OLD POINT FINANCIAL CORP
Form 10-K
March 11, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

or

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

For the transition period from __________ to __________

Commission file number 000-12896

OLD POINT FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Virginia	54-1265373
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1 West Mellen Street, Hampton, Virginia 23663
(Address of principal executive offices) (Zip Code)

(757) 728-1200
(Registrant's telephone number, including area code)

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

Common Stock, $5 par value	The NASDAQ Stock Market LLC
(Title of each class)	(Name of each exchange on which registered)

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

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

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

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

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

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

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [X]

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

The aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of June 30, 2015 was $52,177,061 based on the closing sales price on the NASDAQ Capital Market of $15.63.

There were 4,959,009 shares of common stock outstanding as of March 8, 2016.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Company's Annual Meeting of Stockholders to be held on May 24, 2016, are incorporated by reference in Part III of this report.

OLD POINT FINANCIAL CORPORATION

FORM 10-K

INDEX

PART I		Page
Item 1.	Business	1
Item 1A.	Risk Factors	8
Item 1B.	Unresolved Staff Comments	16
Item 2.	Properties	16
Item 3.	Legal Proceedings	16
Item 4.	Mine Safety Disclosures	17
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	17
Item 6.	Selected Financial Data	18
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	43
Item 8.	Financial Statements and Supplementary Data	43
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	92
Item 9A.	Controls and Procedures	92
Item 9B.	Other Information	93
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	93
Item 11.	Executive Compensation	93
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	94
Item 13.	Certain Relationships and Related Transactions, and Director Independence	94
Item 14.	Principal Accountant Fees and Services	94
PART IV		
Item 15.	Exhibits, Financial Statement Schedules	94
	Index to Consolidated Financial Statements	94
	Index to Exhibits	94
	Signatures	96

Part I
Item 1. Business

GENERAL

Old Point Financial Corporation (the Company) was incorporated under the laws of Virginia on February 16, 1984, for the purpose of acquiring all the outstanding common stock of The Old Point National Bank of Phoebus (the Bank), in connection with the reorganization of the Bank into a one-bank holding company structure. At the annual meeting of the stockholders on March 27, 1984, the proposed reorganization was approved by the requisite stockholder vote. At the effective date of the reorganization on October 1, 1984, the Bank merged into a newly formed national bank as a wholly-owned subsidiary of the Company, with each outstanding share of common stock of the Bank being converted into five shares of common stock of the Company.

The Company completed a spin-off of its trust department as of April 1, 1999. The organization is chartered as Old Point Trust & Financial Services, N.A. (Trust). Trust is a nationally chartered trust company. The purpose of the spin-off was to have a corporate structure more ready to compete in the field of wealth management. Trust is a wholly-owned subsidiary of the Company.

The Bank is a national banking association that was founded in 1922. As of the end of 2015, the Bank had 18 branch offices serving the Hampton Roads localities of Hampton, Newport News, Norfolk, Virginia Beach, Chesapeake, Williamsburg/James City County, York County and Isle of Wight County. The Bank offers a complete line of consumer, mortgage and business banking services, including loan, deposit, and cash management services to individual and commercial customers.

The Company's primary activity is as a holding company for the common stock of the Bank and Trust. The principal business of the Company is conducted through its subsidiaries, which continue to conduct business in substantially the same manner as before the reorganization and spin-off.

As of December 31, 2015, the Company had assets of $896.8 million, loans of $568.5 million, deposits of $746.5 million, and stockholders' equity of $93.2 million. At year-end, the Company and its subsidiaries had a total of 296 employees, 21 of whom were part-time.

MARKET AREA AND COMPETITION

The Company's market area is located in Hampton Roads, situated in the southeastern corner of Virginia and boasting the world's largest natural deep-water harbor. The Hampton Roads Metropolitan Statistical Area (MSA) is the 37th most populous MSA in the United States according to the U.S. Census Bureau's 2010 census and the third largest deposit market in Virginia, after Richmond and the Washington Metropolitan area, according to the Federal Deposit Insurance Corporation (FDIC). Hampton Roads includes the cities of Chesapeake, Hampton, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk, Virginia Beach and Williamsburg, and the counties of Isle of Wight, Gloucester, James City, Mathews, York and Surry. The market area is serviced by 67 banks, savings institutions and credit unions and, in addition, branches of virtually every major brokerage house serve the Company's market area.

The banking business in Virginia, and in the Company's primary service areas in the Hampton Roads MSA, is highly competitive and dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have over the Company is their ability to finance wide-ranging advertising campaigns, and by virtue of their greater total capitalization, to have substantially higher lending limits than the Company. Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution affect competition for deposits and loans. The Company competes by emphasizing customer service and technology, establishing long-term customer relationships and building customer loyalty, and providing products and services to address the specific needs of the Company's customers. The Company targets individual and small-to-medium size business customers.

Concurrently, the Company continues to build a stronger presence in the business banking market, where greater opportunities for fee-based revenues and cross-selling exist. In 2009, the Company expanded its treasury services offerings by adding a Corporate Banking group and expanding its product offerings to match those offered by larger institutions. This expansion has continued throughout 2015 with an aim towards growth and relationship development. Through these business banking capabilities, the Company is able to service a highly lucrative market that offers the opportunities to identify new revenue streams and cross-sell additional products.

Personal assets held by non-banks are difficult to track at a local level, so research relies on deposits reported by governmental agencies to measure market share. In 2015, the Company held tenth place with 2.49% market share of all Hampton Roads deposits, as compared to 2.60% market share in 2014. On the Peninsula, the Company retains first place in Hampton with 31.69% market share and deposit growth from 2014 of over $17.0 million. While deposits dropped in James City County from 2014 by $732 thousand, deposits grew from 2014 in Newport News by over $2.0 million and in York County by $736 thousand.

In Southside Hampton Roads, the Company increased deposit share in Virginia Beach by $249 thousand over 2014 and moved up in rank from thirteenth to eleventh. However, in the Chesapeake, Isle of Wight County and Norfolk markets deposits decreased from 2014 by $435 thousand, $247 thousand and $4 million, respectively. Combined with heightened marketing efforts, the staff in the Company's newer locations continues to work diligently to increase the Company's name recognition in their respective regions of the Hampton Roads MSA.

The Company also faces competitive pressure from credit unions. The three largest credit unions headquartered in the Hampton Roads MSA are Chartway Federal Credit Union, Langley Federal Credit Union, and Newport News Shipbuilding Employees' Credit Union with deposits totaling approximately $1.8 billion, $1.6 billion and $1.1 billion, respectively. Both Chartway Federal Credit Union and Langley Federal Credit Union posted a positive growth rate for 2015.

AVAILABLE INFORMATION

The Company maintains a website on the Internet at www.oldpoint.com. The Company makes available free of charge, on or through its website, its proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). This reference to the Company's Internet address shall not, under any circumstances, be deemed to incorporate the information available at such Internet address into this Form 10-K or other SEC filings. The information available at the Company's Internet address is not part of this Form 10-K or any other report filed by the Company with the SEC. The public may read and copy any documents the Company files at the SEC's Public Reference Room at 100 F Street, N.E. Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company's SEC filings can also be obtained on the SEC's website on the Internet at www.sec.gov.

REGULATION AND SUPERVISION

Set forth below is a brief description of some of the material laws and regulations that affect the Company. The description of these statutes and regulations is only a summary and is not a complete discussion or analysis. This discussion is qualified in its entirety by reference to the statutes and regulations summarized below. No assurance can be given that these statutes or regulations will not change in the future.

General. The Company continues to experience a period of rapidly changing regulations and an environment of constant regulatory reform. These regulatory changes have had and will continue to have a significant impact on how the Company conducts its business. The most significant of these laws is the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), adopted on July 21, 2010, to implement significant structural reforms to the financial services industry. The full extent of the Dodd-Frank Act and other potential regulatory reforms cannot yet be fully determined and will depend to a large extent on regulations that will be adopted in the future.

As a public company, the Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), which include, but are not limited to, the filing of annual, quarterly and other reports with the SEC. The Company is also required to comply with other laws and regulations of the SEC applicable to public companies.

The Company is also a bank holding company within the meaning of the Bank Holding Company Act of 1956 (the BHCA) and is registered as such with, and subject to the supervision of, the Board of Governors of the Federal Reserve System (the FRB). Generally, a bank holding company is required to obtain the approval of the FRB before acquiring direct or indirect ownership or control of more than five percent of the voting shares of a bank or engaging in an activity considered to be a non-banking activity, either directly or through a subsidiary. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates.

As a national bank, the Bank is subject to regulation, supervision and regular examination by the Office of the Comptroller of the Currency (the Comptroller). The prior approval of the Comptroller or other appropriate bank regulatory authority is required for a national bank to merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the constituent organizations and the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act (the CRA) and fair housing initiatives, the data security and cybersecurity infrastructure of the constituent organizations and the combined organization, and the effectiveness of the subject organizations in combating money laundering activities. Each depositor's account with the Bank is insured by the FDIC to the maximum amount permitted by law. The Bank is also subject to certain regulations promulgated by the FRB and applicable provisions of Virginia law, insofar as they do not conflict with or are not preempted by federal banking law.

As a non-depository national banking association, Trust is subject to regulation, supervision and regular examination by the Comptroller. Trust's exercise of fiduciary powers must comply with Regulation 9 promulgated by the Comptroller and with Virginia law.

The regulations of the FRB, the Comptroller and the FDIC govern most aspects of the Company's business, including deposit reserve requirements, investments, loans, certain check clearing activities, issuance of securities, payment of dividends, branching, and numerous other matters. Further, the federal bank regulatory agencies have adopted guidelines and released interpretive materials that establish operational and managerial standards to promote the safe and sound operation of banks and bank holding companies. These standards relate to the institution's key operating functions, including but not limited to internal controls, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings, compensation of management, information systems, data security and cybersecurity, and risk management. As a consequence of the extensive regulation of commercial banking activities in the United States, the Company's business is particularly susceptible to changes in state and federal legislation and regulations, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

The Bank Holding Company Act. As a bank holding company, the Company is subject to the BHCA and regulation and supervision by the FRB. A bank holding company is required to obtain the approval of the FRB before making certain acquisitions or engaging in certain activities. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates.

A bank holding company is required to obtain the approval of the FRB before it may acquire all or substantially all of the assets of any bank, and before it may acquire ownership or control of the voting shares of any bank if, after giving effect to the acquisition, the bank holding company would own or control more than 5 percent of the voting shares of such bank. The approval of the FRB is also required for the merger or consolidation of bank holding companies.

Pursuant to the BHCA, the FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or ownership constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

The Company is required to file periodic reports with the FRB and provide any additional information the FRB may require. The FRB also has the authority to examine the Company and its subsidiaries, as well as any arrangements between the Company and its subsidiaries, with the cost of any such examinations to be borne by the Company. Banking subsidiaries of bank holding companies are also subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates.

The Dodd-Frank Act. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including changes that will affect all bank holding companies and banks, including the Company and the Bank. Among other provisions, the Dodd-Frank Act:

- changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000;

- repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;

- created and centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (CFPB), which is discussed in more detail below;

- imposed limits for debit card interchange fees for issuers that have assets greater than $10 billion, which also could affect the amount of interchange fees collected by financial institutions with less than $10 billion in assets;

- restricted the preemption of state law by federal law and disallowed subsidiaries and affiliates of national banks from availing themselves of such preemption;

- imposed comprehensive regulation of the over-the-counter derivatives market subject to significant rulemaking processes, to include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;

- required loan originators to retain 5 percent of any loan sold or securitized, unless it is a "qualified residential mortgage", subject to certain restrictions;

- prohibited banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and

- implemented corporate governance revisions that apply to all public companies, not just financial institutions.

