

OLD POINT FINANCIAL CORP  
Form 10-K  
March 30, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

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(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2011

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

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

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Virginia  
(State or other jurisdiction of incorporation or  
organization)

54-1265373  
(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)

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

Common Stock, \$5 par value  
(Title of each class)

The NASDAQ Stock Market LLC  
(Name of each exchange on which registered)

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

None

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

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

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

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

Yes  No

Indicate by check mark 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

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

The aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of June 30, 2011 was \$36,703,695 based on the closing sales price on the NASDAQ Capital Market of \$11.73.

There were 4,959,009 shares of common stock outstanding as of February 29, 2012.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Company's Annual Meeting of Stockholders to be held on May 22, 2012, are incorporated by reference in Part III of this report.

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## OLD POINT FINANCIAL CORPORATION

## FORM 10-K

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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 2011, the Bank had 21 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 business 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, 2011, the Company had assets of \$849.5 million, loans of \$520.3 million, deposits of \$690.9 million, and stockholders' equity of \$85.9 million. At year-end, the Company and its subsidiaries had a total of 334 employees, 24 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 deepwater harbor, the Hampton Roads Metropolitan Statistical Area (MSA) is the 37th most populous MSA in the United States according to the US Census Bureau's 2010 census. Recently recognized by a University of Wisconsin study as the nation's most diverse region, 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. An integrated transportation network of interstate highways, air, rail and sea services provide excellent access between the communities of this region and the markets of the world.

Six of the ten largest population centers in the United States are located within 750 miles of Hampton Roads. The Hampton Roads MSA is the largest market between Washington DC and Atlanta, GA, and the fourth largest MSA in the southeast. The region has seen a 5.9% increase in population between 2000 and 2009 and is home to nearly 1.7 million people. The Virginia Employment Commission projects the population in the Hampton Roads MSA to be nearly 1.85 million people by the year 2020.

With the world's largest natural deepwater harbor, Hampton Roads' ports have played an important role in the region's history and economy. 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.

The Hampton Roads MSA is the third largest deposit market in Virginia, after Richmond and the Washington Metropolitan area, according to the Federal Deposit Insurance Corporation (FDIC). The Company's market area is serviced by 377 branches of banks and savings and loans and 87 credit unions. In addition, branches of virtually every major brokerage house serve the Company's market area.

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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 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.

Because community banks typically rely on their local branch and office networks, there is strong competition for local deposits and loans. This is particularly true in the current competitive market with the recent upheaval in the financial services industry. Community banks are well positioned to reclaim business lost to larger banks because banking is a relationship business, where character and creditworthiness both count. A community bank takes more personalized care of its customers because customers are more than just a number to it. This is especially important to consumers now, at a time when the level of trust in larger, more complex institutions is decreasing.

In order to capitalize on these opportunities and emerge from the crisis stronger, community banks must position themselves to compete with larger banks in the long term. To accomplish this, the Company is focused on strengthening customer loyalty, establishing a strong, customer-focused brand and improving its cross-selling strategies across all lines of business. Because high levels of trust drive both referral behavior and future purchase intentions, loyalty experts agree it is more cost-effective to retain customers than to acquire them. By focusing on relationships with current customers, the Company has the opportunity to grow from within, then use these internal growth patterns to expand Company business with new customers.

Concurrently, the Company is striving to build a stronger presence in the business banking market, where greater opportunities for fee-based revenues and cross-selling exist. Small businesses create two thirds or more of all net new jobs, according to the US Department of Labor, and as such, are an extremely valuable resource. 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 continued throughout 2011 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. As of June 30, 2011, the Company held eighth place with 3.13% market share of all Hampton Roads deposits. Overall deposit growth remains consistent in the geographically smaller markets as well. In Hampton, the Company retains first place and continues to gain momentum with 33% market share and deposit growth totaling over \$15 million, as compared to 32% market share at June 30, 2010. Market share also increased in Isle of Wight, with deposits rising by nearly \$2 million over the previous year. By contrast, Newport News' total deposits fell by approximately 6% (\$8 million) and in James City deposits decreased by 5% (\$3 million).

In the Company's Southside Virginia markets, deposits also dropped in each region with Norfolk decreasing approximately \$7 million, Virginia Beach falling by \$3 million, and Chesapeake decreasing by \$2 million in total deposits, as compared to 2010. Combined with heightened marketing efforts, these branches continue 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 Bay Port Credit Union with deposits totaling approximately \$1.75 billion, \$1.41 billion, and \$985 million, respectively. Chartway posted an 18% growth rate, surpassing Langley in deposit growth for the second year in a row. Langley posted a 5% growth rate and Bay Port posted a 3% growth rate. Navy Federal Credit Union also has a very strong presence on the Southside of Hampton Roads, with 24 branches in Virginia Beach, Norfolk, Chesapeake and Portsmouth. Navy Federal has begun to branch out onto the Peninsula. They have opened two branches in Hampton, one branch in Newport News and another branch in Williamsburg.



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AVAILABLE INFORMATION

The Company maintains a website on the Internet at [www.oldpoint.com](http://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](http://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 does not purport to be complete. 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 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. As an Exchange Act reporting company, the Company is directly affected by the Sarbanes-Oxley Act of 2002 (the SOX), which is aimed at improving corporate governance and reporting procedures and requires additional corporate governance measures and expanded disclosure of the Company's corporate operations and internal controls. The Company is complying with the applicable SEC and other rules and regulations implemented pursuant to the SOX and intends to comply with any applicable rules and regulations implemented in the future. Although the Company has incurred and will continue to incur additional expense in complying with the provisions of the SOX and the resulting regulations, this compliance has not had, and is not expected to have, a material impact on the Company's financial condition or results of operations.

When enacted in 2002, Section 404(a) of the SOX required public companies to include in their annual reports on Form 10-K an assessment from management of the effectiveness of the company's internal control over financial reporting, and Section 404(b) of the SOX required the company's auditor to attest to and report on management's assessment. From 2002 through 2012, the SEC had delayed implementation of Section 404(b) of the SOX for public companies with a public float below \$75 million (i.e. companies that are smaller reporting companies or non-accelerated filers). The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) permanently exempted smaller reporting companies and non-accelerated filers from Section 404(b) of the SOX, and the SEC made conforming amendments to certain of its rules and forms in September 2010. Accordingly, the Company will not be required to submit an attestation from its auditor regarding management's assessment of the effectiveness of the Company's internal controls as long as its public float remains below \$75 million.

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, and is registered as such with, and subject to the supervision of, the Board of Governors of the Federal Reserve System. Generally, a bank holding company is required to obtain the approval of the Board of Governors 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 Board of Governors is also required for the merger or

consolidation of bank holding companies.

The Board of Governors of the Federal Reserve Board 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 Board of Governors 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 Federal Reserve Bank (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.

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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. Subject to certain restrictions set forth in the Federal Reserve Act, a bank can loan or extend credit to an affiliate, purchase or invest in the securities of an affiliate, purchase assets from an affiliate or issue a guarantee, acceptance or letter of credit on behalf of an affiliate, as long as the aggregate amount of such transactions of a bank and its subsidiaries with its affiliates does not exceed 10 percent of the capital stock and surplus of the bank on a per affiliate basis or 20 percent of the capital stock and surplus of the bank on an aggregate affiliate basis. In addition, such transactions must be on terms and conditions that are consistent with safe and sound banking practices. In particular, a bank and its subsidiaries generally may not purchase a low-quality asset (as defined in the Federal Reserve Act) from an affiliate. These restrictions also prevent a bank holding company and its other affiliates from borrowing from a banking subsidiary of the bank holding company unless the loans are secured by marketable collateral of designated amounts. Additionally, the Company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services.

A bank holding company is prohibited from engaging in or acquiring direct or indirect ownership or control of more than 5 percent of the voting shares of any company engaged in nonbanking activities. A bank holding company may, however, engage in or acquire an interest in a company that engages in activities which the FRB has determined by regulation or order are so closely related to banking as to be a proper incident to banking. In making these determinations, the FRB considers whether the performance of such activities by a bank holding company would offer advantages to the public that outweigh possible adverse effects.

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). 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 FDIC, the Comptroller and FRB 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, deposit interest rate ceilings and numerous other matters. 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 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. Such provisions affecting the business of the Company and the Bank include the following:

- Insurance of Deposit Accounts. The Dodd-Frank Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminated the ceiling on the size of the Deposit Insurance Fund (DIF) of the FDIC and increased the floor applicable to the size of the DIF. 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 and provided unlimited federal deposit insurance until December 31, 2012 for non-interest bearing demand transaction accounts at all insured depository institutions.

- Payment of Interest on Demand Deposits. The Dodd-Frank Act 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.

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- Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the CFPB), 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. As a smaller institution, most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the Federal Reserve and to the Bank by the Comptroller.
- Debit Card Interchange Fees. The Dodd-Frank Act amended the Electronic Fund Transfer Act (EFTA) to, among other things, require that debit card interchange fees must be reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In June 2011, the Federal Reserve Board adopted regulations setting the maximum permissible interchange fee as the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, with an additional adjustment of up to one cent per transaction if the issuer implements additional fraud-prevention standards. Although issuers that have assets of less than \$10 billion are exempt from the Federal Reserve Board's regulations that set maximum interchange fees, these regulations are expected to significantly affect the interchange fees that financial institutions with less than \$10 billion in assets are able to collect.

In addition, the Dodd-Frank Act implements other far-reaching changes to the financial regulatory landscape, including provisions that:

- Restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption.
- Apply the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies.
- Require bank holding companies and banks to be both well capitalized and well managed in order to acquire banks located outside their home state.
- Impose comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself.
- Require large, publicly traded bank holding companies to create a risk committee responsible for the oversight of enterprise risk management.
- Require loan originators to retain 5 percent of any loan sold or securitized, unless it is a "qualified residential mortgage", which must still be defined by the regulators. FHA, VA and Rural Housing Service loans are specifically exempted from the risk retention requirements.
- Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders that apply to all public companies not just financial institutions.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, Bank and Trust or their customers or the financial industry more generally. Provisions in the legislation that require revisions to the capital requirements of the Company and the Bank could impact the Company's and the Bank's future equity raising activities. Although the Company and Bank have not issued trust preferred securities, provisions in the legislation that revoke the Tier 1 capital treatment of trust preferred securities could cause the Company and the Bank to seek other sources of capital in the future.

Some of the rules that have been proposed and, in some cases, adopted to comply with the Dodd-Frank Act's mandates are discussed further below.

**Incentive Compensation.** In June 2010, the Federal Reserve, the Comptroller and the FDIC issued comprehensive final guidance on incentive compensation 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 guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

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The Federal Reserve 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." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. 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.

**Capital Requirements.** The FRB, the Comptroller and the FDIC have adopted risk-based capital adequacy guidelines for bank holding companies and banks. These capital adequacy regulations are based upon a risk-based capital determination, whereby a bank holding company's capital adequacy is determined in light of the risk, both on- and off-balance sheet, contained in the company's assets. Different categories of assets are assigned risk weightings by the regulatory agencies and are counted as a percentage of their book value. 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.

Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). There are five capital categories applicable to insured institutions, each with specific regulatory consequences. If the appropriate federal banking agency determines, after notice and an opportunity for hearing, that an insured institution is in an unsafe or unsound condition, it may reclassify the institution to the next lower capital category (other than critically undercapitalized) and require the submission of a plan to correct the unsafe or unsound condition. The Comptroller has issued regulations to implement these provisions. Under these regulations, the categories are:

- a. Well Capitalized — the institution exceeds the required minimum level for each relevant capital measure. A well capitalized institution is one (i) having a Risk-based Capital Ratio of 10 percent or greater, (ii) having a Tier 1 Risk-based Capital Ratio of 6 percent or greater, (iii) having a Leverage Ratio of 5 percent or greater and (iv) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.
- b. Adequately Capitalized — the institution meets the required minimum level for each relevant capital measure. No capital distribution may be made that would result in the institution becoming undercapitalized. An adequately capitalized institution is one having (i) a Risk-based Capital Ratio of 8 percent or greater, (ii) a Tier 1 Risk-based Capital Ratio of 4 percent or greater and (iii) a Leverage Ratio of 4 percent or greater or a Leverage Ratio of 3 percent or greater if the institution is rated composite 1 under the CAMELS (Capital, Assets, Management, Earnings, Liquidity and Sensitivity to market risk) rating system.
- c. Undercapitalized — the institution fails to meet the required minimum level for any relevant capital measure. An undercapitalized institution is one having (i) a Risk-based Capital Ratio of less than 8 percent or (ii) a Tier 1 Risk-based Capital Ratio of less than 4 percent or (iii) a Leverage Ratio of less than 4 percent, or if the institution is rated a composite 1 under the CAMELS rating system, a Leverage Ratio of less than 3 percent.
- d. Significantly Undercapitalized — the institution is significantly below the required minimum level for any relevant capital measure. A significantly undercapitalized institution is one having (i) a Risk-based Capital Ratio of less than 6 percent or (ii) a Tier 1 Risk-based Capital Ratio of less than 3 percent or (iii) a Leverage Ratio of less than 3 percent.
- e. Critically Undercapitalized — the institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution is one having a ratio of tangible equity to total assets that is equal to or less than 2 percent.

An institution which is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities. Each company having control over an undercapitalized institution must provide a limited guarantee that the institution will comply with its capital restoration plan. Except under limited circumstances consistent with an accepted capital restoration plan, an undercapitalized institution may not grow. An undercapitalized institution may not acquire another institution, establish additional branch offices or engage in any new line of business unless determined by the appropriate federal banking agency to be consistent with an accepted capital restoration plan, or unless the FDIC determines that the proposed action will further the purpose of prompt corrective action. The appropriate federal banking agency may take any action authorized for a significantly undercapitalized institution if an undercapitalized institution fails to submit an acceptable capital restoration plan or fails in any material respect to implement a plan accepted by the agency. A critically undercapitalized institution is subject to having a receiver or conservator appointed to manage its affairs and for loss of its charter to conduct banking activities.



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An insured depository institution may not pay a management fee to a bank holding company controlling that institution or any other person having control of the institution if, after making the payment, the institution would be undercapitalized. 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 payment of such a management fee or the making of such dividend would cause the Bank to become undercapitalized, it could not pay a management fee or dividend to the Company.

**Basel III Capital Framework.** In December 2010, the Basel Committee on Banking Supervision (the Basel Committee) released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III". Basel III, when implemented by the U.S. banking agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. Implementation is presently scheduled to be phased in between 2014 and 2019, although it is possible that implementation may be delayed as a result of multiple factors including the current condition of the banking industry within the U.S. and abroad.

The Basel III final capital framework, among other things, (i) introduces as a new capital measure "Common Equity Tier 1" (CET1), (ii) specifies that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

When fully phased in on January 1, 2019, Basel III requires banks to maintain (i) as a newly adopted international standard, 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) as a newly adopted international standard, a minimum leverage ratio of 3%, 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).

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

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

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The implementation of the Basel III final framework will commence January 1, 2013. On that date, banking institutions will be required to meet the following minimum capital ratios:

- 3.5% CET1 to risk-weighted assets.
- 4.5% Tier 1 capital to risk-weighted assets.
- 8.0% Total capital to risk-weighted assets.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2014 and will be phased-in over a five-year period (20% per year). The implementation of the capital conservation buffer will begin on January 1, 2016 at 0.625% and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The U.S. banking agencies have indicated informally that they expect to propose regulations implementing Basel III in mid-2012. Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III, including the imposition of additional capital surcharges on globally systemically important financial institutions. In addition to Basel III, the Dodd-Frank Act requires or permits the federal banking agencies to adopt regulations affecting banking institutions' capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. Accordingly, the regulations ultimately applicable to the Company may be substantially different from the Basel III final framework as published in December 2010. Requirements to maintain higher levels of capital or to maintain higher levels of liquid assets could adversely impact the Company's net income and return on equity.

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the DIF of the FDIC. In July 2010, the Dodd-Frank Act permanently raised the basic limit on federal deposit insurance coverage to \$250,000 per depositor, but did not change FDIC deposit insurance coverage for retirement accounts, which remains \$250,000 per depositor. In November 2010, the FDIC issued a final rule to implement provisions of the Dodd-Frank Act that provide for temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts. For purposes of this extension, the definition of noninterest-bearing transaction accounts includes traditional checking accounts or demand deposit accounts on which no interest is paid and Interest on Lawyer Trust Accounts (IOLTAs), and excludes negotiable order of withdrawal consumer check accounts (NOW accounts) and money market deposit accounts. The extended program is not optional and, unlike the insurance coverage that was previously offered by the FDIC through the Transaction Account Guarantee Program, will no longer be funded by separate premiums. This temporary unlimited deposit insurance coverage became effective on December 31, 2010 and terminates on December 31, 2012.

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, 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.

Deposit Insurance Assessments. In February 2011, the FDIC approved a final rule that changed the assessment base from domestic deposits to average consolidated total assets minus average tangible equity (defined as Tier 1 capital); adopted a new large-bank pricing assessment scheme; and set a target "designated reserve ratio" (described in more detail below) of 2 percent for the DIF. The changes went into effect beginning with the second quarter of 2011, which

was payable at the end of September 2011. The rule also implements a lower assessment rate schedule when the fund reaches 1.15 percent and, in lieu of dividends, provides for a lower rate schedule, when the reserve ratio reaches 2 percent and 2.5 percent.

Under the FDIC's deposit insurance assessment system, insured institutions are assigned to one of four risk categories, based on supervisory evaluations, regulatory capital levels and certain other factors. As applied to small institutions, Risk Category I, which contains the least risky depository institutions, contains further risk differentiation based on the FDIC's analysis of financial ratios, examination component ratings (CAMELS components) and other information. An institution's assessment rate depends upon the category to which it is assigned. Assessment rates are determined by the FDIC and, beginning April 1, 2011, initial base assessment rates ranges 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 broker deposits in excess of 10 percent of domestic deposits for institutions not well rated and well capitalized.

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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. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis.

On October 2010, the FDIC adopted a new 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 restoration plan requires the FDIC to update its loss and income projections for the DIF at least semiannually, and if needed the FDIC may increase or decrease assessment rates following a notice-and-comment rulemaking.

Special Deposit Insurance Assessment and Prepayment of Assessments. In May 2009, the FDIC adopted a final rule imposing a five basis point special assessment on each insured depository institution’s assets minus Tier 1 capital as of June 30, 2009. The assessment was part of the FDIC’s efforts to rebuild the DIF and help maintain public confidence in the banking system. In November 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012, on December 31, 2009, along with each institution’s risk-based deposit insurance assessment for the third quarter of 2009. The prepayment was based on an institution’s assessment rate and assessment base for the third quarter of 2009, assuming a five percent annual growth in deposits each year.

Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Act of 1999 (the GLBA) implemented major changes to the statutory framework for providing banking and other financial services in the United States. The GLBA, among other things, eliminated many of the restrictions on affiliations among banks and securities firms, insurance firms and other financial service providers. A bank holding company that qualifies as a financial holding company will be permitted to engage in activities that are financial in nature or incident or complementary to financial activities. The activities that the GLBA expressly lists as financial in nature include insurance underwriting, sales and brokerage activities, providing financial and investment advisory services, underwriting services and limited merchant banking activities.

To become eligible for these expanded activities, a bank holding company must qualify as a financial holding company. To qualify as a financial holding company, each insured depository institution controlled by the bank holding company must be well-capitalized, well-managed and have at least a satisfactory rating under the CRA (discussed below). In addition, the bank holding company must file with the FRB a declaration of its intention to become a financial holding company. While the Company satisfies these requirements, the Company has elected for various reasons not to be treated as a financial holding company under the GLBA.

The GLBA has not had a material adverse impact on the Company’s operations. To the extent that it allows banks, securities firms and insurance firms to affiliate, the financial services industry has experienced further consolidation. This consolidation has increased competition faced from larger institutions and other companies offering financial products and services, many of which may have substantially greater financial resources.

The GLBA and certain new regulations issued by federal banking agencies also provide protections 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.

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

Restrictions on Proprietary Trading. The Dodd-Frank Act requires the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds), with implementation starting as early as July 2012. This provision of the Dodd-Frank Act is commonly called the "Volcker Rule." In October 2011, federal financial regulators proposed rules to implement the Volcker Rule that included an extensive request for comments on the proposed rules. The proposed rules are highly complex and many aspects of their application remain uncertain. Based on the proposed rules, the Company does not currently anticipate that the Volcker Rule will have a material effect on the operations of the Company or the Bank, as the Company and the Bank do not engage in the businesses prohibited by the Volcker Rule. Until final rules are adopted, the precise financial effect of these rules on the Company and the financial industry cannot be determined.

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

Reporting Terrorist Activities. The Office of Foreign Assets Control (OFAC), which is a division of the Department of the Treasury, is responsible for helping to 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. OFAC has sent, and will send, the banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Company finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report and notify the FBI. The Company has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Company actively checks high-risk OFAC areas such as new accounts, wire transfers and customer files. The Company performs these checks utilizing software, which is updated each time a modification is made to the lists provided by OFAC and other agencies of Specially Designated Nationals and Blocked Persons.

Interagency Appraisal and Evaluation Guidelines. In December 2010, the Federal Reserve Board, the Comptroller and the FDIC, jointly with other federal regulatory agencies, issued the Interagency Appraisal and Evaluation Guidelines. This guidance, which updates guidance originally issued in 1994, sets forth the minimum regulatory standards for appraisals. The guidance incorporates previous regulatory issuances affecting appraisals, addresses advances in information technology used in collateral evaluation, and clarifies standards for use of analytical methods and technological tools in developing evaluations. The guidance also requires institutions to use strong internal controls to ensure reliable appraisals and evaluations and to monitor and periodically update valuations of collateral for existing real estate loans and transactions.

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.

