MRC GLOBAL INC.
Form 4
March 11, 2014

FORM 4

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

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Lane Andrew R

(Last) (First) (Middle)

2 HOUSTON CENTER, 909 FANNIN, SUITE 3100

(Street)

HOUSTON, TX 77010

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
MRC GLOBAL INC. [MRC]

3. Date of Earliest Transaction (Month/Day/Year)
03/07/2014

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Chairman, President and CEO

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	03/07/2014		F		1,305 (1)	D	$ 26.36	210,674	I	Through A Limited Partnership

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Lane Andrew R 2 HOUSTON CENTER 909 FANNIN, SUITE 3100 HOUSTON, TX 77010	X		Chairman, President and CEO	

Signatures

/s/ Jeffrey P. Bennett, Attorney-in-fact	03/11/2014
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The reporting person surrendered these shares on March 7, 2014 to satisfy tax withholding obligations resulting from the vesting of certain shares of the issuer's common stock.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number.

0.12%

0.03%

0.14%

(1) Loans are net of unearned income.

We have allocated the allowance for loan losses according to the amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within each of the categories of loans. The allocation of the allowance as shown in the table below should not be interpreted as an indication that losses in future years will occur in the same proportions or that the allocation indicates future loss trends. Furthermore, the portion allocated to each loan category is not the total amount available for future losses that might occur within such categories since the total allowance is a general allowance applicable to the entire portfolio.

Allocation of the Allowance for Loan Losses
(*In thousands*)

	December 31, 2008		December 31, 2007		December 31, 2006		December 31, 2005		December 31, 2004	
	Total	%	Total	%	Total	%	Total	%	Total	%
Commercial	$1,664	27.5%	$ 479	13.8%	$ 377	14.8%	$ 568	29.5%	$ 653	43.2%
Real estate										
Residential	1,142	18.8%	712	20.5%	512	20.1%	358	18.5%	97	6.4%
Commercial	2,166	35.7%	1,204	34.7%	884	34.5%	444	23.0%	474	31.3%
Construction	965	15.9%	989	28.5%	694	27.2%	485	25.1%	205	13.5%
Consumer	122	2.0%	85	2.5%	86	3.4%	76	3.9%	85	5.6%
Total	$6,059	100.0%	$3,469	100.0%	$2,553	100.0%	$1,931	100.0%	$1,514	100.0%

Asset quality

The following table summarizes asset quality information at the dates indicated:

Asset Quality
(*In thousands*)

	December 31, 2008	2007	2006	2005	2004
Nonaccrual loans	$ 8,528	$ 2,585	$ 2,801	$ 1,834	$ 473
Restructured loans	-	-	-	-	-
Foreclosed properties	2,932	270	-	-	-
Total nonperforming assets	$ 11,460	$ 2,855	$ 2,801	$ 1,834	$ 473
Loans past due 90 days and still accruing					
(not included in nonaccrual loans above)	$ 6,197	$ 1,219	$ 6,520	$ 4,932	$ 1,134
Nonperforming assets to loans at end of year (1)	2.43%	0.87%	1.16%	1.06%	0.35%
Nonperforming assets to total assets	2.00%	0.73%	0.96%	0.85%	0.30%
Allowance for loan losses to nonaccrual loans	71.0%	134.2%	91.1%	105.3%	320.1%

(1) Loans are net of unearned income.

Interest is accrued on outstanding loan principal balances, unless the Company considers collection to be doubtful. Commercial and unsecured consumer loans are designated as non-accrual when the Company considers collection doubtful. Mortgage loans and most other types of

consumer loans past due 90 days or more may remain on accrual status if management determines that concern over our ability to collect principal and interest is not significant. When loans are placed in non-accrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received. Interest accruals are resumed on such loans only when in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

At December 31, 2008, the Company had three loans totaling $1,369,000 which were considered impaired and have specific allowances for loan losses totaling $235,000. The gross interest income that would have been earned in 2008 if the loans classified as nonaccrual had been current in accordance with the original terms was $95,000. Forty three loans totaling $6,197,000 at December 31, 2008 were past due 90 days or more and interest was still being accrued as such amounts were considered collectible. The increase in nonaccrual loans is due to the economic condition. Given that the nonaccrual loans are considered higher risk loans the allowance calculated on these loans is higher. The increase in nonaccrual loans has contributed to the higher overall allowance for loan loss at December 31, 2008.

Investment portfolio

At December 31, 2008 and 2007, all of our securities were classified as available-for-sale. The following table presents the composition of our investment portfolio at the dates indicated

Investment Securities Available-for-Sale
(Dollars in thousands)

	Par Value	Amortized Cost	Unrealized Gain (Loss)	Estimated Fair Value	Average Yield
December 31, 2008					
US Government Agencies					
Within one year	$ 360	$ 360	$ (4)	$ 356	4.50%
Five to ten years	5,077	5,027	54	5,081	5.31%
More than ten years	11,500	11,479	130	11,609	5.91%
Total	16,937	16,866	180	17,046	5.70%
Mortgage-backed securities					
One to five years	874	875	9	884	4.47%
Five to ten years	704	704	13	717	4.87%
More than ten years	3,868	3,913	(45)	3,868	5.53%
	5,446	5,492	(23)	5,469	5.27%
Other investments					
More than five years	2,000	1,970	(184)	1,786	5.65%
Total investment securities	$ 24,383	$ 24,328	$ (27)	$ 24,301	5.60%
December 31, 2007					
US Government Agencies					
Within one year	$ 1,600	$ 1,579	$ (3)	$ 1,576	4.22%
One to five years	360	360	(3)	357	4.65%
Five to ten years	9,200	9,140	74	9,214	5.66%
More than ten years	590	590	1	591	5.56%
Total	11,750	11,669	69	11,738	5.35%
Mortgage-backed securities					
More than ten years	40	40	1	41	3.61%
Other investments					
Five to ten years	2,000	1,968	(36)	1,932	5.65%
Total investment securities	$ 13,790	$ 13,677	$ 34	$ 13,711	5.39%

Deposits

The following table gives the composition of our deposits at the dates indicated.