Dodd-Frank Act provisions that require revisions to the capital requirements of the Company, the Bank and Trust could impact their ability to raise capital in the future. Although the Company has not issued trust preferred securities, Dodd-Frank Act provisions that revoke the Tier 1 capital treatment of trust preferred securities could cause the Company, the Bank and Trust to seek other sources of capital in the future. Some of the rules that have been adopted or proposed to comply with Dodd-Frank Act mandates are discussed in more detail below.

Capital Requirements and Prompt Corrective Action. The FRB, the Comptroller and the FDIC have adopted risk-based capital adequacy guidelines for bank holding companies and banks pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) and the Basel III Capital Accords. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources" in Item 7 of this report on Form 10-K.

The federal banking agencies have broad powers to take prompt corrective action to resolve problems of insured depository institutions. Under the FDICIA, there are five capital categories applicable to bank holding companies and insured institutions, each with specific regulatory consequences. The extent of the agencies' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." These terms are defined under uniform regulations issued by each of the federal banking agencies. If the appropriate federal banking agency determines that an insured institution is in an unsafe or unsound condition, it may reclassify the institution to a lower capital category (other than critically undercapitalized) and require the submission of a plan to correct the unsafe or unsound condition.

Failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for a financial institution could subject the Company and its subsidiaries to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting or renewing brokered deposits, limitations on the rates of interest that the institution may pay on its deposits, and other restrictions on its business. In addition, an institution may not make a capital distribution, such as a dividend or other distribution that is in substance a distribution of capital to the owners of the institution if following such a distribution the institution would be undercapitalized. Thus, if the making of such dividend would cause the Bank to become undercapitalized, it could not pay a dividend to the Company.

Basel III Capital Framework. The federal bank regulatory agencies have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the Basel III Final Rules). For purposes of these capital rules, (i) common equity Tier 1 capital (CET1) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stock and trust preferred securities; and (iii) Tier 2 capital consists principally of Tier 1 capital plus qualifying subordinated debt and preferred stock, and limited amounts of an institution's allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, including, importantly, applying higher risk weightings to certain commercial real estate loans.

The Basel III Final Rules were effective on January 1, 2015, and the Basel III Final Rules' capital conservation buffer (as described below) will be phased in through 2019. When fully phased in, the Basel III Final Rules require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, and primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. These deductions from and adjustments to regulatory capital are generally subject to a phase in period, which began in 2015 and will continue through 2018.

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

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC. The basic limit on FDIC deposit insurance coverage is $250,000 per depositor.

Under the Federal Deposit Insurance Act (FDIA), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations as an insured institution, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target "designated reserve ratio" (described in more detail below) of 2 percent for the DIF, and established a lower assessment rate schedule when the reserve ratio reaches 1.15 percent and, in lieu of dividends, provides for a lower assessment rate schedule, when the reserve ratio reaches 2 percent and 2.5 percent.

An institution's assessment rate depends upon the institution's assigned risk category, which is based on supervisory evaluations, regulatory capital levels and certain other factors. Initial base assessment rates range from 2.5 to 45 basis points. The FDIC may make the following further adjustments to an institution's initial base assessment rates: decreases for long-term unsecured debt including most senior unsecured debt and subordinated debt; increases for holding long-term unsecured debt or subordinated debt issued by other insured depository institutions; and increases for brokered deposits in excess of 10 percent of domestic deposits for institutions not well rated and well capitalized.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the "designated reserve ratio." Among other changes, the Dodd-Frank Act (i) raised the minimum designated reserve ratio to 1.35 percent and removed the upper limit on the designated reserve ratio, (ii) requires that the designated reserve ratio reach 1.35 percent by September 2020, and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than $10 billion of raising the designated reserve ratio from 1.15 percent to 1.35 percent – which requirement will be met through rules proposed by the FDIC during 2015. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis. The FDIC has adopted a DIF restoration plan to ensure that the fund reserve ratio reaches 1.35 percent by September 30, 2020, as required by the Dodd-Frank Act.

The Sarbanes-Oxley Act. The Sarbanes-Oxley Act (SOX) enacted major reforms of the federal securities laws intended to protect investors by improving the accuracy and reliability of corporate disclosures. It impacts all companies with securities registered under the Exchange Act, including the Company. SOX creates increased responsibility for chief executive officers and chief financial officers with respect to the content of filings with the SEC. Section 404 of SOX and related SEC rules focused increased scrutiny by internal and external auditors on the Company's systems of internal controls over financial reporting, to insure that those internal controls are effective in both design and operation. SOX sets out enhanced requirements for audit committees, including independence and expertise, and it includes stronger requirements for auditor independence and limits the types of non-audit services that auditors can provide. Finally, SOX contains additional and increased civil and criminal penalties for violations of securities laws.

Incentive Compensation Guidance. The FRB, the Comptroller and the FDIC have issued regulatory guidance (the Incentive Compensation Guidance) intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The FRB will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." The findings will be included in reports of examination, and deficiencies will be incorporated into the organization's supervisory ratings. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

As required by the Dodd-Frank Act, in March 2011 the SEC and the federal bank regulatory agencies proposed regulations that would require financial institutions with assets of at least $1 billion to disclose the structure of their incentive compensation practices and prohibit such institutions from maintaining executive compensation arrangements that encourage inappropriate risk taking by providing excessive compensation or that could lead to material financial loss. If the regulations are adopted in the form initially proposed, they will impose limitations on the manner in which a company whose total consolidated assets reach or exceed $1 billion may structure compensation for its executives and will require such company to submit annual reports to the Federal Reserve regarding the company's incentive compensation. These proposed regulations incorporate the principles discussed in the Incentive Compensation Guidance. A final rule has not yet been published. Although the final rule is not expected to apply to institutions with less than $1 billion in total consolidated assets, the federal banking agencies, including the Comptroller, emphasize that all banking organizations, regardless of size, must carefully design and oversee incentive compensation policies to ensure such policies do not undermine the safety and soundness of such organizations.

Community Reinvestment Act. The Company is subject to the requirements of the CRA, which imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution's efforts in meeting community credit needs are currently assessed based on specified factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility.

Confidentiality and Required Disclosures of Consumer Information. The Company is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure.

The Company is also subject to various laws and regulations that attempt to combat money laundering and terrorist financing. The Bank Secrecy Act requires all financial institutions to, among other things, create a system of controls designed to prevent money laundering and the financing of terrorism, and imposes recordkeeping and reporting requirements. The USA Patriot Act facilitates information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering, and requires financial institutions to establish anti-money laundering programs. The Federal Bureau of Investigation (FBI) sends banking regulatory agencies lists of the names of persons suspected of involvement in terrorist activities, and requests banks to search their records for any relationships or transactions with persons on those lists. If the Bank finds any relationships or transactions, it must file a suspicious activity report with the U.S. Department of the Treasury (the Treasury) and contact the FBI. The Office of Foreign Assets Control (OFAC), which is a division of the Treasury, is responsible for helping to ensure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name of an "enemy" of the United States on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds into a blocked account, file a suspicious activity report with the Treasury and notify the FBI.

Consumer Laws and Regulations. The Company is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act and the Fair Housing Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions transact business with customers. The Company must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

The CFPB is the federal regulatory agency responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. The CFPB supervises and regulates providers of consumer financial products and services and has rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth in Lending Act and the Real Estate Settlement Procedures Act). As a smaller institution (i.e., with assets of $10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the FRB and to the Bank by the Comptroller. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's prudential regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and banks, could influence how the FRB and Comptroller apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise effect of the CFPB's consumer protection activities on the Company cannot be forecast.

Mortgage Banking Regulation. In connection with making mortgage loans, the Bank is subject to rules and regulations that, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers, in some cases, restrict certain loan features and fix maximum interest rates and fees, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level. The Bank's mortgage origination activities are subject to the Equal Credit Opportunity Act, Truth in Lending Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, and Home Ownership Equity Protection Act, and the regulations promulgated under these acts, among other additional state and federal laws, regulations and rules.

The Bank's mortgage origination activities are also subject to Regulation Z, which implements the Truth in Lending Act. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined as mortgage loans without negative amortization, interest-only payments, balloon payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3% of the total loan amount. Higher-priced qualified mortgages (e.g., subprime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Bank does not originate first mortgage loans at this time, and the first mortgages it purchases comply with Regulation Z's "qualified mortgage" rules. The Bank does originate second mortgages, or equity loans, and these loans do not conform to the qualified mortgage criteria but comply with applicable ability-to-repay rules.

Volcker Rule. The Dodd-Frank Act prohibits bank holding companies and their subsidiary banks from engaging in proprietary trading except in limited circumstances, and places limits on ownership of equity investments in private equity and hedge funds (the Volcker Rule). On December 10, 2013, the U.S. financial regulatory agencies (including the FRB, the FDIC, the Comptroller and the SEC) adopted final rules to implement the Volcker Rule. In relevant part, these final rules would have prohibited banking entities from owning collateralized debt obligations (CDOs) backed by trust preferred securities (TruPS), effective July 21, 2015. However, subsequent to these final rules the U.S. financial regulatory agencies issued an interim rule effective April 1, 2014 to exempt CDOs backed by TruPS from the final rule implementing the Volcker Rule, provided that (a) the CDO was established prior to May 19, 2010, (b) the banking entity reasonably believes that the CDO's offering proceeds were used to invest primarily in TruPS issued by banks with less than $15 billion in assets, and (c) the banking entity acquired the CDO investment on or before December 10, 2013. The Company currently does not have any CDO investments, and the Company believes that its financial condition will not be significantly impacted by the Volcker Rule, the final rules or the interim rule. Smaller banks, with total consolidated assets of $10 billion or less, engaged in modest proprietary trading activities for their own accounts are subject to a simplified compliance program under the final rules. Several portions of the Volcker Rule remain subject to regulatory rulemaking and legislative activity, including to further delay effectiveness of some provisions of the Volcker Rule. The Company does not expect that any delays in the effectiveness of a portion of the Volcker Rule will significantly impact its financial condition.

Item 1A. Risk Factors

U.S. and international economic conditions and credit markets pose challenges for the Company and could adversely affect the results of operations, liquidity and financial condition. The Company is currently operating in a challenging and uncertain economic environment, both in the local markets it serves and in the broader national and international economies. In addition, uncertainty regarding oil prices, ongoing federal budget negotiations, the implementation of the employer mandate under the Patient Protection and Affordable Care Act, and the level of U.S. debt may present challenges to businesses and have a destabilizing effect on financial markets. If the economic recovery continues to be relatively weak or there is further deterioration of national or international economic conditions, the financial condition and operating performance of financial institutions, including the Company, could be adversely affected. Such adverse effects could include a decline in the value of the Company's securities portfolio, and could increase the regulatory scrutiny of financial institutions. Another deterioration of local economic conditions could again lead to declines in real estate values and home sales and increases in the financial stress on borrowers and unemployment rates, all of which could lead to increases in loan delinquencies, problem assets and foreclosures and reductions in loan collateral value. Such a deterioration of local economic conditions could cause the level of loan losses to exceed the level the Company has provided in its allowance for loan losses which, in turn, would reduce the Company's earnings.

