 2016 and December 31, 2015.

| (Dollars are in thousands)          | Carrying Amount | Fair Value | Fair Value Measurements                         |   |   |
|-------------------------------------|-----------------|------------|---|---|---|
|                                     |                 |            | Quoted market price in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| June 30, 2016                       |                 |            |   |   |   |
| Financial Instruments – Assets      |                 |            |   |   |   |
| Net Loans                           | \$452,964       | \$455,841  | \$—   | \$440,897                                     | \$ 14,944                                 |
| Financial Instruments – Liabilities |                 |            |   |   |   |
| Time Deposits                       | 251,598         | 251,587    | —   | 251,587                                       | —   |
| FHLB Advances                       | 9,358           | 9,355      | —   | 9,355   | —   |
| December 31, 2015                   |                 |            |   |   |   |

Financial Instruments – Assets

|           |           |           |     |           |           |
|-----------|-----------|-----------|-----|-----------|-----------|
| Net Loans | \$433,676 | \$438,589 | \$— | \$422,248 | \$ 16,341 |
|-----------|-----------|-----------|-----|-----------|-----------|

Financial Instruments – Liabilities

|               |         |         |   |         |   |
|---------------|---------|---------|---|---------|---|
| Time Deposits | 256,978 | 256,797 | — | 256,797 | — |
| FHLB Advances | 2,958   | 2,958   | — | 2,958   | — |

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**NOTE 13 SUBSEQUENT EVENTS:**

In July 2016, the Bank and its wholly-owned subsidiary NPB Insurance Services, Inc. announced by press release it is teaming up with The Hilb Group of Virginia dba CSE Insurance Services, a division of the Hilb Group, LLC (“CSE”), located in Abingdon, Virginia, to provide insurance services for its current and future customers. Effective July 1, 2016, NPB Insurance Services, Inc. sold its existing book of business to CSE. These customers will be serviced by CSE and the Bank will refer future insurance needs of its bank customers to CSE.

**NOTE 14 RECENT ACCOUNTING DEVELOPMENTS:**

The following is a summary of recent authoritative announcements:

In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2017. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2015, the FASB issued guidance to eliminate from U.S. GAAP the concept of an extraordinary item, which is an event or transaction that is both (1) unusual in nature and (2) infrequently occurring. Under the new guidance, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company applied the guidance prospectively. Adoption of these amendments did not have a material effect on the Company’s financial statements.

In February 2015, the FASB issued guidance which amends the consolidation requirements and significantly changes the consolidation analysis required under U.S. GAAP. Although the amendments are expected to result in the deconsolidation of many entities, the Company will need to reevaluate all its previous consolidation conclusions. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted (including during an interim period), provided that the guidance is applied as of the beginning of the annual period containing the adoption date. Adoption of these amendments did not have a material effect on the Company’s financial statements.

In June 2015, the FASB issued amendments to clarify the Accounting Standards Codification (“ASC”), correct unintended application of guidance, and make minor improvements to the ASC that are not expected to have a significant effect on current accounting practice or create a significant cost to most entities. The amendments were effective upon issuance (June 12, 2015) for amendments that do not have transition guidance. Amendments that are subject to transition guidance will be effective 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. Adoption of these amendments did not have a material effect on the Company’s financial statements.

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In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral the guidance in ASU 2014-09 will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2015, the FASB issued amendments to the Interest topic of the ASC to clarify the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line-of-credit arrangements. The amendments were effective upon issuance. Adoption of these amendments did not have a material effect on the Company's financial statements.

In January 2016, the FASB amended the Financial Instruments topic of the ASC to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

In February 2016, the FASB amended the Leases topic of the ASC to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them to apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for the Company for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify guidance related to identifying performance obligations and accounting for licenses of intellectual property. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify guidance related to collectability, noncash consideration, presentation of sales tax, and transition. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

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

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## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **Caution About Forward Looking Statements**

We make forward looking statements in this quarterly report that are subject to risks and uncertainties. These forward looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, business strategy, and financial and other goals. The words “believes,” “expects,” “may,” “will,” “should,” “projects,” “contemplates,” “anticipates,” “forecasts,” “intends,” or other similar words or terms are intended to identify forward looking statements.