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The Dodd-Frank Act created the CFPB, a federal regulatory agency that is 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 Dodd-Frank Act gives the CFPB authority to supervise and regulate providers of consumer financial products and services, and establishes the CFPB's power to act against unfair, deceptive or abusive practices. The CFPB has stated that it will focus on (i) risks to consumers and compliance with federal consumer financial laws, (ii) the markets in which firms operate and risks to consumers posed by activities in those markets, (iii) depository institutions that offer a wide variety of consumer financial products and services, and depository institutions with a more specialized focus, and (iv) non-depository companies that offer one or more consumer financial products or services.

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 Federal Reserve and to the Bank by the Comptroller. However, the CFPB may include its own examiners in regulatory examinations by a small 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 could influence how the Federal Reserve 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 cannot be forecast.

Future Regulation. From time to time, various legislative and regulatory initiatives are introduced in the United States Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company or the Bank in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company, the Bank or Trust could have a material effect on the business of the Company.

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. A further deterioration of national or international economic conditions could adversely affect the financial condition and operating performance of financial institutions, including by reducing the value of the Company's securities portfolio, and could increase the regulatory scrutiny of financial institutions. A further deterioration of local economic conditions could lead to further 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 further 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 continue to be 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. Continued 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. The Company tries to minimize its exposure to interest rate risk, but it is unable to completely eliminate this risk. 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. At December 31, 2011, 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.

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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.

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 Company's profitability depends significantly on local economic conditions. The Company's success depends primarily on the general economic conditions of the markets the Company operates in. 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. The decline in general economic conditions and the current challenging economic environment have negatively affected the financial results of the Company's operations.

A decline in real estate values could cause a significant portion of the Company's loan portfolio to be under-collateralized and adversely impact the Company's operating results and financial condition. 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. 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.

In recent years, the market value of real estate has declined, leaving the Company with certain loans that are 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 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 foreclosed property. These factors have had an adverse affect on operating results.

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.

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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 Board of Governors of 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 may have an adverse effect on deposit levels, net interest margin, loan demand or the Company's business and operations.

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. 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 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. Federal regulatory agencies, as an integral part of their examination process, review the Company's loans and allowance for loan losses. 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 Dodd-Frank Act could increase the Company's regulatory compliance burden and associated costs, place restrictions on certain products and services and limit its future capital raising strategies. A wide range of regulatory initiatives directed at the financial services industry have been proposed in recent years. One of those initiatives, the Dodd-Frank Act, was signed into law on July 21, 2010. The Dodd-Frank Act represents a sweeping overhaul of the financial services industry within the United States and mandates significant changes in the financial regulatory landscape that will impact all financial institutions, including the Company and the Bank. When fully implemented, the Dodd-Frank Act will likely 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. However, it is too early to fully assess the impact of the Dodd-Frank Act and subsequent regulatory rulemaking processes on the Company's and the Bank's business, financial condition or results of operations.

Among the Dodd-Frank Act's significant regulatory changes, the Act creates a new financial consumer protection agency that could impose new regulations and include its examiners in routine regulatory examinations conducted by the Comptroller. This agency, named the Consumer Financial Protection Bureau, may reshape the consumer financial laws through rulemaking and enforcement of the Dodd-Frank Act's prohibitions against unfair, deceptive and abusive business practices, which may directly impact 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 Consumer Financial Protection Bureau has jurisdiction over banks with \$10 billion or greater in assets, rules, regulations and policies issued by the Bureau may

also apply to the Company, the Bank and/or Trust by virtue of the adoption of such policies and best practices by the Federal Reserve, Comptroller and FDIC. The costs and limitations related to this additional regulatory agency and the limitations and restrictions that will be placed upon the Company with respect to its consumer product and service offerings have yet to be determined. However, these 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.

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The recent repeal of federal prohibitions on payment of interest on demand deposits could increase interest expense. As part of the Dodd-Frank Act, the prohibition on the ability of financial institutions to pay interest on commercial demand deposit accounts was repealed. As a result, beginning on July 21, 2011, financial institutions could begin offering interest on demand deposits. Although the Company cannot be certain what rates other institutions may offer, the Company expects the impact of offering interest on demand deposits to remain minimal as long as the low rate environment continues. When rates begin to increase, however, the Company's interest expense may increase and the net interest margin may decline, which could adversely affect the Company's business, financial condition and results of 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 Deposit Insurance Fund (the DIF) at a certain level. Economic conditions since 2008 have increased the rate of bank failures and expectations for further bank failures, requiring the FDIC to make payments for insured deposits from the DIF and prepare for future payments from the DIF.

During 2009, the FDIC imposed a special deposit insurance assessment on all institutions which it regulates, including the Bank. This special assessment was imposed due to the need to replenish the DIF, as a result of increased bank failures and expected future bank failures. In addition, the FDIC required regulated institutions to prepay their fourth quarter 2009, and full year 2010, 2011 and 2012 assessments in December 2009. Any similar, additional measures taken by the FDIC to maintain or replenish the DIF may have an adverse effect on the Company's financial condition and results of operations.

On February 7, 2011, the FDIC adopted final rules to implement changes required by the Dodd-Frank Act with respect to the FDIC assessment rules that were effective April 1, 2011. A depository institution's deposit insurance assessment is now calculated based on the institution's total assets less tangible equity, rather than the previous base of total deposits. These changes did not increase the Company's FDIC insurance assessments for comparable asset and deposit levels. However, if the Bank's asset size increases or the FDIC takes other actions to replenish the DIF, the Bank's FDIC insurance premiums could increase.

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 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.

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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.

System failures, interruptions or breaches of security 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, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. 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. Although the Company and the Bank rely on commonly used security and processing systems to provide the security and authentication necessary to effect the secure transmission of data, these precautions 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. 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. 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 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 and possible financial liability. Any of these occurrences could have 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 and could expose it to litigation and regulatory action. 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 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, which is 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. Although the Company and its subsidiaries seek to mitigate operational risk through a system of internal controls, there can be no assurance that they will not suffer losses from operational risks in the future that may be material in amount. Any losses resulting from transaction risk could take



the form of explicit charges, increased operational costs, litigation costs, harm to reputation or forgone opportunities, any and all of which could have a material adverse effect on business, financial condition and results of operations.

Item 1B. Unresolved Staff Comments

None.

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## Item 2. Properties

As of December 31, 2011, the Company owned the main office located in Hampton, Virginia, five office buildings and 16 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 expired in October 2011. The Bank is currently negotiating a new written lease. 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. The three branch leases have renewal options that expire anywhere within three to nine years from December 31, 2011.

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. (74) Chairman, President & Chief Executive Officer Old Point Financial Corporation	1965	Banker
Louis G. Morris (57) Executive Vice President/Bank Old Point Financial Corporation	1988	Banker
Laurie D. Grabow (54) Chief Financial Officer & Senior Vice President/Finance Old Point Financial Corporation	1999	Banker
Eugene M. Jordan, II (57) Executive Vice President/Trust Old Point Financial Corporation	2003	Banker
Robert F. Shuford, Jr. (47) Senior Vice President/Operations Old Point Financial Corporation	2003	Banker

Melissa L. Burroughs (47) Senior Vice President/Lending & Business Development Old Point Financial Corporation	2007	Banker
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Joseph R. Witt (51) Senior Vice President/Corporate Banking Old Point Financial Corporation	2008	Banker
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Prior to 2008, Joseph Witt served as the North American Treasurer for an international building supply company for thirteen years. Mr. Witt holds an MBA with a concentration in banking and is a Certified Public Accountant.

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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 February 29, 2012 was 1,262. On that date, the closing price of the Company's common stock on the NASDAQ Capital Market was \$10.42. The range of high and low sale prices and dividends paid per share of the Company's common stock for each quarter during 2011 and 2010 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 stockholder matters can be found in Note 16 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 2011. 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 2011.

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## 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,                      2011                      2010                      2009                      2008                      2007  
(in thousands except per share data)

## RESULTS OF OPERATIONS

Interest income	\$36,251	\$40,890	\$41,682	\$46,501	\$49,021
Interest expense	6,715	9,982	14,323	19,006	23,349
Net interest income	29,536	30,908	27,359	27,495	25,672
Provision for loan losses	3,700	8,800	6,875	2,400	1,000
Net interest income after provision for loan losses	25,836	22,108	20,484	25,095	24,672
Net gains (losses) on available-for-sale securities	787	541	290	(47 )	3
Noninterest income	11,409	12,098	12,324	12,769	12,483
Noninterest expenses	33,679	33,051	31,205	28,376	26,023
Income before income taxes	4,353	1,696	1,893	9,441	11,135
Income tax expense	1,063	149	211	2,651	3,166
Net income	\$3,290	\$1,547	\$1,682	\$6,790	\$7,969

## FINANCIAL CONDITION

Total assets	\$849,504	\$886,842	\$921,422	\$834,965	\$822,557
Total deposits	690,879	679,214	662,502	646,524	596,165
Total loans	520,327	586,619	635,242	637,452	597,144
Stockholders' equity	85,865	80,952	81,608	82,898	79,707
Average assets	853,849	924,709	868,082	832,533	824,727
Average equity	83,322	82,513	82,772	82,195	77,479

## PERTINENT RATIOS

Return on average assets	0.39	%	0.17	%	0.19	%	0.82	%	0.97	%
Return on average equity	3.95	%	1.87	%	2.03	%	8.26	%	10.29	%
Dividends paid as a percent of net income	30.12	%	79.64	%	137.16	%	47.66	%	37.78	%
Average equity as a percent of average assets	9.76	%	8.92	%	9.54	%	9.87	%	9.39	%

## PER SHARE DATA \*\*\*

Basic earnings per share	\$0.66	\$0.31	\$0.34	\$1.39	\$1.61
Diluted earnings per share	0.66	0.31	0.34	1.38	1.59
Cash dividends declared	0.20	0.25	0.47	0.66	0.61
Book value	17.31	16.40	16.60	16.90	16.24

## GROWTH RATES

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Year-end assets	-4.21	%	-3.75	%	10.35	%	1.51	%	-2.95	%
Year-end deposits	1.72	%	2.52	%	2.47	%	8.45	%	1.32	%
Year-end loans	-11.30	%	-7.65	%	-0.35	%	6.75	%	2.32	%
Year-end equity	6.07	%	-0.80	%	-1.56	%	4.00	%	6.75	%
Average assets	-7.66	%	6.52	%	4.27	%	0.95	%	3.82	%
Average equity	0.98	%	-0.31	%	0.70	%	6.09	%	6.81	%
Net income	112.67	%	-8.03	%	-75.23	%	-14.79	%	13.45	%
Cash dividends declared	-20.00	%	-46.81	%	-28.79	%	8.20	%	8.93	%
Book value	5.55	%	-1.20	%	-1.78	%	4.06	%	8.56	%

\*\*\* Per share data have been adjusted to reflect the 5 for 4 stock split in the form of a dividend declared on August 16, 2007 and paid on October 1, 2007.

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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 statements regarding profitability, liquidity, the loan portfolio, allowance for loan losses, the securities portfolio, interest rate sensitivity, levels of net loan charge-offs, noninterest expense, income taxes, expected impact of efforts to restructure the balance sheet, 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 having similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to, changes in interest rates, general economic conditions, the quality or composition of the loan or investment portfolios, the level of nonperforming assets and charge-offs, the local real estate market, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, FDIC premiums and/or assessments, demand for loan products, levels of noninterest income and expense, deposit flows, competition, adequacy of the allowance for loan losses and 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 in the past few years have resulted in significant write-downs of asset values by the Company as well as by other financial institutions in the U.S. Concerns about future economic conditions and financial markets generally have reduced the availability of funding to certain financial institutions, leading to a tightening of credit and reduction of business activity.

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 business customers. The Bank is an independent community bank. In November of 2009, the Bank opened the Ghent office in Norfolk. With this opening, the Bank has 21 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.

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### Management Initiatives in 2011

Beginning in 2010 and continuing in 2011, in consideration of the lack of quality loan demand, the Company decided to restructure its balance sheet while ensuring that liquidity remained strong. With this restructuring, management's goal was to maximize the net interest margin and reduce the Company's dependence on higher-cost sources of funding. Management determined that the Company would not pay for higher cost deposits unless the customer had a strong relationship with the Company. In addition, the Company did not renew higher-cost term repurchase agreements. Based on this strategy, at December 31, 2011, total deposits increased to \$690.9 million, an increase of 1.72% from \$679.2 million on December 31, 2010. Noninterest-bearing deposits increased by \$34.4 million, while time deposits decreased by \$29.9 million when comparing 2011 to 2010. In addition, higher cost term repurchase agreements decreased by \$37.5 million in 2011.

### Primary Financial Data for 2011

The Company earned \$3.3 million in 2011, as compared to net income of \$1.5 million in 2010. The increase in net income was due to a reduction in the provision for loans losses, from \$8.8 million in 2010 to \$3.7 million in 2011. Decreases in loans and in nonperforming assets between December 31, 2010 and December 31, 2011 allowed management to reduce the provision for loan losses in 2011.

Nonperforming assets as of December 31, 2011 were 46.00% lower than nonperforming assets as of December 31, 2010, due to a 59.41% decline in nonaccrual loans and a 17.98% decline in foreclosed assets over the same time period. Nonaccrual loans totaling \$13.4 million were sold without recourse in the second and third quarters of 2011. Of the \$8.4 million net loans charged off in 2011, \$4.6 million was included in the 2010 provision for loan losses when management realized that these losses were probable.

### 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 value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance 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 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.

Reserves for commercial loans are determined by applying estimated loss factors to the portfolio based on management's evaluation and risk grading of the commercial loan portfolio. Reserves are provided for noncommercial loan categories using estimated loss factors applied to the total outstanding loan balance of each loan category. 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.

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While management uses the best information available to establish the allowance for loan and lease 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 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 \$3.3 million, or \$0.66 per diluted share, in 2011 compared to \$1.5 million, or \$0.31 per diluted share, in 2010 and \$1.7 million, or \$0.34 per diluted share, in 2009. During 2011, the Company decreased its loan loss provision to \$3.7 million as compared to \$8.8 million and \$6.9 million in 2010 and 2009 respectively. The decrease to the loan loss provision was mainly a result of the reduction in nonperforming assets. Another benefit from the improvement in nonperforming assets during 2011 was the reduction of legal expenses which decreased \$178 thousand when comparing 2011 to 2010. In addition, loss on write-down/sale of foreclosed assets in 2011 decreased by \$29 thousand compared to 2010.

### 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 \$29.7 million in 2011, down \$1.4 million from 2010 and up \$2.0 million from 2009. The net interest margin was 3.81% in 2011 as compared to 3.63% in 2010 and 3.44% in 2009.

When comparing 2011 to 2010, the following changes were noted. Tax equivalent interest income decreased \$4.7 million, or 11.40%. Average earning assets declined \$76.3 million, or 8.92%. Total average loans decreased \$77.0 million, or 12.39%, while average investment securities increased \$14.4 million, or 7.47%. The yield on earning assets decreased by 13 basis points due to decreasing yields in the loan portfolio. The Company's securities portfolio increased in 2011 as demand for the Company's loan products dropped and the Company invested excess funds in securities. The Company intends to continue investing excess funds in securities until quality loan demand increases. 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. To partially offset this anticipated decline in loan yields, management has placed an increased focus on prudently increasing the yields on the Company's securities portfolio.

Interest expense decreased \$3.3 million, or 32.73% in 2011 as compared to 2010, while average interest-bearing liabilities decreased \$91.3 million, or 12.81%. The cost of interest-bearing liabilities decreased 32 basis points due to the low interest rate environment. Management expects that the reduction of the Company's interest expense will not continue at such a rapid pace in the future, because the majority of the higher cost time deposits have repriced to current, lower market rates.



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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,	2011			2010			2009		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
	(in thousands)								
<b>ASSETS</b>									
Loans	\$544,523	\$32,176	5.91%	\$621,550	\$37,142	5.98%	\$633,614	\$38,168	6.02%
Investment securities:									
Taxable	203,198	3,884	1.91%	186,992	3,419	1.83%	118,122	2,566	2.17%
Tax-exempt	3,763	238	6.32%	5,579	406	7.28%	11,319	815	7.20%
Total investment securities	206,961	4,122	1.99%	192,571	3,825	1.99%	129,441	3,381	2.61%
Interest-bearing due from banks	9,819	22	0.22%	1,156	3	0.26%	818	2	0.24%
Federal funds sold	13,622	21	0.15%	35,608	75	0.21%	25,310	54	0.21%
Other investments	4,599	62	1.35%	4,939	44	0.89%	16,129	419	2.60%
Total earning assets	779,524	36,403	4.67%	855,824	41,089	4.80%	805,312	42,024	5.22%
Reserve for loan losses	(10,349)			(11,064)			(7,232)		
	769,175			844,760			798,080		
Cash and due from banks	13,227			12,486			11,405		
Bank premises and equipment, net	29,896			30,051			35,246		
Other assets	41,551			37,412			23,351		
Total assets	\$853,849			\$924,709			\$868,082		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Time and savings deposits:									
Interest-bearing transaction accounts	\$11,512	\$7	0.06%	\$11,031	\$7	0.06%	\$9,812	\$7	0.07%
Money market deposit accounts	169,951	352	0.21%	159,934	359	0.22%	136,651	301	0.22%
Savings accounts	48,252	49	0.10%	45,281	47	0.10%	41,132	53	0.13%
Time deposits, \$100,000 or more	126,711	1,862	1.47%	182,983	2,647	1.45%	183,160	3,743	2.04%
Other time deposits	180,162	2,634	1.46%	161,399	3,977	2.46%	153,137	6,208	4.05%
Total time and savings deposits	536,588	4,904	0.91%	560,628	7,037	1.26%	523,892	10,312	1.97%
Federal funds purchased, repurchase agreements	50,196	106	0.21%	104,859	545	0.52%	79,113	566	0.72%

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and other borrowings

Federal Home Loan Bank advances	35,000	1,705	4.87%	47,620	2,400	5.04%	66,528	3,445	5.18%
Total interest-bearing liabilities	621,784	6,715	1.08%	713,107	9,982	1.40%	669,533	14,323	2.14%
Demand deposits	147,069			126,829			112,826		
Other liabilities	1,674			2,260			2,951		
Total liabilities	770,527			842,196			785,310		
Stockholders' equity	83,322			82,513			82,772		
Total liabilities and stockholders' equity	\$853,849			\$924,709			\$868,082		
Net interest margin		\$29,688	3.81%		\$31,107	3.63%		\$27,701	3.44%

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

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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*								
	2011 vs. 2010			2010 vs. 2009			2009 vs. 2008		
	Increase (Decrease) Due to Changes in:			Increase (Decrease) Due to Changes in:			Increase (Decrease) Due to Changes in:		
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
<b>EARNING ASSETS:</b>									
Loans	\$ (4,603 )	\$(363 )	\$ (4,966 )	\$(727 )	\$(299 )	\$(1,026 )	\$705	\$(3,478 )	\$(2,773 )
Investment securities:									
Taxable	296	169	465	1,496	(643 )	853	1,277	(2,087 )	(810 )
Tax-exempt	(132 )	(36 )	(168 )	(413 )	4	(409 )	(587 )	0	(587 )
Total investment securities	164	133	297	1,083	(639 )	444	690	(2,087 )	(1,397 )
Federal funds sold	(46 )	(8 )	(54 )	22	(1 )	21	168	(501 )	(333 )
Other investments **	64	(27 )	37	(270 )	(104 )	(374 )	(409 )	(112 )	(521 )
Total earning assets	(4,421 )	(265 )	(4,686 )	108	(1,043 )	(935 )	1,154	(6,178 )	(5,024 )
<b>INTEREST-BEARING LIABILITIES:</b>									
Interest-bearing									
transaction accounts	0	0	0	1	(1 )	0	(1 )	(6 )	(7 )
Money market deposit									
accounts	22	(29 )	(7 )	51	7	58	(17 )	(659 )	(676 )
Savings accounts	3	(1 )	2	5	(11 )	(6 )	9	(59 )	(50 )
Time deposits,									
\$100,000 or more	(814 )	29	(785 )	(4 )	(1,092 )	(1,096 )	2,350	(3,373 )	(1,023 )
Other time deposits	462	(1,805 )	(1,343 )	335	(2,566 )	(2,231 )	(2,031 )	(3 )	(2,034 )
Total time and savings deposits	(327 )	(1,806 )	(2,133 )	388	(3,663 )	(3,275 )	310	(4,100 )	(3,790 )
Federal funds									
purchased, repurchase									
agreements and other									
borrowings	(284 )	(155 )	(439 )	184	(205 )	(21 )	490	(801 )	(311 )
Federal Home Loan									
Bank advances	(636 )	(59 )	(695 )	(979 )	(66 )	(1,045 )	(594 )	12	(582 )
Total interest-bearing liabilities	(1,247 )	(2,020 )	(3,267 )	(407 )	(3,934 )	(4,341 )	206	(4,889 )	(4,683 )
Change in net interest									
income	\$ (3,174 )	\$1,755	\$ (1,419 )	\$515	\$2,891	\$3,406	\$948	\$(1,289 )	\$(341 )

\* 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, 2011. It should be noted, however, that non-maturing deposit liabilities, which consist of interest checking, money market and savings accounts, are less interest sensitive than other market driven deposits. On December 31, 2011 non-maturing deposit liabilities totaled \$232.3 million, or 44.07%, 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, 2011.