Global credit market conditions could return to being disrupted and volatile. Although the Company remains well capitalized and has not suffered any liquidity issues, the cost and availability of funds may be adversely affected by illiquid credit markets. Any future turbulence in the U.S. and international markets and economy may adversely affect the Company's liquidity, financial condition and profitability.

The Company is subject to interest rate risk and variations in interest rates may negatively affect its financial performance. The Company's profitability depends in substantial part on its net interest margin, which is the difference between the rates received on loans and investments and the rates paid for deposits and other sources of funds. The net interest margin depends on many factors that are partly or completely outside of the Company's control, including competition; federal economic, monetary and fiscal policies; and economic conditions. Changes in interest rates affect operating performance and financial condition. Because of the differences in the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect the Company's net interest margin and, in turn, its profitability. In December 2015, the FRB's Federal Open Market Committee raised the target range for the federal funds rate, which is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight, to 0.25%-0.50%, which was the first change since the target range was lowered to 0%-0.25% in 2008. The FOMC's monetary policy remains accommodative after this increase, and the overall low interest rate environment is expected to continue in 2016. Continued low interest rates could put further pressure on the yields generated by the Company's loan portfolio and on the Company's net interest margin. At December 31, 2015, based on scheduled maturities only, the Company's balance sheet was liability sensitive at the one-year time frame and, as a result, its net interest margin will tend to decrease in a rising interest rate environment and increase in a declining interest rate environment. However, when using decay rates to simulate maturities for non-maturing deposits, the Company's balance sheet as of December 31, 2015 is asset sensitive at the one-year time frame. When the Company is asset sensitive, the net interest margin should rise if rates rise and should fall if rates fall. For additional details, See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Sensitivity" in Item 7 of this report on Form 10-K.

In addition, any substantial and prolonged increase in market interest rates could reduce the Company's customers' desire to borrow money or adversely affect their ability to repay their outstanding loans by increasing their credit costs. Interest rate changes could also affect the fair value of the Company's financial assets and liabilities. Accordingly, changes in levels of market interest rates could materially and adversely affect the Company's net interest margin, asset quality, loan origination volume, business, financial condition, results of operations and cash flows.

System failures, interruptions, breaches of security, or the failure of a third-party provider to perform its obligations could adversely impact the Company's business operations and financial condition. Communications and information systems are essential to the conduct of the Company's businesses, as such systems are used to manage customer relationships, general ledger, deposits and loans. While the Company has established policies and procedures to prevent or limit the impact of systems failures, interruptions and security breaches, the Company's information, security, and other systems may stop operating properly or become disabled or damaged as a result of a number of factors, including events beyond the Company's control, such as sudden increases in customer transaction volume, electrical or telecommunications outages, natural disasters, and cyber-attacks. Information security risks have increased in recent years in part because of the proliferation of new technologies to conduct financial transactions and the increased sophistication and activities of hackers, activists and other external parties. The Company may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. In addition, any compromise of the security systems could deter customers from using the Bank's website and online banking service, both of which involve the transmission of confidential information. The security and authentication precautions imposed by the Company and the Bank may not protect the systems from compromises or breaches of security, which would adversely affect the Company's results of operations and financial condition.

In addition, the Company outsources certain data processing to certain third-party providers. Accordingly, the Company's operations are exposed to risk that these third-party providers will not perform in accordance with the contracted arrangements under service agreements. If the third-party providers encounter difficulties, or if the Company has difficulty in communicating with them, the Company's ability to adequately process and account for customer transactions could be affected, and the Company's business operations could be adversely impacted. Further, a breach of a third-party provider's technology may cause loss to the Company's customers. Replacing these third-party providers could also create significant delay and expense. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any systems failure, interruption or breach of security, or the failure of a third-party provider to perform its obligations, could expose the Company to risks of data loss or data misuse, could damage the Company's reputation and result in a loss of customers and business, could subject it to additional regulatory scrutiny or could expose it to civil litigation, possible financial liability and costly response measures. Any of these occurrences could have a material adverse effect on the Company's financial condition and results of operations.

The Company's accounting estimates and risk management processes rely on analytical and forecasting models. Processes that management uses to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on the Company's earnings performance and liquidity, depend upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are accurate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation.

If the models that management uses for interest rate risk and asset-liability management are inadequate, the Company may incur increased or unexpected losses upon changes in market interest rates or other market measures and may be unable to maintain sufficient liquidity. If the models that management uses to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the Company could realize upon sale or settlement of such financial instruments. Any such failure in management's analytical or forecasting models could have a material adverse effect on the Company's business, financial condition and results of operations.

Weaknesses in the commercial real estate markets could negatively affect the Company's financial performance due to the Company's concentration in commercial real estate loans. At December 31, 2015, the Company had $297.4 million, or 52.32%, of total loans concentrated in commercial real estate, which includes, for purposes of this concentration, all construction loans, loans secured by multifamily residential properties, loans secured by farmland and loans secured by nonfarm, nonresidential properties. Commercial real estate loans expose the Company to a greater risk of loss than residential real estate and consumer loans. Commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Consequently, an adverse development with respect to one commercial real estate loan or credit relationship exposes the Company to a significantly greater risk of loss compared to an adverse development with respect to one residential real estate loan. Commercial real estate loans carry risks associated with the successful operation of a business if the properties are owner occupied. If the properties are non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts. Repayment of commercial real estate loans may, to a greater extent than residential real estate loans, be subject to adverse conditions in the real estate market or economy. Weak economic or market conditions may impair a borrower's business operations, slow the execution of new leases and lead to turnover in existing leases. The combination of these factors could result in deterioration in value of some of the Company's loans. The deterioration of one or more of the Company's significant commercial real estate loans could cause a significant increase in nonaccrual loans. An increase in nonaccrual loans could result in a loss of interest income from those loans, an increase in the provision for loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial performance.

The Company's profitability depends significantly on local economic conditions and changes in the federal government's military or defense spending may negatively affect the local economy. The Company's success depends primarily on the general economic conditions of the markets in which the Company operates. Unlike larger financial institutions that are more geographically diversified, the Company provides banking and financial services to customers primarily in the Hampton Roads MSA. The local economic conditions in this area have a significant impact on the demand for loans, the ability of the borrowers to repay these loans and the value of the collateral securing these loans. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, unemployment or other factors beyond the Company's control could impact these local economic conditions.

In addition, Hampton Roads is home to one of the largest military installations in the world and one of the largest concentrations of Department of Defense personnel in the United States. Some of the Company's customers may be particularly sensitive to the level of federal government spending on the military or on defense-related products. Federal spending is affected by numerous factors, including macroeconomic conditions, presidential administration priorities, and the ability of the federal government to enact relevant appropriations bills and other legislation. Any of these factors could result in future cuts to military or defense spending or increased uncertainty about federal spending, which could have a severe negative impact on individuals and businesses in the Company's primary service area. Any related increase in unemployment rates or reduction in business development activities in the Company's primary service area could lead to increases in loan delinquencies, problem assets and foreclosures and reductions in loan collateral value, which could have a material adverse effect on the Company's operating results and financial condition.

The Company is subject to losses resulting from fraudulent and negligent acts on the part of loan applicants, correspondents or other third parties. The Company relies heavily upon information supplied by third parties, including the information contained in credit applications, employment and income documentation, property appraisals, title information, and equipment pricing and valuation, in deciding which loans to originate, as well as in establishing the terms of those loans. If any of the information upon which the Company relies during the loan approval process is misrepresented, either fraudulently or inadvertently, and the misrepresentation is not detected prior to asset funding, the value of the asset may be significantly lower than expected, the Company may fund a loan that it would not have otherwise funded or the Company may fund a loan on terms that it would not have otherwise extended. Whether a misrepresentation is made by the applicant or by another third party, the Company generally bears the risk of loss associated with the misrepresentation. In addition, a loan subject to a material misrepresentation is typically unsellable or subject to repurchase if it is sold prior to detection of the misrepresentation. The sources of the misrepresentation are often difficult to locate, and it may be difficult to recover any monetary loss the Company may suffer.

Declines in loans outstanding could have a material adverse impact on the Company's operating results and financial condition. If quality loan demand does not continue to increase and the Company's loan portfolio begins to decline, the Company expects that excess liquidity will be invested in marketable securities. Because loans typically yield higher returns than the Company's securities portfolio, a shift towards investments in the Company's asset mix would likely result in an overall reduction in net interest income and the net interest margin. The principal source of earnings for the Company is net interest income, and as discussed above, the Company's net interest margin is a major determinant of the Company's profitability. The effects of a reduction in net interest income and the net interest margin may be exacerbated by the intense competition for quality loans in the Company's primary service area and by rate reductions on loans currently held in the portfolio. As a result, a reduction in loans could have a material adverse effect on the Company's operating results and financial condition.

The Company's substantial dependence on dividends from its subsidiaries may prevent it from paying dividends to its stockholders and adversely affect its business, results of operations or financial condition. The Company is a separate legal entity from its subsidiaries and does not have significant operations or revenues of its own. The Company substantially depends on dividends from its subsidiaries to pay dividends to stockholders and to pay its operating expenses. The availability of dividends from the subsidiaries is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Company and other factors, that the Comptroller could assert that payment of dividends by the subsidiaries is an unsafe or unsound practice. In the event the subsidiaries are unable to pay dividends to the Company, the Company may not be able to pay dividends on the Company's common stock, service debt or pay operating expenses. Consequently, the inability to receive dividends from the subsidiaries could adversely affect the Company's financial condition, results of operations, cash flows and limit stockholders' return, if any, to capital appreciation.

The small-to-medium size businesses the Company targets may have fewer financial resources to weather a downturn in the economy, which could materially harm operating results. The Company targets individual and small-to-medium size business customers. Small-to-medium-size businesses frequently have smaller market shares than their competitors, may be more vulnerable to economic downturns, often need substantial additional capital to expand and compete and may experience significant volatility in operating results. Any one or more of these factors may impair a borrower's ability to repay a loan. In addition, the success of a small-to-medium size business often depends on the management talents and efforts of one or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact businesses in the Company's primary service area could have a proportionately greater impact on small-to-medium-size businesses and accordingly could cause the Company to incur substantial credit losses that could negatively affect its results of operations and financial condition.

A decline in real estate values has caused the Company to experience losses in selling foreclosed properties, and the continuation of this decline could cause a significant portion of the Company's loan portfolio to be under-collateralized and lead to additional future losses. The market value of real estate, particularly real estate held for investment, can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. The Company's business activities and credit exposures are primarily concentrated in the Hampton Roads MSA. If the value of the real estate serving as collateral for the Company's loan portfolio were to decline materially, a significant part of the loan portfolio could become under-collateralized. If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then, in the event of foreclosure, the Company may not be able to realize the dollar value from the collateral that it anticipated at the time of originating the loan. If real estate values decline, it is also more likely that the Company would be required to increase the allowance for loan losses, which could also adversely affect the Company's business, financial condition and results of operations.

In recent years, the market value of real estate declined considerably. While values have begun to recover, certain of the Company's loans remain under-collateralized. Some of these loans have become troubled and have been foreclosed upon, and the Company was unable to realize the expected value of the collateral. Due to these events, the

Company has established a valuation reserve for other real estate owned (OREO), including foreclosed assets, which negatively affects the Company's earnings in periods in which a provision is added to the valuation reserve.

In addition, the decline in real estate values has caused and could continue to cause the Company to experience losses when selling OREOs. These factors have had an adverse effect on operating results.