Certain information contained in this discussion may include “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements contain the Company’s expectations, plans, future financial performance, and other statements that are not historical facts. These forward-looking statements are generally identified by phrases such as “the Company expects,” “the Company believes” or words of similar importance. Such forward-looking statements involve known and unknown risks including, but not limited to, changes in general economic and business conditions, interest rate fluctuations, competition within and from outside the banking industry, new products and services in the banking industry, risk inherent in making loans such as repayment risks and fluctuating collateral values, problems with technology utilized by the Company, changing trends in customer profiles and changes in laws and regulations applicable to the Company. Although the Company believes that its expectations with respect to the forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

Because of these uncertainties, our actual future results may be materially different from the results indicated by these forward looking statements. In addition, our past results of operations do not necessarily indicate our future results.

### **Written Agreement**

The Company and the Bank had previously entered into the Written Agreement with the Federal Reserve Bank of Richmond and the Virginia State Corporation Commission Bureau of Financial Institutions. On February 2, 2016, the Company and the Bank announced that they had successfully complied with all of the requirements of the Written Agreement and accordingly, effective January 20, 2016, the agreement had been terminated.



Under the terms of the Written Agreement, the Bank developed and submitted for approval within specified time periods written plans related to board oversight; the Bank's management and governance, including management of the Bank's operations, credit risk management, lending and credit risk administration, management of commercial real estate concentrations; the review and grading of the Bank's loan portfolio; the improvement of Bank problem assets in excess of \$1 million; the maintenance of an adequate allowance for loan and lease losses; the enhanced management of the Bank's liquidity position and funds management practices; the revision of the Bank's contingency funding and strategic plans; and the enhancement of the Bank's anti-money laundering activities. The Written Agreement also imposed limitations on actions taken on criticized credits and credits classified as "loss". The Written Agreement required the submission of capital plans and the maintenance of adequate capital and restricted the payment of dividends and other distributions, the redemption of stock and the incurrence of debt.

### **Critical Accounting Policies**

For discussion of our significant accounting policies see our Annual Report on Form 10-K for the year ended December 31, 2015. Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements. Our most critical accounting policies relate to our provision for loan losses and the calculation of our deferred tax asset and related valuation allowance.

The provision for loan losses reflects the estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our borrowers were to further deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additional provisions could be required.

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Our deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. If all or a portion of the net deferred tax asset is determined to be unlikely to be realized in the foreseeable future, a valuation allowance is established to reduce the net deferred tax asset to the amount that is more likely than not to be realized. For further discussion of the deferred tax asset and valuation allowance, we refer you to the section on “Deferred Tax Asset and Income Taxes” below.

## Overview

The Company had net income for the quarter ended June 30, 2016 of \$882 thousand, or basic net income per share of \$0.04, as compared to a net income of \$462 thousand, or basic net income per share of \$0.02, for the quarter ended June 30, 2015. This is an improvement of \$420 thousand, or 90.91%. The improvement was mainly driven by a negative provision for loan losses of \$500 thousand during the second quarter 2016. The Company had net income for the six months ended June 30, 2016 of \$1.6 million, or basic net income per share of \$0.07, as compared to the six months ending June 30, 2015 whereby the Company had net income of \$1.1 million, or \$0.05 basic net income per share. This is an improvement of \$496 thousand, or \$0.02 per share.

## Quarter-to-Date Results

Highlights from the second quarter of 2016 include:

- Strong net interest margin of 3.94% for the quarter;
- A negative provision for loans losses of \$500 thousand;
- A reduction in nonaccrual loans of \$1.0 million, or 7.44% during the quarter;
- Gains on the sales of investment securities were \$135 thousand for the quarter as compared to no gains for the same period in 2015;
- The Bank is considered well-capitalized under regulatory standards; and,
- Book value per share of \$2.08 as of June 30, 2016.

In the second quarter of 2016, our net interest margin was 3.94%, as compared to 3.86% for the same period in 2015, an improvement of 8 basis points. The Company’s primary source of income, net interest income, decreased \$199 thousand, or 3.55%, to \$5.4 million for the second quarter of 2016 from \$5.6 million for the same period in 2015. Loan interest income decreased \$312 thousand, or 5.27%, from \$5.9 million for the second quarter of 2015 to \$5.6 million for the second quarter of 2016. While we have been successful in our strategy to conservatively grow the loan portfolio, renewed loans are repricing at lower rates and new loans are being booked at lower rates due to competitive pressures. Investment interest income decreased \$60 thousand to \$363 thousand for the second quarter of 2016 as compared to \$423 thousand for the second quarter of 2015 due to decreases in the investment portfolio used to fund loan growth. Interest expense decreased \$182 thousand, or 22.44%, from \$811 thousand for the quarter ended June 30,

2015 to \$629 thousand for the same quarter of 2016 as a result of time deposits re-pricing at lower interest rates at maturity, as well as a favorable shift in the deposit mix whereby our higher-cost time deposits were replaced with lower-cost deposit products.