Deposits
(In thousands)

	December 31, 2008		December 31, 2007		December 31, 2006	
	Amount	%	Amount	%	Amount	%
Demand accounts	$ 34,483	7.4%	$ 23,223	6.8%	$ 22,381	8.8%
Interest checking accounts	17,427	3.7%	10,518	3.1%	9,415	3.7%
Money market accounts	30,003	6.4%	22,060	6.5%	17,942	7.1%
Savings accounts	5,388	1.2%	3,373	1.0%	4,107	1.6%
Time deposits of $100,000 and over	148,173	31.8%	101,987	30.1%	66,423	26.2%
Other time deposits	230,758	49.5%	178,136	52.5%	133,042	52.5%
Total	$ 466,232	100.0%	$ 339,297	100.0%	$ 253,310	100.0%

Total deposits increased by 37%, 34% and 36% in 2008, 2007 and 2006, respectively.

The variety of deposit accounts offered by the Company has allowed us to be competitive in obtaining funds and has allowed us to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of funds away from depository institutions such as banking institutions into direct investment vehicles such as government and corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, and will continue to be, significantly affected by money market conditions.

The following table is a schedule of average balances and average rates paid for each deposit category for the periods presented:

Average Deposits and Rates Paid
(In thousands)

	Year Ended December 31,					
	2008		2007		2006	
Account Type	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest-bearing demand accounts	$ 27,657	-	$ 22,686	-	$ 19,976	-
Interest-bearing deposits						
Interest checking accounts	12,735	1.25%	10,454	0.99%	7,744	1.14%
Money market accounts	28,215	1.99%	21,618	3.36%	21,722	3.28%
Savings accounts	6,891	2.81%	3,669	1.16%	4,124	1.14%
Time deposits of $100,000 and over	100,840	4.90%	81,828	5.23%	51,654	4.75%
Other time deposits	190,789	4.44%	151,580	5.14%	108,265	4.60%

Total interest-bearing deposits	339,470	4.23%	269,149	4.81%	193,509	4.28%
Total average deposits	$ 367,127		$291,835		$213,485	

37

The following table is a schedule of maturities for time deposits of $100,000 or more at December 31, 2008.

Maturities of Time Deposits of $100,000 or More
(*In thousands*)

Due within three months	$ 37,875
Due after three months through six months	18,851
Due after six months through twelve months	61,313
Over twelve months	30,134
	$ 148,173

Borrowings

We utilize borrowings to supplement deposits when they are available at a lower overall cost to us or they can be invested at a positive rate of return.

As a member of the Federal Home Loan Bank of Atlanta (“FHLB”), the Bank is required to own capital stock in the FHLB and is authorized to apply for borrowings from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. Borrowings from the FHLB were $25,000,000 and $12,000,000 at December 31, 2008 and 2007 respectively. The FHLB advances are secured by the pledge of residential mortgage loans and our FHLB stock. Available borrowings at December 31, 2008 were approximately $15 million.

Securities sold under agreements to repurchase, which totaled $9,425,000 as of December 31, 2008, are classified as borrowings in accordance with the provisions of FAS 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities” and 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.

Federal funds purchased represent unsecured borrowings from other banks and generally mature daily. We did not have any purchased federal funds at December 31, 2008 or 2007.

On September 24, 2008 the Company obtained a note payable from Virginia Community Bank for $2,250,000 bearing interest at 5% payable quarterly and maturing September 24, 2009.

On September 12, 2007, the Company entered into a promissory note payable to Community Bankers’ Bank for $11,000,000 bearing interest at thirty day LIBOR plus 2.375% and maturing September 12, 2009. Interest on any outstanding balance is paid monthly with principal due at maturity. Proceeds advanced under the promissory note were used to finance the construction of the Company’s new principal administrative

offices in Chesterfield County which was completed in July 2008. The balances outstanding were $10,021,871 and $2,836,090 at December 31, 2008 and 2007 respectively.

Contractual obligations and other commitments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contractual amounts of these

instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Unless noted otherwise, the Company does not require collateral or other security to support financial instruments with credit risk.

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 may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Capital resources

Stockholders' equity at December 31, 2008 was $46,163,000, compared to $26,893,000 at December 31, 2007 and $25,644,000 at December 31, 2006. During the third quarter of 2008, the Company took steps to increase the capital position of both the Company and the Bank in connection with the planned merger with River City Bank. Such actions were taken, in part, to allow the FDIC to consider the merger application on an expedited/delegated basis. In that regard, the Company issued 59,885 shares of common stock and received proceeds of $500,000 as a result of the exercise of previously issued options to its directors, all of which was contributed to the Bank as capital. In addition, the Company obtained a loan for $2,250,000 from Virginia Community Bank of which it contributed $2,000,000 to the Bank as capital. And lastly, the Company issued 106,250 shares of common stock to the Company's largest shareholder for proceeds of $850,000, all of which was contributed to the Bank as capital. The merger with River City Bank resulted in an additional $5,764,000 in common stock and $10,505,000 of surplus. All of the above transactions contributed to the $19,270,000 increase in equity during 2008. The $1,249,000 increase in equity during 2007 was due primarily to net income of $1,001,000 for 2007 and $192,000 increase in the market value of investments. The proceeds from the issuance of stock was attributable to the exercise of stock warrants and related issuance of common stock discussed in Note 15 of the *Notes to Consolidated Financial Statements* and, to a much lesser extent, the exercise of stock options.

During the first quarter of 2005, the Company issued $5.2 million in Trust Preferred Capital Notes to increase its regulatory capital and to help fund its expected growth in 2005. During the third quarter of 2007, the Company issued $3.6 million in Trust Preferred Capital Notes to partially fund the construction of an 80,000 square foot headquarters building scheduled for completion in January 2008. The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. See Note 15 of the *Notes to Consolidated Financial Statements* for a more detailed discussion of the Trust Preferred Capital Notes.