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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, 2011 (in thousands)	Within 3 Months	4-12 Months	1-5 Years	Over 5 Years	Total
<b>Uses of funds</b>					
Interest-bearing due from banks	\$ 13,978	\$ 0	\$ 0	\$ 0	13,978
Federal funds sold	1,354	0	0	0	1,354
Taxable investments	1,556	0	41,810	182,342	225,708
Tax-exempt investments	442	601	565	10,798	12,406
Total federal funds sold and investment securities	17,330	601	42,375	193,140	253,446
<b>Loans</b>					
Commercial	\$ 2,305	\$ 9,834	\$ 17,179	\$ 5,697	\$ 35,015
Consumer	1,571	1,101	9,992	4,377	17,041
Real estate	51,385	54,955	269,299	60,302	435,941
Other	22,376	1,042	7,628	1,285	32,330
Total loans	77,637	66,932	304,098	71,661	520,327
Total earning assets	\$ 94,967	\$ 67,533	\$ 346,473	\$ 264,801	\$ 773,773
<b>Sources of funds</b>					
Interest-bearing transaction accounts	\$ 15,732	\$ 0	\$ 0	\$ 0	\$ 15,732
Money market deposit accounts	166,331	0	0	0	166,331
Savings accounts	50,285	0	0	0	50,285
Time deposits \$100,000 or more	25,303	43,977	56,370	0	125,650
Other time deposits	22,844	66,672	79,726	0	169,242
Federal funds purchased and other borrowings	0	0	0	0	0
Overnight repurchase agreements	35,001	0	0	0	35,001
Term repurchase agreements	1,480	0	0	0	1,480
FHLB advances	35,000	0	0	0	35,000
Total interest bearing liabilities	\$ 351,976	\$ 110,649	\$ 136,096	\$ 0	\$ 598,721
Rate sensitivity GAP	\$ (257,009 )	\$ (43,116 )	\$ 210,377	\$ 264,801	\$ 175,052
Cumulative GAP	\$ (257,009 )	\$ (300,125 )	\$ (89,748 )	\$ 175,050	

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.

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Under the rate environment forecasted by management, rate shocks in 50 to 100 basis point increments are applied to see 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, 2011, 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.

Change in interest Rates	As of December 31, 2011	
	Amount	Percent
Up 4.00%	\$ 1,343	4.79 %
Up 3.00%	\$ 1,144	4.08 %
Up 2.00%	\$ 836	2.98 %
Up 1.00%	\$ 519	1.85 %
Up 0.50%	\$ 207	0.74 %
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 was \$3.7 million in 2011 as compared to \$8.8 million in 2010 and \$6.9 million in 2009. Loans that were charged off during 2011 totaled \$9.3 million compared to \$4.5 million in 2010 and \$6.4 million in 2009. Recoveries amounted to \$877 thousand in 2011, \$1.1 million in 2010 and \$937 thousand in 2009. The Company's net loans charged off to year-end loans were 1.62% in 2011, 0.59% in 2010 and 0.85% in 2009. The allowance for loan losses, as a percentage of year-end loans, was 1.63% in 2011, 2.25% in 2010 and 1.24% in 2009. Net loan charge-offs for 2011, 2010 and 2009 are higher than normal due to the economic downturn as borrowers struggled to make their payments. Management believes that net loan charge-offs will be lower in the immediate future than what has been experienced in past three years but will more than likely continue to be at above-normal levels until the economy is well into recovery.

Management contributed \$3.7 million to the allowance for loan losses through the provision, or \$4.7 million less than net charge-offs during the year ended December 31, 2011, based on management's evaluation of loan losses in the loan portfolio, which is discussed below. Of the \$8.4 million net loans charged off in 2011, \$4.6 million was included in the 2010 provision for loan losses when management realized that these losses were probable. In 2010, the provision for loan losses was \$5.4 million higher than net charge-offs for 2010.

The provision for loan losses is an expense that is based on management's estimate of credit losses that may be sustained in the loan portfolio. Management's evaluation included credit quality trends, collateral values, 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. Management's evaluation identified improvement in the credit quality of the Company's loan portfolio. This improvement supported the decrease in the provision for loan losses and the allowance for loan losses as a percent of total loans. Management believes that smaller contributions to the provision for loan losses, relative to 2010 and 2009 contributions to the provision for loan losses, will continue if current economic conditions remain stable or improve.

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Noninterest Income

Noninterest income decreased \$446 thousand, or 3.53% in 2011 from 2010 compared to an increase of \$24 thousand, or 0.19%, in 2010 from 2009. The decrease of \$446 thousand is due to several positive and negative factors. In 2011, the gains on sales of available-for-sale securities were \$246 thousand higher than in 2010. Service charges on deposit accounts decreased \$504 thousand when comparing 2011 to 2010. Overdraft fee income, which is a component of service charges on deposit accounts, was \$513 thousand lower in 2011 than in 2010, due to changes in Regulation E that went into effect during the third quarter of 2010. The changes require advance authorization from customers for overdrafts caused by debit card and ATM transactions. The Company has made an effort to educate customers on the benefits of its overdraft programs, and as a result, overdraft fee income for the second half of 2011 was up \$60 thousand from the same period in 2010. Despite this positive trend, the Company expects continued uncertainty regarding overdraft fee income. To compensate, the Company is developing and marketing other income-producing products, such as remote deposit capture, lockbox services, positive pay and online payables to help drive future noninterest income. Positive Pay is a fraud prevention tool utilized by Commercial customers to reduce fraud exposure on checking accounts and identifies checks that are mismatched against the company's register. Online Payables is an integrated payments system offering outsourced print and mail solutions for the delivery of a variety of check payments, including checks for payroll, A/P payments, rebates, commissions, refunds, and dividends. As a result of this emphasis, income from merchant processing and debit cards has grown \$248 thousand, or 13.71%, between 2010 and 2011. Income from merchant processing and debit cards are included in the category of other service charges, commissions and fees, which increased by \$157 thousand in 2011 as compared to 2010.

The Company expects the Dodd-Frank Act, when fully implemented, to 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 Expenses

The Company's noninterest expense increased \$625 thousand or 1.89% between 2010 and 2011 after increasing \$1.8 million, or 5.91%, in 2010 over 2009. This increase was due to an \$843 thousand growth in salaries and benefits, as several higher-paid positions were filled in the second half of 2010 and in 2011. Many of these newly-hired employees are in the Company's private banking and corporate lending areas and were hired to increase small business lending, treasury services and lending in areas other than commercial real estate as part of management's focus on increasing loans and noninterest income.

The increase in salaries and benefits during 2011 was partially offset by decreases in other areas, particularly advertising, postage and courier expense, legal and audit expense and FDIC insurance. The Company has reduced advertising expense as part of its effort to control noninterest expenses and has focused on earned publicity rather than paid advertising. Implementing and marketing electronic statements has allowed the reduction in postage and courier expense which was also a product of the effort to control expenses. Legal and audit expense decreased as the Company's nonperforming assets decreased during 2011. Finally, the reduction in FDIC insurance expense was due to changes in the method for calculating FDIC deposit insurance assessments, which were effective in 2011.

Loss on write-down/sale of foreclosed assets and other outside service fees remained elevated in 2011 as in 2010 when these two years are compared to the same line items in 2009. The increase in loss on write-down/sale of foreclosed assets expense account was due to the sale of properties at below book value or the write-down of properties after obtaining current appraisals for these properties at lower market values. This is a trend that management expects to continue if economic conditions and real estate markets do not improve. The majority of the increase in other outside service fees was related to the use of an independent contractor to provide coverage for two open positions in the information technology area.

In this current economic environment, management is keenly aware of the need to improve net income. During 2010 and 2011, management implemented several cost cutting measures. These cost cutting measures can be seen in the lower expenses in various noninterest expense categories in 2011 as compared to 2010, and also when comparing 2010 to 2009. In February 2012, the Company made an early retirement offer to employees age 60 years or over whose age plus years of service will equal at least 70 at December 31, 2012. Senior officers, including the Company's named executive officers, were not permitted to participate in the plan. It is still too early to predict the financial effect of this offer. The Company will expense the payments made to employees when they are both measurable and probable, which is expected to be in the first and second quarters of 2012. The offer is expected to reduce total salaries and benefits expense beginning in the third quarter of 2012. The Company will continue its focus on improving operating efficiency and monitoring noninterest expenses.

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## Balance Sheet Review

At December 31, 2011, the Company had total assets of \$849.5 million, a decrease of \$37.3 million, or 4.21%, compared to assets as of December 31, 2010, largely due to a reduction of \$66.3 million, or 11.30%, in the Company's loan portfolio. This decrease was driven by the current loan environment, reduced loan demand by quality borrowers and suppressed economic activity. Management has also placed an increased emphasis on improving the Company's net interest margin by reducing dependence on higher-cost sources of funding. As a result, the Company's higher-cost time deposits decreased by \$29.9 million, or 9.21%, from December 31, 2010 to December 31, 2011.

Term repurchase agreements also decreased, partially due to the exiting of certain high-cost, non-relationship accounts and partially due to an internal restructuring of the accounts of a single large customer from repurchase agreements to noninterest-bearing deposit accounts. Because the FDIC recently began offering full insurance coverage to certain noninterest-bearing deposit accounts, the Company was able to make the change and free up securities that were used as collateral for the repurchase agreements which also improved the Company's liquidity position.

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, 2011.

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 local market area.

The following table details, as of December 31, 2011, the Company's loans with subprime characteristics that were secured by 1-4 family first mortgages, 1-4 family open-end and 1-4 family junior lien loans 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

	Amount (in thousands)	Percent	
Subprime	\$ 22,040	20.71	%
Non-subprime	84,403	79.29	%
	\$ 106,443	100.0	%
Total loans	\$ 520,327		
Percentage of Real Estate-Secured Subprime Loans to Total Loans		4.24	%

In addition to the subprime loans secured by real estate discussed above, as of December 31, 2011, the Company had an additional \$2.6 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, 2011 were \$24.6 million, amounting to 4.73% of the Company's total loans at December 31, 2011.

Additionally, the Company has no investments secured by “Alt-A” type mortgage loans such as adjustable rate and nontraditional type mortgages or subprime loans.

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## Investment Portfolio

Total available-for-sale and held-to-maturity securities at December 31, 2011 were \$238.1 million, an increase of 14.45% from \$208.0 million on December 31, 2010. As quality loan demand has decreased in recent years, management has invested excess funds in securities that can be readily liquidated when loan demand recovers. The Company's goal is to provide maximum return on the investment portfolio within the framework of its asset/liability objectives. The objectives include managing interest sensitivity, liquidity and pledging requirements.

Beginning in 2011, management re-evaluated its investment strategy in response to several factors. Management wanted to improve the consistency of cash flows provided by the investment portfolio, which would improve the Company's liquidity position. Securities issued by government agencies are typically structured so that investors receive all the cash flow (i.e., all principal and interest on the security) at either the call or maturity date. In contrast, investments in mortgage-backed securities guaranteed by government-sponsored enterprises provide investors with a continuous cash flow stream in the form of periodic principal and interest payments. During 2011, the Company substantially increased its investments in mortgage-backed securities that are guaranteed by government-sponsored enterprises. The cash flow provided by these mortgage-backed securities will provide the Company with liquidity to fund loans when quality loan demand improves. Also, at the present time, these mortgage-backed securities provide a higher yield for the same estimated duration of the security as compared to securities issued by government agencies. Finally, management has increased its investment in obligations of states and political subdivisions, as these securities tend to bear a higher yield than securities issued by government agencies. Although obligations of states and political subdivisions typically have a longer duration than alternative investments, management believes that it is maintaining appropriate levels of interest-rate risk in the securities portfolio. Management will continue to review its strategy as the economic and interest-rate environments continue to change.

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

TABLE IV  
INVESTMENT PORTFOLIO

As of December 31,	2011	2010	2009
		(in thousands)	
Available-for-sale securities, at fair value:			
U.S. Treasury securities	\$ 250	\$ 600	\$ 400
Obligations of U.S. Government agencies	119,554	200,121	161,540
Obligations of state and political subdivisions	12,261	3,172	8,825
Mortgage-backed securities	103,228	382	1,304
Money market investments	1,306	1,817	1,706
	\$ 236,599	\$ 206,092	\$ 173,775
Held-to-maturity securities, at cost:			
Obligations of U.S. Government agencies	\$ 1,370	\$ 1,670	\$ 1,800
Obligations of state and political subdivisions	145	282	412
	\$ 1,515	\$ 1,952	\$ 2,212
Restricted securities:			
Federal Home Loan Bank stock	\$ 3,282	\$ 4,151	\$ 4,646
Federal Reserve Bank stock	169	169	169

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	\$ 3,451	\$ 4,320	\$ 4,815
Total	\$ 241,565	\$ 212,364	\$ 180,802

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The following table summarizes the contractual maturity of the investment portfolio and their weighted average yields as of December 31, 2011:

	1 year or less		1-5 years		5-10 years		Over 10 years		Total
	(in thousands)								
U.S. Treasury securities	\$ 250		\$ 0		\$ 0		\$ 0		\$ 250
Weighted average yield	0.01	%	0.00	%	0.00	%	0.00	%	0.01
Obligations of U.S.									
Government agencies	\$ 0		\$ 41,810		\$ 79,114		\$ 0		\$ 120,924
Weighted average yield	0.00	%	1.99	%	2.05	%	0.00	%	2.03
Obligations of state and political subdivisions									
	\$ 898		\$ 2,640		\$ 7,378		\$ 1,490		\$ 12,406
Weighted average yield	4.57	%	2.73	%	2.50	%	2.92	%	2.75
Mortgage-backed securities									
	\$ 0		\$ 0		\$ 5,123		\$ 98,105		\$ 103,228
Weighted average yield	0.00	%	0.00	%	2.07	%	2.19	%	2.18
Money market investments									
	\$ 1,306		\$ 0		\$ 0		\$ 0		\$ 1,306
Weighted average yield	0.01	%	0.00	%	0.00	%	0.00	%	0.01
Federal Home Loan Bank stock - restricted									
	\$ 0		\$ 0		\$ 0		\$ 3,282		\$ 3,282
Weighted average yield	0.00	%	0.00	%	0.00	%	0.21	%	0.21
Federal Reserve Bank stock - restricted									
	\$ 0		\$ 0		\$ 0		\$ 169		\$ 169
Weighted average yield	0.00	%	0.00	%	0.00	%	6.00	%	6.00
Total securities	\$ 2,454		\$ 44,450		\$ 91,615		\$ 103,046		\$ 241,565
Weighted average yield	1.68	%	2.03	%	2.09	%	2.14	%	2.09

Yields are calculated on a fully tax-equivalent basis using a 34% rate.

## Loan Portfolio

The following table shows a breakdown of total loans by segment at December 31 for years 2007 through 2011:

TABLE V  
LOAN PORTFOLIO

As of December 31,	2011	2010	2009	2008	2007
	(in thousands)				
Commercial	\$ 35,015	\$ 36,053	\$ 60,353	\$ 70,353	\$ 66,408
	19,981	19,206	30,696	60,604	56,007

Real  
estate-construction

Real estate-mortgage	415,960	489,190	506,196	460,235	415,492
Consumer	17,041	24,389	33,371	40,789	51,912
Other	32,330	17,781	4,626	5,471	7,325
<b>Total</b>	<b>\$ 520,327</b>	<b>\$ 586,619</b>	<b>\$ 635,242</b>	<b>\$ 637,452</b>	<b>\$ 597,144</b>

Based on the North American Industry Classification System code, there are no categories of loans that exceed 10% of total loans other than the categories disclosed in the preceding table.

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As of December 31, 2011, the Company's real estate-mortgage and consumer loan portfolio segments collectively decreased by \$80.6 million from December 31, 2010. These reductions were principally due to higher than normal amortization of loans in 2011 due to an attractive refinance market; closer management of revolving credits; purposeful exiting of troubled credits; partial charge-offs of some larger troubled loans to properly account for reasonable collateral value; regularly scheduled payments exceeding loan demand from qualified borrowers; and reduced quality loan demand in the Company's markets. These factors may continue to impact the Company's loan portfolio until economic conditions and real estate markets improve. The increase in the Company's "Other" loan portfolio segment during 2011 was due to increased use of warehouse lines by mortgage company customers. Management does not anticipate a similar increase in this segment of the loan portfolio in 2012.

The maturity distribution and rate sensitivity of certain categories of the Company's loan portfolio at December 31, 2011 is presented below:

TABLE VI  
MATURITY SCHEDULE OF SELECTED LOANS

December 31, 2011	Within 1 year	1 to 5 years	After 5 years	Total
	(in thousands)			
Commercial	\$ 11,187	\$ 17,576	\$ 6,252	\$ 35,015
Real estate - construction	11,420	8,199	362	19,981
<b>Total</b>	<b>\$ 22,607</b>	<b>\$ 25,775</b>	<b>\$ 6,614</b>	<b>\$ 54,996</b>
Loans due after 1 year with:				
Fixed interest rate		\$ 21,835	\$ 5,524	\$ 27,359
Variable interest rate		3,940	1,090	5,030
<b>Total</b>		<b>\$ 25,775</b>	<b>\$ 6,614</b>	<b>\$ 32,389</b>

## Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and accruing interest, nonperforming restructured loans, and foreclosed assets (real estate from foreclosures of loan collateral). Restructured loans are loans with terms that were modified in a troubled debt restructuring for borrowers experiencing financial difficulties. As of December 31, 2011, the Company had four restructured loans, all of which have been performing according to their modified terms for at least six months and therefore are not included in the Company's total nonperforming assets.

As of December 31, 2011, nonperforming assets totaled \$18.4 million, down from \$34.0 million at year-end 2010. The December 2011 total consisted of \$9.4 million of foreclosed assets, \$517 thousand in loans still accruing interest but past due 90 days or more and \$8.5 million in nonaccrual loans. The \$9.4 million of foreclosed assets consisted of the following:

Foreclosed Assets (in thousands)	
Construction, land development, and other land	\$ 3,969
1-4 family residential properties	3,650
Nonfarm nonresidential properties	1,771
<b>Total</b>	<b>\$ 9,390</b>

\$8.5 million of the Company's nonperforming assets consist of nonaccrual loans, with \$8.3 million of the loans secured by real estate. The majority of the nonaccrual loans are classified as substandard. Substandard loans are a component of the allowance for loan losses. When a loan changes from "90 days past due but still accruing interest" to "nonaccrual" status, the loan is normally reviewed for impairment. If the loan is considered impaired, then the Company records a charge-off based on the value of the collateral or the loan's expected future cash flows. If the Company is waiting on an appraisal to determine the collateral's value, management allocates funds to cover the deficiency to the allowance for loan losses based on information available to management at the time.

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Impaired loans decreased to \$9.6 million as of December 31, 2011 from \$20.1 million as of December 31, 2010 as detailed in Note 4 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplemental Data" of this report on Form 10-K. The majority of these loans were collateralized. The reasons for the significant decrease in impaired loans from 2010 to 2011 were foreclosures, payoffs and charge offs of loans in 2011 that were impaired as of the end of 2010. Management continues to evaluate loans for impairment as necessary.

The following table presents information concerning the aggregate amount of nonperforming assets, which includes nonaccrual loans, past due loans, troubled debts restructured and foreclosed assets:

TABLE VII  
NONPERFORMING ASSETS

As of December 31,	2011	2010	2009	2008	2007
	(in thousands)				
Nonaccrual loans					
Commercial	\$129	\$178	\$255	\$219	\$62
Real estate-construction	0	37	524	370	0
Real estate-mortgage (1)	8,334	20,550	4,109	337	22
Consumer	12	116	29	119	0
Total nonaccrual loans	\$8,475	\$20,881	\$4,917	\$1,045	\$84
Loans past due 90 days or more and accruing interest					
Commercial	\$0	\$0	\$40	\$66	\$15
Real estate-construction	0	16	0	375	0
Real estate-mortgage	510	33	228	2,744	297
Consumer	2	23	117	335	308
Other	5	1	4	9	3
Total loans past due 90 days or more and accruing interest	\$517	\$73	\$389	\$3,529	\$623
Restructured loans					
Real estate-construction	\$0	\$0	\$0	\$6,594	\$0
Real estate-mortgage (1)	4,277	1,639	2,480	0	1,321
Total restructured loans	\$4,277	\$1,639	\$2,480	\$6,594	\$1,321
Less restructured loans in compliance (2)	4,277	0	2,480	0	1,321
Net nonperforming restructured loans	\$0	\$1,639	\$0	\$6,594	\$0
Foreclosed assets					
Foreclosed assets	\$9,390	\$11,448	\$7,623	\$3,751	\$1,119
Total nonperforming assets	\$18,382	\$34,041	\$12,929	\$14,919	\$1,826
Interest income that would have been recorded under original loan terms on nonaccrual loans					
Interest income that would have been recorded under original loan terms on nonaccrual loans	\$1,353	\$1,507	\$442	\$244	\$79
Interest income recorded for the period on nonaccrual loans					
Interest income recorded for the period on nonaccrual loans	\$506	\$790	\$440	\$185	\$105

(1) The real estate-mortgage segment includes residential 1 – 4 family, commercial real estate, second mortgages and equity lines of credit.

(2) Amounts listed represent restructured loans that are in compliance with their modified terms as of the date presented.

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As shown in the table above, as of December 31, 2011 as compared to December 31, 2010, the nonaccrual loan category decreased by \$12.4 million and the 90-day past due and still accruing interest category increased by \$444 thousand. The table also shows that the majority of the nonaccrual loans were collateralized by real estate at December 31, 2011.

Management believes the Company has excellent credit quality review processes in place to identify problem loans quickly. As seen by the reduction in nonperforming assets during the year ended December 31, 2011, the quality of the Company's loan portfolio has improved with nonperforming assets stabilizing due to charge-offs and nonrecourse sales of nonaccrual loans. Management believes that the elevated levels of nonperforming assets in 2010 were primarily due to economic conditions, depressed commercial and residential real estate markets and the effects of unemployment on borrowers. However, management remains cautious about the future and is well aware that if the economy does not continue to improve, nonperforming assets could increase in future periods. As the Company experienced in 2010, the effect of a sustained increase in nonperforming assets would be lower earnings caused by larger contributions to the loan loss provision, which in turn would be driven by larger impairments in the loan portfolio and higher levels of loan charge-offs. For a detailed discussion of the Company's nonperforming assets, refer to Note 4 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplemental Data" of this report on Form 10-K.