A negative provision of \$500 thousand was recorded in the second quarter as a result of improved loan quality. Asset quality is discussed below.

Noninterest income for the second quarter of 2016 was \$1.8 million, which is an increase of \$212 thousand when compared to the \$1.5 million for the same period in 2015. This increase was primarily due to the \$135 thousand gain on the sale of investment securities during the quarter, compared to no investment security gains in the second quarter 2015. In June 2016, we began offering the Optional Overdraft Protection Service and Optional Overdraft Protection Service Plus products to our deposit customers. As a result our nonsufficient funds income and overdraft income increased by \$45 thousand during the quarter. We expect nonsufficient funds income and overdraft income to increase in the future as customers utilize these new services.

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Noninterest expense increased \$96 thousand, or 1.44%, to \$6.8 million for the second quarter 2016 as compared to \$6.7 million for the second quarter of 2015. Salaries and employee benefits increased \$457 thousand, or 15.86% in the quarter-to-quarter comparison from \$2.9 million at June 30, 2015 to \$3.3 million for the same period in 2016. This increase was primarily the result of seasoned commercial bankers hired during the fourth quarter of 2015 and first half of 2016 as a part of our strategy to grow the loan portfolio as well as staff added to operate the Interactive Teller Machines (“ITMs”). Occupancy and equipment expenses increased \$148 thousand from \$920 thousand for the second quarter of 2015 to \$1.1 million for the second quarter of 2016. Advertising expenses and data processing expenses increased \$57 thousand and \$73 thousand, respectively, in the quarter-to-quarter comparison. The increase in occupancy and equipment, advertising and data processing expenses was mainly due to the rollout of the ITMs during the second quarter of 2016. The ITMs, a new, state-of-the-art technology which replaced the Bank’s ATMs, will help provide additional convenience by providing teller services from 7 AM to 7 PM Monday thru Saturday. Other real estate owned and repossessed asset expenses decreased \$618 thousand, or 87.41%, to \$89 thousand for the second quarter of 2016 as compared to \$707 thousand for the same period in 2015.

### Year-to-Date Results

Highlights from the first six months of 2016 include:

- A reduction in nonaccrual loans of \$2.3 million, or 15.67% during the first six months of 2016;
- Net charge offs of \$344 thousand for the six-months ended June 30, 2016, which is an improvement of \$844 thousand, or 71.04%, versus net charges offs of \$1.2 million reported for the six-months ended June 30, 2015;
- \$18.4 million, or 4.18% increase in loans during the first six months of 2016; and,
- \$5.4 million, or 2.09% decrease in higher-costing time deposits during the first six months of 2016.

Net interest income year-to-date for June 30, 2016 was \$10.9 million, which was a slight decline of \$158 thousand, or 1.43% when compared to the same period in 2015. Loan interest income for the first six months of 2016 decreased \$528 thousand, or 4.51%, from \$11.7 million as of June 30, 2015 to \$11.2 million as of June 30, 2016.

This decrease is primarily related to continued high level of nonaccrual loans, and newer loans being booked at lower interest rates. Mostly offsetting the decline in interest income from loans was the decline in interest paid on deposits. Interest expense on deposits declined \$423 thousand, for the six-months ended June 30, 2016, when comparing it to the same period in 2015. The main driver in the decline in interest expense on deposits is the 3.73%, or \$21.5 million, decline in deposits when comparing the balances at June 30, 2016 and 2015, respectively. Also aiding in the decline in deposit expense is the favorable shift in the deposit mix of higher-costing time deposits to lower-costing non-time deposits.

A negative provision of \$500 thousand was recorded in the first half of 2016 as a result of improved loan quality. Asset quality is discussed below.

Year-to-date June 30, 2016, noninterest income increased to \$3.3 million from \$3.0 million in 2015. This increase was primarily due to the \$240 thousand gain on the sale of investment securities during the first six months, compared to the \$35 thousand gain on the sale of investment securities for the same period in 2015.