The following table presents the composition of regulatory capital and the capital ratios at the dates indicated.

Analysis of Capital
(*In thousands*)

	As of December 31,		
	2008	2007	2006
Tier 1 capital			
Common stock	$ 16,917	$ 10,304	$ 10,248
Additional paid-in capital	25,737	13,726	13,589
Retained earnings	3,454	2,986	1,985
Qualifying trust preferred securities	8,500	8,500	5,000
Total equity	54,608	35,516	30,822
Less: goodwill	(7,422)	(689)	(689)
Total Tier 1 capital	47,186	34,827	30,133
Tier 2 capital			
Allowance for loan losses	6,059	3,469	2,553
Total Tier 2 capital	6,059	3,469	2,553
Total risk-based capital	53,245	38,296	32,686
Risk-weighted assets	$ 500,689	$ 378,020	$ 275,323
Capital ratios			
Tier 1 capital to risk-weighted assets	9.4%	9.2%	10.9%
Total capital to risk-weighted assets	10.6%	10.1%	11.9%
Leverage ratio (Tier 1 capital to average assets)	8.4%	9.1%	14.1%
Equity to total assets	8.1%	6.8%	8.0%

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, under capitalized, significantly under capitalized, and critically under capitalized. The Bank meets the criteria to be categorized as a "well capitalized" institution as of December 31, 2008 and was "adequately capitalized" at December 31, 2007. When capital falls below the "well capitalized" requirement, consequences can include: new branch approval could be withheld; more frequent examinations by the FDIC; brokered deposits cannot be renewed without a waiver from the FDIC; and other potential limitations as described in FDIC Rules and Regulations sections 337.6 and 303, and FDIC Act section 29. In addition, the FDIC insurance assessment increases when an institution falls below the "well capitalized" classification.

Liquidity

Liquidity provides us with the ability to meet normal deposit withdrawals, while also providing for the credit needs of customers. We are committed to maintaining liquidity at a level sufficient to protect depositors, provide for reasonable growth, and fully comply with all regulatory requirements.

At December 31, 2008, cash, cash equivalents and investment securities available-for-sale totaled $50,902,000, or 8.8% of total assets.

At December 31, 2008, we had commitments to originate $88,892,000 of loans. Fixed commitments to incur capital expenditures were less than $25,000 at December 31, 2008. Certificates of deposit scheduled to mature in the 12-month period ending December 31, 2008 total $301,200,000. We believe that a significant portion of such deposits will remain with us. We further believe that deposit growth, loan repayments and other sources of funds will be adequate to meet our foreseeable short-term and long-term liquidity needs.

Interest rate sensitivity

An important element of asset/liability management is the monitoring of our sensitivity to interest rate movements. In order to measure the effects of interest rates on our net interest income, management takes into consideration the expected cash flows from the securities and loan portfolios and the expected magnitude of the repricing of specific asset and liability categories. We evaluate interest sensitivity risk and then formulate guidelines to manage this risk based on management's outlook regarding the economy, forecasted interest rate movements and other business factors. Our goal is to maximize and stabilize the net interest margin by limiting exposure to interest rate changes.

Contractual principal repayments of loans do not necessarily reflect the actual term of our loan portfolio. The average lives of mortgage loans are substantially less than their contractual terms because of loan prepayments and because of enforcement of due-on-sale clauses, which gives us the right to declare a loan immediately due and payable in the event, among other things, the borrower sells the real property subject to the mortgage and the loan is not repaid. In addition, certain borrowers increase their equity in the security property by making payments in excess of those required under the terms of the mortgage.

The sale of fixed rate loans is intended to protect us from precipitous changes in the general level of interest rates. The valuation of adjustable rate mortgage loans is not as directly dependent on the level of interest rates as is the value of fixed rate loans. As with other investments, we regularly monitor the appropriateness of the level of adjustable rate mortgage loans in our portfolio and may decide from time to time to sell such loans and reinvest the proceeds in other adjustable rate investments.

The data in the following table reflects repricing or expected maturities of various assets and liabilities at December 31, 2008. The gap analysis represents the difference between interest-sensitive assets and liabilities in a specific time interval. Interest sensitivity gap analysis presents a position that existed at one particular point in time, and assumes that assets and liabilities with similar repricing characteristics will reprice at the same time and to the same degree.

Village Bank and Trust Financial Corp.
Interest Rate Sensitivity GAP Analysis
December 31, 2008
(*In thousands*)

	Within 3 Months	3 to 6 Months	6 to 12 Months	13 to 36 Months	More than 36 Months	Total
Interest Rate Sensitive Assets						
Loans (1)						
Fixed rate	$ 25,281	$ 16,754	$ 24,174	$ 24,795	$144,250	$235,254
Variable rate	169,853	5,846	6,801	10,518	42,646	235,664
Investment securities	356	-	-	753	23,192	24,301
Loans held for sale	4,326	-	-	-	-	4,326
Federal funds sold	13,494	-	-	-	-	13,494
Total rate sensitive assets	213,310	22,600	30,975	36,066	210,088	513,039
Cumulative rate sensitive assets	213,310	235,910	266,885	302,951	513,039	
Interest Rate Sensitive Liabilities						
Interest checking (2)	-	-	-	17,427	-	17,427
Money market accounts	30,003	-	-	-	-	30,003
Savings (2)	-	-	-	5,388	-	5,388
Certificates of deposit	87,939	56,419	159,055	62,184	13,334	378,931
FHLB advances	-	-	-	25,000	-	25,000
Trust Preferred Securities	-	-	-	-	8,764	8,764
Federal funds purchased	-	-	-	-	-	-
Other borrowings	23,963	-	-	-	-	23,963
Total rate sensitive liabilities	141,905	56,419	159,055	109,999	22,098	489,476
Cumulative rate sensitive liabilities	141,905	198,324	357,379	467,378	489,476	
Rate sensitivity gap for period	$ 71,405	$(33,819)	$(128,080)	$ (73,933)	$187,990	$ 23,563
Cumulative rate sensitivity gap	$ 71,405	$ 37,586	$ (90,494)	$ (164,427)	$ 23,563	
Ratio of cumulative gap to total assets	12.5%	6.6%	(15.8)%	(28.7)%	4.1%	
Ratio of cumulative rate sensitive assets to cumulative rate sensitive liabilities	150.3%	119.0%	74.7%	64.8%	104.8%	
Ratio of cumulative gap to cumulative rate sensitive assets	33.5%	15.9%	(33.9)%	(54.3)%	4.6%	

(1) Includes nonaccrual loans of approximately $8,528,000, which are spread throughout the categories.
(2) Management believes that interest checking and savings accounts are generally not sensitive to changes in interest rates and therefore has placed such deposits in the "13 to 36 months" category.