#### The Allowance for Loan Losses

The allowance for loan losses is based on several components. In evaluating the adequacy of the allowance, each segment of the loan portfolio is divided into several pools of loans:

- |    |    |  |
|----|----|--|
|    | 1. | Doubtful-specific identification   |
|    | 2. | Substandard-specific identification  |
|    | 3. | Pool-substandard   |
| 4. |    | Pool-other assets especially mentioned (OAEM) (rated just above substandard) |
|    | 5. | Pool-pass loans (all other rated loans)                                      |

Historical loss rates, adjusted for the current environment, are applied to the above five pools of loans for each segment of the loan portfolio, except for certain doubtful and substandard loans which have losses specifically calculated on an individual loan basis. Historical loss is one of the components of the allowance. The historical loss is based on the past eight quarters, which management believes better reflects the risk related to each segment of loans in the current economic environment. Prior to 2010, the historical loss component was generally based on the previous four years. The historical loss component of the allowance amounted to \$5.6 million and \$5.1 million as of December 31, 2011 and 2010, respectively. The increase was due to higher charge-offs in 2011 as compared to the level of charge-offs in certain quarters included in past historical loss periods. The Company uses a rolling eight-quarter average to calculate the historical loss component of the allowance, so lower charge-offs in the four quarters of 2009 are no longer included in the historical loss component calculation as of December 31, 2011, which has caused this component to increase.

In addition, nonperforming loans and both performing and nonperforming troubled debts restructured (TDRs) are analyzed for impairment under U.S. GAAP and are allocated based on this analysis. Increases in nonperforming loans affect this portion of the adequacy review. The Company's nonperforming loans and nonperforming TDRs fall into the following pools of loans: doubtful-specific identification and substandard-specific identification. Performing TDRs can fall into any of the five pools noted above. Therefore changes in nonperforming loans and TDRs affect the dollar amount of the allowance. Unless the nonperforming loan or TDR is not impaired (e.g. the collateral value is considered sufficient), increases in nonperforming loans and TDRs are reflected as an increase in the allowance for loan losses.

The majority of the Company's nonperforming loans are collateralized by real estate. When reviewing loans for impairment, the Company obtains current appraisals. If the Company has not yet received a current appraisal on loans being reviewed for impairment, any loan balance that is in excess of the estimated appraised value is allocated in the allowance. As of December 31, 2011 and 2010, the impaired loan component of the allowance amounted to \$1.0 million and \$3.0 million, respectively. The reduction between 2010 and 2011 of this component is a direct result of the improvement in nonperforming loans as discussed above. The impairment loan component of the allowance for loan losses is reflected as a valuation allowance related to impaired loans in Note 4 of the Notes to Consolidated Financial Statements included in this Form 10-K.

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The final component of the allowance consists of qualitative factors and includes items such as economic conditions, growth trends, concentrations, and legal and regulatory changes. The qualitative component of the allowance amounted to \$1.9 million and \$5.1 million as of December 31, 2011 and 2010, respectively. The reduction in this component is due to several reasons. Total loans have declined \$66.3 million or 11.30% from December 31, 2010 to December 31, 2011. In addition, as detailed in Note 4 of the Notes to the Consolidated Financial Statements included in this Form 10-K, nonaccrual loans have declined \$12.4 million, from December 31, 2010 to December 31, 2011 and the credit quality of the loan portfolio has dramatically improved with OAEM, substandard and doubtful loans dropping from \$78.0 million or 13.3% of the total loan portfolio at December 31, 2010 to \$40.0 million or 7.69% of the total loan portfolio at December 31, 2011. The large drop in the risk rated assets indicates that the quality of the loan portfolio is improving. The strength of the loan portfolio is also supported by the improvement in past due loans which dropped from \$16.6 million as of December 31, 2010 to \$3.4 million as of December 31, 2011.

As a result of these changes and management's belief that nonperforming assets are declining and will continue to decline, the Company added, through the provision, \$3.7 million to the allowance for loan losses in 2011. Management believes that the allowance has been appropriately funded for additional losses on existing loans, based on currently available information. The Company will continue to monitor the loan portfolio and levels of nonperforming assets closely and make changes to the allowance for loan losses when necessary.

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The following table shows an analysis of the allowance for loan losses:

TABLE VIII  
ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

As of December 31,	2011	2010	2009	2008	2007
	(in thousands)				
Balance at the beginning of period	\$ 13,228	\$ 7,864	\$ 6,406	\$ 5,130	\$ 4,784
<b>Charge-offs:</b>					
Commercial	942	556	799	190	87
Real estate-construction	0	126	2,170	0	0
Real estate-mortgage	7,822	2,971	2,360	401	71
Consumer	333	655	785	649	501
Other	210	180	240	347	376
Total charge-offs	9,307	4,488	6,354	1,587	1,035
<b>Recoveries:</b>					
Commercial	141	192	104	118	23
Real estate-mortgage	575	636	649	6	89
Consumer	102	155	80	183	126
Other	59	69	104	156	143
Total recoveries	877	1,052	937	463	381
Net charge-offs	8,430	3,436	5,417	1,124	654
Provision for loan losses	3,700	8,800	6,875	2,400	1,000
Balance at end of period	\$ 8,498	\$ 13,228	\$ 7,864	\$ 6,406	\$ 5,130
<b>Selected loan loss statistics</b>					
Loans (net of unearned income):					
End of period balance	\$ 520,327	\$ 586,619	\$ 635,242	\$ 637,452	\$ 597,144
Average balance	\$ 544,523	\$ 621,550	\$ 633,614	\$ 622,883	\$ 587,645
Net charge-offs to average total loans	1.55	0.55	0.85	0.18	0.11
	%	%	%	%	%
Provision for loan losses to average total loans	0.68	1.42	1.09	0.39	0.17
	%	%	%	%	%
Provision for loan losses to net charge-offs	43.89	256.11	126.92	213.52	152.91
	%	%	%	%	%
Allowance for loan losses to period end loans	1.63	2.25	1.24	1.00	0.86
	%	%	%	%	%
Earnings to loan loss coverage*	0.96	3.05	1.62	10.53	18.56

Allowance for loan losses to nonperforming loans	94.51	%	58.55	%	141.18	%	57.36	%	252.96	%
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\* Income before taxes plus provision for loan losses, divided by net charge-offs.

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The following table shows the amount of the allowance for loan losses allocated to each category at December 31 of the years presented.

TABLE IX  
ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

As of December 31,	2011			2010			2009			2008			2007		
	Amount	Percent of Loans to Total Loans	(in thousands)	Amount	Percent of Loans to Total Loans	(in thousands)	Amount	Percent of Loans to Total Loans	(in thousands)	Amount	Percent of Loans to Total Loans	(in thousands)	Amount	Percent of Loans to Total Loans	(in thousands)
Commercial	\$1,011	6.73 %		\$799	6.15 %		\$935	9.50 %		\$977	11.04 %		\$675	11.12 %	
Real estate-construction	323	3.84 %		441	3.27 %		354	4.83 %		31	9.51 %		67	9.38 %	
Real estate-mortgage	6,735	79.94 %		11,498	83.39 %		5,552	79.69 %		4,318	72.20 %		3,116	69.58 %	
Consumer	300	3.28 %		357	4.16 %		672	5.25 %		590	6.40 %		642	8.69 %	
Other	129	6.21 %		133	3.03 %		351	0.73 %		490	0.86 %		630	1.23 %	
Total	\$8,498	100.00 %		\$13,228	100.00 %		\$7,864	100.00 %		\$6,406	100.00 %		\$5,130	100.00 %	

As can be seen by the status of nonperforming loans in Table VII, the quality of the real estate portfolio has improved in 2011. While charge-offs related to real estate loans were higher in 2011 than in 2010, a significantly lower amount of the real estate portfolio was in nonaccrual status at December 31, 2011 than at December 31, 2010. Due to the improvement in the real estate-mortgage portfolio, management decreased the allocation of the allowance for loan losses to the real estate-mortgage portfolio. Management also increased the allocation of the allowance for loan losses in the commercial portfolio by \$212 thousand due to commercial loans making up a larger percent of the overall loan portfolio at December 31, 2011 as compared to December 31, 2010.

Although the allowance for loan losses is allocated into these categories, the entire allowance for loan losses is available to cover loan losses in any category. For example, if real estate construction loans experienced losses of \$500 thousand, the allowance for loan losses could handle these losses even though only \$323 thousand is allocated to that category.

## Deposits

The following table shows the average balances and average rates paid on deposits.

TABLE X  
DEPOSITS

Years ended December 31,	2011		2010		2009	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	\$ 11,512	0.06 %	\$ 11,031	0.06 %	\$ 9,812	0.07 %

Interest-bearing transaction accounts							
Money market deposit accounts							
	169,951	0.21 %	159,934	0.22 %	136,651	0.22 %	
Savings accounts	48,252	0.10 %	45,281	0.10 %	41,132	0.13 %	
Time deposits, \$100,000 or more							
	126,711	1.47 %	182,983	1.45 %	183,160	2.04 %	
Other time deposits	180,162	1.46 %	161,399	2.46 %	153,137	4.05 %	
Total interest-bearing deposits							
	536,588	0.91 %	560,628	1.26 %	523,892	1.97 %	
Demand deposits	147,069		126,829		112,826		
Total deposits	\$ 683,657		\$ 687,457		\$ 636,718		

The Company's average total deposits were \$683.7 million for 2011, a decrease of \$3.8 million or 0.55% from average total deposits in 2010. Although there was a small decrease in total average deposits during 2011, higher cost deposits decreased while lower cost deposits increased. Average time deposits, which are one of the Company's most expensive deposit categories, decreased by \$37.5 million, as seen in the table above. This decrease was partially offset by a \$20.2 million increase in demand deposits. See the Balance Sheet Review section of Management's Discussion and Analysis on this Form 10-K for a more detailed explanation of these changes. The rates paid on interest bearing deposits by the Company decreased from 1.26% for the year ended December 31, 2010 to 0.91% for the year ended December 31, 2011. The reduction in average rates paid on deposits is partially related to the Company's balance sheet restructuring initiatives in 2011, including the reduction in the average rate paid on other time deposits.

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The following table shows time deposits in amounts of \$100 thousand or more by time remaining until maturity.

TABLE XI  
TIME DEPOSITS OF \$100,000 OR MORE

As of December 31,	2011	2010	2009
		(in thousands)	
Maturing in:			
Within 3 months	\$ 24,957	\$ 25,596	\$ 43,698
4 through 6 months	14,760	26,331	23,644
7 through 12 months	29,337	30,761	32,734
Greater than 12 months	56,596	54,195	36,254
	\$ 125,650	\$ 136,883	\$ 136,330

## Return on Equity and Assets

The return on average stockholders' equity and assets, the dividend pay-out ratio, and the average equity to average assets ratio for the past three years are presented below.

As of December 31,	2011	2010	2009
Return on average assets	0.39 %	0.17 %	0.19 %
Return on average equity	3.95 %	1.87 %	2.03 %
Dividend pay-out ratio	30.12 %	79.64 %	137.16 %
Average equity to average assets	9.76 %	8.92 %	9.54 %

## Capital Resources

Total stockholders' equity as of December 31, 2011 was \$85.9 million, up 6.07% from \$81.0 million on December 31, 2010. The Company's capital position remains strong as evidenced by the regulatory capital measurements. Under the banking regulations, Total Capital is composed of core capital (Tier 1) and supplemental capital (Tier 2). Tier 1 capital consists of common stockholders' equity less goodwill. Tier 2 capital consists of certain qualifying debt and a qualifying portion of the allowance for loan losses. The following is a summary of the Company's capital ratios for the past three years. As shown below, these ratios were all well above the regulatory minimum levels.

	2011 Regulatory Minimums	2011	2010	2009
Tier 1	4.00 %	14.46 %	12.74 %	11.88 %
Total Capital	8.00 %	15.71 %	14.00 %	13.01 %
Tier 1 Leverage	4.00 %	10.17 %	9.19 %	9.20 %

Year-end book value per share was \$17.31 in 2011, \$16.40 in 2010, and \$16.60 in 2009. Cash dividends were \$991 thousand or \$0.20 per share in 2011, \$1.2 million or \$0.25 per share in 2010, and \$2.3 million or \$0.47 per share in 2009. The common stock of the Company has not been extensively traded. The table below shows the high and low sales prices and dividends paid for each quarter of 2011 and 2010. The stock is quoted on the NASDAQ Capital Market under the symbol "OPOF" and the prices below are based on trade information as reported by The NASDAQ Stock Market, LLC. There were 1,262 stockholders of record of the Company as of February 29, 2012. This stockholder count does not include stockholders who hold their stock in a nominee registration.





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The following is a summary of the quarterly dividends paid and high and low sales prices of Old Point Financial Corporation common stock for the previous two years.

	Dividend	2011 Sales Price		Dividend	2010 Sales Price	
		High	Low		High	Low
1st Quarter	\$ 0.05	\$ 13.00	\$ 11.35	\$ 0.10	\$ 17.23	\$ 13.75
2nd Quarter	\$ 0.05	\$ 12.09	\$ 10.03	\$ 0.05	\$ 15.35	\$ 11.25
3rd Quarter	\$ 0.05	\$ 11.89	\$ 9.90	\$ 0.05	\$ 13.15	\$ 11.15
4th Quarter	\$ 0.05	\$ 10.91	\$ 9.00	\$ 0.05	\$ 12.53	\$ 10.40

Liquidity

Liquidity is the ability of the Company to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments in securities and loans maturing within one year.

In addition, secondary sources are available through the use of borrowed funds if the need should arise. The Company's sources of funds include a large stable deposit base and secured advances from the FHLB. As of December 31, 2011, the Company had \$218.6 million in FHLB borrowing availability. The Company has available short-term unsecured borrowed funds in the form of federal funds with correspondent banks. As of year-end 2011, the Company had \$38.0 million available in federal funds to handle any short-term borrowing needs, up from \$15.0 million at December 31, 2010. Available federal funds lines of credit decreased during 2010 as a result of more stringent requirements from correspondent banks. The Company could have maintained these lines if it was willing to pledge collateral, such as investment securities. Since the Company rarely utilizes these lines, management chose to keep a reserve of unpledged securities and allow the lines to be reduced. During 2011, these more stringent requirements were relaxed and the Company's federal funds lines of credit were reinstated.

Although the Company remains very liquid, one potential source of liquidity utilized by the Company has become more limited. The FHLB instituted more stringent requirements for securing advances. The FHLB is now applying a discount rate to loans used as collateral to simulate the falling value of the properties securing those loans. Even with this additional collateral requirement, the Company still has more than sufficient collateral to pledge against outstanding advances.

As a result of the Company's management of liquid assets, availability of borrowed funds and the ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and to meet its customers' future borrowing needs.

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The following table sets forth information relating to the Company's sources of liquidity and the outstanding commitments for use of liquidity at December 31, 2011 and December 31, 2010. Dividing the total sources of liquidity by the outstanding commitments for use of liquidity derives the liquidity coverage ratio.

**LIQUIDITY SOURCES AND USES**  
(in thousands)

	December 31, 2011			December 31, 2010		
	Total	In Use	Available	Total	In Use	Available
<b>Sources:</b>						
Federal funds lines of credit	\$38,000	\$0	\$38,000	\$15,000	\$0	\$15,000
Federal Home Loan Bank advances	253,604	35,000	218,604	264,725	35,000	229,725
Federal funds sold			15,521			12,828
Securities, available for sale and unpledged at fair value			175,563			100,191
<b>Total short-term funding sources</b>			<b>\$447,688</b>			<b>\$357,744</b>
<b>Uses:</b>						
Unfunded loan commitments and lending lines of credit			40,281			48,969
Letters of credit			740			1,115
Commitments to purchase assets			409			1,029
Anticipated decline in borrowed funds (demand note)			0			731
<b>Total potential short-term funding uses</b>			<b>\$41,430</b>			<b>\$51,844</b>
<b>Ratio of short-term funding sources to potential uses</b>			<b>1080.6 %</b>			<b>690.0 %</b>

Other than the more stringent requirements for the FHLB advances, management is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on the liquidity, capital resources or operations of the Company. Nor is management aware of any current recommendations by regulatory authorities that would have a material affect on liquidity, capital resources or operations. The Company's internal sources of such liquidity are deposits, loan and investment repayments and securities available-for-sale. The Company's primary external source of liquidity is advances from the FHLB of Atlanta.

The Company's operating activities provided \$9.4 million of cash during the year ended December 31, 2011, compared to \$2.8 million provided during the same period in 2010 primarily due to the reduction of the loan loss provision. The Company's investing activities provided \$30.0 million during 2011, compared to providing \$12.3 million during 2010, principally due to decreases in loans made to customers in 2011 as quality loan demand decreased. The Company's financing activities used \$43.0 million of cash during 2011, compared to using \$34.3 million of cash during 2010, principally due to a decrease in repurchase agreement, other borrowings and time deposits during 2011. These decreases played an important role in the Company's balance sheet restructuring efforts during 2011.

## Effects of Inflation

Management believes that the key to achieving satisfactory performance in an inflationary environment is its ability to maintain or improve its net interest margin and to generate additional fee income. The Company's policy of investing in and funding with interest-sensitive assets and liabilities is intended to reduce the risks inherent in a volatile inflationary economy.

#### Off-Balance Sheet Lending Related Commitments

The Company had \$84.0 million in consumer and commercial commitments at December 31, 2011. As of the same date, the Company also had \$2.5 million in letters of credit that the Company will fund if certain future events occur. It is expected that only a portion of these commitments will ever actually be funded.

Management believes that the Company has the liquidity and capital resources to handle these commitments in the normal course of business. See Note 14 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplemental Data" of this report on Form 10-K.

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## Contractual Obligations

In the normal course of business, there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, that may or may not require future cash outflows. The following table provides the Company's contractual obligations as of December 31, 2011:

(in thousands)		Payments due by period				
		Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Contractual Obligations						
Short-Term Debt Obligations	\$ 36,481	\$ 36,481	\$ 0	\$ 0	\$ 0	
Long-Term Debt Obligations	35,000	10,000	0	25,000	0	
Operating Lease Obligations	684	249	344	91	0	
Total contractual cash obligations excluding deposits	72,165	46,730	344	25,091	0	
Deposits	690,879	553,402	92,087	45,390	0	
Total	\$ 763,044	\$ 600,132	\$ 92,431	\$ 70,481	\$ 0	

Short-term debt obligations include federal funds purchased, overnight repurchase agreements, term repurchase agreements and a U.S. Treasury demand note.

The Company has plans to expand the building of a current branch office. On January 26, 2011 the Company signed a contract with a general contractor for construction of the building. The contract entitles the contractor to the cost of construction plus a fee of 2.50%. In late 2011, by mutual agreement between the Company and the contractor, the contract was terminated. A total of \$178 thousand had been disbursed under the old contract for various pre-construction services. The Company expects to sign a contract with a new general contractor to continue the project in the near future, but had not signed one as of the writing of this annual report on Form 10-K. The Company anticipates that the project will likely cost between \$13.0 million and \$15.0 million over the next one to two years.

## Short-Term Borrowings

Certain short-term borrowings at December 31, 2011, 2010 and 2009 are presented below. Information is presented only on those categories whose average balance at December 31 exceeded 30 percent of total stockholders' equity at the same date.

TABLE XII  
SHORT-TERM BORROWINGS

	2011		2010		2009	
	Balance	Rate	Balance	Rate	Balance	Rate
Balance at December 31,						
Repurchase agreements	\$36,481	0.20	% \$89,716	0.30	% \$109,419	0.69

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Average daily balance for the  
year ended December 31,

Repurchase agreements	\$49,335	0.21	%	\$103,924	0.52	%	\$78,013	0.75	%
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Maximum month-end  
outstanding balance:

Repurchase agreements	\$87,023		\$130,435		\$109,419
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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

This information is incorporated herein by reference from Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, on pages 19 through 39 of this report on Form 10-K.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements and related footnotes of the Company are presented below followed by the financial statements of the Parent.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders  
Old Point Financial Corporation and subsidiaries  
Hampton, Virginia

We have audited the accompanying consolidated balance sheets of Old Point Financial Corporation and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years ended December 31, 2011, 2010 and 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Old Point Financial Corporation and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years ended December 31, 2011, 2010 and 2009, in conformity with U.S. generally accepted accounting principles.

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

Winchester, Virginia  
March 30, 2012



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## Old Point Financial Corporation and Subsidiaries

## Consolidated Balance Sheets

	December 31, 2011	December 31, 2010
	(dollars in thousands, except share data)	
<b>Assets</b>		
Cash and due from banks	\$ 9,523	\$ 14,207
Interest-bearing due from banks	13,978	1,396
Federal funds sold	1,354	12,828
Cash and cash equivalents	24,855	28,431
Securities available-for-sale, at fair value	236,599	206,092
Securities held-to-maturity (fair value approximates \$1,526 and \$1,957)	1,515	1,952
Restricted securities	3,451	4,320
Loans, net of allowance for loan losses of \$8,498 and \$13,228	511,829	573,391
Premises and equipment, net	30,264	29,616
Bank owned life insurance	21,593	18,020
Foreclosed assets, net of valuation allowance of \$1,851 and \$2,124	9,390	11,448
Other assets	10,008	13,572
	\$ 849,504	\$ 886,842
<b>Liabilities &amp; Stockholders' Equity</b>		
<b>Deposits:</b>		
Noninterest-bearing deposits	\$ 163,639	\$ 129,208
Savings deposits	232,348	225,210
Time deposits	294,892	324,796
Total deposits	690,879	679,214
Federal funds purchased and other short-term borrowings	0	731
Overnight repurchase agreements	35,001	50,757
Term repurchase agreements	1,480	38,959
Federal Home Loan Bank advances	35,000	35,000
Accrued expenses and other liabilities	1,279	1,229
Total liabilities	763,639	805,890
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Common stock, \$5 par value, 10,000,000 shares authorized; 4,959,009 and 4,936,989 shares issued and outstanding	24,795	24,685
Additional paid-in capital	16,310	16,026
Retained earnings	45,109	42,810
Accumulated other comprehensive loss	(349 )	(2,569 )
Total stockholders' equity	85,865	80,952
Total liabilities and equity	\$ 849,504	\$ 886,842

See Notes to Consolidated Financial Statements.