Noninterest expense increased \$204 thousand, or 1.58%, for the first six months of 2016 from \$12.9 million as of June 30, 2015 to \$13.1 million as of June 30, 2016. For the six months ended June 30, 2016, salaries and employee benefits increased \$725 thousand, or 12.45%, to \$6.5 million as compared to \$5.8 million for the same period in 2015. This increase was primarily the result of seasoned commercial bankers hired during the fourth quarter of 2015 and first half of 2016 as a part of our strategy to grow the loan portfolio as well as staff added to operate the ITMs. Total full time equivalent employees have increased to 262 at June 30, 2016 from 244 at June 30, 2015, an increase of 18, or 7.38%. Other real estate owned and repossessed asset expenses decreased \$814 thousand, or 76.36%, to \$252 thousand for the first six months of 2016 as compared to \$1.1 million for the same period in 2015. During the first six months of 2016 we had net gains on the sale of other real estate owned of \$185 thousand as compared to a net gain on the sale of other real estate owned of \$15 thousand for the same period in 2015. Writedowns on other real estate owned were \$24 thousand for the first six months of 2016 as compared to writedowns of \$639 thousand for the same period in 2015.

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Balance Sheet

Total assets increased \$6.4 million, or 1.02%, to \$632.3 million at June 30, 2016 from \$625.9 million at December 31, 2015. Loans showed an increase of \$18.4 million as a result of our efforts to conservatively grow the loan portfolio, which was funded by a \$24.8 million in investment sales during the first six months of 2016.

Total investments decreased \$25.0 million, or 24.61%, to \$76.6 million at June 30, 2016 from \$101.6 million at December 31, 2015. We sold \$24.8 million in investment securities during the first six months of 2016. These sales resulted in net realized gains of \$240 thousand. These sales were executed in order to take advantage of gains in the investment portfolio while providing liquidity to fund loan growth. Interest bearing deposits with banks increased \$2.5 million, or 2.28%, in the first six months of 2016 to \$13.8 million from \$11.3 million at December 31, 2015.

Total loans increased \$18.4 million, or 4.18%, to \$459.6 million at June 30, 2016 as compared to \$441.2 million at December 31, 2015. Our strategy is to conservatively grow the loan portfolio as we refocus our efforts away from complying with the Written Agreement to enhancing shareholder value. To assist in these efforts, we have added several commercial lenders, during the latter part of 2015 and first half of 2016, mostly focused in the tri-cities market of Bristol, VA and TN, Kingsport, TN, and Johnson City, TN. We expect increasing total loans during the latter half of 2016 to be comparable to the rate of growth we experienced in the first six months of 2016, subject to economic conditions, customer demand, and competition in our markets.

Total deposits decreased \$2.9 million from \$558.0 million at December 31, 2015 to \$555.1 million at June 30, 2016. Noninterest bearing deposits declined 0.65%, or \$1.0 million, from \$149.7 million at December 31, 2015 to \$148.7 million at June 30, 2016. We experienced an increase of \$12.4 million, or 41.22%, in interest-bearing demand deposits during the first six months of 2016. We have experienced a \$9.1 million, or 7.47%, decrease in non-maturity deposits. Time deposits decreased by \$5.4 million, or 2.09%, from \$257.0 million at December 31, 2015 to \$251.6 million at June 30, 2016. Time deposit levels have stabilized during the second quarter of 2016 and we do not anticipate decreasing any further in the foreseeable future. Overall, we continue to maintain core deposits through attractive consumer and commercial deposit products and strong ties with our customer base and communities. The shift from higher-costing time deposits to lower-costing deposit products represents a favorable repositioning of the Company's deposit mix. We have recently increased our interest rates on time deposits in an effort to stop shrinking the bank, to help provide funds for loan growth, and to increase deposit market share. Existing higher cost deposits should continue to reprice at lower interest rates, but the level of these higher yielding deposits is decreasing; thus, the opportunity to continue decreasing interest expense will diminish.

Total borrowings increased to \$9.4 million at June 30, 2016, an increase of \$6.4 million from the \$3.0 million outstanding balance at December 31, 2015. Borrowings decreased \$600 thousand during the first six months of 2016 due to regularly scheduled principal payments on the \$3.0 million outstanding at December 31, 2015. In June 2016 we borrowed \$7.0 million in advances from the Federal Home Loan Bank to take advantage of lower interest rates to also help fund our loan growth as we work to grow our deposits and loans.