At December 31, 2008, our liabilities that reprice within one year exceeded assets that reprice within one year by $90,494,000 and therefore we were in a liability-sensitive position. A negative gap can adversely affect earnings in periods of increasing interest rates. This negative position is due primarily to the short maturity of certificates of deposit.

Critical accounting policies

The financial condition and results of operations presented in the financial statements, accompanying notes to the financial statements and management’s discussion and analysis are, to a large degree, dependent upon the Company’s accounting policies. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change.

Presented below is discussion of those accounting policies that management believes are the most

important accounting policies to the portrayal and understanding of our financial condition and results of operations. These critical accounting policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood. See also Note 1 of the *Notes to Consolidated Financial Statements*.

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in our loan portfolio. We maintain policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance they are maintained in accordance with accounting principles generally accepted in the United States of America; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan and lease portfolio; and the loan grading system.

We evaluate various loans individually for impairment as required by Statement of Financial Accounting Standards (SFAS) 114, *Accounting by Creditors for Impairment of a Loan*, and SFAS 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures*. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment. If a loan evaluated individually is not impaired, then the loan is assessed for impairment under SFAS 5, *Accounting for Contingencies*, with a group of loans that have similar characteristics.

For loans without individual measures of impairment, we make estimates of losses for groups of loans as required by SFAS 5. Loans are grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon estimates of default rates for a given loan grade, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amount of estimated impairment for individually evaluated loans and groups of loans is added together for a total estimate of loan losses. This estimate of losses is compared to our allowance for loan losses as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. If the estimate of losses is below the range of reasonable estimates, the allowance would be reduced by way of a credit to the provision for loan losses. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the Financial Statements.

New accounting standards

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. The Statement does not

43

require any new fair value measurements and was initially effective for the Corporation beginning January 1, 2008. In February 2008, the FASB approved the issuance of FASB Staff Position (FSP) FAS 157-2. FSP FAS 157-2 defers the effective date of SFAS No. 157 until January 1, 2009 for nonfinancial assets and nonfinancial liabilities except those items recognized or disclosed at fair value on an annual or more frequently recurring basis. Management has not completed its review of the new guidance; however, the effect of the Statement's implementation is not expected to be material to the Corporation's results of operations or financial position.

On October 10, 2008, the FASB issued FSP No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP 157-3"). FSP 157-3 clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on the Company's determination of fair value for its financial assets.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115". This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assts and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. This Statement became effective for the Company on January 1, 2008. The adoption of SFAS 159 did not have a material impact on the Company's consolidated financial position or results of operations.

In November 2007, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" ("SAB 109"). SAB 109 expresses the current view of the SEC staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply this guidance on a prospective basis to derivative loan commitments issued or modified in the first quarter of 2008 and thereafter. The adoption of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," ("SFAS 141(R)") which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. The Company does not expect the adoption of this statement to have a material effect on our results of operations or financial position as of December 31, 2008, however, it will impact the accounting for acquisitions subsequent to the effective date.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements-an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting non-controlling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financials statements and separate from the parent's equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity

transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The adoption of this standard is not expected to have any impact on the Company's consolidated financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB statement No. 133". SFAS 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related items are accounted for under Statement 133 and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The new standard is effective for the Company on January 1, 2009. The adoption of this standard is not expected to have any impact on the Company's consolidated financial position or results of operations.

Impact of inflation and changing prices

The financial statements in this document have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars, without consideration of changes in the relative purchasing power of money over time due to inflation.

Unlike industrial companies, most of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services, since such prices are affected by inflation.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

Report of Independent Registered Public Accounting Firm

Board of Directors

Village Bank and Trust Financial Corp.

Midlothian, Virginia

We have audited the accompanying consolidated balance sheets of Village Bank and Trust Financial Corp. and Subsidiary as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 consolidated financial position of Village Bank and Trust Financial Corp. and Subsidiary as of December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

BDO Seidman, LLP

Richmond, Virginia

March 27, 2009

46

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
December 31, 2008 and 2007

	2008	2007
Assets		
Cash and due from banks	$ 13,107,245	$ 5,752,332
Federal funds sold	13,493,584	16,362,672
Investment securities available for sale	24,300,962	13,711,399
Loans held for sale	4,325,746	3,489,886
Loans		
Outstanding	470,918,182	327,775,829
Allowance for loan losses	(6,059,272)	(3,469,273)
Deferred fees	(195,896)	(432,816)
	464,663,014	323,873,740
Premises and equipment, net	28,173,518	19,162,054
Accrued interest receivable	3,499,793	2,752,755
Goodwill	7,422,141	689,108
Real estate owned	2,932,100	270,000
Bank owned life insurance	5,099,022	3,990,511
Other assets	5,390,868	3,209,542
	$ 572,407,993	$ 393,263,999
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	466,232,043	339,297,258
Trust preferred securities	8,764,000	8,764,000
Federal home loan bank advances	25,000,000	12,000,000
Other borrowings	23,962,898	3,972,569
Accrued interest payable	1,014,534	587,980
Other liabilities	1,271,944	1,748,893
Total liabilities	526,245,419	366,370,700
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $1 par value - 1,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, $4 par value - 10,000,000 shares authorized; 4,229,372 shares issued and outstanding at December 31, 2008 2,575,985 shares issued and outstanding at December 31, 2007	16,917,488	10,303,940
Additional paid-in capital	25,737,048	13,726,269
Accumulated other comprehensive income (loss)	54,250	(122,607)
Retained earnings	3,453,788	2,985,697
Total stockholders' equity	46,162,574	26,893,299
	$ 572,407,993	$ 393,263,999