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Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Income

	Years Ended December 31,		
	2011	2010	2009
(in thousands, except per share data)			
<b>Interest and Dividend Income:</b>			
Interest and fees on loans	\$32,105	\$37,081	\$38,103
Interest on due from banks	22	3	2
Interest on federal funds sold	21	75	54
<b>Interest on securities:</b>			
Taxable	3,884	3,419	2,566
Tax-exempt	157	268	538
Dividends and interest on all other securities	62	44	419
<b>Total interest and dividend income</b>	<b>36,251</b>	<b>40,890</b>	<b>41,682</b>
<b>Interest Expense:</b>			
Interest on savings deposits	408	413	361
Interest on time deposits	4,496	6,624	9,951
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	106	545	566
Interest on Federal Home Loan Bank advances	1,705	2,400	3,445
<b>Total interest expense</b>	<b>6,715</b>	<b>9,982</b>	<b>14,323</b>
<b>Net interest income</b>	<b>29,536</b>	<b>30,908</b>	<b>27,359</b>
Provision for loan losses	3,700	8,800	6,875
<b>Net interest income, after provision for loan losses</b>	<b>25,836</b>	<b>22,108</b>	<b>20,484</b>
<b>Noninterest Income:</b>			
Income from fiduciary activities	3,002	3,074	2,987
Service charges on deposit accounts	4,256	4,760	5,473
Other service charges, commissions and fees	3,003	2,846	2,511
Income from bank owned life insurance	823	972	956
Gain on sale of available-for-sale securities, net	787	541	290
Other operating income	325	449	401
<b>Total noninterest income</b>	<b>12,196</b>	<b>12,642</b>	<b>12,618</b>
<b>Noninterest Expense:</b>			
Salaries and employee benefits	19,139	18,296	17,781
Occupancy and equipment	4,292	4,254	4,128
FDIC insurance	1,222	1,365	1,630
Data processing	1,386	1,248	1,089
Customer development	908	839	798
Advertising	448	654	619
Foreclosed assets expense	505	416	474
Other outside service fees	612	621	354
Employee professional development	579	491	500
Postage and courier expense	488	511	550
Legal and audit expense	696	874	479
Loss on write-down/sale of foreclosed assets	1,413	1,442	680

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Other operating expense	1,991	2,043	2,127
Total noninterest expense	33,679	33,054	31,209
Income before income taxes	4,353	1,696	1,893
Income tax expense	1,063	149	211
Net income	\$3,290	\$1,547	\$1,682
Basic Earnings per Share:			
Average shares outstanding	4,952	4,928	4,908
Net income per share of common stock	\$0.66	\$0.31	\$0.34
Diluted Earnings per Share:			
Average shares outstanding	4,952	4,932	4,935
Net income per share of common stock	\$0.66	\$0.31	\$0.34

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries  
 Consolidated Statements of Changes in Stockholders' Equity  
 Years ended December 31, 2011, 2010, and 2009

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(dollars in thousands, except per share data)					
Balance at December 31, 2008	4,905,229	\$24,526	\$15,506	\$43,251	\$ (385 )	\$82,898
<b>Comprehensive income:</b>						
Net income	0	0	0	1,682	0	1,682
Unrealized holding losses arising during the period (net of tax benefit, \$231)	0	0	0	0	(450 )	(450 )
Reclassification adjustment, (net of tax, \$99)	0	0	0	0	(191 )	(191 )
Pension liability adjustment (net of tax benefit, \$122)	0	0	0	0	(237 )	(237 )
Total comprehensive income	0	0	0	1,682	(878 )	804
Exercise of stock options	13,124	66	152	(80 )	0	138
Repurchase and retirement of common stock	(1,818 )	(9 )	0	(27 )	0	(36 )
Stock compensation expense	0	0	111	0	0	111
Cash dividends (\$.47 per share)	0	0	0	(2,307 )	0	(2,307 )
Balance at December 31, 2009	4,916,535	\$24,583	\$15,769	\$42,519	\$ (1,263 )	\$81,608
<b>Comprehensive income:</b>						
Net income	0	0	0	1,547	0	1,547
Unrealized holding losses arising during the period (net of tax benefit, \$310)	0	0	0	0	(601 )	(601 )
Reclassification adjustment (net of tax, \$184)	0	0	0	0	(357 )	(357 )
Pension liability adjustment (net of tax benefit, \$181)	0	0	0	0	(348 )	(348 )
Total comprehensive income	0	0	0	1,547	(1,306 )	241
Exercise of stock options	23,874	119	127	0	0	246
Tax benefit from disqualification of stock options	0	0	16	0	0	16
Repurchase and retirement of common stock	(3,420 )	(17 )	0	(24 )	0	(41 )
Stock compensation expense	0	0	114	0	0	114
Cash dividends (\$.25 per share)	0	0	0	(1,232 )	0	(1,232 )
Balance at December 31, 2010	4,936,989	\$24,685	\$16,026	\$42,810	\$ (2,569 )	\$80,952

Comprehensive income:						
Net income	0	0	0	3,290	0	3,290
Unrealized holding gains arising during the period (net of tax expense, \$1,531)	0	0	0	0	2,971	2,971
Reclassification adjustment (net of tax, \$268)	0	0	0	0	(519 )	(519 )
Pension liability adjustment (net of tax benefit, \$120)	0	0	0	0	(232 )	(232 )
Total comprehensive income	0	0	0	3,290	2,220	5,510
Exercise of stock options	22,020	110	174	0	0	284
Stock compensation expense	0	0	110	0	0	110
Cash dividends (\$.20 per share)	0	0	0	(991 )	0	(991 )
Balance at December 31, 2011	4,959,009	\$24,795	\$16,310	\$45,109	\$ (349 )	\$85,865

See Notes to Consolidated Financial Statements.

IndexOld Point Financial Corporation and Subsidiaries  
Consolidated Statements of Cash Flows

Years Ended December 31,	2011	2010	2009
	(dollars in thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$3,290	\$1,547	\$1,682
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,816	1,938	1,854
Provision for loan losses	3,700	8,800	6,875
Net gain on sale of available-for-sale securities	(787 )	(541 )	(290 )
Net amortization of securities	285	66	140
Net loss on disposal of premises and equipment	0	3	4
Net loss on write-down/sale of foreclosed assets	1,413	1,442	680
Income from bank owned life insurance	(823 )	(972 )	(956 )
Stock compensation expense	110	114	111
Deferred tax (benefit) expense	2,094	(2,428 )	(453 )
Increase in other assets	(1,756 )	(6,491 )	(12,183 )
Increase (decrease) in other liabilities	50	(645 )	(386 )
Net cash provided by (used in) operating activities	9,392	2,833	(2,922 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of available-for-sale securities	(251,239 )	(251,096 )	(244,960 )
Purchases of held-to-maturity securities	(2,000 )	(2,270 )	(2,700 )
Proceeds from sales (cash used in purchases) of restricted securities	869	495	(24 )
Proceeds from maturities and calls of securities	132,670	128,354	127,875
Proceeds from sales of available-for-sale securities	94,716	91,978	43,032
(Increase) decrease in loans made to customers	57,862	45,187	(3,207 )
Proceeds from sales of foreclosed assets	2,376	1,703	4,400
Purchases of bank owned life insurance	(2,750 )	(940 )	(2,000 )
Purchases of premises and equipment	(2,464 )	(1,159 )	(5,112 )
Net cash provided by (used in) investing activities	30,040	12,252	(82,696 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Increase (decrease) in noninterest-bearing deposits	34,431	17,571	(12,118 )
Increase in savings deposits	7,138	19,562	18,543
Increase (decrease) in time deposits	(29,904 )	(20,421 )	9,553
Increase (decrease) in federal funds purchased, repurchase agreements and other borrowings	(53,966 )	(19,991 )	77,156
Decrease in Federal Home Loan Bank advances	0	(30,000 )	(5,000 )
Proceeds from exercise of stock options	284	246	138
Repurchase and retirement of common stock	0	(41 )	(36 )
Tax benefit from disqualified stock options	0	16	0
Cash dividends paid on common stock	(991 )	(1,232 )	(2,307 )
Net cash provided by (used in) financing activities	(43,008 )	(34,290 )	85,929
Net increase (decrease) in cash and cash equivalents	(3,576 )	(19,205 )	311
Cash and cash equivalents at beginning of period	28,431	47,636	47,325
Cash and cash equivalents at end of period	\$24,855	\$28,431	\$47,636

## SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

## Cash payments for:

Interest	\$6,963	\$10,607	\$14,651
Income tax	\$0	\$2,850	\$650

## SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS

Unrealized gain (loss) on investment securities	\$3,715	\$(1,452)	\$(971)
Loans transferred to foreclosed assets	\$2,741	\$5,968	\$10,044
Change in pension liability	\$(352)	\$(529)	\$(359)

See Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1, Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Old Point Financial Corporation (the Company) and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services N.A. (Trust). All significant intercompany balances and transactions have been eliminated in consolidation. The Company consolidates subsidiaries in which it holds, directly or indirectly, more than 50 percent of the voting rights or where it exercises control. Entities where the Company holds 20 to 50 percent of the voting rights, or has the ability to exercise significant influence, or both, are accounted for under the equity method. As discussed below, the Company consolidates entities deemed to be variable interest entities (VIEs) when it is determined to be the primary beneficiary.

NATURE OF OPERATIONS

Old Point Financial Corporation is a holding company that conducts substantially all of its operations through two subsidiaries, The Old Point National Bank of Phoebus and Old Point Trust & Financial Services, N.A. The Bank services individual and commercial customers, the majority of which are in Hampton Roads, Virginia. As of December 31, 2011, the Bank had 21 branch offices. The Bank offers a full range of deposit and loan products to its retail and commercial customers. Trust offers a full range of services for individuals and businesses. Products and services include retirement planning, estate planning, financial planning, estate and trust administration, retirement plan administration, tax services and investment management services.

VARIABLE INTEREST ENTITIES

A legal entity is referred to as a VIE if any of the following conditions exist, which are outlined in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) variable interest accounting guidance (FASB ASC 810-10-15-14): (1) the total equity investment at risk is insufficient to permit the legal entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors that cannot make significant decisions about the entity's operations or that do not absorb their proportionate share of the expected losses or receive the expected returns of the entity.

In addition, as specified in VIE accounting guidance (FASB ASC 810-10-25-38), a VIE must be consolidated by the Company if it is deemed to be the primary beneficiary of the VIE, which is the party involved with the VIE that will absorb a majority of the expected losses, receive a majority of the expected residual returns, or both. At this time, the Company has no VIEs that are consolidated. The Company does have an interest in one VIE, Old Point Mortgage, LLC, which is not consolidated because the Company is not the primary beneficiary.

USE OF ESTIMATES

In preparing consolidated financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other-than-temporary impairment of securities, the fair value of financial instruments, the valuation of deferred tax assets and the valuation allowance on foreclosed assets.

SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Company's activities are with customers located within the Hampton Roads region. The types of securities that the Company invests in are included in Note 3. The types of lending that the Company engages in are included in Note 4. The Company has significant concentrations in the following industries: construction, lessors of real estate,

activities related to real estate, ambulatory health care and religious organizations. The Company does not have any significant concentrations to any one customer.

At December 31, 2011 and 2010, there were \$308.1 million and \$363.6 million, or 59.21% and 61.97%, respectively of total loans concentrated in commercial real estate. Commercial real estate for purposes of this note includes all construction loans, loans secured by multifamily residential properties, loans secured by farmland and loans secured by nonfarm, nonresidential properties.

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### CASH AND CASH EQUIVALENTS

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash and balances due from banks and federal funds sold, all of which mature within 90 days.

### INTEREST-BEARING DEPOSITS IN BANKS

Interest-bearing deposits in banks mature within one year and are carried at cost.

### RECLASSIFICATIONS

Certain amounts in the consolidated financial statements have been reclassified to conform to classifications adopted in the current year.

### SECURITIES

Certain debt securities that management has the positive intent and ability to hold until maturity are classified as “held-to-maturity” and recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss). Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company employs a systematic methodology that considers available evidence in evaluating potential impairment of its investments. In the event that the cost of an investment exceeds its fair value, the Company evaluates, among other factors, the magnitude and duration of the decline in fair value; the expected cash flows of the securities; the financial health of and business outlook for the issuer; the performance of the underlying assets for interests in securitized assets; and the Company’s intent and ability to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in investment income and a new cost basis in the investment is established.

### FEDERAL HOME LOAN BANK STOCK

The Company, as a member of the Federal Home Loan Bank of Atlanta (FHLB), is required to maintain an investment in the capital stock of the FHLB. Based on the redemption provisions of the FHLB, the stock has no quoted market value, is carried at cost and listed as a restricted security. In March of 2009, the FHLB announced that it was changing its policy on the redemption of its stock. Previously, the FHLB would repurchase 100 percent of a member bank’s excess activity-based stock. As of March 2009, the FHLB will determine each quarter how much stock it will repurchase, if any, based on its available cash and capital. Since March 2009, the FHLB has made limited repurchases of excess stock of its members. At its discretion, the FHLB may declare dividends on its stock. For a discussion of the Company’s evaluation of FHLB stock for impairment, see Note 3 of this annual report on Form 10-K. The Company reviews its holdings for impairment based on the ultimate recoverability of the cost basis in the FHLB stock.

### LOANS

The Company grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Hampton Roads. The ability of the Company’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for unearned income, the allowance for loan losses and any unamortized deferred fees or costs on originated loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

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All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, or when the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments for at least six months.

### ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired, such as a loan that is considered a TDR (discussed in detail below). These loans are excluded from pooled loss forecasts and a separate reserve is provided under the accounting guidance for loan impairment. Consumer loans whose terms have been modified in a TDR are also individually analyzed for estimated impairment. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical charge-off experience and expected future losses given estimated defaults derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

### LOAN CHARGE-OFF POLICIES

Consumer loans are generally fully or partially charged down to the fair value of collateral securing the asset when:

- Management determines the asset to be uncollectible;
- Repayment is deemed to be protracted beyond reasonable time frames;
- The asset has been classified as a loss by either the internal loan review process or external examiners;

- The borrower has filed for bankruptcy protection and the loss becomes evident due to a lack of borrower assets; or
  - The loan is 90 days or more past due unless the loan is both well secured and in the process of collection.

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For other loans, the Company's charge-off policies are as follows:

- Real Estate: Generally charged down to the net realizable value when the loan is 120 days past due.
  - Commercial Loans: Generally charged off when the loan is 90 days past due.
  - Construction loans: Generally charged off when the loan is 120 days past due.
- Other Secured Loans: Generally fully or partially charged down to the net realizable value when the loan is 90 days past due.

## TROUBLED DEBT RESTRUCTURINGS

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management grants a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a TDR. Management strives to identify borrowers in financial difficulty before their loans reach nonaccrual status and works with them to grant appropriate concessions, if necessary, and modify their loans to more affordable terms. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the Company's economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans. The Company had \$4.3 million and \$1.6 million in loans classified as TDRs as of December 31, 2011 and 2010, respectively.

## TRANSFERS OF FINANCIAL ASSETS

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

## FORECLOSED ASSETS

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance (direct write-downs) are included in net expenses from foreclosed assets.

## PREMISES AND EQUIPMENT

Land is carried at cost. Buildings and equipment are stated at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets. Buildings and equipment are depreciated over their estimated useful lives ranging from three to 39 years; leasehold improvements are amortized over the lives of the respective leases or the estimated useful life of the leasehold improvement, whichever is less. Software is amortized over its estimated useful life ranging from three to five years.

## OFF-BALANCE SHEET CREDIT RELATED FINANCIAL INSTRUMENTS

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial letters of credit and lines of credit. Such financial instruments are recorded when they are funded.

## PENSION PLAN

The Company has a non-contributory defined benefit pension plan. Effective September 30, 2006, the Company took action to freeze the plan. Benefits for participants will remain frozen in the plan until such time as further action

occurs. No additional participants will be added to the plan.

The compensation cost of the pension plan is recognized on the projected unit credit method. The aggregate cost method is utilized for funding purposes.

#### STOCK COMPENSATION PLANS

Stock compensation accounting guidance (FASB ASC 718, Compensation-Stock Compensation) requires that the compensation cost related to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans.

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The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black Scholes model is used to estimate the fair value of the stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards.

## INCOME TAXES

The Company accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, Income Taxes). The Company adopted the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability or balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the difference between the book and tax basis of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more-likely-than-not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more-likely-than-not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

## EARNINGS PER COMMON SHARE

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional potential common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

## TRUST ASSETS AND INCOME

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

## ADVERTISING EXPENSES

Advertising expenses are expensed as incurred.

## COMPREHENSIVE INCOME

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available-for-sale and unrealized losses related to changes in the funded status of the pension plan which are also recognized as separate components of equity.

#### FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

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SUBSEQUENT EVENTS

In accordance with ASC 855-10/SFAS 165, the Company evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

The Company has plans to expand the building of a current branch office. On January 26, 2011 the Company signed a contract with a general contractor for construction of the building. The contract entitles the contractor to the cost of construction plus a fee of 2.50%. In late 2011, by mutual agreement between the Company and the contractor, the contract was terminated. A total of \$178 thousand had been disbursed under the old contract for various pre-construction services. The Company expects to sign a contract with a new general contractor to continue the project in the near future, but had not signed one as of the writing of this annual report on Form 10-K. The Company anticipates that the project will likely cost between \$13.0 million and \$15.0 million over the next one to two years.

Other than the branch expansion discussed above, the Company did not identify any recognized or nonrecognized subsequent events that would have required adjustment to or disclosure in the financial statements.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, "Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The new disclosure guidance significantly expands the existing requirements and will lead to greater transparency into a company's exposure to credit losses from lending arrangements. The extensive new disclosures of information as of the end of a reporting period became effective for both interim and annual reporting periods ending on or after December 15, 2010. Specific disclosures regarding activity that occurred before the issuance of the ASU, such as the allowance roll forward and modification disclosures, will be required for periods beginning on or after December 15, 2010. The Company has included the required disclosures in its consolidated financial statements.

The SEC has issued Final Rule No. 33-9002, "Interactive Data to Improve Financial Reporting", which requires companies to submit financial statements in extensible business reporting language (XBRL) format with their SEC filings on a phased-in schedule. Large accelerated filers and foreign large accelerated filers using U.S. GAAP were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2010. All remaining filers were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2011. The Company complied with this Rule beginning with the filing of its quarterly report on Form 10-Q for the quarter ended June 30, 2011.

In January 2011, the FASB issued ASU 2011-01, "Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." The amendments in this ASU temporarily delayed the effective date of the disclosures about troubled debt restructurings in ASU 2010-20 for public entities. The delay was intended to

allow the Board time to complete its deliberations on what constitutes a troubled debt restructuring. After the delay, the new disclosures about troubled debt restructurings for public entities and the guidance for determining what constitutes a troubled debt restructuring were effective for interim and annual periods ending after June 15, 2011. The Company has adopted ASU 2011-01 and included the required disclosures in its consolidated financial statements.

In March 2011, the SEC issued Staff Accounting Bulletin (SAB) 114. This SAB revises or rescinds portions of the interpretive guidance included in the codification of the Staff Accounting Bulletin Series. This update is intended to make the relevant interpretive guidance consistent with current authoritative accounting guidance issued as a part of the FASB's Codification. The principal changes involve revision or removal of accounting guidance references and other conforming changes to ensure consistency of referencing throughout the SAB Series. The effective date for SAB 114 is March 28, 2011. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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In April 2011, the FASB issued ASU 2011-02, "Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." The amendments in this ASU clarify the guidance on a creditor's evaluation of whether it has granted a concession to a debtor. The amendments also clarify the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulty. The amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011. Early adoption was permitted. Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, an entity may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has adopted ASU 2011-02 and included the required disclosure in its consolidated financial statements.

In April 2011, the FASB issued ASU 2011-03, "Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements." The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2011-03 will have on its consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs)." This ASU is the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and IFRSs. The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application is not permitted. The Company is currently assessing the impact that ASU 2011-04 will have on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income." The objective of this ASU is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The single statement of comprehensive income should include the components of net income, a total for net income, the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present all the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The amendments do not change the items that must be reported in other comprehensive income, the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, or the calculation or reporting of earnings per share. The amendments in this ASU should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. The amendments do not require transition disclosures. The Company is currently assessing the impact that ASU 2011-05 will have on its consolidated financial statements.

In August 2011, the SEC issued Final Rule No. 33-9250, "Technical Amendments to Commission Rules and Forms related to the FASB's Accounting Standards Codification." The SEC has adopted technical amendments to various rules and forms under the Securities Act of 1933 (Securities Act), the Securities Exchange Act of 1934 (Exchange Act) and the Investment Company Act of 1940 (Investment Company Act). These revisions were necessary to conform those rules and forms to the FASB Accounting Standards Codification. The technical amendments include revision of certain rules in Regulation S-X, certain items in Regulation S-K, and various rules and forms prescribed under the Securities Act, Exchange Act and Investment Company Act. The rule was effective as of August 12, 2011. The adoption of the rule did not have a material impact on the Company's consolidated financial statements.