Total equity at June 30, 2016 was \$48.5 million. That represents an increase of \$2.4 million, or 5.20%, when compared to the December 31, 2015 balance of \$46.1 million. Net income of \$1.6 million and the \$818 thousand increase in other comprehensive income resulting from an increase in net unrealized gains in the investment portfolio during the six months ended June 30, 2016 were the drivers of the increase in equity.

Asset Quality

We continue to make progress in reducing the levels of non-performing assets. However, as asset quality improves, the level of nonperforming assets remains elevated as a result of the prolonged deteriorated residential and commercial real estate markets, as well as the sluggish economy. Loans rated substandard decreased \$2.9 million, or 14.56%, to \$16.8 million at June 30, 2016 from \$19.7 million at December 31, 2015.

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The ratio of nonperforming assets to total assets lowered to 4.22% at June 30, 2016 as compared to 4.35% at December 31, 2015. Nonperforming assets, which include nonaccrual loans, other real estate owned and past due loans greater than 90 days still accruing interest, decreased to \$26.7 million at June 30, 2016 from \$27.2 million at December 31, 2015, a reduction of \$590 thousand, or 2.17%. We continue undertaking extensive and more aggressive measures to work out problem credits and liquidate foreclosed properties in an effort to accelerate a reduction of nonperforming assets. Our goal is to reduce the nonperforming assets being mindful of the impact to earnings and capital; however, we may recognize some losses and reductions in the allowance for loan loss as we expedite the resolution of these problem assets. Delinquencies increased in the first six months of 2016 as total past due loans increased to \$15.6 million at June 30, 2016 from \$13.4 million at December 31, 2015, an increase of \$2.2 million, or 16.80%.

Other real estate owned (“OREO”) increased \$1.7 million to \$14.1 million at June 30, 2016 from \$12.4 million at December 31, 2015. All properties are available for sale by commercial and residential realtors under the direction of our Special Assets division. During the first six months of 2016, OREO increased by \$3.1 million as a result of settlement of foreclosed loans, which was offset by sales of \$1.5 million of our properties with gains of \$185 thousand realized as a result of the sales. Future sales of these properties are contingent upon an economic recovery; consequently, it is difficult to estimate the duration of our ownership of these assets. We do have lease agreements on certain other real estate owned properties which are generating rental income at market rates. Rental income on OREO properties was \$123 thousand for the first six months of 2016, an increase of \$21 thousand, or 20.59%, when compared to the \$102 thousand recognized in the first six months of 2015.

Our allowance for loan losses at June 30, 2016 was \$6.6 million, or 1.45% of total loans as compared to \$7.5 million, or 1.70% of total loans at December 31, 2015. Impaired loans decreased \$1.5 million, or 8.57%, to \$15.8 million with an estimated related allowance of \$895 thousand for potential losses at June 30, 2016 as compared to \$17.3 million in impaired loans with an estimated related allowance of \$983 thousand at the end of 2015. No provision for loan losses was recorded during first six months of 2015 and the first quarter of 2016, while a negative provision of \$500 thousand was recorded in the second quarter of 2016. In the first six months of 2016, net charge offs were \$344 thousand, or 0.15% of average loans, as compared to \$1.2 million, or 0.53% of average loans, in the same period of 2015. The allowance for loan losses is being maintained at a level that management deems appropriate to absorb any potential future losses and known impairments within the loan portfolio whether or not the losses are actually ever realized. We continue to adjust the allowance for loan loss model to best reflect the risks in the portfolio and the improvements made in our internal policies and procedures; however, future provisions may be deemed necessary.

### Capital Ratios

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board’s Small Bank Holding Company Policy Statement issued in February 2015, and is no longer obligated to report consolidated regulatory capital. The Bank continues to be subject to various capital requirements administered by banking agencies.



At June 30, 2016, the Bank remains well capitalized under the regulatory framework for prompt corrective action. The following ratios existed at June 30, 2016 for the Bank: Tier 1 leverage ratio of 9.98%, Tier 1 risk based capital ratio of 15.70%, Total risk based capital ratio of 16.95%, and Common Equity Tier 1 ratio of 15.70%. The ratios were as follows at December 31, 2015: Tier 1 leverage ratio of 9.67%, Tier 1 risk based capital ratio of 16.29%, Total risk based capital ratio of 17.55%, and Common Equity Tier 1 ratio of 16.29%.