47

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Income
Year Ended December 31,

	2008	2007	2006
Interest income			
Loans	$ 28,140,129	$ 24,379,103	$ 17,961,729
Investment securities	698,790	847,364	450,044
Federal funds sold	233,227	438,768	607,338
Total interest income	29,072,146	25,665,235	19,019,111
Interest expense			
Deposits	14,348,287	12,949,807	8,278,308
Borrowed funds	1,621,496	856,908	508,292
Total interest expense	15,969,783	13,806,715	8,786,600
Net interest income	13,102,363	11,858,520	10,232,511
Provision for loan losses	2,005,633	1,187,482	796,006
Net interest income after provision for loan losses	11,096,730	10,671,038	9,436,505
Noninterest income			
Service charges and fees	1,160,500	748,695	582,860
Gain on sale of loans	2,381,023	1,513,318	1,519,442
Gain on sale of fixed assets	57,827	-	-
Rental income	4,183	-	-
Other operating income	581,194	404,943	380,491
Total noninterest income	4,184,727	2,666,956	2,482,793
Noninterest expense			
Salaries and benefits	7,976,472	6,842,990	5,727,791
Occupancy	1,264,757	900,913	681,477
Equipment	751,698	659,014	516,358
Supplies	464,900	353,573	322,542
Professional and outside services	1,544,895	1,173,135	1,029,046
Advertising and marketing	315,985	439,749	384,304
Other operating expense	2,253,564	1,451,858	1,155,572
Total noninterest expense	14,572,271	11,821,232	9,817,090
Income before income taxes	709,186	1,516,762	2,102,208
Income tax expense	241,097	515,699	702,990
Net income	$ 468,089	$ 1,001,063	$ 1,399,218
Earnings per share, basic	$ 0.16	$ 0.39	$ 0.62
Earnings per share, diluted	$ 0.16	$ 0.37	$ 0.59

See accompanying notes to consolidated financial statements.

48

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Stockholders' Equity
and Comprehensive Income
Year Ended December 31, 2008, 2007 and 2006

	Common Stock Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2005	1,854,618	$ 7,418,472	$ 9,191,567	$ 585,416	$ (43,562)	$ 17,151,893
Issuance of common stock	707,470	2,829,880	4,374,314	-	-	7,204,194
Stock based compensation	-	-	23,007	-	-	23,007
Minimum pension adjustment (net of income taxes of $75,112)	-	-	-	-	(145,806)	(145,806)
Net income	-	-	-	1,399,218	-	1,399,218
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $4,743)	-	-	-	-	11,609	11,609
Total comprehensive income	-	-	-	-	-	1,410,827
Balance, December 31, 2006	2,562,088	10,248,352	13,588,888	1,984,634	(177,759)	25,644,115
Issuance of common stock	13,897	55,588	77,646	-	-	133,234
Stock based compensation	-	-	59,735	-	-	59,735
Minimum pension adjustment (net of income taxes of $4,419)					8,579	8,579
Net income	-	-	-	1,001,063	-	1,001,063
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $23,992)	-	-	-	-	46,573	46,573
Total comprehensive income	-	-	-	-	-	1,047,636
Balance, December 31, 2007	2,575,985	10,303,940	13,726,269	2,985,697	(122,607)	26,893,299
Issuance of common stock	212,413	849,652	950,712	-	-	1,800,364
Stock issued in acquisition of				-	-	-
River City Bank	1,440,974	5,763,896	10,504,700			16,268,596
Stock based compensation	-	-	555,367	-	-	555,367
Minimum pension adjustment (net of income taxes of $2,917)	-	-	-	-	8,580	8,580
Net income	-	-	-	468,091		468,091
Change in unrealized gain (loss) on securities (net of income taxes of $57,214)	-	-	-	-	168,277	168,277
Total comprehensive income						636,368
Balance, December 31, 2008	4,229,372	$16,917,488	$ 25,737,048	$ 3,453,788	$ 54,250	$ 46,162,574

See accompanying notes to consolidated financial statements.

49

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
Cash Flows from Operating Activities			
Net income	$ 468,089	$ 1,001,063	$ 1,399,218
Adjustments to reconcile net income to net			
cash provided by (used in) operating activities:			
Depreciation and amortization	798,965	673,110	477,517
Deferred income taxes	(291,679)	(236,072)	(300,568)
Provision for loan losses	2,005,633	1,187,482	796,006
Gain on securities	(23,194)	-	-
Gain on loans sold	(2,381,023)	(1,513,318)	(1,519,442)
Gain on sale of premises and equipment	(57,827)		
Stock compensation expense	555,367	59,735	23,007
Proceeds from sale of mortgage loans	101,624,820	68,667,081	64,268,836
Origination of mortgage loans for sale	(100,079,657)	(67,494,471)	(63,038,132)
Amortization of premiums and accretion of discounts			
on securities, net	(31,098)	37,759	(39,324)
Increase in interest receivable	(43,355)	(451,491)	(1,364,675)
Increase in other assets	(5,715,821)	(2,134,332)	(741,916)
Increase (decrease) in interest payable	(178,382)	157,994	208,662
Increase(decrease) in other liabilities	262,945	(501,892)	767,395
Net cash provided by (used in) operating activities	(3,086,217)	(547,352)	936,584
Cash Flows from Investing Activities			
Purchases of available for sale securities	282,960	(23,532,491)	(25,378,393)
Maturities and calls of available for sale securities	16,336,043	22,641,205	15,630,798
Net increase in loans	(29,547,499)	(86,562,804)	(68,847,151)
Purchases of premises and equipment	(8,954,314)	(8,080,207)	(4,950,612)
Proceeds from sale of premises and equipment	1,144,595	-	-
Acquisition net of cash required	(57,175)	-	-
Net cash used in investing activities	(20,795,390)	(95,534,297)	(83,545,358)
Cash Flows from Financing Activities			
Issuance of common stock	1,800,364	133,234	7,204,194
Net increase (decrease) in deposits	(3,277,260)	85,987,377	66,557,074
Federal Home Loan Bank borrowings	13,000,000	8,000,000	-
Proceeds from issuance of trust preferred securities	-	3,609,000	-
Net increase in other borrowings	16,844,328	3,268,539	217,455
Net cash provided by financing activities	28,367,432	100,998,150	73,978,723
Net increase (decrease) in cash and cash equivalents	4,485,825	4,916,501	(8,630,051)
Cash and cash equivalents, beginning of period	22,115,004	17,198,503	25,828,554
Cash and cash equivalents, end of period	$ 26,600,829	$ 22,115,004	$ 17,198,503