The ownership of foreclosed property exposes the Company to significant costs, some of which are uncertain. When the Company has to foreclose upon real property held as collateral, the Company is exposed to the risks inherent in the ownership of real estate. The amount that the Company may realize after a loan default is dependent upon factors outside of the Company's control, including environmental cleanup liability, especially with regard to non-residential real estate, neighborhood values, real estate tax rates, operating or maintenance expenses of the foreclosed properties, and supply of and demand for properties. Significant costs associated with the ownership of real estate may materially and adversely affect the Company's business, financial condition, cash flows and result of operations.

The Company and its subsidiaries are subject to extensive regulation which could adversely affect them. The Company is subject to extensive regulation by federal, state and local governmental authorities and is subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of operations, including those referenced above. Regulations adopted by these agencies, which are generally intended to protect depositors and customers rather than to benefit stockholders, govern a comprehensive range of matters including, without limitation, ownership and control of the Company's shares, acquisition of other companies and businesses, permissible activities that the Company and its subsidiaries may engage in, maintenance of adequate capital levels and other aspects of operations. These regulations could limit the Company's growth by restricting certain of its activities. The laws, rules and regulations applicable to the Company are subject to regular modification and change. Regulatory changes could subject the Company to more demanding regulatory compliance requirements which could affect the Company in unpredictable and adverse ways. Such changes could subject the Company to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or damage to the Company's reputation, which could have a material adverse effect on the Company's business, financial condition and results of operations. Legislation and regulatory initiatives containing wide-ranging proposals for altering the structure, regulation and competitive relationship of financial institutions are introduced regularly. The Company cannot predict in what form or whether a proposed statute or regulation will be adopted or the extent to which such adoption may affect its business.

The Dodd-Frank Act has increased the Company's regulatory compliance burden and associated costs, placed restrictions on certain products and services and limited its future capital raising strategies. A wide range of regulatory initiatives directed at the financial services industry has been proposed and/or implemented in recent years. Since its enactment in 2010, the Dodd-Frank Act has increased the Company's regulatory compliance burden and its continuing implementation will likely continue to increase the Company's regulatory compliance burden and may have a material adverse effect on the Company, by increasing the costs associated with regulatory examinations and compliance measures.

One of the Dodd-Frank Act's significant regulatory changes is the creation of the CFPB, a financial consumer protection agency that has the authority to impose new regulations and include its examiners in routine regulatory examinations conducted by the Comptroller. The CFPB is reshaping the consumer financial laws through rulemaking and enforcement of the Dodd-Frank Act's prohibitions against unfair, deceptive and abusive business practices, directly impacting the business operations of financial institutions offering consumer financial products or services, including the Company and the Bank. This agency's broad rulemaking authority includes identifying practices or acts that are unfair, deceptive or abusive in connection with any consumer financial transaction or consumer financial product or service. Although the CFPB generally has jurisdiction over banks with $10 billion or more in assets, rules, regulations and policies issued by the CFPB may also apply to the Company, the Bank and/or Trust through the adoption of such policies and best practices by the FRB, Comptroller and FDIC.

The full costs and limitations related to this additional regulatory agency and the limitations and restrictions that may be placed upon the Company with respect to its consumer product and service offerings have yet to be determined in their entirety. However, the Company has already experienced a reduction in overdraft fee income due to regulatory changes promulgated under Dodd-Frank, with income from overdraft fees declining $860 thousand, or 22.93%, when comparing 2010 to 2015. Additional costs, limitations and restrictions may have a material impact on the Company's business, financial condition and results of operations.

The Dodd-Frank Act also increases regulatory supervision and examination of bank holding companies and their banking and non-banking subsidiaries. These and other regulations included in the Dodd-Frank Act could increase the Company's regulatory compliance burden and costs, restrict the financial products and services the Bank can offer to its customers and restrict the Company's ability to generate revenues from non-banking operations. The Dodd-Frank Act imposes more stringent capital requirements on bank holding companies, which could limit the Company's future capital strategies.

Market risk affects the earnings of Trust. The fee structure of Trust is generally based upon the market value of accounts under administration. Most of these accounts are invested in equities of publicly traded companies and debt obligations of both government agencies and publicly traded companies. As such, fluctuations in the equity and debt markets in general have had a direct impact upon the earnings of Trust.

Compliance with the CFPB regulations aimed at the mortgage banking industry may require substantial changes to mortgage lending systems and processes that may adversely affect income from the Company's residential mortgage activities. The CFPB has finalized a number of significant rules that impact nearly every aspect of the lifecycle of a residential real estate loan. Among other things, the rules adopted by the CFPB require mortgage lenders either to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms, or to originate "qualified mortgages." In June 2015, the CFPB issued rules that combined disclosures previously established by the Truth in Lending Act and the Real Estate Settlement Procedures Act into a single disclosure referred to as the TILA-RESPA Integrated Disclosure, or TRID. TRID applies to most closed-end mortgage loans and overhauls the manner in which mortgage loan origination disclosures are made.

Although the Company does not originate or sell first mortgage loans at this time, it may elect to do so in the future, and TRID does apply to the mortgages it purchases. TRID also applies to second mortgages originated by the Company (but not to equity lines of credit). During 2015, the Company made significant changes to its residential real estate business, including investments in technology and employee training. These CFPB rules, in addition to other previously-issued and to-be-issued CFPB regulations, could materially affect the Company's ability to originate and sell residential real estate loans or limit the terms on which the Company may offer products, which could adversely affect the Company's financial condition and results of operations.

The Basel III Final Rules require higher levels of capital and liquidity, which could adversely affect the Company's net income and return on equity. The capital adequacy and liquidity guidelines applicable to the Company and the Bank under the Basel III Final Rules began to be phased in beginning in 2015. The Basel III Final Rules, when fully phased in, will require the Company and the Bank to maintain substantially more capital as a result of higher minimum capital levels and more demanding regulatory capital risk-weightings and calculations. The changes to the standardized calculations of risk-weighted assets are complex and may create enormous compliance burdens for the Company and the Bank. The Basel III Final Rules will require the Company and the Bank to substantially change the manner in which they collect and report information to calculate risk-weighted assets, and may increase dramatically risk-weighted assets as a result of applying higher risk weightings to many types of loans and securities. As a result, the Company and the Bank may be forced to limit originations of certain types of commercial and mortgage loans, thereby reducing the amount of credit available to borrowers and limiting opportunities to earn interest income from the loan portfolio, which may have a detrimental impact on the Company's net income.

If the Company were to require additional capital as a result of the Basel III Final Rules, it could be required to access the capital markets on short notice and in relatively weak economic conditions, which could result in raising capital that significantly dilutes existing stockholders. Additionally, the Company may be forced to limit banking operations and activities, and growth of loan portfolios and interest income, to focus on retention of earnings to improve capital levels. Higher capital levels may also lower the Company's return on equity.

The Company is dependent on key personnel and the loss of one or more of those key personnel could harm its business. The banking business in Virginia, and in the Company's primary service area in the Hampton Roads MSA, is highly competitive and dominated by a relatively small number of large banks. Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of and experience in the Virginia community banking industry. The Company's success depends to a significant degree upon its ability to attract and retain qualified management, loan origination, administrative, marketing and technical personnel and upon the continued contributions of and customer relationships developed by management and personnel. In particular, the Company's success is highly dependent upon the capabilities of its senior executive management. The Company believes that its management team, comprised of individuals who have worked in the banking industry for many years, is integral to implementing the Company's business plan. The Company has not entered into employment agreements with any of its executive management employees, and the loss of the services of one or more of them could harm the Company's business.

The allowance for loan losses may not be adequate to cover actual losses. A significant source of risk arises from the possibility that losses could be sustained because borrowers, guarantors, and related parties may fail to perform in accordance with the terms of their loans and leases. There is no precise method to predict loan losses. Like all financial institutions, the Company maintains an allowance for loan losses to provide for loan defaults and non-performance. The allowance for loan losses may not be adequate to cover actual loan losses. In addition, future provisions for loan losses could materially and adversely affect, and have in recent years materially and adversely affected, the Company's operating results.

The allowance for loan losses is determined by analyzing historical loan losses, current trends in delinquencies and charge-offs, plans for problem loan resolutions, changes in the size and composition of the loan portfolio and industry information. Also included in management's estimates for loan losses are considerations with respect to the impact of economic events, the outcome of which are uncertain. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and judgment. The amount of future losses is susceptible to changes in economic and other conditions, including changes in interest rates, that may be beyond the Company's control and these future losses may exceed current estimates. If management's assumptions prove to be incorrect or if the Company experiences significant loan losses in future periods, the current level of the allowance for loan losses may not be adequate to cover actual loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. In addition, federal regulatory agencies, as an integral part of their examination process, review the Company's loans and allowance for loan losses and may require an increase in the allowance for loan losses or recognition of additional loan charge-offs, based on judgments different from those of management. While management believes that the Company's allowance is adequate to cover current losses, the Company cannot assure investors that it will not need to increase the allowance or that regulators will not require the allowance to be increased. Either of these occurrences could materially and adversely affect earnings and profitability.

The Company may be adversely affected by changes in government monetary policy. As a bank holding company, the Company's business is affected by the monetary policies established by the FRB, which regulates the national money supply in order to mitigate recessionary and inflationary pressures. In setting its policy, the FRB may utilize techniques such as the following:

- Engaging in open market transactions in U.S. Government securities;
- Setting the discount rate on member bank borrowings; and
- Determining reserve requirements.

These techniques determine, to a significant extent, the Company's cost of funds for lending and investing. These techniques, all of which are outside the Company's control, may have an adverse effect on deposit levels, net interest margin, loan demand or the Company's business and operations.

Deposit insurance premiums could increase in the future, which may adversely affect future financial performance. The FDIC insures deposits at FDIC insured financial institutions, including the Bank. The FDIC charges insured financial institutions premiums to maintain the DIF at a certain level. Economic conditions from 2008 to 2011 increased the rate of bank failures and expectations for further bank failures, requiring the FDIC to make payments for insured deposits from the DIF. Although the DIF has since been replenished, a similar economic downturn in the future could require measures similar to those implemented during the last financial crisis, such as special assessments or required prepayments of insurance premiums. If the FDIC takes action to replenish the DIF, or if the Bank's asset size increases, the Bank's FDIC insurance premiums could increase, which could have an adverse effect on the Company's results of operations.

The Company's future success depends on its ability to compete effectively in the highly competitive financial services industry. The Company faces substantial competition in all phases of its operations from a variety of different competitors. Growth and success depends on the Company's ability to compete effectively in this highly competitive financial services environment. Many competitors offer products and services that are not offered by the Company, and many have substantially greater resources, name recognition and market presence that benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively and may have larger lending limits that would allow them to serve the credit needs of larger customers. Some of the financial services organizations with which the Company competes are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured national banks. As a result, these non-bank competitors have certain advantages over the Company in accessing funding and in providing various services. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Failure to compete effectively to attract new and retain current customers in the Company's markets could cause it to lose market share, slow its growth rate and may have an adverse effect on its financial condition and results of operations.

The Company may not be able to compete effectively without the appropriate use of current technology. The use of technology in the financial services market, including the banking industry, evolves frequently. The Company may be unable to attract and maintain banking relationships with certain customers if it does not offer appropriate technology-driven products and services. In addition to better serving customers, the effective use of technology may increase efficiency and reduce costs. The Company may not be able to effectively implement new technology-driven products or services or be successful in marketing these products and services to its customers. As a result, the Company's ability to compete effectively may be impaired, which could lead to a material adverse effect on the Company's financial condition and results of operations.