The ratios mentioned above for the Bank comply with the Federal Reserve rules to align with the Basel III Capital requirements effective January 1, 2015. As a result of these new rules the Bank is now subject to a Common Equity Tier 1 ratio set out above.

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## Deferred Tax Asset and Income Taxes

Due to timing differences between book and tax treatment of several income and expense items, a net deferred tax asset of \$4.8 million existed at June 30, 2016 as compared to a net deferred tax asset of \$5.1 million at December 31, 2015. At June 30, 2016 we had a valuation allowance of \$5.1 million as compared to a valuation allowance of \$5.7 million at December 31, 2015. During the first six months of 2016 we reversed \$553 thousand of our deferred tax valuation allowance. As of June 30, 2016, the Company had \$15.2 million of net operating loss carryforwards which will expire in 2031 thru 2035. Management expects to utilize all of these carryforwards prior to expiration. Direct charge-offs contributed to a reduction of the tax asset and are permitted as tax deductions. In addition, writedowns on other real estate owned property are expensed for book purposes but are not deductible for tax purposes until disposition of the property. Goodwill expense also was realized for book purposes in 2011 but continues to only be tax deductible based on the statutory requirements; thus, creating a deferred tax asset. When, and if, taxable income increases in the future and during the net operating loss carryforward period, this valuation allowance may be reversed and used to decrease tax obligations in the future. Our income tax expense was computed at the normal corporate income tax rate of 34% of taxable income included in net income. We do not have significant nontaxable income or nondeductible expenses.

## Capital Resources

Our total capital at the end of the first quarter 2016 was \$48.5 million compared to \$46.1 million at December 31, 2015. The increase was \$2.4 million, or 5.20%. New Peoples equity as a percentage of total assets was 7.67% at June 30, 2016 compared to 7.36% at December 31, 2015. The tangible book value per common share was \$2.08 at June 30, 2016 compared to \$1.97 at December 31, 2015.

Total assets increased during the first six months 2016 and we anticipate asset levels to increase in the future due to an emphasis on growing the loan portfolio and the core deposit base of the Bank. Our primary source of capital comes from earnings. Under current economic conditions, we believe it is prudent to continue to increase capital to support planned asset growth while being able to absorb potential losses that may occur if asset quality deteriorates further. Based upon projections, we believe retained earnings will be sufficient to support the Bank's planned asset growth. As part of our initiative to maintain well capitalized status as defined by regulatory guidelines, we are working to further replace our nonperforming assets with high-quality interest-earning assets. We are also focused on improving earnings by maintaining a strong net interest margin and decreasing overhead expenses. However, these efforts alone may not provide us adequate capital if further losses related to OREO or loans are realized.

No cash dividends have been paid historically and we do not anticipate paying a cash dividend in the foreseeable future as the Company continues to have a retained deficit. Earnings will continue to be retained to build capital and position the Company to pay a dividend to its shareholders as soon as practicable.

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## Liquidity

We closely monitor our liquidity and our liquid assets which consist of cash, due from banks, federal funds sold, and unpledged available for sale investments. Collectively, those balances were \$96.4 million at June 30, 2016, down from \$112.6 million at December 31, 2015. A surplus of short-term assets are maintained at levels management deems adequate to meet potential liquidity needs.

At June 30, 2016, all of our investments are classified as available-for-sale. These investments provide an additional source of liquidity in the amount of \$64.1 million, which is net of the \$12.5 million of securities pledged as collateral. Investment securities available for sale serve as a source of liquidity while yielding a higher return versus other short term investment options, such as federal funds sold and overnight deposits with the Federal Reserve Bank. Due to maturities, paydowns, and sales of securities to fund loan growth our investment portfolio has declined from \$101.6 million at December 31, 2015 to \$76.6 million at June 30, 2016. A \$1.2 million increase in the fair market value of the investment portfolio during the first six months of 2016 resulted in a net unrealized gain of \$743 thousand at June 30, 2016 compared to the net unrealized loss of \$496 thousand at December 31, 2015.