See accompanying notes to consolidated financial statements.

50

Explanation of Responses:

Village Bank and Trust Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements

Years Ended December 31, 2008, 2007 and 2006

Note 1. Summary of Significant Accounting Policies

The accounting and reporting policies of Village Bank and Trust Financial Corp. and subsidiary (the "Company") conform to accounting principles generally accepted in the United States of America and to general practice within the banking industry. The following is a description of the more significant of those policies:

Business

The Company is the holding company of and successor to the Village Bank (the "Bank"). Effective April 30, 2004, the Company acquired all of the outstanding stock of the Bank in a statutory share exchange transaction. In the transaction, the shares of the Bank's common stock were exchanged for shares of the Company's common stock, par value $4.00 per share ("Common Stock"), on a one-for-one basis. As a result, the Bank became a wholly owned subsidiary of the Company, the Company became the holding company for the Bank and the shareholders of the Bank became shareholders of the Company.

The Bank opened to the public on December 13, 1999 as a traditional community bank offering deposit and loan services to individuals and businesses in the Richmond, Virginia metropolitan area. During 2003, the Bank acquired or formed three wholly owned subsidiaries, Village Bank Mortgage Corporation ("Village Mortgage"), a full service mortgage banking company, Village Insurance Agency, Inc. ("Village Insurance"), a full service property and casualty insurance agency, and Village Financial Services Corporation ("Village Financial Services"), a financial services company. Through these subsidiaries, the Bank provides a broad array of financial services to its customers.

On October 14, 2008, the Company completed its merger with River City Bank pursuant to an Agreement and Plan of Reorganization and Merger, dated as of March 9, 2008, by and among the Company, the Bank and River City Bank. The merger had previously been approved by both companies' shareholders at their respective annual meetings on September 30, 2008 as well as the banking regulators.

The Company is subject to intense competition from existing bank holding companies, commercial banks and savings banks which have been in business for many years and have established customer bases. Competition also comes from a variety of other non-bank businesses that offer financial services. Many of these competitors operate in the same geographic market where the Company operates, are well-known with long-standing relationships with businesses and individuals in the communities, and are substantially larger with greater resources than the Company.

The Bank is also subject to regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. As a consequence of the extensive regulation of commercial banking activities, the Bank's business is susceptible to being affected by state and federal legislation and regulations.

The majority of the Company's real estate loans are collateralized by properties in markets in the Richmond, Virginia metropolitan area. Accordingly, the ultimate collectibility of those loans collateralized by real estate is particularly susceptible to changes in market conditions in the Richmond area.

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of the Company, the Bank and the Bank's subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the statements of financial condition and revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

Investment securities

At the time of purchase, debt securities are classified into the following categories: held-to-maturity, available-for-sale or trading. Debt securities that the Company has both the positive intent and ability to hold to maturity are classified as held-to-maturity. Held-to-maturity securities are stated at amortized cost adjusted for amortization of premiums and accretion of discounts on purchase using a method that approximates the effective interest method. Investments classified as trading or available-for-sale are stated at fair market value. Changes in fair value of trading investments are included in current earnings while changes in fair value of available-for-sale investments are excluded from current earnings and reported, net of taxes, as a separate component of stockholders' equity. Presently, the Company does not maintain a portfolio of trading securities.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed other than temporary results in a charge to earnings and the corresponding establishment of a new cost basis for the security. No such declines have occurred.

Interest income is recognized when earned. Realized gains and losses for securities classified as available-for-sale and held-to-maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Loans held for sale

The Company, through the Bank's mortgage banking subsidiary, Village Bank Mortgage, originates residential mortgage loans for sale in the secondary market. Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value on an individual loan basis as determined by outstanding commitments from investors. The Company requires a firm purchase commitment from a permanent investor before a loan can be closed, thus limiting interest rate risk. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Residential mortgage loans held for sale are sold to the permanent investor with the mortgage servicing rights released. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. This difference arises primarily as a result of the value of the mortgage servicing rights.

Once a residential mortgage loan is sold to a permanent investor, the Company has no further involvement or retained interest in the loan. There are limited circumstances in which the permanent investor can contractually require the Company to repurchase the loan. The Company makes no provision for any such recourse related to loans sold as history has shown repurchase of loans under these circumstances has been remote.

Rate lock commitments

The Company, through the Bank's mortgage banking subsidiary, Village Bank Mortgage, enters into commitments to originate residential mortgage loans in which the interest rate on the loan is determined prior to funding, termed rate lock commitments. Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives and must be accounted for as such. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 30 to 120 days. The Company protects itself from changes in interest rates during this period by requiring a firm purchase agreement from a permanent investor before a loan can be closed. As a result, the Company is not exposed to losses nor will it realize gains or losses related to its rate lock commitments due to changes in interest rates.

Loans

Loans are stated at the principal amount outstanding, net of unearned income. Loan origination fees and certain direct loan origination costs are deferred and amortized to interest income over the life of the loan as an adjustment to the loan's yield over the term of the loan.