Negative public opinion could damage the Company's reputation and adversely impact the Company's business, financial condition and results of operation. Reputation risk, or the risk to the Company's business, financial condition and results of operation from negative public opinion, is inherent in the financial services industry. Negative public opinion can result from actual or alleged conduct in any number of activities, including lending practices and corporate governance, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion could adversely affect the Company's ability to keep and attract customers and employees, could expose it to litigation and regulatory action, and could adversely affect its access to the capital markets. Damage to the Company's reputation could adversely affect deposits and loans and otherwise negatively affect the Company's business, financial condition and results of operation.

The Company may need to raise additional capital in the future and such capital may not be available when needed or at all. The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs, particularly if its asset quality or earnings were to deteriorate significantly. Economic conditions and the loss of confidence in financial institutions may increase the Company's cost of funding and limit access to certain customary sources of capital, including inter-bank borrowings, repurchase agreements and borrowings from the Federal Reserve Bank's discount window. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of the Company's control, and the Company's financial performance.

The Company cannot assure that such capital will be available on acceptable terms or at all. Any occurrence that may limit the Company's access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of the Bank or counterparties participating in the capital markets, or a downgrade of the parent company or the Bank's ratings, may adversely affect the Company's capital costs and its ability to raise capital and, in turn, its liquidity. Moreover, if the Company needs to raise capital in the future, it may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on the Company's liquidity, business, financial condition and results of operations.

The Company and its subsidiaries are subject to operational risk, which could adversely affect business, financial condition and results of operation. The Company and its subsidiaries, like all businesses, are subject to operational risk, including the risk of loss resulting from human error, fraud or unauthorized transactions due to inadequate or failed internal processes and systems, and external events that are wholly or partially beyond the Company's control (including, for example, computer viruses or electrical or telecommunications outages). Operational risk also encompasses compliance (legal) risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices or ethical standards. The Company and its subsidiaries have established a system of internal controls to address these risks, but there are inherent limitations to such risk management strategies as there may exist, or develop in the future, risks that are not anticipated, identified or monitored. Any losses resulting from operational risk could take the form of explicit charges, increased operational costs, litigation costs, harm to reputation or forgone opportunities, loss of customer business, or the unauthorized release, misuse, loss or destruction of proprietary information, any and all of which could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company's directors and executive officers own a significant portion of the Company's common stock and can exert significant influence over its business and corporate affairs. The Company's directors and executive officers, as a group, beneficially owned 32.68% of the Company's common stock as of June 30, 2015. Consequently, if they vote their shares in concert, they can significantly influence the outcome of matters submitted to the Company's stockholders for approval, including the election of directors. The interests of the Company's directors and executive officers may conflict with the interests of other holders of the Company's common stock, and the Company's directors and executive officers may take actions affecting the Company with which other holders of the Company's common stock disagree.

Future sales of the Company's common stock by stockholders or the perception that those sales could occur may cause the common stock price to decline. Although the Company's common stock is listed for trading on the NASDAQ Capital Market, the trading volume in the common stock may be lower than that of other larger financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the potential for lower relative trading volume in the common stock, significant sales of the common stock in the public market, or the perception that those sales may occur, could cause the trading price of the Company's common stock to decline or to be lower than it otherwise might be in the absence of these sales or perceptions.

Future issuances of the Company's common stock could adversely affect the market price of the common stock and could be dilutive. The Company may issue additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, shares of the Company's common stock. Issuances of a substantial number of shares of common stock, or the expectation that such issuances might occur, could materially adversely affect the market price of the common stock and could be dilutive to stockholders. Any decision the Company makes to issue common stock in the future will depend on market conditions and other factors, and the Company cannot predict or estimate the amount, timing, or nature of possible future issuances of common stock. Accordingly, holders of the Company's common stock bear the risk that future issuances of securities will reduce the market price of the common stock and dilute their stock holdings in the Company.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 31, 2015, the Company owned the main office, which includes a branch, located in Hampton, Virginia; the corporate headquarters, which includes a branch; six office buildings; and 12 branches. All of these are owned directly and free of any encumbrances. The land at the Fort Monroe branch is leased by the Company under an agreement that expires in June 2017. Two of the remaining three branches are leased from unrelated parties. The Crown Center branch is leased from Crown Center Associates, LLC, which is indirectly owned by Michael Glasser, a member of the Company's Board of Directors. These three branch leases have renewal options that expire anywhere within two to nine years from December 31, 2015.

For more information concerning the commitments under current leasing agreements, see Note 6 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

Item 3. Legal Proceedings

Neither the Company nor any of its subsidiaries is a party to any material pending legal proceedings before any court, administrative agency, or other tribunal.

Item 4. Mine Safety Disclosures

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

Name (Age) And Present Position	Served in Current Position Since	Principal Occupation During Past Five Years
Robert F. Shuford, Sr. (78) Chairman, President & Chief Executive Officer Old Point Financial Corporation	1965	Banker
Robert F. Shuford, Jr. (51) Executive Vice President/Bank Old Point Financial Corporation	2015	Banker
Laurie D. Grabow (58) Chief Financial Officer & Senior Vice President/Finance Old Point Financial Corporation	1999	Banker
Eugene M. Jordan, II (61) Secretary & Executive Vice President/Trust Old Point Financial Corporation	2003	Banker
Joseph R. Witt (55) Chief Business Development Officer & Senior Vice President Old Point Financial Corporation	2008	Banker

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of the Company is quoted on the NASDAQ Capital Market under the symbol "OPOF". The approximate number of stockholders of record as of March 8, 2016 was 1,119. On that date, the closing price of the Company's common stock on the NASDAQ Capital Market was $19.14. The range of high and low sale prices and dividends paid per share of the Company's common stock for each quarter during 2015 and 2014 is presented in Item 7 of this report on Form 10-K under "Capital Resources" and is incorporated herein by reference. Additional information related to restrictions on funds available for dividend declaration can be found in Note 17 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

On January 12, 2010, the Company authorized a program to repurchase during any given calendar year up to an aggregate of 5 percent of the shares of the Company's common stock outstanding as of January 1 of that calendar year. The Company did not repurchase any shares of the Company's common stock under this plan during 2015. There is currently no stated expiration date for this program.

Pursuant to the Company's stock option plans, participants may exercise stock options by surrendering shares of the Company's common stock that the participants already own. Shares surrendered by participants of these plans are repurchased at current market value pursuant to the terms of the applicable stock options. No such repurchases occurred during 2015.

Item 6. Selected Financial Data

The following table summarizes the Company's performance for the past five years.

SELECTED FINANCIAL HIGHLIGHTS

Years ended December 31,	2015	2014	2013	2012	2011
(dollars in thousands except per share data)					
RESULTS OF OPERATIONS					
Interest income	$30,295	$30,289	$29,823	$32,580	$36,251
Interest expense	3,632	3,849	4,680	5,774	6,715
Net interest income	26,663	26,440	25,143	26,806	29,536
Provision for loan losses	1,025	600	1,300	2,400	3,700
Net interest income after provision for loan losses	25,638	25,840	23,843	24,406	25,836
Net gains (losses) on available-for-sale securities	76	2	(26)	2,313	787
Noninterest income	13,060	12,642	12,799	12,646	11,409
Noninterest expenses	35,086	34,172	33,105	34,183	33,679
Income before income taxes	3,688	4,312	3,511	5,182	4,353
Income tax expense	54	196	348	995	1,063
Net income	$3,634	$4,116	$3,163	$4,187	$3,290
FINANCIAL CONDITION					
Total assets	$896,787	$876,280	$864,288	$907,499	$849,504
Total deposits	$746,471	$716,654	$725,405	$753,816	$690,879
Total loans	$568,475	$535,994	$500,699	$471,133	$520,327
Stockholders' equity	$93,176	$88,497	$80,761	$89,300	$85,865
Average assets	$884,386	$869,965	$881,378	$869,436	$853,849
Average equity	$90,433	$85,550	$84,695	$87,912	$83,322
PERTINENT RATIOS					
Return on average assets	0.41 %	0.47 %	0.36 %	0.48 %	0.39 %
Return on average equity	4.02 %	4.81 %	3.73 %	4.76 %	3.95 %
Dividends paid as a percent of net income	46.40 %	31.32 %	34.49 %	23.67 %	30.12 %
Average equity as a percent of average assets	10.23 %	9.83 %	9.61 %	10.11 %	9.76 %
PER SHARE DATA					
Basic earnings per share	$0.73	$0.83	$0.64	$0.84	$0.66
Diluted earnings per share	$0.73	$0.83	$0.64	$0.84	$0.66
Cash dividends declared	$0.34	$0.26	$0.22	$0.20	$0.20
Book value	$18.79	$17.85	$16.29	$18.01	$17.31
GROWTH RATES					
Year-end assets	2.34 %	1.39 %	-4.76 %	6.83 %	-4.21 %
Year-end deposits	4.16 %	-1.21 %	-3.77 %	9.11 %	1.72 %
Year-end loans	6.06 %	7.05 %	6.28 %	-9.45 %	-11.30 %

Year-end equity	5.29	%	9.58	%	-9.56	%	4.00	%	6.07	%
Average assets	1.66	%	-1.29	%	1.37	%	1.83	%	-7.66	%
Average equity	5.71	%	1.01	%	-3.66	%	5.51	%	0.98	%
Net income	-11.71	%	30.13	%	-24.46	%	27.26	%	112.67	%
Cash dividends declared	30.77	%	18.18	%	10.00	%	0.00	%	-20.00	%
Book value	5.27	%	9.58	%	-9.55	%	4.04	%	5.55	%

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company, consisting of the parent company (the Parent) and its wholly-owned subsidiaries, the Bank and Trust. This discussion should be read in conjunction with the Consolidated Financial Statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements
In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include, but are not limited to, statements regarding profitability, including the focus on reducing time deposits; the net interest margin; strategies for managing the net interest margin and the expected impact of such efforts; liquidity; the loan portfolio and expected trends in the quality of the loan portfolio; the allowance and provision for loan losses; the effect of a sustained increase in nonperforming assets; the securities portfolio; interest rate sensitivity; asset quality; levels of net loan charge-offs and nonperforming assets; levels of interest expense; levels and components of noninterest income and noninterest expense; lease expense; income taxes; expected impact of efforts to restructure the balance sheet; expected yields on the loan and securities portfolios; expected rates on interest-bearing liabilities; market risk; business and growth strategies; investment strategy; and financial and other goals. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" or other words of similar meaning. These statements can also be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to, changes in interest rates and yields; general economic and general business conditions, including unemployment levels; uncertainty over future federal spending or the effects of federal budget cuts, particularly to the Department of Defense, on the Company's service area; changes associated with the new leadership of the Bank; effects of the transfer of the securities portfolio from held-to-maturity securities to available-for-sale securities; the quality or composition of the loan or securities portfolios; changes in the volume and mix of interest-earning assets and interest-bearing liabilities; the effects of management's investment strategy and strategy to manage the net interest margin; the adequacy of the Company's credit quality review processes; the level of nonperforming assets and related charge-offs and recoveries; turnover times experienced by the mortgage companies to which the Company has extended warehouse lines of credit; the federal government's guarantee of repayment of student loans purchased by the Company; the ability of the Company to diversify its sources of noninterest income; the effect of the Company's sales training efforts for branch staff; the local real estate market; volatility and disruption in national and international financial markets; government intervention in the U.S. financial system; application of the Basel III capital standards to the Company and its subsidiaries; FDIC premiums and/or assessments; demand for loan and other banking products and financial services in the Company's primary service area; levels of noninterest income and expense; deposit flows; competition; the use of inaccurate assumptions in management's modeling systems; technology; any interruption or breach of security in the Company's information systems or those of the Company's third party vendors or other service providers; reliance on third parties for key services; adequacy of the allowance for loan losses; and changes in accounting principles, policies and guidelines. The Company could also be adversely affected by monetary and fiscal policies of the U.S. Government, as well as any regulations or programs implemented pursuant to the Dodd-Frank Act or other legislation and policies of the Comptroller, U.S. Treasury and the Federal Reserve Board.