Available third-party sources of liquidity at June 30, 2016 include the following: a line of credit with the Federal Home Loan Bank of Atlanta, access to brokered certificates of deposit markets and internet certificates of deposit, and the discount window at the Federal Reserve Bank of Richmond. In May 2015, we received notification that a \$3.0 million unsecured federal funds line of credit facility with a correspondent bank had been reinstated. In February 2016, we received notification that this facility had been increased to \$5.0 million. In March 2016, we received notification that another correspondent bank had reinstated an unsecured federal funds line of credit facility in the amount of \$5.0 million. As a result we had the ability to borrow \$10.0 million in unsecured federal funds as of June 30, 2016, which gives us an additional source of liquidity.

At June 30, 2016, we had borrowings from the Federal Home Loan Bank ("FHLB") totaling \$9.4 million as compared to \$3.0 million at December 31, 2015. None of the FHLB advances are overnight borrowings and therefore none of the advances are subject to daily interest rate changes. \$2.4 million of the borrowings have a maturity date in the year 2018, but are amortizing monthly or quarterly. These borrowings decreased \$600 thousand during the first six months of 2016 due to regularly scheduled principal payments. In June 2016 the Bank borrowed an additional \$2.0 million with a maturity date in the year 2019 and an additional \$5.0 million borrowing with a maturity date in the year 2021. These borrowings were done to take advantage of lower interest rates to also help fund our loan growth as we work to grow our deposits and loans. We also used our line of credit with the Federal Home Loan Bank to issue letters of credit for \$7.0 million in 2013 and \$5.0 million in 2015 to the Treasury Board of Virginia for collateral on public funds. An additional \$81.3 million was available on June 30, 2016 on the \$102.7 million line of credit, which is secured by a blanket lien on our residential real estate loans.

We have access to the brokered deposits market. Currently we have \$2.7 million in 10-year term time deposits comprised of \$3 thousand incremental deposits which yield an interest rate of 4.10%. With the exception of CDARS time deposits, we have no other brokered deposits. Though this has not been a strategy in the past, we may utilize this

source in the future as a lower cost source of funds. In February 2016, our ability to participate in CDARS one way buys was reinstated. As of June 30, 2016 we had \$2.8 million in CDARS one way buys outstanding.

We are a member of an internet certificate of deposit network whereby we may purchase funds from other financial institutions at auction. We may invest funds through this network as well. Currently, we only intend to use this source of liquidity in a liquidity crisis event.

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The Bank has access to additional liquidity through the Federal Reserve Bank discount window for overnight funding needs. We may collateralize this line with investment securities and loans at our discretion; however, we do not anticipate using this funding source except as a last resort.

Additional liquidity is expected to be provided by loan repayments and core deposit growth that will result from an increase in market share in our targeted trade area. During the first six months of 2016, rates paid on time deposits were increased in an effort to slow down the trend of declining time deposit balances.

With the increased asset liquidity and other external sources of funding, we believe we have adequate liquidity and capital resources to meet our requirements and needs for the foreseeable future. However, liquidity can be further affected by a number of factors such as counterparty willingness or ability to extend credit, regulatory actions and customer preferences, etc.

The bank holding company has \$1.1 million in cash on deposit at the Bank as of June 30, 2016. These funds will be used to pay operating expenses, trust preferred interest payments, and provide additional capital injections to the Bank, if needed.

The Company is making quarterly interest payments on the trust preferred securities. The restriction requiring regulatory approval before the payment of interest on the trust preferred securities was lifted when the Written Agreement was terminated effective January 20, 2016.

During the capital raise in 2012, common stock warrants were issued to investors. The warrants are immediately exercisable through December 2017 at a price of \$1.75 per share. No warrants were exercised during the first six months of 2016 and the number of warrants outstanding at June 30, 2016 was 882,353. If these warrants are exercised, additional funds may be received by the Company, which provides potentially up to \$1.5 million in additional liquidity and capital to the holding company. Additional contingent funding sources will be explored as available.

### **Off Balance Sheet Items and Contractual Obligations**

There have been no material changes during the quarter ended June 30, 2016 to the off-balance sheet items and the contractual obligations disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2015.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not Applicable.

### **Item 4. Controls and Procedures**

We have carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer (our “CEO”) and our Senior Vice President and Chief Financial Officer (our “CFO”), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were operating effectively in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

### **Changes in Internal Control Over Financial Reporting**

There were no changes in the Company’s internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended June 30, 2016 that have materially affected or are reasonably likely to materially affect the Company’s internal control over financial reporting.