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In December 2011, the FASB issued ASU 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.” This ASU requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company is currently assessing the impact that ASU 2011-11 will have on its consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, “Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.” The amendments are being made to allow the Board time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company is currently assessing the impact that ASU 2011-12 will have on its consolidated financial statements.

## NOTE 2, Restrictions on Cash and Amounts Due from Banks

The Company is required to maintain average balances on hand or with the FRB. At December 31, 2011 and 2010, the required reserve balances amounted to \$350 thousand for both years.

The Company had approximately \$161 thousand in deposits in financial institutions in excess of amounts insured by the FDIC at December 31, 2011. All but one of the Company’s transaction accounts were noninterest-bearing and were fully insured by the FDIC as provided by the Dodd-Frank Act. The section of the Dodd-Frank Act which provides for full coverage of all noninterest-bearing transaction accounts expires on December 31, 2012.

## NOTE 3, Securities Portfolio

The amortized cost and fair value, with gross unrealized gains and losses, of securities held-to-maturity were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
December 31, 2011				
Obligations of U.S. Government agencies	\$ 1,370	\$ 8	\$ 0	\$ 1,378
Obligations of state and political subdivisions	145	3	0	148
<b>Total</b>	<b>\$ 1,515</b>	<b>\$ 11</b>	<b>\$ 0</b>	<b>\$ 1,526</b>
December 31, 2010				
	\$ 1,670	\$ 4	\$ (7 )	\$ 1,667

Obligations of U.S. Government agencies				
Obligations of state and political subdivisions	282	8	0	290
Total	\$ 1,952	\$ 12	\$ (7 )	\$ 1,957

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The amortized cost and fair value, with gross unrealized gains and losses, of securities available-for-sale were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in thousands)				
December 31, 2011				
U.S. Treasury securities	\$ 250	\$ 0	\$ 0	\$ 250
Obligations of U.S. Government agencies	117,848	1,706	0	119,554
Obligations of state and political subdivisions	11,999	266	(4 )	12,261
Mortgage-backed securities	102,884	396	(52 )	103,228
Money market investments	1,306	0	0	1,306
Total	\$ 234,287	\$ 2,368	\$ (56 )	\$ 236,599
December 31, 2010				
U.S. Treasury securities	\$ 600	\$ 0	\$ 0	\$ 600
Obligations of U.S. Government agencies	201,601	513	(1,993 )	200,121
Obligations of state and political subdivisions	3,103	69	0	3,172
Mortgage-backed securities	374	8	0	382
Money market investments	1,817	0	0	1,817
Total	\$ 207,495	\$ 590	\$ (1,993 )	\$ 206,092

Securities with a fair value of \$85.4 million and \$135.5 million at December 31, 2011 and 2010, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, FHLB advances and for other purposes required or permitted by law.

At December 31, 2011, the Company held no securities of any single issuer (excluding U.S. Government agencies) with a book value that exceeded 10 percent of stockholders' equity.

The amortized cost and fair value of securities by contractual maturity are shown below.

	December 31, 2011			
	Available-for-Sale Amortized Cost	Fair Value	Held-to-Maturity Amortized Cost	Fair Value
(in thousands)				
Due in one year or less	\$ 1,130	\$ 1,148	\$ 145	\$ 148
Due after one year through five years	42,434	42,935	1,370	1,378
Due after five years through ten years	90,215	91,615	0	0
Due after ten years	99,202	99,595	0	0
Total debt securities	232,981	235,293	1,515	1,526
	1,306	1,306	0	0

Other securities without  
stated maturities

Total securities	\$ 234,287	\$ 236,599	\$ 1,515	\$ 1,526

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The following table provides information about securities sold in the years ended December 31:

	2011	2010	2009
	(in thousands)		
Proceeds from sales	\$ 94,716	\$ 91,978	\$ 43,032
Gross realized gains	\$ 787	\$ 541	\$ 290
Gross realized losses	\$ 0	\$ 0	\$ 0

**OTHER-THAN-TEMPORARILY IMPAIRED SECURITIES**

Management assesses whether the Company intends to sell or it is more-likely-than-not that the Company will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Company separates the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best-estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best-estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds, and structural support, including subordination and guarantees.

The Company has a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, and cash flow projections as indicators of credit issues. On a quarterly basis, management reviews all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. Management considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (a) the extent and length of time the fair value has been below cost; (b) the reasons for the decline in value; (c) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (d) for fixed maturity securities, the Company's intent to sell a security or whether it is more-likely-than-not the Company will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, the Company's ability and intent to hold the security for a period of time that allows for the recovery in value.

The Company has not recorded impairment charges on securities for the years ended December 31, 2011, 2010 and 2009.

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The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are deemed to be temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	December 31, 2011					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale						
Obligations of state and political subdivisions	\$4	\$1,706	\$0	\$0	\$4	\$1,706
Mortgage-backed securities	52	29,364	0	0	52	29,364
Total	\$56	\$31,070	\$0	\$0	\$56	\$31,070

	December 31, 2010					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale						
Obligations of U. S. Government agencies	\$1,993	\$128,362	\$0	\$0	\$1,993	\$128,362
Securities Held-to-Maturity						
Obligations of U. S. Government agencies	\$7	\$762	\$0	\$0	\$7	\$762
Total	\$2,000	\$129,124	\$0	\$0	\$2,000	\$129,124

## U.S. Government and federal agency obligations

The Company had no unrealized losses on U.S. Government obligations at December 31, 2011. The unrealized losses on fifteen investments in U.S. Government obligations at December 31, 2010 were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

## Mortgage-backed securities

The unrealized losses on three investments in mortgage-backed securities at December 31, 2011 were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the

investments and it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2011. There were no unrealized losses on investments in mortgage-backed securities at December 31, 2010.

Obligations of state and political subdivisions

The unrealized losses on two investments in obligations of state and political subdivisions at December 31, 2011 were caused by interest rate increases. Because the Company does not intend to sell the investments and it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at December 31, 2011. There were no unrealized losses on investments in obligations of state and political subdivisions at December 31, 2010.

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The restricted security category is comprised of FHLB and FRB stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and the securities lack a market. Therefore, FHLB and FRB stock is carried at cost and evaluated for impairment. When evaluating these stocks for impairment, their value is determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. Restricted stock is viewed as a long-term investment and management believes that the Company has the ability and the intent to hold this stock until its value is recovered.

The Company evaluated the positive and negative factors of FHLB stock for impairment and determined the stock not to be impaired at December 31, 2011 or December 31, 2010. This analysis is based on the following information. Although the FHLB temporarily suspended excess stock repurchases in 2009, the FHLB resumed its stock repurchase program in 2010, reported net income in all four quarters of 2010 and 2011, and as of December 31, 2011, declared dividends for the first three quarters of 2011.

## Note 4. Loans and the Allowance for Loan Losses

The following is a summary of the balances in each segment of the Company's loan portfolio:

	December 31, 2011	December 31, 2010
	(in thousands)	
Mortgage loans on real estate:		
Residential 1-4 family	\$ 77,588	\$ 89,690
Commercial	288,108	344,347
Construction	19,981	19,206
Second mortgages	16,044	16,105
Equity lines of credit	34,220	39,048
Total mortgage loans on real estate	435,941	508,396
Commercial loans	35,015	36,053
Consumer loans	17,041	24,389
Other	32,330	17,781
Total loans	520,327	586,619
Less: Allowance for loan losses	(8,498 )	(13,228 )
Loans, net of allowance and deferred fees	\$ 511,829	\$ 573,391

Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts totaled \$583 thousand and \$607 thousand at December 31, 2011 and December 31, 2010, respectively.

**CREDIT QUALITY INFORMATION**

The Company uses internally-assigned risk grades to estimate the capability of borrowers to repay the contractual obligations of their loan agreements as scheduled or at all. The Company's internal risk grade system is based on experiences with similarly graded loans. Credit risk grades are updated at least quarterly as additional information becomes available, at which time management analyzes the resulting scores to track loan performance.

The Company's internally assigned risk grades are as follows:

- Pass: Loans are of acceptable risk.
- Other Assets Especially Mentioned (OAEM): Loans have potential weaknesses that deserve management's close attention.
-

Substandard: Loans reflect significant deficiencies due to several adverse trends of a financial, economic or managerial nature.

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- Doubtful: Loans have all the weaknesses inherent in a substandard loan with added characteristics that make collection or liquidation in full based on currently existing facts, conditions and values highly questionable or improbable.
- Loss: Loans have been charged off because they are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

The following table presents credit quality exposures by internally assigned risk ratings:

Credit Quality Information  
As of December 31, 2011  
(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$74,839	\$677	\$2,072	\$0	\$77,588
Commercial	258,610	11,803	17,695	0	288,108
Construction	19,548	396	37	0	19,981
Second mortgages	15,212	0	832	0	16,044
Equity lines of credit	33,390	182	648	0	34,220
Total mortgage loans on real estate	401,599	13,058	21,284	0	435,941
Commercial loans	29,455	4,295	1,265	0	35,015
Consumer loans	16,955	0	86	0	17,041
Other	32,330	0	0	0	32,330
Total	\$480,339	\$17,353	\$22,635	\$0	\$520,327

Credit Quality Information  
As of December 31, 2010  
(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$75,803	\$2,383	\$11,504	\$0	\$89,690
Commercial	287,551	23,969	30,000	2,827	344,347
Construction	18,052	0	1,154	0	19,206
Second mortgages	15,010	0	1,095	0	16,105
Equity lines of credit	37,206	1,109	733	0	39,048
Total mortgage loans on real estate	433,622	27,461	44,486	2,827	508,396
Commercial loans	33,275	2,179	599	0	36,053
Consumer loans	23,981	1	407	0	24,389
Other	17,693	87	1	0	17,781
Total	\$508,571	\$29,728	\$45,493	\$2,827	\$586,619

As of December 31, 2011 and December 31, 2010 the Company did not have any loans internally classified as Loss.

#### AGE ANALYSIS OF PAST DUE LOANS BY CLASS

All classes of loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Interest and fees continue to accrue on past due loans until the date the loan is placed in nonaccrual status, if applicable. The following table includes an aging analysis of the recorded investment of past due loans. Also included in the table below are loans that are 90 days or more past due as to interest and principal



and still accruing interest, either because they are (1) well-secured and in the process of collection or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Loans in nonaccrual status that are also past due are included in the aging categories in the table below.

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## Age Analysis of Past Due Loans at December 31, 2011

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans (1)	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
(in thousands)							
Mortgage loans on real estate:							
Residential 1-4 family	\$75	\$ 0	\$627	\$702	\$76,886	\$77,588	\$0
Commercial	0	0	1,123	1,123	286,985	288,108	510
Construction	148	0	0	148	19,833	19,981	0
Second mortgages	104	0	469	573	15,471	16,044	0
Equity lines of credit	159	0	369	528	33,692	34,220	0
Total mortgage loans on real estate	486	0	2,588	3,074	432,867	435,941	510
Commercial loans	101	0	0	101	34,914	35,015	0
Consumer loans	58	89	2	149	16,892	17,041	2
Other	44	0	5	49	32,281	32,330	5
Total	\$689	\$ 89	\$2,595	\$3,373	\$516,954	\$520,327	\$517

## Age Analysis of Past Due Loans at December 31, 2010

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans (1)	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
(in thousands)							
Mortgage loans on real estate:							
Residential 1-4 family	\$ 1,550	\$ 85	\$ 1,641	\$ 3,276	\$ 86,414	\$ 89,690	\$ 0
Commercial	240	617	10,555	11,412	332,935	344,347	0
Construction	0	0	16	16	19,190	19,206	16
Second mortgages	475	0	187	662	15,443	16,105	33
Equity lines of credit	597	0	22	619	38,429	39,048	0
Total mortgage loans on real	2,862	702	12,421	15,985	492,411	508,396	49

estate

Commercial							
loans	78	11	0	89	35,964	36,053	0
Consumer							
loans	297	49	69	415	23,974	24,389	23
Other	79	0	1	80	17,701	17,781	1
Total	\$ 3,316	\$ 762	\$ 12,491	\$ 16,569	\$ 570,050	\$ 586,619	\$ 73

(1) For purposes of these tables, Total Current Loans includes loans that are 1 - 29 days past due.

#### NONACCRUAL LOANS

The Company generally places non-consumer loans in nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred or the loan reaches 90 days past due, unless the credit is well-secured and in the process of collection. Under regulatory rules, consumer loans, which are loans to individuals for household, family and other personal expenditures, and loans secured by 1-4 family residential properties are not required to be placed in nonaccrual status. Although consumer loans and loans secured by 1-4 family residential property are not required to be placed in nonaccrual status, the Company may place a consumer loan or loan secured by 1-4 family residential property in nonaccrual status, if necessary to avoid a material overstatement of interest income.

Generally, consumer loans not secured by real estate are placed in nonaccrual status only when part of the principal has been charged off. These loans are charged off or written down to the net realizable value of the collateral when deemed uncollectible, due to bankruptcy or other factors, or when they reach 90 days past due based on loan product, industry practice, terms and other factors.

When management places a loan in nonaccrual status, the accrued unpaid interest receivable is reversed against interest income and the loan is accounted for by the cash or cost recovery method, until it qualifies for return to accrual status. Generally, management returns a loan to accrual status if (a) all delinquent interest and principal payments become current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer doubtful.

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The following table presents loans in nonaccrual status by class of loan:

Nonaccrual Loans by Class			
(in thousands)			
	December 31,		December 31,
	2011		2010
Mortgage loans on real estate:			
Residential 1-4 family	\$	748	\$ 6,302
Commercial		6,719	13,281
Construction		0	37
Second mortgages		499	540
Equity lines of credit		368	427
Total mortgage loans on real estate		8,334	20,587
Commercial loans		129	178
Consumer loans		12	116
Total	\$	8,475	\$ 20,881

The following table presents the interest income that the Company would have earned under the original terms of its nonaccrual loans and the actual interest recorded by the Company on nonaccrual loans for the periods presented:

Years ended December 31,	2011	2010	2009
	(in thousands)		
Interest income that would have been recorded under original loan terms	\$ 1,353	\$ 1,507	\$ 442
Actual interest income recorded for the period	506	790	440
Reduction in interest income on nonaccrual loans	\$ 847	\$ 717	\$ 2

**MODIFICATIONS**

The Company's loan portfolio also includes certain loans that have been modified in a TDR, where economic concessions have been granted to borrowers who are experiencing financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reduction in the interest rate below current market rates, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance in accordance with the restructured terms for a reasonable period, generally six months. When the Company modifies a loan, management evaluates any possible impairment as stated in the impaired loan section above.

FASB issued Accounting Standards Update 2011-02 "A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring" (ASU 2011-02). As a result of adopting ASU 2011-02, the Company reassessed all restructurings that occurred on or after January 1, 2011 to determine whether the restructurings should be considered TDRs. The Company identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Company classified those loans as impaired. ASU 2011-02 requires prospective application of the impairment measurement for those loans newly identified as impaired. As of December 31, 2011, the end of the first interim period of adoption, the recorded investment in loans for which the allowance was previously measured under a general allowance methodology and are now impaired was \$2.0 million and the allowance for loan losses associated with those loans, on the basis of a current evaluation of the loss, was zero.



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The following tables present TDRs during the periods indicated, by class of loan:

Troubled Debt Restructurings by Class  
For the Year Ended December 31, 2011  
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on December 31, 2011
Mortgage loans on real estate:				
Residential 1-4 family	1	\$ 175	\$ 175	\$ 174
Commercial	3	4,102	3,083	3,012
Total mortgage loans on real estate	4	4,277	3,258	3,186
<b>Total</b>	<b>4</b>	<b>\$ 4,277</b>	<b>\$ 3,258</b>	<b>\$ 3,186</b>

The residential 1-4 family TDR was given an interest rate below the current market rate for customers with similar risk profiles. The three commercial real estate TDRs were given principal reductions totaling \$1.0 million. The financial effects of these modifications can not be determined due to the fact that these loans would not have been made if the loans had not been restructurings of troubled loans already on the Company's books.

All loans in the table above have been performing according to their modified terms for at least six months and therefore are not included in the Company's total nonperforming assets discussed elsewhere in this annual report on Form 10-K. None of the Company's previously-restructured loans defaulted during 2011.

**IMPAIRED LOANS**

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans and loans modified in a troubled debt restructuring. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole or remaining source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of the discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is in nonaccrual status, all payments are applied to principal under the cost-recovery method. For financial statement purposes, the recorded investment in the loan is the actual principal balance reduced by payments that would otherwise have been applied to interest. When reporting information on these loans to the applicable customers, the unpaid principal balance is reported as if payments were applied to principal and interest under the original terms of the loan agreements. Therefore, the unpaid principal balance reported to the customer would be higher than the recorded investment in the loan for financial statement purposes. When the ultimate collectability of the total principal of the impaired loan is not in doubt and the loan is in nonaccrual status, contractual interest is credited to interest income when received under the cash-basis method.

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during 2011 and 2010. The average balances are calculated based on the month-end balance of the loans for the year ended December 31, 2010 and on the daily average balance for the year ended December 31, 2011.

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	Impaired Loans by Class (in thousands)				For the year ended December 31, 2011	
	As of December 31, 2011				Average Recorded Investment	Interest Income Recognized
	Unpaid Principal Balance	Without Valuation Allowance	With Valuation Allowance	Associated Allowance		
Mortgage loans on real estate:						
Residential 1-4 family	\$ 486	\$ 391	\$ 91	\$ 6	\$ 3,753	\$ 554
Commercial	8,263	4,734	3,371	968	8,911	456
Construction	0	0	0	0	0	0
Second mortgages	520	250	258	31	603	24
Equity lines of credit	371	369	0	0	392	21
Total mortgage loans on real estate	\$ 9,640	\$ 5,744	\$ 3,720	\$ 1,005	\$ 13,659	\$ 1,055
Commercial loans	142	19	110	23	130	2
Total	\$ 9,782	\$ 5,763	\$ 3,830	\$ 1,028	\$ 13,789	\$ 1,057

	Impaired Loans by Class (in thousands)				For the Year Ended December 31, 2010	
	As of December 31, 2010				Average Recorded Investment	Interest Income Recognized
	Unpaid Principal Balance	Without Valuation Allowance	With Valuation Allowance	Associated Allowance		
Mortgage loans on real estate:						
Residential 1-4 family	\$5,850	\$5,008	\$810	\$70	\$4,298	\$320
Commercial	13,319	3,798	9,400	2,827	14,320	593
Construction	0	0	0	0	194	5
Second mortgages	508	100	404	62	377	33
Equity lines of credit	405	262	143	11	300	24
Total mortgage loans on real estate	\$20,082	\$9,168	\$10,757	\$2,970	\$19,489	\$975
Commercial loans	184	178	0	0	73	13
Consumer loans	0	0	0	0	0	0
Other	0	0	0	0	0	0
Total	\$20,266	\$9,346	\$10,757	\$2,970	\$19,562	\$988

**MONITORING OF LOANS AND EFFECT OF MONITORING FOR THE ALLOWANCE FOR LOAN LOSSES**

Loan officers are responsible for continual portfolio analysis and prompt identification and reporting of problem loans, which includes assigning a risk grade to each applicable loan at its origination and revising such grade as the situation dictates. Loan officers maintain frequent contact with borrowers, which should enable the loan officer to identify potential problems before other personnel. In addition, meetings with loan officers and upper management are held to discuss problem loans and review risk grades. Nonetheless, in order to avoid over-reliance upon loan officers for problem loan identification, the Bank's loan review system provides for review of loans and risk grades by individuals who are independent of the loan approval process. Risk grades and historic loss rates by risk grades are



used as a component of the calculation of the allowance for loan losses.

#### ALLOWANCE FOR LOAN LOSSES

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, real estate-construction, real estate-mortgage, consumer and other loans. The Company also sub-segments the real estate-mortgage segment into four classes: residential 1-4 family, commercial real estate, second mortgages and equity lines of credit. The Company uses an internally developed risk evaluation model in the estimation of the credit risk process. The model and assumptions used to determine the allowance are independently validated and reviewed to ensure that the theoretical foundation, assumptions, data integrity, computational processes and reporting practices are appropriate and properly documented.

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Each portfolio segment has risk characteristics as follows:

- **Commercial:** Commercial loans carry risks associated with the successful operation of a business or project, in addition to other risks associated with the ownership of a business. The repayment of these loans may be dependent upon the profitability and cash flows of the business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.
- **Real estate-construction:** Construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may at any point in time be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be the loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.
- **Real estate-mortgage:** Residential mortgage loans and equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral. Commercial real estate loans carry risks associated with the successful operation of a business if owner occupied. If non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts.
- **Consumer loans:** Consumer loans carry risks associated with the continued credit-worthiness of the borrowers and the value of the collateral. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.
- **Other loans:** Other loans are loans to mortgage companies, loans for purchasing or carrying securities, and loans to insurance, investment and finance companies. These loans carry risks associated with the successful operation of a business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time, may depend on interest rates or may fluctuate in active trading markets.

To determine the balance of the allowance account for each segment of the loan portfolio, management pools each segment by risk grade individually and applies a historical loss percentage. At December 31, 2011 and December 31, 2010, the historical loss percent was based on losses sustained in each segment of the portfolio over the previous eight quarters.

Management also provides an allocated component of the allowance for loans that are classified as impaired. An allocated allowance is established when the discounted value of future cash flows from the impaired loan (or the collateral value or observable market price of the impaired loan) is lower than the carrying value of that loan.

Based on credit risk assessments and management's analysis of qualitative factors, additional loss factors are applied to loan balances. These additional qualitative factors include: economic conditions, trends in growth, concentrations, changes in underwriting, changes in management and changes in the legal and regulatory environment.

### THE COMPANY'S ESTIMATION PROCESS

The 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. In addition, impaired loans are separately identified for evaluation and are measured based on the present value of expected future cash flows, the observable market price of the loans or the fair value of the collateral. Also, various qualitative factors are applied to each segment of the loan portfolio.

### ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$8.5 million adequate to cover loan losses inherent in the loan portfolio at December 31, 2011. The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.



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## ALLOWANCE FOR LOAN LOSSES AND RECORDED INVESTMENT IN LOANS

Year ended December 31, 2011	(in thousands)					
	Commercial	Real Estate - Construction	Real Estate - Mortgage	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at beginning of year	\$ 799	\$ 441	\$ 11,498	\$ 357	\$ 133	\$ 13,228
Charge-offs	(942 )	0	(7,822 )	(333 )	(210 )	(9,307 )
Recoveries	141	0	575	102	59	877
Provision for loan losses	1,013	(118 )	2,484	174	147	3,700
Ending balance	\$ 1,011	\$ 323	\$ 6,735	\$ 300	\$ 129	\$ 8,498
Ending balance individually evaluated for impairment						
	\$ 23	\$ 0	\$ 1,005	\$ 0	\$ 0	\$ 1,028
Ending balance collectively evaluated for impairment						
	988	323	5,730	300	129	7,470
Ending balance	\$ 1,011	\$ 323	\$ 6,735	\$ 300	\$ 129	\$ 8,498
Loan Balances:						
Ending balance individually evaluated for impairment						
	\$ 129	\$ 0	\$ 9,464	\$ 0	\$ 0	\$ 9,593
Ending balance collectively evaluated for impairment						
	34,886	19,981	406,496	17,041	32,330	510,734
Ending balance	\$ 35,015	\$ 19,981	\$ 415,960	\$ 17,041	\$ 32,330	\$ 520,327
Year ended December 31, 2010						
	Commercial	Real Estate - Construction	Real Estate - Mortgage	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at beginning of year	\$ 935	\$ 354	\$ 5,552	\$ 672	\$ 351	\$ 7,864
Charge-offs	(556 )	(126 )	(2,971 )	(655 )	(180 )	(4,488 )
Recoveries	192	0	636	155	69	1,052
Provision for loan losses	228	213	8,281	185	(107 )	8,800
Ending balance	\$ 799	\$ 441	\$ 11,498	\$ 357	\$ 133	\$ 13,228
Ending balance individually evaluated for impairment						
	\$ 0	\$ 0	\$ 2,970	\$ 0	\$ 0	\$ 2,970
Ending balance collectively evaluated for impairment						
	799	441	8,528	357	133	10,258
Ending balance	\$ 799	\$ 441	\$ 11,498	\$ 357	\$ 133	\$ 13,228
Loan Balances:						
Ending balance individually evaluated for impairment						
	\$ 178	\$ 0	\$ 19,925	\$ 0	\$ 0	\$ 20,103
Ending balance collectively evaluated for impairment						
	35,875	19,206	469,265	24,389	17,781	566,516
Ending balance	\$ 36,053	\$ 19,206	\$ 489,190	\$ 24,389	\$ 17,781	\$ 586,619

2009 (in thousands)	
Balance, beginning of year	\$ 6,406
Recoveries	937
Provision for loan losses	6,875

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Loans charged off	(6,354 )
Balance, end of year	\$ 7,864

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## CHANGES IN ACCOUNTING METHODOLOGY

There were no changes in the Company's accounting methodology for the allowance for loan losses during the year ended December 31, 2011.

## NOTE 5, Foreclosed Assets

Foreclosed assets are presented net of a valuation allowance for losses. An analysis of the valuation allowance on foreclosed assets is as follows:

	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
Balance at beginning of year	\$ 2,124	\$ 860	\$ 428
Additions and write-downs	942	1,379	695
Reductions due to sales	(1,215 )	(115 )	(263 )
Balance at end of year	\$ 1,851	\$ 2,124	\$ 860

Expenses applicable to foreclosed assets include the following:

	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
Net loss (gain) on sales of real estatetr	\$ 471	\$ 63	\$ (15 )
Provision for losses (direct writedowns)	942	1,379	695
Operating expenses, net of income*	477	392	463
Total Expenses	\$ 1,890	\$ 1,834	\$ 1,143

\* included in other operating income and other operating expense

## NOTE 6, Premises and Equipment

At December 31, premises and equipment consisted of:

	2011	2010
	(in thousands)	
Land	\$ 7,804	\$ 7,808
Buildings	26,436	25,647
Leasehold improvements	858	855
Furniture, fixtures and equipment	16,947	15,994
	52,045	50,304
Less accumulated depreciation and amortization	21,781	20,688
	\$ 30,264	\$ 29,616

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 amounted to \$1.8 million, \$1.9 million and \$1.9 million, respectively.

The Company has noncancellable leases on premises and equipment expiring at various dates, not including extensions, to the year 2015. Certain leases provide for increased annual payments based on increases in real estate

taxes and the Consumer Price Index.

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The total approximate minimum rental commitment at December 31, 2011 under noncancellable leases is \$684 thousand which is due as follows (in thousands):

2012	\$249
2013	181
2014	163
2015	91
Total	\$684

The aggregate rental expense of premises and equipment was \$286 thousand, \$282 thousand and \$347 thousand for 2011, 2010 and 2009, respectively.

## NOTE 7, Deposits

The aggregate amount of time deposits in denominations of \$100 thousand or more at December 31, 2011 and 2010 was \$125.7 million and \$136.9 million, respectively. As of December 31, 2011, no single customer relationship exceeded 5 percent of total deposits.

At December 31, 2011, the scheduled maturities of time deposits (in thousands) are as follows:

2012	\$157,415
2013	53,598
2014	38,489
2015	27,028
2016	18,362
	\$294,892

## NOTE 8, Short Term and Long Term Borrowings

The Company's short-term borrowings include federal funds purchased, overnight repurchase agreements and U.S. Treasury demand notes. Overnight repurchase agreements, which totaled \$35.0 million and \$50.8 million as of December 31, 2011 and 2010, respectively, are classified as secured borrowings that generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. The U.S. Treasury demand notes are subject to call by the U.S. Treasury with interest paid monthly at the rate of 25 basis points (1/4%) below the federal funds rate. U.S. Treasury demand notes totaled zero and \$731 thousand as of December 31, 2011 and 2010, respectively. The U.S. Treasury demand notes totaled zero at December 31, 2011 because of the elimination of retained electronic tax deposits (affecting both Retainer and Investor depositories) and subsequently the designation Retainer Depository from the Treasury Tax & Loan Program effective January 1, 2012. One hundred percent of the demand note was called at the close of business on December 30, 2011.

As of December 31, 2011, four customer relationships exceeded 5 percent of total repurchase agreements, with a combined outstanding balance of \$27.5 million, or 75.26% of total repurchase agreements.

The Company's long-term debt at December 31, 2011 and 2010 consisted of fixed-rate FHLB advances. The FHLB advances are secured by a blanket lien on qualified 1 – 4 family residential real estate loans. These pledged loans totaled \$64.6 million at December 31, 2011.





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The contractual maturities of long-term debt are as follows:

	December 31,			
	2011		2010	
	Fixed Rate (in thousands)	Weighted Avg Rate	Fixed Rate (in thousands)	Weighted Avg Rate
Due in 2012	\$ 10,000	4.74 %	\$ 10,000	4.74 %
Due in 2016	25,000	4.83 %	25,000	4.83 %
Total long-term debt	\$ 35,000	4.80 %	\$ 35,000	4.80 %

## NOTE 9, Stock Option Plan

On March 9, 2008, the Company's 1998 stock option plan expired. At December 31, 2011, options to purchase 165,710 shares of common stock granted under the stock option plan were outstanding. The exercise price of each option equals the market price of the Company's common stock on the date of the grant, and an option's maximum term is ten years.

Stock option plan activity for the year ended December 31, 2011 is summarized below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding, January 1, 2011	225,127	\$ 19.62		
Granted	0	0		
Exercised	(22,020 )	12.91		
Canceled or expired	(37,397 )	14.66		
Options outstanding, December 31, 2011	165,710	\$ 21.64	4.46	\$ 0
Options exercisable, December 31, 2011	146,468	\$ 21.84	4.28	\$ 0

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2011. This amount changes based on changes in the market value of the Company's stock.

As of December 31, 2011, the outstanding options had no intrinsic value because the exercise prices of all outstanding options were above the market value of a share of the Company's common stock.

No in-the-money options were exercised during the year ended December 31, 2011. However, six option-holders chose to exercise options where the option price was greater than the current market value. Proceeds from these exercises were \$284 thousand. The total proceeds of the in-the-money options exercised during the years ended December 31, 2010 and 2009 were \$246 thousand and \$138 thousand. Total intrinsic value of options exercised during the years ended December 31, 2010 and 2009 was \$65 thousand and \$83 thousand, respectively.

As of December 31, 2011, there was \$84 thousand in unrecognized compensation expense related to nonvested options, which is expected to be recognized over a weighted-average period of nine months. Stock compensation expense was \$110 thousand, \$114 thousand and \$111 thousand during the years ended December 31, 2011, 2010 and 2009.

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Information pertaining to options outstanding at December 31, 2011 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Weighted Average Exercise Price
\$ 23.83	69,500	2.61	\$ 23.83	69,500	\$ 23.83	\$ 23.83
20.05	96,210	5.79	20.05	76,968	20.05	20.05
	165,710	4.46	\$ 21.64	146,468	\$ 21.84	\$ 21.84

## NOTE 10, Earnings per Common Share

Earnings per common share has been computed based on the following:

	Years Ended December 31,		
	2011	2010	2009
Net Income applicable to common stock	\$ 3,290	\$ 1,547	\$ 1,682
Average number of common shares outstanding	4,952	4,928	4,908
Effect of dilutive options	0	4	27
Average number of common shares outstanding used to calculate diluted earnings per common share	4,952	4,932	4,935

The Company did not include an average of 191 thousand, 206 thousand and 186 thousand potential common shares attributable to outstanding stock options in the diluted earnings per share calculation for 2011, 2010 and 2009, respectively, because they were antidilutive.

## NOTE 11. Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal shareholders, executive officers and directors and their affiliates. These loans were made on substantially the same terms and conditions, including interest rates, collateral and repayment terms, as those prevailing at the same time for comparable transactions with unrelated persons, and, in the opinion of management and the Company's board of directors, do not involve more than normal risk or present other unfavorable features. None of the principal shareholders, executive officers or directors had direct or indirect loans exceeding 10 percent of stockholders' equity at December 31, 2011.

Annual activity consisted of the following:

	2011	2010
	(in thousands)	
Balance, beginning of year	\$ 2,193	\$ 2,599

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Additions	946	218
Reductions	(1,091)	(624 )
Balance, end of year	\$ 2,048	\$ 2,193

Deposits from related parties held by the Company at December 31, 2011 and 2010 amounted to \$18.5 million and \$23.6 million, respectively. One member of the Company's Board of Directors is an attorney and was assigned \$10.9 million of settlement funds in 2010. These funds were partially disbursed in 2011 and will continue to disburse over the next few years as court approval is obtained. Undisbursed funds at December 31, 2011 totaled \$4.8 million.

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## NOTE 12, Income Taxes

The components of income tax expense for the current year-end and the preceding two are as follows:

	2011	2010	2009
		(in thousands)	
Current tax expense (benefit)	\$ (1,031 )	\$ 2,577	\$ 664
Deferred tax expense (benefit)	2,094	(2,428 )	(453 )
Reported tax expense	\$ 1,063	\$ 149	\$ 211

A reconciliation of the "expected" Federal income tax expense on income before income taxes with the reported income tax expense for the same periods follows:

	2011	2010	2009
		(in thousands)	
Expected tax expense (34%)	\$ 1,480	\$ 577	\$ 644
Interest expense on tax-exempt assets	7	10	23
Tax credit for investment	(82 )	(27 )	0
Tax-exempt interest	(100 )	(131 )	(226 )
Bank-owned life insurance	(280 )	(331 )	(325 )
Other, net	38	51	95
Reported tax expense	\$ 1,063	\$ 149	\$ 211

The effective tax rates for 2011, 2010 and 2009 were 24.4%, 8.8% and 11.1%, respectively.

The components of the net deferred tax asset, included in other assets, are as follows:

	December 31,	
	2011	2010
	(in thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 2,889	\$ 4,497
Interest on nonaccrual loans	101	311
Foreclosed assets	899	968
Pension - other comprehensive income	966	846
Bank owned life insurance benefit	91	78
Contribution carried forward	97	0
Net unrealized loss on securities available-for sale	0	477
Unexercised nonqualified options	32	24
	\$ 5,075	\$ 7,201
Deferred tax liabilities:		
Depreciation	\$ (741 )	\$ (367 )
Accretion of discounts on securities	(2 )	(3 )
Deferred loan fees and costs	(291 )	(317 )
Pension	(914 )	(935 )
Net unrealized gains on securities available-for-sale	(786 )	0
Other	(1 )	(3 )
	(2,735 )	(1,625 )

Net deferred tax assets	\$ 2,340	\$ 5,576
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The Company files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2008.

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The last Internal Revenue Service (IRS) examination was conducted in 2009 on the Company's U.S. income tax return for 2008.

## NOTE 13, Pension Plan

The Company provides pension benefits for eligible participants through a non-contributory defined-benefit pension plan. The plan was frozen effective September 30, 2006; therefore no additional participants will be added to the plan.

Information pertaining to the activity in the plan, using a measurement date of December 31, is as follows:

	Years ended December 31,		
	2011	2010	2009
	(in thousands)		
Change in benefit obligation			
Benefit obligation at beginning of year	\$5,896	\$5,318	\$4,657
Service cost	0	0	0
Interest cost	305	314	284
Benefits paid	(572 )	(354 )	(222 )
Actuarial loss	246	618	599
Benefit obligation at end of year	\$5,875	\$5,896	\$5,318
Change in plan assets			
Fair value of plan assets at beginning of year	\$6,156	\$5,658	\$4,411
Actual return on plan assets	137	352	469
Employer contribution	0	500	1,000
Benefits paid	(572 )	(354 )	(222 )
Fair value of plan assets at end of year	\$5,721	\$6,156	\$5,658
Funded Status at end of year	\$(154 )	\$260	\$340
Amounts recognized in the consolidated balance sheets at December 31,			
Prepaid pension cost (pension liability)	\$(154 )	\$260	\$340
Amounts recognized in other comprehensive income (loss)			
Loss	\$2,842	\$2,489	\$1,961
Deferred taxes	(966 )	(846 )	(667 )
Net loss	\$1,876	\$1,643	\$1,294
Accumulated benefit obligation	\$5,875	\$5,896	\$5,318
Assumptions used to determine the benefit obligations at December 31,			
Discount rate	2010 5.00	2010 % 5.30	2009 % 6.01
Rate of compensation increase	7.00	% 7.00	% 7.00



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Components of net periodic pension cost	Years ended December 31,		
	2011	2010	2009
	(in thousands)		
Interest cost	\$305	\$313	\$284
Expected return on plan assets	(418)	(389)	(331)
Amortization of unrecognized loss	175	127	104
Net periodic pension cost	\$62	\$51	\$57
Components of other amounts recognized in other comprehensive income			
Net loss	\$527	\$656	\$359
Amortization of loss (gain)	(175)	(127)	0
Total recognized in other comprehensive income	\$352	\$529	\$359
Total recognized in net periodic benefit cost and other comprehensive income	\$414	\$580	\$416

The estimated net loss for the pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next year is \$225 thousand.

Weighted-average assumptions used to determine net periodic pension cost	Years ended December 31,					
	2011		2010		2009	
Discount rate	5.30	%	6.01	%	6.49	%
Expected long-term rate of return on plan assets	7.00	%	7.00	%	8.00	%

The overall expected long-term rate of return on plan assets was determined based on the current asset allocation and the related volatility of those investments.

The Company's overall investment strategy is growth with income. The emphasis of the objective is on both capital appreciation and income. The portfolio contains a blend of securities expected to grow in value over the long term and those expected to produce income. Moderate market value volatility is expected.

The pension plan invests primarily in large and mid-cap equities and government and corporate bonds, with the following target allocations: equities 55 percent, fixed income 40 percent and cash 5 percent. The pension plan has a very small investment in emerging markets equity mutual funds, representing approximately 1 percent of the total account value.

Fair value is discussed in detail in Note 15. The fair value of the Company's pension plan assets by asset category are as follows:

Asset Category	Assets at Fair Value as of December 31, 2011			
	Level 1	Level 2	Level 3	Total
Money market funds	\$311	\$0	\$0	\$311
U.S. Government securities	100	0	0	100
Mutual Funds	123	0	0	123
Common Stock	3,232	0	0	3,232
Corporate bonds	0	1,955	0	1,955
Total assets at fair value	\$3,766	\$1,955	\$0	\$5,721

Assets at Fair Value as of December 31, 2010  
(in thousands)

Asset Category	Level 1	Level 2	Level 3	Total
Money market funds	\$900	\$0	\$0	\$900
U.S. Government securities	372	0	0	372
Mutual Funds	147	0	0	147
Common Stock	3,128	0	0	3,128
Corporate bonds	0	1,609	0	1,609
Total assets at fair value	\$4,547	\$1,609	\$0	\$6,156

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The Company did not contribute to the pension plan in 2011. In 2010 the Company's contribution was \$500 thousand. Management has not determined at this time how much, if any, contributions to the plan will be for the year ended December 31, 2012.

Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows (in thousands):

2012	\$288
2013	358
2014	306
2015	321
2016	276
Thereafter	2,128
Total	\$3,677

## 401(K) PLAN

The Company has a 401(k) Plan in which substantially all employees are eligible to participate. Employees may contribute to the plan subject to certain limits based on federal tax laws. The Company makes matching contributions equal to 100 percent of the first 4 percent of an employee's compensation contributed to the plan. Matching contributions vest to the employee immediately. The Company may make profit sharing contributions to the plan as determined by the Board of Directors. Profit sharing contributions vest to the employee over a six-year period. For the years ended December 31, 2011, 2010 and 2009, expense attributable to the plan amounted to \$530 thousand, \$489 thousand, and \$484 thousand, respectively.

## NOTE 14, Commitments and Contingencies

## CREDIT-RELATED FINANCIAL INSTRUMENTS

The Company is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

The following financial instruments whose contract amounts represent credit risk were outstanding at December 31:

	2011	2010
	(in thousands)	
Commitments to extend credit:		
Home equity lines of credit	\$ 29,686	\$ 31,043
Commercial real estate, construction and development loans committed but not funded	8,662	14,061
Other lines of credit (principally commercial)	45,678	58,458
Total	\$ 84,026	\$ 103,562
Letters of credit	\$ 2,466	\$ 3,717

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extensions of credit is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Unfunded commitments under commercial lines of credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are not collateralized and usually do not contain a specified maturity date, and ultimately may not be drawn upon to the total extent to which the Company is committed.

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Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year, with the exception of two guarantees which expire in 2013 and 2014. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds various collateral supporting those commitments for which collateral is deemed necessary.

### LEGAL CONTINGENCIES

Various legal claims arise from time to time in the normal course of business, which, in the opinion of management, have no material effect on the Company's consolidated financial statements.

### NOTE 15, Fair Value Measurements

#### DETERMINATION OF FAIR VALUE

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

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

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments, using as appropriate the fair value hierarchy discussed below:

#### CASH AND CASH EQUIVALENTS

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

#### INVESTMENT SECURITIES

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Securities are classified as Level 2 if quoted market prices are not available. Fair value is estimated using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes and credit spreads. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified in Level 3.

#### RESTRICTED SECURITIES

The restricted security category is comprised of FHLB and FRB stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and they lack a market. Therefore, the carrying amounts of restricted securities approximate fair value.

#### LOANS RECEIVABLE

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., 1-4 family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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**BANK OWNED LIFE INSURANCE**

Bank owned life insurance represents insurance policies on certain officers of the Company. The cash value of the policies is estimated using information provided by the insurance carrier. These policies are carried at their cash value, which approximates the fair value.

**DEPOSIT LIABILITIES**

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

**SHORT-TERM BORROWINGS**

The carrying amounts of federal funds purchased, overnight repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

**LONG-TERM BORROWINGS**

The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

**ACCRUED INTEREST**

The carrying amounts of accrued interest approximate fair value.

**COMMITMENTS TO EXTEND CREDIT AND IRREVOCABLE LETTERS OF CREDIT**

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At December 31, 2011 and 2010, the fair value of fees charged for loan commitments and irrevocable letters of credit was immaterial.

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The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments are as follows:

	December 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 24,855	\$ 24,855	\$ 28,431	\$ 28,431
Securities available-for-sale	236,599	236,599	206,092	206,092
Securities held-to-maturity	1,515	1,526	1,952	1,957
Restricted securities	3,451	3,451	4,320	4,320
Loans, net of allowances for loan losses	511,829	515,105	573,391	571,906
Bank owned life insurance	21,593	21,593	18,020	18,020
Accrued interest receivable	2,528	2,528	2,652	2,652
<b>Financial liabilities:</b>				
Deposits	\$ 690,879	\$ 692,539	\$ 679,214	\$ 682,001
Federal funds purchased and other borrowings	0	0	731	731
Overnight repurchase agreements	35,001	35,001	50,757	50,757
Term repurchase agreements	1,480	1,481	38,959	38,955
Federal Home Loan Bank advances	35,000	39,341	35,000	39,260
Accrued interest payable	577	577	824	824

**FAIR VALUE HIERARCHY**

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

Level 1 –Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 –Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 –Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.



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

**ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS**

Debt and equity securities with readily determinable fair values are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Securities available-for-sale are recorded at fair value on a recurring basis.