The Company has experienced losses due to the current economic climate. Dramatic declines in the residential and commercial real estate market during the recent economic crisis resulted in significant write-downs of asset values by the Company as well as by other financial institutions in the U.S.

In July 2010, the President signed into law the Dodd-Frank Act, which implements far-reaching changes across the financial regulatory landscape. It is not clear what other impacts the Dodd-Frank Act, regulations promulgated thereunder and other regulatory initiatives of the Treasury and other bank regulatory agencies will have on the financial markets and the financial services industry.

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

Executive Overview

Description of Operations

Headquartered in Hampton, Virginia, the Company is the parent company of Trust and the Bank. Trust is a wealth management services provider. The Bank offers a complete line of consumer, mortgage and business banking services, including loan, deposit, and cash management services to individual and commercial customers. The Bank is an independent community bank. The Bank has 18 branches throughout the Hampton Roads localities of Chesapeake, Hampton, Isle of Wight County, Newport News, Norfolk, Virginia Beach, Williamsburg/James City County and York County.

Management Initiatives in 2015

Similarly to 2014, management's 2015 initiatives were to improve asset quality, grow the loan portfolio, expand the Company's noninterest income, and concentrate on improving the Company's efficiency. Management believes substantial progress was made with respect to all four initiatives.

Management was able to improve asset quality as is evident by the $1.1 million reduction in nonperforming assets and the $1.4 million reduction in impaired loans when comparing December 31, 2014 and 2015. Details of the improvement of asset quality can be found in the Nonperforming Assets section of the Management's Discussion and Analysis of this report on Form 10-K. In addition, noninterest income was $492 thousand higher for the year ended December 31, 2015 as compared to 2014. The loan portfolio grew by $31.8 million when comparing net loans on December 31, 2015 to December 31, 2014. Finally, the Company continued to focus on efficiency, with a net decrease of four employees during 2015, to 296 employees.

In the third quarter of 2015, the Bank experienced a change in leadership with the appointment of a new president following the retirement of its former president. This change in leadership provided the Company with the opportunity to re-evaluate its credit culture, sales management process, and investment strategy. In combination with the progress made on the 2015 initiatives, management believes these changes leave the Company well positioned for improved income in future years, which will provide value to stockholders and the community.

Primary Financial Data for 2015

The Company earned $3.6 million in 2015, as compared to net income of $4.1 million in 2014, a decrease of $482 thousand or 11.71%. The decrease in net income was due to a higher provision for loan losses and higher noninterest expense. The provision for loan losses increased $425 thousand mainly due to growth in the loan portfolio, while noninterest expense increased due to increases in salaries and employee benefits and occupancy and equipment expenses.

Assets as of December 31, 2015 were $896.8 million, an increase of $20.5 million or 2.34% compared to assets as of December 31, 2014. During 2015, the Company continued the loan growth seen in 2013 and 2014, funding this growth mainly from increases in low-cost deposits and cash flows from the securities portfolio. Net loans grew $31.8 million, or 6.02%, over the year, while low-cost deposits increased $43.1 million, or 8.74%, and securities declined $15.2 million, or 6.64%. In years prior to 2013, the Company experienced a lack of quality loan demand in its market area and invested excess funds in securities that could be readily liquidated as the Company waited for loan demand to recover. This recovery began in the second half of 2013 and continued through 2015.

Critical Accounting Estimates

The accounting and reporting policies of the Company are in accordance with U.S. generally accepted accounting principles (GAAP) and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's consolidated financial position and/or results of operations. The accounting policy that required management's most difficult, subjective or complex judgments is the Company's allowance for loan losses, which is described below.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on three basic principles of accounting which require: (i) that losses be accrued when they are probable of occurring and estimable, (ii) that losses be accrued based on the differences between the loan balances and the value of collateral, present value of expected future cash flows or values that are observable in the secondary market and (iii) that adequate documentation exist to support the allowance for loan losses estimate.

The Company's allowance for loan losses is the accumulation of various components that are calculated based on independent methodologies. Management's estimate is based on certain observable, historical data that management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; discounted cash flow analysis; loan volumes; geographic, borrower and industry concentrations; the findings of internal credit quality assessments; and results from external bank regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, are used in developing estimated loss factors used in the calculations.

Authoritative accounting literature requires that the impairment of loans that have been separately identified for evaluation be measured based on the present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment is to be based on the net realizable value of the collateral. Authoritative accounting literature, as amended, also requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans.

The loan portfolio is segmented into pools, based on the loan classifications as defined by Schedule RC-C of the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income Form 041 (Call Report) and collectively evaluated for impairment. Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on whether the loan's payments are current (including loans 1-29 days past due), or are 30 – 59 days past due, 60 – 89 days past due, or 90 days or more past due. All other loans, including loans to consumers that are secured by real estate, are segmented by the Company's internally assigned risk grades: substandard, other assets especially mentioned (rated just above substandard), and pass (all other loans). The Company may also assign loans to the risk grades of doubtful or loss, but as of December 31, 2015 and December 31, 2014, the Company had no loans in these categories.

Specific reserves are determined on a loan-by-loan basis based on management's evaluation of the Company's exposure for each credit, given the current payment status of the loan and the net market value of any underlying collateral.

While management uses the best information available to establish the allowance for loan losses, future adjustment to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Income Taxes

The Company recognizes expense for federal income and state bank franchise taxes payable as well as deferred federal income taxes for estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the Consolidated Financial Statements. Income and franchise tax returns are subject to audit by the Internal Revenue Service (IRS) and state taxing authorities. Income and franchise tax expense for current and prior periods is subject to adjustment based on the outcome of such audits. The Company believes it has adequately provided for all taxes payable.

Earnings Summary

Net income was $3.6 million, or $0.73 per diluted share, in 2015 compared to $4.1 million, or $0.83 per diluted share, in 2014. This decrease was due to a higher provision for loan losses and higher noninterest expense, partially offset by increases in net interest income and noninterest income. Growth in the loan portfolio required the Company to set aside additional funds through the provision for loan losses. Noninterest expense increased due to additional expenses for salaries and employee benefits and occupancy and equipment. The increase in net interest income before the provision was mainly due to decreases in interest expense as a result of lower time account balances, while noninterest income increased primarily due to additional income from Old Point Mortgage LLC, a joint venture between the Bank and Tidewater Mortgage Services (Old Point Mortgage).

Net Interest Income

The principal source of earnings for the Company is net interest income. Net interest income is the difference between interest and fees generated by earning assets and interest expense paid to fund them. Changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as their respective yields and rates, have a significant impact on the level of net interest income. The net interest margin is calculated by dividing tax-equivalent net interest income by average earning assets. Net interest income, on a fully tax-equivalent basis, was $27.7 million in 2015, an increase of $259 thousand from 2014 and an increase of $1.8 million from 2013. The net interest margin was 3.56% in 2015 as compared to 3.57% in 2014 and 3.23% in 2013.

When comparing 2015 to 2014, the following changes were noted. Tax equivalent interest income increased $42 thousand, or 0.13%. Average earning assets increased $8.1 million, or 1.06%. Total average loans increased $46.4 million, or 8.96%, and average investment securities decreased $36.5 million, or 15.28%, as continued loan demand allowed the Company to shift its assets from securities to loans.

The Company's portfolio of mortgage-backed securities generates cash flows on a monthly basis, which are typically re-invested into loans. In the fourth quarter of 2015, management began a re-examination of its strategy for the securities portfolio given the current and anticipated future interest rate environments. While this analysis was in progress, excess cash flows generated by the Company's portfolio of mortgage-backed securities were allowed to remain in cash and due from banks. On a combined basis, average cash and due from banks and interest-bearing due from banks increased $6.7 million, or 21.41%, during 2015. Although this reduced interest income in 2015, management believes that its new investment strategy will provide the Company with additional liquidity and flexibility in future years.

Interest income was also impacted by continued declines in average loan yields, from 4.83% in 2014 to 4.63% in 2015. Management expects that the Company's loan yields will continue to decline, due to intense competition for quality loans and rate reductions on loans currently held in the portfolio. The reduction in loan yields will likely continue in 2016 at approximately the same pace seen in 2015, depending on monetary policy actions taken by the Federal Open Market Committee (FOMC). Although the FOMC did raise the target range for the federal funds rate in December of 2015, predictions for future rate increases are varied. Barring additional rate increases by the FOMC in 2016, management expects continued declines in loan yields. To partially offset this anticipated decline, management has placed an increased focus on managing the mix of the liabilities in order to increase low cost funds and reduce high cost funds when possible. If the FOMC does increase the target rate in 2016, management expects that the decline in loan yields will slow or stop. Based on current predictions of the FOMC's likely actions with regards to the target range, management does not expect loan yields to increase in 2016.

Interest expense decreased $217 thousand, or 5.64% in 2015 as compared to 2014, while average interest-bearing liabilities decreased $3.8 million, or 0.63%. The cost of interest-bearing liabilities decreased 3 basis points due to the low interest rate environment. As discussed above, management has focused on adjusting the composition of its interest-bearing liabilities, specifically by allowing high-cost time deposits to reduce. Management expects that the reduction of the Company's interest expense will continue to slow in the future, because the majority of the higher cost time deposits have repriced to current, lower market rates. However, management will continue to focus on the mix of deposits as stated above, by actively targeting new noninterest bearing deposits.

The following table shows an analysis of average earning assets, interest-bearing liabilities and rates and yields. Nonaccrual loans are included in loans outstanding.