Interest is accrued on outstanding principal balances, unless the Company considers collection to be doubtful. Commercial and unsecured consumer loans are designated as non-accrual when payment is delinquent 90 days or at the point which the Company considers collection doubtful, if earlier. Mortgage loans and most other types of consumer loans past due 90 days or more may remain on accrual status if management determines that concern over our ability to collect principal and interest is not significant. When loans are placed in non-accrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received. Interest accruals are resumed on such loans only when in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

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 represents an amount that, in management's judgment, will be adequate to absorb any losses on existing loans that may become uncollectible. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions which may affect a borrower's ability to repay, overall portfolio quality, and review of specific potential losses. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general, specific and unallocated components. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The specific component relates to loans that we have concluded, based on the value of collateral, guarantees and any other pertinent factors, have known losses. For such loans that are also 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. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the

53

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 the 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.

Premises and equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation of buildings and improvements is computed using the straight-line method over the estimated useful lives of the assets of 39 years. Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 7 years. Amortization of premises (leasehold improvements) is computed using the straight-line method over the term of the lease or estimated lives of the improvements, whichever is shorter.

Goodwill

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is evaluated at least annually for impairment by comparing its fair value with its recorded amount and is written down when appropriate. Projected net operating cash flows are compared to the carrying amount of the goodwill recorded and if the estimated net operating cash flows are less than the carrying amount, a loss is recognized to reduce the carrying amount to fair value. No impairment was recognized on goodwill during the period ended December 31, 2008.

Income taxes

Deferred income taxes are recognized for the tax consequences of “temporary differences” by applying enacted tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on recorded deferred income taxes of a change in tax laws or rates is recognized in income in the period that includes the enactment date. To the extent that available evidence about the future raises doubt about the realization of a deferred income tax asset, a valuation allowance is established. The primary temporary differences are the allowance for loan losses and depreciation and amortization.

Consolidated statements of cash flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, due from banks (including cash items in process of collection), interest-bearing deposits with banks and federal funds sold. Generally, federal funds are purchased and sold for one-day periods. Cash flows from loans originated by the Bank and deposits are reported net. The Company paid interest of $15,543,000, $13,649,000 and $8,578,000 in 2008, 2007, and 2006, respectively. The Company paid income taxes of $260,000, $800,400 and $986,000 in 2008, 2007 and 2006, respectively. Non-cash investing activities included loans converted to real estate owned of $2,662,000 in 2008 and $270,000 in 2007.

Comprehensive income

SFAS 130, *Reporting Comprehensive Income,* established standards for reporting and display of comprehensive income, its components and accumulated balances. Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. Among other disclosures, SFAS 130 requires that all items that are required to be recognized under current accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements.

Earnings per common share

Basic earnings per common share is computed by dividing the net earnings by the weighted-average number of common shares outstanding during the period, which totaled 3,013,175, 2,569,529 and 2,269,092 during 2008, 2007 and 2006, respectively. Diluted earnings per share reflects the potential dilution of securities that could share in the net earnings of the Company. Outstanding options and warrants to purchase Common Stock (see Notes 13 and 14) were considered in the computation of diluted earnings per share for the years presented. For the years ended December 31, 2008, 2007 and 2006, the weighted average number of common shares on a fully diluted basis totaled 3,013,622, 2,695,010 and 2,368,686, respectively.

Stock warrant and incentive plans

On March 21, 2000, the Company approved the Organizational Investors Warrant Plan which made available 140,000 warrants for grant to the Company’s initial (organizational) investors for certain risks associated with the establishment of the Bank. The warrants had an exercise price of $10 per share (which approximated the fair value per share of common stock at issuance date) and expired on April 30, 2008. Prior to expiration, warrants to purchase 47,500 shares were exercised resulting in $475,000 in additional capital.

In September and October 2002, the Company completed an offering of units, each of which consisted of one share of its common stock and one warrant to purchase one share of its common stock, through the sale of 817,200 units at a price of $8.50 per unit. Proceeds to the Company from the offering (net of offering expenses of $624,000) were $6,322,000. The share of common stock and warrant that comprised each unit traded together for 45 days after the offering, but subsequently traded separately. The Company also issued 40,860 warrants to the underwriter of the offering. Each warrant entitled the holder to purchase one share of common stock, at a price of $10.20 per share, at any time through September 27, 2007, unless the warrants were cancelled. The warrants could be cancelled after December 31, 2003 by the Company in whole or in part upon 30 days’ written notice if for 20 or more trading days within any period of 30 consecutive trading days, including the last day of the period, the bid price of the stock exceeds $12.75 per share. On April 26, 2006, the Company announced that it would be canceling these warrants effective June 13, 2006 under this provision of the agreement covering the warrants and, on June 13, 2006, the warrants that were not exercised following this announcement were canceled. The exercise of warrants subject to cancellation resulted in the issuance of 672,638 shares of common stock and the addition of $6,860,908 in capital in the second quarter of 2006.

The Company has a stock incentive plan which authorizes the issuance of up to 455,000 shares of common stock (increased from 255,000 shares by amendment to the Incentive Plan approved by the Company’s shareholders at its 2006 annual meeting on May 23, 2006) to assist the Company in recruiting and retaining key personnel. See Note 14 for more information on the stock incentive plan.

Fair values of financial instruments

The fair value information for financial instruments, which is provided below, is based on the requirements of Financial Accounting Standard Board Statement of Financial Accounting Standards

55

No. 107, “Disclosures about Fair Value of Financial Instruments,” and does not represent the aggregate net fair value of the Bank. Much of the information used to determine fair value is subjective and judgmental in nature; therefore, fair value estimates, especially for less marketable securities, may vary. The amounts actually realized or paid upon settlement or maturity could be significantly different. The Bank uses the following methods and assumptions in estimating fair values of financial instruments (See Note 17):

Cash and cash equivalents – The carrying amount of cash and cash equivalents approximates fair value.