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Assets measured at fair value on a recurring basis are summarized below:

Description	Balance	Fair Value Measurements at December 31, 2011 Using (in thousands)		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities				
U.S. Treasury securities	\$ 250	\$ 0	\$ 250	\$ 0
Obligations of U.S. Government agencies	119,554	0	119,554	0
Obligations of state and political subdivisions	12,261	0	12,261	0
Mortgage-backed securities	103,228	0	103,228	0
Money market investments	1,306	0	1,306	0
Total available-for-sale securities	\$ 236,599	\$ 0	\$ 236,599	\$ 0

Description	Balance	Fair Value Measurements at December 31, 2010 Using (in thousands)		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities				
U.S. Treasury securities	\$ 600	\$ 0	\$ 600	\$ 0
Obligations of U.S. Government agencies	200,121	0	200,121	0
Obligations of state and political subdivisions	3,172	0	3,172	0
Mortgage-backed securities	382	0	382	0
Money market investments	1,817	0	1,817	0
Total available-for-sale securities	\$ 206,092	\$ 0	\$ 206,092	\$ 0

**ASSETS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS**

Under certain circumstances, adjustments are made to the fair value for assets and liabilities although they are not measured at fair value on an ongoing basis.

#### Impaired loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as part of the provision for loan losses on the Consolidated Statements of Income.

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## Foreclosed assets

Loans are transferred to foreclosed assets when the collateral securing them is foreclosed on. The measurement of loss associated with foreclosed assets is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property. If there is a contract for the sale of a property, and management reasonably believes the transaction will be consummated in accordance with the terms of the contract, fair value is based on the sale price in that contract (Level 1). Lacking such a contract, the value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. Any fair value adjustments to foreclosed assets are recorded in the period incurred and expensed against current earnings.

The following table presents the financial instruments carried on the consolidated balance sheets by caption and by level in the fair value hierarchy for which a nonrecurring change in fair value has been recorded:

Carrying Value at December 31, 2011 (in thousands)				
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 2,802	\$ 0	\$ 2,572	\$ 230
Foreclosed assets	\$ 9,390	\$ 0	\$ 9,390	\$ 0

Carrying Value at December 31, 2010 (in thousands)				
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 7,787	\$ 523	\$ 6,182	\$ 1,082
Foreclosed assets	\$ 11,448	\$ 0	\$ 11,448	\$ 0

## NOTE 16, Regulatory Matters

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can cause certain mandatory and possibly additional discretionary actions to be initiated by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the

regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. The terms Tier 1 capital, risk-weighted assets and average assets, as used in this note, are as defined in the applicable regulations. Management believes, as of December 31, 2011 and 2010, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

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As of December 31, 2011, the most recent notification from the Comptroller categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's and the Bank's actual capital amounts and ratios as of December 31, 2011 and 2010 are also presented in the table.

	Actual		Minimum Capital Requirement			Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	
December 31, 2011:							
Total Capital to Risk Weighted Assets:							
Consolidated	\$ 93,680	15.71 %	\$ 47,698	8.00 %	N/A	N/A	
Old Point National Bank	88,410	14.85 %	47,627	8.00 %	\$ 59,534	10.00 %	
Tier 1 Capital to Risk Weighted Assets:							
Consolidated	86,214	14.46 %	23,849	4.00 %	N/A	N/A	
Old Point National Bank	80,955	13.60 %	23,814	4.00 %	35,720	6.00 %	
Tier 1 Capital to Average Assets:							
Consolidated	86,214	10.17 %	33,900	4.00 %	N/A	N/A	
Old Point National Bank	80,955	9.60 %	33,729	4.00 %	42,161	5.00 %	
December 31, 2010:							
Total Capital to Risk Weighted Assets:							
Consolidated	\$ 91,778	14.00 %	\$ 52,446	8.00 %	N/A	N/A	
Old Point National Bank	86,300	13.18 %	52,386	8.00 %	\$ 65,483	10.00 %	
Tier 1 Capital to Risk							

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Weighted Assets:								
Consolidated	83,521	12.74	%	26,223	4.00	%	N/A	N/A
Old Point National Bank								
	78,056	11.92	%	26,193	4.00	%	39,290	6.00 %
Tier 1 Capital to Average Assets:								
Consolidated	83,521	9.19	%	36,373	4.00	%	N/A	N/A
Old Point National Bank								
	78,056	8.63	%	36,188	4.00	%	45,235	5.00 %

The approval of the Comptroller is required if the total of all dividends declared by a national bank in any calendar year exceeds the bank's net profits for that year combined with its retained net profits for the preceding two calendar years. Under this formula, the Bank and Trust can distribute as dividends to the Company in 2012, without approval of the Comptroller, \$3.7 million plus an additional amount equal to the Bank's and Trust's retained net profits for 2012 up to the date of any dividend declaration.

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## NOTE 17, Quarterly Data (Unaudited)

	Year Ended December 31,							
	2011				2010			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(in thousands, except per share data)							
Interest and dividend income	\$8,742	\$8,992	\$9,152	\$9,365	\$10,081	\$10,172	\$10,221	\$10,416
Interest expense	(1,561 )	(1,619 )	(1,690 )	(1,845 )	(2,070 )	(2,253 )	(2,695 )	(2,964 )
Net interest income	7,181	7,373	7,462	7,520	8,011	7,919	7,526	7,452
Provision for loan losses	(800 )	(600 )	(500 )	(1,800 )	(1,300 )	(1,500 )	(1,300 )	(4,700 )
Net interest income, after provision for loan losses	6,381	6,773	6,962	5,720	6,711	6,419	6,226	2,752
Noninterest income	3,239	3,201	2,951	2,805	2,824	3,389	3,128	3,298
Noninterest expenses	(8,474 )	(8,539 )	(8,500 )	(8,166 )	(8,943 )	(8,397 )	(7,976 )	(7,735 )
Income before income taxes	1,146	1,435	1,413	359	592	1,411	1,378	(1,685 )
Provision for income taxes	(279 )	(392 )	(378 )	(14 )	(142 )	(376 )	(370 )	739
Net income	\$867	\$1,043	\$1,035	\$345	\$450	\$1,035	\$1,008	\$(946 )
Earnings per common share:								
Basic	\$0.18	\$0.21	\$0.21	\$0.07	\$0.09	\$0.21	\$0.21	\$(0.19 )
Diluted	\$0.18	\$0.21	\$0.21	\$0.07	\$0.09	\$0.21	\$0.20	\$(0.19 )

## NOTE 18, Segment Reporting

The Company operates in a decentralized fashion in three principal business segments: the Bank, the Trust, and the Parent. Revenues from the Bank's operations consist primarily of interest earned on loans and investment securities and service charges on deposit accounts. Trust's operating revenues consist principally of income from fiduciary activities. The Parent company's revenues are mainly interest and dividends received from the Bank and Trust companies. The Company has no other segments.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technologies and marketing strategies.



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Information about reportable segments, and reconciliation of such information to the consolidated financial statements as of and for the years ended December 31 follows:

2011	Bank	Trust	Unconsolidated Parent (in thousands)	Eliminations	Consolidated
<b>Revenues</b>					
Interest and dividend income	\$36,207	\$41	\$ 3,633	\$ (3,630 )	\$ 36,251
Income from fiduciary activities	0	3,002	0	0	3,002
Other income	8,942	314	300	(362 )	9,194
Total operating income	45,149	3,357	3,933	(3,992 )	48,447
<b>Expenses</b>					
Interest expense	6,716	0	12	(13 )	6,715
Provision for loan losses	3,700	0	0	0	3,700
Salaries and employee benefits	16,574	2,044	521	0	19,139
Other expenses	13,755	906	241	(362 )	14,540
Total operating expenses	40,745	2,950	774	(375 )	44,094
Income before taxes	4,404	407	3,159	(3,617 )	4,353
Income tax expense (benefit)	1,056	138	(131 )	0	1,063
Net income	\$3,348	\$269	\$ 3,290	\$ (3,617 )	\$ 3,290
Total assets	\$845,323	\$4,979	\$ 85,989	\$ (86,787 )	\$ 849,504
2010	Bank	Trust	Unconsolidated Parent (in thousands)	Eliminations	Consolidated
<b>Revenues</b>					
Interest and dividend income	\$40,837	\$50	\$ 1,893	\$ (1,890 )	\$ 40,890
Income from fiduciary activities	0	3,074	0	0	3,074
Other income	9,209	416	303	(360 )	9,568
Total operating income	50,046	3,540	2,196	(2,250 )	53,532
<b>Expenses</b>					
Interest expense	9,990	0	12	(20 )	9,982
Provision for loan losses	8,800	0	0	0	8,800
Salaries and employee benefits	15,738	2,039	519	0	18,296
Other expenses	13,935	936	248	(361 )	14,758
Total operating expenses	48,463	2,975	779	(381 )	51,836
Income before taxes	1,583	565	1,417	(1,869 )	1,696
Income tax expense (benefit)	87	192	(130 )	0	149
Net income	\$1,496	\$373	\$ 1,547	\$ (1,869 )	\$ 1,547

Total assets	\$882,415	\$4,980	\$ 81,196	\$(81,749 )	\$ 886,842
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2009	Bank	Trust	Unconsolidated Parent (in thousands)	Eliminations	Consolidated
Revenues					
Interest and dividend income	\$41,607	\$77	\$ 2,026	\$ (2,028 )	\$ 41,682
Income from fiduciary activities	0	2,987	0	0	2,987
Other income	9,310	373	300	(356 )	9,627
Total operating income	50,917	3,437	2,326	(2,384 )	54,296
Expenses					
Interest expense	14,343	0	10	(30 )	14,323
Provision for loan losses	6,875	0	0	0	6,875
Salaries and employee benefits	15,229	2,025	527	0	17,781
Other expenses	12,669	872	239	(356 )	13,424
Total operating expenses	49,116	2,897	776	(386 )	52,403
Income before taxes	1,801	540	1,550	(1,998 )	1,893
Income tax expense (benefit)	159	184	(132 )	0	211
Net income	\$1,642	\$356	\$ 1,682	\$ (1,998 )	\$ 1,682
Total assets	\$917,311	\$4,844	\$ 81,853	\$ (82,586 )	\$ 921,422

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from operations before income taxes not including nonrecurring gains or losses.

The Bank extends a line of credit to the Parent. This line of credit is primarily used to repurchase the Parent's publicly traded stock, but may, from time to time, be used for other purposes. Interest is charged at the Wall Street Journal Prime Rate minus 0.5%, with a floor of 5.0%. This loan is secured by a held-to-maturity security with a book value of \$145 thousand and a market value of \$148 thousand at December 31, 2011. Both the Parent and the Trust companies maintain deposit accounts with the Bank, on terms substantially similar to those available to other customers. These transactions are eliminated to reach consolidated totals.

The Company operates in one geographical area and does not have a single external customer from which it derives 10 percent or more of its revenues.

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## NOTE 19, Condensed Financial Statements of Parent Company

Financial information pertaining to Old Point Financial Corporation (parent company only) is as follows:

Balance Sheets	December 31,		
	2011	2010	
	(in thousands)		
<b>Assets</b>			
Cash and cash equivalents	\$ 85	\$ 202	
Securities held-to-maturity	145	282	
Investment in common stock of subsidiaries	85,498	80,461	
Other assets	261	251	
<b>Total assets</b>	<b>\$ 85,989</b>	<b>\$ 81,196</b>	
<b>Liabilities and Stockholders' Equity</b>			
Note payable - subsidiary	\$ 124	\$ 244	
Common stock	24,795	24,685	
Additional paid-in capital	16,310	16,026	
Retained earnings	45,109	42,810	
Accumulated other comprehensive loss	(349 )	(2,569 )	
<b>Total liabilities and stockholders' equity</b>	<b>\$ 85,989</b>	<b>\$ 81,196</b>	
	Years Ended December 31,		
Statements of Income	2011	2010	2009
	(in thousands)		
<b>Income:</b>			
Dividends from subsidiary	\$ 800	\$ 1,000	\$ 2,495
Interest on investments	16	24	28
Other income	300	303	300
<b>Total income</b>	<b>1,116</b>	<b>1,327</b>	<b>2,823</b>
<b>Expenses:</b>			
Salary and benefits	521	519	527
Legal expenses	56	57	44
Service fees	160	143	119
Other operating expenses	37	61	86
<b>Total expenses</b>	<b>774</b>	<b>780</b>	<b>776</b>
<b>Income before income taxes and equity in undistributed net income of subsidiaries</b>	<b>342</b>	<b>547</b>	<b>2,047</b>
Income tax benefit	131	131	132
	473	678	2,179
<b>Equity in undistributed net income (loss) of subsidiaries</b>	<b>2,817</b>	<b>869</b>	<b>(497 )</b>
<b>Net income</b>	<b>\$ 3,290</b>	<b>\$ 1,547</b>	<b>\$ 1,682</b>

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Statements of Cash Flows	Years Ended December 31,		
	2011	2010 (in thousands)	2009
Cash flows from operating activities:			
Net income	\$ 3,290	\$ 1,547	\$ 1,682
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net (income) loss of subsidiaries	(2,817 )	(869 )	497
Stock compensation expense	110	114	111
Decrease (increase) in other assets	(10 )	8	(9 )
Increase (decrease) in other liabilities	0	(7 )	0
Net cash provided by operating activities	573	793	2,281
Cash flows from investing activities; calls of investment securities			
	137	130	55
Cash flows from financing activities:			
Repayment of advances from subsidiaries	(120 )	0	0
Exercise of stock options	284	246	138
Repurchase and retirement of common stock	0	(41 )	(36 )
Tax effect of nonqualified stock options	0	16	0
Cash dividends paid on common stock	(991 )	(1,232 )	(2,307 )
Net cash used in financing activities	(827 )	(1,011 )	(2,205 )
Net increase (decrease) in cash and cash equivalents	(117 )	(88 )	131
Cash and cash equivalents at beginning of year	202	290	159
Cash and cash equivalents at end of year	\$ 85	\$ 202	\$ 290

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 9A. Controls and Procedures

Disclosure Controls and Procedures. Management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In designing and evaluating its disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. The design of any disclosure controls and procedures

also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Management's Report on Internal Control over Financial Reporting. Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act.

Because of its inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In conducting this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this evaluation, using those criteria, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2011.

Changes in Internal Control over Financial Reporting. There was no change in the internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

Part III

Except as otherwise indicated, information called for by the following items under Part III is contained in the Proxy Statement for the Company's 2012 Annual Meeting of Stockholders (the 2012 Proxy Statement) to be held on May 22, 2012.

Item 10. Directors, Executive Officers and Corporate Governance

The information with respect to the directors of the Company is set forth under the caption "Election of Directors" in the 2012 Proxy Statement and is incorporated herein by reference. The information regarding the Section 16(a) reporting requirements of the directors and executive officers is set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2012 Proxy Statement and is incorporated herein by reference. The information concerning the executive officers of the Company required by this item is included in Part I of this report on Form 10-K under the caption "Executive Officers of the Registrant." The information regarding the Company's Audit Committee and its Audit Committee Financial Expert is set forth under the caption "Board Committees and Attendance" in the 2012 Proxy Statement and is incorporated herein by reference.

The Company has a Code of Ethics which details principles and responsibilities governing ethical conduct for all Company directors, officers, employees and principal stockholders.

A copy of the Code of Ethics will be provided free of charge, upon written request made to Company's secretary at 1 West Mellen Street, Hampton, Virginia 23663 or by calling (757) 728-1200. The Code of Ethics is also posted on the Company's website at [www.oldpoint.com](http://www.oldpoint.com) in the "About" section under "Investor Relations" and then "Governance Documents" of the website. The Company intends to satisfy the disclosure requirements of Form 8-K with respect to waivers of or amendments to the Code of Ethics with respect to certain officers of the Company by posting such disclosures on its website under "Waivers of or amendments to the Code of Ethics." The Company may, however, elect to disclose any such amendment or waiver in a report on Form 8-K filed with the SEC either in addition to or in lieu of the website disclosure.

Item 11. Executive Compensation

The information set forth under the captions "Compensation and Benefits Committee Interlocks and Insider Participation," "Executive Compensation" and "General Compensation Disclosure" in the 2012 Proxy Statement is incorporated herein by reference.





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Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information set forth under the caption “Securities Authorized for Issuance Under Equity Compensation Plans” in the 2012 Proxy Statement is incorporated herein by reference.

The information set forth under the caption “Security Ownership of Certain Beneficial Owners and Management” in the 2012 Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information set forth under the caption “Interest of Management in Certain Transactions” in the 2012 Proxy Statement is incorporated herein by reference.

The information regarding director independence set forth under the captions “Board Committees and Attendance” in the 2012 Proxy Statement is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information set forth under the caption “Principal Accountant Fees” and “Audit Committee Pre-Approval Policy” in the 2012 Proxy Statement is incorporated herein by reference.

Part IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Consolidated Financial Statements

The following consolidated financial statements and reports are included in Part II, Item 8, of this report on Form 10-K.

Report of Independent Registered Public Accounting Firm (Yount, Hyde & Barbour, P.C.)

Consolidated Balance Sheets – December 31, 2011 and 2010

Consolidated Statements of Income – Years Ended December 31, 2011, 2010 and 2009

Consolidated Statements of Changes in Stockholders' Equity – Years Ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows – Years Ended December 31, 2011, 2010 and 2009

Notes to Consolidated Financial Statements

(a)(2) Consolidated Financial Statement Schedules

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

(a)(3) Exhibits

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

Exhibit No.

Description

3.1 Articles of Incorporation of Old Point Financial Corporation, as amended June 22, 2000 (incorporated by reference to Exhibit 3.1 to Form 10-K filed on March 12, 2009)

3.2

Bylaws of Old Point Financial Corporation, as amended and restated March 8, 2011 (incorporated by reference to Exhibit 3.2 to Form 8-K filed on March 10, 2011)

10.1\*Old Point Financial Corporation 1998 Stock Option Plan, as amended April 24, 2001 (incorporated by reference to Exhibit 4.4 to Form S-8 filed July 24, 2001)

10.2\*Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 10-K filed March 30, 2005)

10.3\*Form of Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Form 10-K filed March 30, 2005)

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10.4*	Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with The Northwestern Mutual Life Insurance Company entered into with each of Robert F. Shuford, Sr., Louis G. Morris, Laurie D. Grabow and Eugene M. Jordan, II (incorporated by reference to Exhibit 10.4 to Form 10-K filed March 30, 2005)
10.5*	Directors' Compensation (incorporated by reference to Exhibit 10.5 to Form 10-K filed March 12, 2009)
<u>10.6*</u>	Base Salaries of Executive Officers of the Registrant
10.7*	Description of Management Incentive Plan (incorporated by reference to Exhibit 10.7 to Form 10-K filed March 12, 2009)
10.7.1*	2012 Target Bonuses and Performance Goals under the Management Incentive Plan (incorporated by reference to Form 8-K filed February 15, 2012)
10.8*	Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with Ohio National Life Assurance Corporation entered into with each of Louis G. Morris, Laurie D. Grabow, Eugene M. Jordan, II and Melissa L. Burroughs (incorporated by reference to Exhibit 10.8 to Form 10-K filed March 14, 2008)
10.9	Memorandum of Understanding between The Old Point National Bank of Phoebus and Tidewater Mortgage Services, Inc., dated September 10, 2007 (incorporated by reference to Exhibit 10.8 to Form 10-Q filed November 9, 2007)
10.10*	Form of 162 Insurance Plan (incorporated by reference to Exhibit 10.10 to Form 10-K filed March 12, 2009)
10.11*	Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with Ohio National Life Assurance Corporation entered into with Joseph R. Witt (incorporated by reference to Exhibit 10.11 to Form 10-K filed March 12, 2010)
<u>10.12*</u>	Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with New York Life Insurance and Annuity Corporation entered into with Eugene M. Jordan, II, Robert F. Shuford, Jr, and Joseph R. Witt
21	Subsidiaries of the Registrant (incorporated by reference to Exhibit 21 to Form 10-K filed March 30, 2005)
<u>23</u>	Consent of Yount, Hyde & Barbour, P.C.
<u>24</u>	Powers of Attorney
<u>31.1</u>	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.2</u>	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>32.1</u>	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Old Point Financial Corporation's annual report on Form 10-K for the year ended December 31, 2011, formatted in XBRL (Extensible Business Reporting Language), furnished herewith: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Changes in Stockholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial

Statements

\* Denotes management contract.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OLD POINT FINANCIAL  
CORPORATION

/s/Robert F. Shuford, Sr.  
Robert F. Shuford, Sr.,  
Chairman, President & Chief Executive  
Officer

Date: March 30, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/Robert F. Shuford, Sr.	Chairman, President & Chief Executive Officer and Director
Robert F. Shuford, Sr.	Principal Executive Officer

Date: March 30, 2012

/s/Laurie D. Grabow	Chief Financial Officer & Senior Vice President/ Finance
Laurie D. Grabow	Principal Financial & Accounting Officer

Date: March 30, 2012

/s/James Reade Chisman*	Director
James Reade Chisman	

/s/Richard F. Clark*	Director
Richard F. Clark	

/s/Russell S. Evans, Jr.*	Director
Russell S. Evans, Jr.	

/s/Michael A. Glasser*	Director
Michael A. Glasser	

/s/Dr. Arthur D. Greene*	Director
Dr. Arthur D. Greene	

/s/Stephen D. Harris*	Director
Stephen D. Harris	

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/s/John Cabot Ishon* John Cabot Ishon	Director
/s/John B. Morgan, II* John B. Morgan, II	Director
/s/Louis G. Morris* Louis G. Morris	Director
/s/Robert L. Riddle* Robert L. Riddle	Director
/s/Dr. H. Robert Schappert* Dr. H. Robert Schappert	Director

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/s/Robert F. Shuford, Jr.\*                      Director  
Robert F. Shuford, Jr.

/s/Ellen Clark Thacker\*                      Director  
Ellen Clark Thacker

/s/Joseph R. Witt\*                      Director  
Joseph R. Witt

\*By Robert F. Shuford, Sr., as Attorney in Fact

Date: March 30, 2012