TABLE I
AVERAGE BALANCE SHEETS, NET INTEREST INCOME* AND RATES*

Years ended December 31,	2015			2014			2013		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
	(dollars in thousands)								
ASSETS									
Loans	$563,534	$26,106	4.63 %	$517,183	$24,959	4.83 %	$471,203	$23,769	5.04 %
Investment securities:									
Taxable	130,541	2,510	1.92 %	164,755	3,562	2.16 %	229,914	4,547	1.98 %
Tax-exempt	71,831	2,520	3.51 %	74,112	2,580	3.48 %	55,745	2,042	3.66 %
Total investment securities	202,372	5,030	2.49 %	238,867	6,142	2.57 %	285,659	6,589	2.31 %
Interest-bearing due from banks	5,848	15	0.26 %	5,356	13	0.24 %	37,581	96	0.26 %
Federal funds sold	1,860	2	0.11 %	3,515	5	0.14 %	1,906	1	0.05 %
Other investments	2,373	133	5.60 %	2,944	125	4.25 %	3,374	96	2.85 %
Total earning assets	775,987	31,286	4.03 %	767,865	31,244	4.07 %	799,723	30,551	3.82 %
Allowance for loan losses	(7,404)			(7,062)			(7,239)		
	768,583			760,803			792,484		
Cash and due from banks	31,858			25,700			13,446		
Bank premises and equipment, net	41,988			42,277			36,188		
Other assets	41,957			41,185			39,260		
Total assets	$884,386			$869,965			$881,378		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Time and savings deposits:									
Interest-bearing transaction accounts	$11,219	$4	0.04 %	$11,537	$5	0.04 %	$11,129	$6	0.05 %
Money market deposit accounts	228,627	186	0.08 %	213,918	179	0.08 %	199,848	234	0.12 %
Savings accounts	74,436	37	0.05 %	73,576	46	0.06 %	62,562	62	0.10 %
Time deposits, $100,000 or more	113,945	1,111	0.98 %	108,630	1,038	0.96 %	126,127	1,436	1.14 %
Other time deposits	107,142	1,033	0.96 %	128,383	1,316	1.03 %	157,154	1,683	1.07 %

Total time and savings deposits	535,369	2,371	0.44 %	536,044	2,584	0.48 %	556,820	3,421	0.61 %
Federal funds purchased, repurchase agreements and other borrowings	30,777	30	0.10 %	32,848	32	0.10 %	31,182	35	0.11 %
Federal Home Loan Bank advances	27,466	1,231	4.48 %	28,507	1,233	4.33 %	25,000	1,224	4.90 %
Total interest-bearing liabilities	593,612	3,632	0.61 %	597,399	3,849	0.64 %	613,002	4,680	0.76 %
Demand deposits	194,677			184,555			180,538		
Other liabilities	5,664			2,461			3,143		
Total liabilities	793,953			784,415			796,683		
Stockholders' equity	90,433			85,550			84,695		
Total liabilities and stockholders' equity	$884,386			$869,965			$881,378		
Net interest margin		$27,654	3.56 %		$27,395	3.57 %		$25,871	3.23 %

* Computed on a fully taxable equivalent basis using a 34% rate.

The following table summarizes changes in net interest income attributable to changes in the volume of interest-bearing assets and liabilities and changes in interest rates.

Table II
VOLUME AND RATE ANALYSIS*
(in thousands)

	2015 vs. 2014 Increase (Decrease) Due to Changes in:			2014 vs. 2013 Increase (Decrease) Due to Changes in:			2013 vs. 2012 Increase (Decrease) Due to Changes in:		
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
EARNING ASSETS									
Loans	$2,237	$(1,090)	$1,147	$2,319	$(1,129)	$1,190	$(390)	$(2,406)	$(2,796)
Investment securities									
Taxable	(740)	(312)	(1,052)	(1,289)	304	(985)	(668)	(23)	(691)
Tax-exempt	(79)	19	(60)	673	(135)	538	1,264	(254)	1,010
Total investment securities	(819)	(293)	(1,112)	(616)	169	(447)	596	(277)	319
Federal funds sold	(2)	(1)	(3)	1	3	4	0	(1)	(1)
Other investments **	(1)	11	10	(153)	99	(54)	41	(5)	36
Total earning assets	1,415	(1,373)	42	1,551	(858)	693	247	(2,689)	(2,442)
INTEREST-BEARING LIABILITIES									
Interest-bearing transaction accounts	0	(1)	(1)	0	(1)	(1)	0	(1)	(1)
Money market deposit accounts	12	(5)	7	16	(71)	(55)	35	(123)	(88)
Savings accounts	1	(10)	(9)	11	(27)	(16)	9	0	9
Time deposits, $100,000 or more	51	22	73	(199)	(199)	(398)	(60)	(117)	(177)
Other time deposits	(218)	(65)	(283)	(308)	(59)	(367)	(195)	(350)	(545)
Total time and savings deposits	(154)	(59)	(213)	(480)	(357)	(837)	(211)	(591)	(802)
Federal funds purchased, repurchase agreements and other borrowings	(2)	0	(2)	2	(5)	(3)	2	(22)	(20)
Federal Home Loan Bank advances	(45)	43	(2)	172	(163)	9	(273)	1	(272)
Total interest-bearing liabilities	(201)	(16)	(217)	(306)	(525)	(831)	(482)	(612)	(1,094)
Change in net interest income	$1,616	$(1,357)	$259	$1,857	$(333)	$1,524	$729	$(2,077)	$(1,348)

* Computed on a fully tax-equivalent basis using a 34% rate.
** Other investments include interest-bearing balances due from banks.

Interest Sensitivity

An important element of earnings performance and the maintenance of sufficient liquidity is proper management of the interest sensitivity gap. The interest sensitivity gap is the difference between interest sensitive assets and interest sensitive liabilities in a specific time interval. This gap can be managed by repricing assets or liabilities, which are variable rate instruments, by replacing an asset or liability at maturity or by adjusting the interest rate during the life of the asset or liability. Matching the amounts of assets and liabilities maturing in the same time interval helps to hedge interest rate risk and to minimize the impact of rising or falling interest rates on net interest income.

The Company determines the overall magnitude of interest sensitivity risk and then formulates policies governing asset generation and pricing, funding sources and pricing, and off-balance sheet commitments. These decisions are based on management's expectations regarding future interest rate movements, the state of the national and regional economy, and other financial and business risk factors. The Company uses computer simulations to measure the effect of various interest rate scenarios on net interest income. This modeling reflects interest rate changes and the related impact on net interest income and net income over specified time horizons.

Based on scheduled maturities only, the Company was liability sensitive at the one-year timeframe as of December 31, 2015. It should be noted, however, that non-maturing, interest-bearing deposit liabilities, which consist of interest checking, money market and savings accounts, are less interest sensitive than other market driven deposits. On December 31, 2015 non-maturing, interest-bearing deposit liabilities totaled $321.4 million, or 60.48%, of total interest-bearing deposits. In a rising rate environment these deposit rates have historically lagged behind the changes in earning asset rates, thus mitigating the impact from the liability-sensitive position. The asset/liability model allows the Company to reflect the fact that non-maturing deposits are less rate sensitive than other deposits by using a decay rate. The decay rate is a type of artificial maturity that simulates maturities for non-maturing deposits over the number of months that more closely reflects historic data. Using the decay rate, the model reveals that the Company is asset sensitive at the one-year timeframe as of December 31, 2015.

When the Company is liability sensitive, net interest income should decrease if interest rates rise since liabilities will reprice faster than assets. Conversely, if interest rates fall, net interest income should increase, depending on the optionality (prepayment speeds) of the assets. When the Company is asset sensitive, net interest income should rise if rates rise and should fall if rates fall.

The Company's interest rate sensitivity position is illustrated in the following table. The carrying amounts of assets and liabilities are presented in the periods they are expected to reprice or mature.

TABLE III
INTEREST SENSITIVITY ANALYSIS

As of December 31, 2015 (in thousands)	Within 3 Months	4-12 Months	1-5 Years	Over 5 Years	Total
Uses of Funds					
Interest-bearing due from banks	$1,064	$0	$0	$0	$1,064
Federal funds sold	2,412	0	0	0	2,412
Taxable investments	20,831	301	3,291	117,441	141,864
Tax-exempt investments	0	0	14,783	57,545	72,328
Total federal funds sold and investment securities	24,307	301	18,074	174,986	217,668
Loans					
Commercial	$15,569	$3,664	$12,266	$11,698	$43,197
Consumer	22,581	784	7,710	19,352	50,427
Real estate	55,433	26,156	256,944	118,311	456,844
Other	7,665	141	3,391	6,810	18,007
Total loans	101,248	30,745	280,311	156,171	568,475
Total earning assets	$125,555	$31,046	$298,385	$331,157	$786,143
Sources of funds					
Interest-bearing transaction accounts	$16,789	$0	$0	$0	$16,789
Money market deposit accounts	227,824	0	0	0	227,824
Savings accounts	76,757	0	0	0	76,757
Time deposits $100,000 or more	24,205	19,811	65,081	0	109,097
Other time deposits	13,527	29,142	58,245	0	100,914
Federal funds purchased and other borrowings	0	0	0	0	0
Overnight repurchase agreements	25,950	0	0	0	25,950
Term repurchase agreements	0	0	0	0	0
FHLB advances	25,000	0	0	0	25,000
Total interest bearing liabilities	$410,052	$48,953	$123,326	$0	$582,331

Rate sensitivity GAP	$(284,497)	$(17,907)	$175,059	$331,157	$203,812
Cumulative GAP	$(284,497)	$(302,404)	$(127,345)	$203,812	

The most likely scenario represents the rate environment as management forecasts it to occur. Management uses a "static" test to measure the effects of changes in interest rates on net interest income. This test assumes that management takes no steps to adjust the balance sheet to respond to the shock by repricing assets/liabilities, as discussed in the first paragraph of this section.

Under the rate environment forecasted by management, rate shocks in 50 to 100 basis point increments are applied to estimate the impact on the Company's net interest income. The table below shows the estimated impact of changes in interest rates on net interest income as of December 31, 2015, assuming gradual and parallel changes in interest rates, and consistent levels of assets and liabilities. Net interest income for the following twelve months is projected to increase when interest rates are higher than current rates. Due to the current low interest rate environment, no measurement was considered necessary for a further decline in interest rates.

Estimated Changes in Net Interest Income
(dollars in thousands)
As of December 31, 2015

	Changes in Net Interest Income		
Changes in Interest Rates	Amount	Percent	
Up 4.00%	$ 535	1.95	%
Up 3.00%	$ 388	1.42	%
Up 2.00%	$ 208	0.76	%
Up 1.00%	$ 75	0.27	%
No change	$ 0	0.00	%

Management cannot predict future interest rates or their exact effect on net interest income. Computations of future effects of hypothetical interest rate changes are based on numerous assumptions and should not be relied upon as indicative of actual results. Certain limitations are inherent in such computations. Assets and liabilities may react differently than projected to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while rates on other types of assets and liabilities may lag changes in market interest rates. Interest rate shifts may not be parallel.

Changes in interest rates can cause substantial changes in the amount of prepayments of loans and mortgage-backed securities, which may in turn affect the Company's interest rate sensitivity position. Additionally, credit risk may rise if an interest rate increase adversely affects the ability of borrowers to service their debt.

Provision for Loan Losses

The provision for loan losses is a charge against earnings necessary to maintain the allowance for loan losses at a level consistent with management's evaluation of the loan portfolio. The provision for loan losses is an expense that is based on management's estimate of credit losses that are probable of being sustained in the loan portfolio.

The provision for loan losses was $1.0 million for the year ended December 31, 2015 as compared to $600 thousand for 2014. Loans that were charged off during 2015 totaled $897 thousand compared to $1.2 million in 2014. Recoveries amounted to $535 thousand in 2015 and $882 thousand in 2014. The Company's net loans charged off to year-end loans were 0.06% in 2015 as compared to 0.07% in 2014. The allowance for loan losses, as a percentage of year-end loans, was 1.36% in 2015 and 1.32% in 2014. Net loan charge-offs for 2015 were lower than in 2014 due to continued improvements in asset quality and the concomitant reduction in charge-offs. Although net charge-offs in 2015 were marginally higher than in 2014, net charge-offs in 2014 were substantially lower than those experienced in prior years due to the receipt of unanticipated large recoveries. While the Company did obtain some significant recoveries in 2015, the unusually high level of recoveries seen in 2014 did not re-occur.

Management believes that net loan charge-offs in subsequent years will be higher than what was experienced in 2014 and 2015, as no similarly large recoveries are anticipated in the future. The state of the local economy also significantly impacts the level of loan charge-offs. If the economy begins to contract, nonperforming assets could increase as a result of declines in real estate values and home sales or increases in unemployment rates and financial stress on borrowers. Increased nonperforming assets would cause increased charge-offs and lower earnings due to larger contributions to the loan loss provision.