## **Part II Other Information**

### **Item 1. Legal Proceedings**

On June 24, 2015 New Peoples Bank filed an Amended Complaint in the Circuit Court of Russell County Virginia against Arthur Wayne Bostic, Michael W. Bostic, Sr. and Jeffrey C. Bostic to enforce guarantees of loans made to Bostic Ford Sales, Inc. and seeking judgment against the guarantors for \$1,427,709.76 with interest and legal fees. On July 24, 2015 Arthur Bostic filed a counterclaim against New Peoples Bank. On March 8, 2016 Michael Bostic, Sr. and Jeffrey Bostic filed their counterclaims against the Bank. The counterclaims assert lender liability theories of recovery and arise from the refusal of the Bank to continue to extend credit to Bostic Ford Sales, Inc. in 2008-2009. The defendants seek a judgment against the Bank of at least \$3 million.

**Item 1A. Risk Factors**

Not Applicable.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not Applicable

**Item 3. Defaults Upon Senior Securities**

Not Applicable

**Item 4. Mine Safety Disclosures**

Not Applicable

**Item 5. Other Information**

Not Applicable

**Item 6. Exhibits**

See Index of Exhibits.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

August 10, 2013

**NEW PEOPLES BANKSHARES, INC.**  
**(Registrant)**

By: /s/ C. TODD ASBURY  
C. Todd Asbury  
President and Chief Executive Officer

Date: August 15, 2016

By: /s/ JOSEPH D. PENNINGTON  
Joseph D. Pennington  
Senior Vice President and Chief Financial Officer

Date: August 15, 2016

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Index of Exhibits

|            |  |
|------------|--|
| Une        |  |
| 30         |  |
| <b>arc</b> |  |
|            | <u>Description</u>   |
| <u>No.</u> |  |
| 2.1        | Agreement and Plan of Share Exchange dated August 15, 2011 (incorporated by reference to Exhibit 2 to Form 8-K filed December 17, 2011).   |
| 3.1        | Amended Articles of Incorporation of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q for the quarterly period ended June 30, 2008 filed on August 11, 2008).   |
| 3.2        | Bylaws of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K filed on April 15, 2004).   |
| 4.1        | Specimen Common Stock Certificate of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 4.1 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).   |
| 4.2        | Form of Warrant to Purchase Shares of Common Stock (incorporated by reference to Exhibit 4.2 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).  |
| 4.3        | Form of Rights Certificate (incorporated by reference to Exhibit 4.3 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).  |
| 10.1*      | New Peoples Bank, Inc. 2001 Stock Option Plan (incorporated by reference to Exhibit 10.1 to Annual Report on Form 10-KSB for the fiscal year ended December 31, 2001).   |
| 10.2*      | Form of Non-Employee Director Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 8-K filed November 30, 2004).  |
| 10.3*      | Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Form 8-K filed November 30, 2004).  |
| 10.4*      | Salary Continuation Agreement dated December 18, 2002 between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.6 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).  |
| 10.5*      | First Amendment dated June 30, 2003 to Salary Continuation Agreement between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.7 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).   |
| 10.6*      | Letter Agreement, dated as of June 29, 2009, between the Company and Kenneth D. Hart (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2009).   |
| 10.7       | Written Agreement, effective August 4, 2010, by and among New Peoples Bankshares, Inc., New Peoples Bank, Inc., the Federal Reserve Bank of Richmond and the State Corporation Commission Bureau of Financial Institutions (incorporated by reference to Exhibit 10.1 to Form 8-K filed August 6, 2010). |
| 10.8       | Engagement Letters of Scott & Stringfellow, LLC (incorporated by reference to Exhibit 10.8 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).  |
| 10.9       | Convertible Note Payable, B. Scott White, dated June 27, 2012 (incorporated by reference to Exhibit 10.1 to Form 8-K filed June 29, 2012).   |
| 10.10      | Convertible Note Payable, Harold Lynn Keene, dated June 27, 2012 (incorporated by reference to Exhibit 10.2 to Form 8-K filed June 29, 2012).  |
| 31.1       | Certification by Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.  |
| 31.2       | Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.  |

- 32 Certification by Chief Executive Officer and Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.  
The following materials for the Company's 10-Q Report for the quarterly period ended June 30, 2016, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the
- 101 Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to the Consolidated Financial Statements, tagged as blocks of text.

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\* Denotes management contract.

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