In 2015, management contributed $1.0 million to the allowance for loan losses through the provision, or $425 thousand more than the provision for the year ended December 31, 2014. This decision was based on management's evaluation of loan losses in the loan portfolio. Management's evaluation included credit quality trends, collateral values, discounted cash flow analysis, loan volumes, geographic, borrower and industry concentrations, the findings of internal credit quality assessments and results from external regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, were used in developing estimated loss factors for determining the loan loss provision.

The additional provision was mainly due to the growth in the loan portfolio. It was also impacted by impaired loans for which there was a specific allocation. While total impaired loans decreased by $1.4 million, the deteriorating condition of certain of these loans required management to set aside additional funds to cover anticipated future losses. Management believes that, if loan growth continues and current economic conditions remain stable, the loan loss provision will continue at the level seen in 2015.

Noninterest Income

Noninterest income increased $492 thousand or 3.89% for the year ended December 31, 2015 as compared to the year ended December 31, 2014. This increase was driven by an additional $213 thousand in income from Old Point Mortgage. During the latter part of 2014 and continuing in 2015, Old Point Mortgage worked to improve its efficiencies and re-define its incentive structure for its sales staff. The success of these efforts is evident in the increased income seen in 2015, compared to 2014.

In addition to the improved income from Old Point Mortgage, most other categories of noninterest income also increased. Service charges on deposit accounts was the only category to decrease when comparing the years ended December 31, 2015 and 2014, a $98 thousand decline that was mainly driven by a decrease in overdraft fee income. Regulatory changes in recent years have curtailed this income source for most banks, including the Company. Service charges on deposit accounts not related to overdraft fees increased by $39 thousand for the year ended December 31, 2015, but that increase was offset by the $137 thousand decrease in overdraft fee income for the same period.

Income from fiduciary activities increased $111 thousand when comparing 2015 to 2014, in part because income in 2014 was artificially depressed by Trust's determination in the second quarter of that year that certain customer fees had been inadvertently charged in prior years. While the majority of the increase in income from fiduciary activities was due to the correction in 2014, estate administration income also increased and was not affected by the correction in 2014. Income from fiduciary activities is difficult to project, due to the unpredictable nature of its primary source, the market value of assets under management by Trust. However, management does expect that, over all, income from fiduciary activities will continue to trend upward in future years as a result of business development efforts.

Other service charges, commissions and fees increased $144 thousand when comparing 2015 to 2014. Additional income from merchant processing fees and brokerage sales contributed significantly to this increase, as did income from Penact. In the fourth quarter of 2013, Trust acquired Penact, a company that provides consultation, administration and valuation services for retirement plans. Revenue from Penact was $408 thousand for the year ended December 31, 2015, $71 thousand higher than in 2014.

In addition to the previously-discussed increase in income from Old Point Mortgage, other income was also increased by foreclosed property income and income from early withdrawal penalties on time deposits. Foreclosed property income increased due to foreclosures on tenant-occupied real estate. Several of these tenant-occupied properties were sold in 2015, and as a result, management expects foreclosed property income to be lower in 2016 than in 2015. Income from early withdrawal penalties increased due to a change in the Bank's fee structure for early withdrawals. With this change, management hopes to better control its interest expense when rates rise.

The Company also saw smaller increases in income from bank-owned life insurance and gain on sale of available-for-sale securities between 2014 and 2015. During the last several years, the Company has focused on restructuring its securities portfolio to improve the portfolio's cash flow, increase its yields, and reduce its susceptibility to interest rate risk. As a result of this restructuring, the Company recorded a net gain on sales of $76 thousand in 2015, compared to $2 thousand in 2014.

The Company continues to focus on diversifying noninterest income through efforts to expand Trust relationships and a continued focus on business checking and other corporate services. The portions of the Dodd-Frank Act that have been fully implemented have increased, and the Company expects the Dodd-Frank Act when fully implemented to further increase, government regulation of consumer financial products and services, including fees generated on consumer financial transactions. Although the impact of the Dodd-Frank Act and regulations promulgated thereunder is not yet fully known, the Company expects that this additional regulation of consumer financial products, services and transactions may materially impact the Company's ability to generate future noninterest income.

Noninterest Expense

The Company's noninterest expense increased $914 thousand or 2.67% for the year ended December 31, 2015 as compared to the year ended December 31, 2014. The largest increases were in salaries and employee benefits and occupancy and equipment expenses. Occupancy and equipment expenses increased $444 thousand, or 9.09% when comparing 2015 and 2014, due to the completion of the Company's new corporate headquarters. The building was completed and occupied in the second quarter of 2014, making 2015 its first full year of operations.

When comparing 2015 to 2014, salaries and employee benefits increased $863 thousand, or 4.34%, due to three main factors. The most significant of these was the retirement package provided by the Company to the retiring president of the Bank. Although the retirement package will be paid in 2016, accounting rules required that the entire amount of $353 thousand be expensed in 2015. Salaries and employee benefits was also impacted by an increase in the cost of employer-provided medical insurance of $258 thousand. In addition, the Company's expense for its pension plan, which was frozen in 2006, increased by $108 thousand due to changes in actuarial estimates.

The following categories of noninterest expense also increased in 2015 when compared to 2014: legal and audit expenses ($114 thousand), other outside service fees ($109 thousand), ATM and check losses ($42 thousand) and loss on write-down/sale of other real estate owned ($85 thousand). Legal and audit expenses increased due to legal fees paid for the negotiation and preparation of contracts with certain employees. Other outside services increased mainly as a result of outsourcing of certain information technology, loan review and audit functions requiring extremely specialized skills and expertise. Check cashing and wire frauds committed in 2015 increased ATM and check losses, while loss on write-down/sale of other real estate owned was affected by the Company's ongoing efforts to sell these properties, which are considered nonperforming assets.

These increases in noninterest expense were partially offset by decreases in other areas, the largest of which were FDIC insurance, customer development and employee professional development. FDIC insurance decreased $118 thousand due to reductions in nonperforming assets, which reduces the Company's FDIC insurance assessment rate. Reductions in charitable contributions and public relations expenses resulted in a decrease to customer development of $238 thousand. Employee professional development decreased $130 thousand due to reduced spending on external training for employees. Management is aware of the need to control noninterest expense and is working to reduce it wherever feasible.

Income tax expense was also lower in 2015 than in 2014 due to lower income. While income before income taxes declined from 2014 to 2015, tax-exempt income remained essentially flat. As a result, tax-exempt income made up a greater portion of the Company's income, reducing its effective tax rate to 1.46%. The Company also took advantage of several tax credits during 2015. Together, all of these factors reduced 2015 income tax expense by 72.45% compared to 2014.

Balance Sheet Review

At December 31, 2015, the Company had total assets of $896.8 million, an increase of $20.5 million or 2.34% compared to assets as of December 31, 2014. Net loans increased $31.8 million or 6.02%, from $528.9 million at December 31, 2014 to $560.7 million at December 31, 2015. Loan demand began to increase in 2013 and continued throughout 2014 and 2015, but until loan demand recovers significantly, the Company will likely continue to manage the interest margin by allowing higher cost funds, such as time deposits, to decrease. High-cost time deposits decreased $13.3 million or 5.95% between December 31, 2014 and December 31, 2015, while low-cost funds in the form of noninterest-bearing and savings deposits increased $43.1 million or 8.74% in the same time period.

The Company's holdings of Alternative A-paper, or "Alt-A", type mortgage loans such as adjustable rate and nontraditional type loans were inconsequential, amounting to less than 1.00% of the Company's loan portfolio as of December 31, 2015.

The Company does not have a formal program for subprime lending. The Company is, however, required by law to comply with the CRA, which imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low- and moderate-income borrowers. In order to comply with the CRA and meet the credit needs of its local communities, the Company finds it necessary to make certain loans with subprime characteristics.

For the purposes of this discussion, a "subprime loan" is defined as a loan to a borrower having a credit score of 660 or below. The majority of the Company's subprime loans are to customers in the Company's primary service area.

The following table details, as of December 31, 2015, the Company's loans with subprime characteristics that were secured by 1-4 family first mortgages, 1-4 family open-end (i.e., equity lines of credit) and 1-4 family junior lien loans (i.e., second mortgages) for which the Company has recorded a credit score in its system.

Loans Secured by 1 - 4 Family First Mortgages, 1 - 4 Family Open-end and 1 - 4 Family Junior Liens
As of December 31, 2015
(dollars in thousands)

	Amount	Percent
Subprime	$20,856	13.9 %
Non-subprime	129,310	86.1 %
	$150,166	100.0 %
Total loans	$568,475	
Percentage of Real Estate-Secured Subprime Loans to Total Loans		3.67 %

In addition to the subprime loans secured by real estate discussed above, as of December 31, 2015, the Company had an additional $1.1 million in subprime consumer loans that were either unsecured or secured by collateral other than real estate. Together with the subprime loans secured by real estate, the Company's total subprime loans as of December 31, 2015 were $22.0 million, amounting to 3.86% of the Company's total loans at December 31, 2015.

The Company has no investments secured by "Alt-A" type mortgage loans such as adjustable rate and nontraditional type mortgages or subprime loans.

Securities Portfolio

In February of 2016, management decided to transfer the Company's held-to-maturity securities to available-for-sale to increase the portfolio's liquidity and flexibility. Although management made this decision in the first quarter of 2016, it reflected a change in intent regarding the securities portfolio as of December 31, 2015. As the primary distinction between available-for-sale and held-to-maturity is management's intent, this transfer was effective-dated back to December 31, 2015. Due to this transfer, securities available-for-sale increased $74.8 million and securities held-to-maturity decreased $90.1 million when comparing December 31, 2015 to December 31, 2014. Classifying the securities as available-for-sale gives management the flexibility to sell the securities as needed to fund loan growth or manage the interest-rate risk in the portfolio. As detailed in Note 3 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K, the net effect of this transfer was to increase the carrying value of the securities portfolio by $3.7 million, reduce other assets by $1.2 million, and increase other comprehensive income by $2.3 million.

Beginning in 2014 and continuing in 2015, the Company began purchasing short-term U.S. Treasury and government agency securities as part of a strategy to reduce its capital stock tax expense. While both of these types of securities have very low yields, the anticipated future reduction in capital stock tax, included in noninterest expense, should more than offset the reduction in interest income.

During 2015, the total securities portfolio declined $15.2 million, mainly due to cash flows received from mortgage-backed securities. To reduce the portfolio's susceptibility to interest rate risk, the Company sold certain securities and purchased others during the year, with no net effect on the total of the portfolio. The Company's goal is to provide maximum return on the securities portfolio within the framework of its asset/liability objectives and consistent with its need to manage tax exposure when necessary. The asset/liability objectives include managing interest sensitivity, liquidity and pledging requirements.

The following table sets forth a summary of the securities portfolio:

TABLE IV
SECURITIES PORTFOLIO

As of December 31,	2015	2014	2013
	(in thousands)		
Available-for-sale securities, at fair value:			
U.S. Treasury securities	$0	$20,000	$0
Obligations of U.S. Government agencies	24,240	4,618	15,024
Obligations of state and political subdivisions	78,433	50,246	47,100
Mortgage-backed securities	107,396	60,888	90,750
Money market investments	631	719	691
Corporate bonds	3,393	2,790	2,074
Other marketable equity securities			