Investment securities – The fair value of investment securities held-to-maturity and available-for-sale is estimated based on bid quotations received from independent pricing services. The carrying amount of other investments approximates fair value.

Loans – For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. For all other loans, fair values are calculated by discounting the contractual cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loans, or by using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits – The fair value of deposits with no stated maturity, such as demand, interest checking and money market, and savings accounts, is equal to the amount payable on demand at year-end. The fair value of certificates of deposit is based on the discounted value of contractual cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowings – The fair value of FHLB borrowings is based on the discounted value of contractual cash flows using the rates currently offered for borrowings of similar remaining maturities. The carrying amounts of federal funds purchased approximate their fair values. Other borrowings are short-term in nature and the carrying amounts approximate fair value.

Accrued interest – The carrying amounts of accrued interest receivable and payable approximate fair value.

Off-balance-sheet instruments – The fair value of off-balance-sheet lending commitments is equal to the amount of commitments outstanding at December 31, 2008 of $88,892,000. This is based on the fact that the Bank generally does not offer lending commitments or standby letters of credit to its customers for long periods, and therefore, the underlying rates of the commitments approximate market rates.

New accounting pronouncements

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “Fair Value Measurements”. SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (“GAAP”), and expands disclosures about fair value measurements. While the Statement applies under other accounting pronouncements that require or permit fair value measurements, it does not require any new fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. In addition, the Statement establishes a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Lastly, SFAS 157 requires additional disclosures for each interim and annual period separately for each major category of assets and liabilities. SFAS 157 became effective for the Company on January 1, 2008. See Note 17 of the accompanying notes to the consolidated financial statements for additional

information.

56

In February 2008, the FASB issued FASB Staff Position No. 157-2. The staff position delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The delay is intended to allow additional time to consider the effect of various implementation issues with regard to the application of SFAS 157. The new staff position defers the effective date of SFAS No. 157 to January 1, 2009 for items within the scope of the staff position. The Company is currently evaluating the impact of FASB Staff Position No. 157-2 on the consolidated financial statements.

On October 10, 2008, the FASB issued FSP No. 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“FSP 157-3”). FSP 157-3 clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on the Company’s determination of fair value for its financial assets.

In February 2007, the FASB issued SFAS 159, “The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115”. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board’s long-term measurement objectives for accounting for financial instruments. This Statement became effective for the Company on January 1, 2008. The adoption of SFAS 159 did not have a material impact on the Company’s consolidated financial position or results of operations.

In November 2007, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 109, “Written Loan Commitments Recorded at Fair Value Through Earnings” (“SAB 109”). SAB 109 expresses the current view of the SEC staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply this guidance on a prospective basis to derivative loan commitments issued or modified in the first quarter of 2008 and thereafter. The adoption of this standard did not have a material impact on the Company’s consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations,” (“SFAS 141(R)”) which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company does not expect the adoption of this statement to have a material effect on our results of operations or financial position as of December 31, 2008, however, it will impact the accounting for acquisitions subsequent to the effective date.

In December 2007, the FASB issued SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements-an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting non-

controlling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financials statements and separate from the parent's equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The adoption of this standard is not expected to have any impact on the Company's consolidated financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB statement No. 133". SFAS 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related items are accounted for under Statement 133 and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The new standard is effective for the Company on January 1, 2009. The adoption of this standard is not expected to have any impact on the Company's consolidated financial position or results of operations.

Note 2. Business Combination

On September 30, 2008 the Company acquired River City Bank for approximately $20,720,000. The total consideration included approximately $16,269,000 of common stock, representing approximately 1,441,000 shares, and cash of $3,962,244 paid to stockholders of River City Bank. The transaction requires no future contingent consideration payments. The merger of the Company and River City Bank resulted in a combined company with approximately $572 million in assets and increases the Company's market presence in Henrico County and establishes a presence in Hanover County continuing our goal of expanding our franchise into other counties in the Richmond metropolitan area.

Goodwill of $6.7 million has been recorded in this transaction which will not be amortizable and is not deductible for tax purposes. The Company also recorded $809,318 in core deposits intangibles which will be amortized over eight years using the straight line method.

This acquisition of River City Bank constituted a business combination under SFAS No. 141 "Business Combinations," and was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the respective assets acquired and liabilities assumed based on their estimated fair values on the date of acquisition. The excess of purchase price over the fair value of net assets was recorded as goodwill. The purchase price allocation as of December 31, 2008, is subject to revision in future periods, including adjustments that may be necessary upon the filing of the final tax returns for River City Bank.

The following is the calculation of the purchase price for the River City Bank acquisition.

Purchase price	
Value of common stock issued by VBFC	$ 16,268,596
Cash consideration	3,962,244
Fair value of outstanding stock options	489,481
Transactions costs	806,949
	21,527,271

The following are the assets acquired and liabilities assumed from River City Bank at September 30, 2008 including the fair value adjustments.

	River City Bank	Fair Market Value Adjustments	As Adjusted
Assets aquired:			
Cash and due from banks	$ 2,524,045	$ -	$ 2,524,045
Federal funds sold	326,079	-	326,079
Interest-bearing deposits in banks	1,591,000	-	1,591,000
Investment securities available for sale	22,530,219	(417,152)	22,113,067
Loans	118,893,418	715,409	119,608,827
Premises and equipment, net	1,942,885	-	1,942,885
Accrued interest receivable	703,683	-	703,683
Goodwill	-	6,733,033	6,733,033
Core deposit intangible	-	809,318	809,318
Other assets	874,998	423,491	1,298,489
	$ 149,386,327	$ 8,264,099	$ 157,650,426
Liabilities assumed:			
Deposits	$ 131,219,679	$ 1,007,634	$ 132,227,313
Federal funds purchased	3,146,000	-	3,146,000
Accrued interest payable	604,936	-	604,936
Other liabilities	144,906	-	144,906
Total liabilities	135,115,521	1,007,634	136,123,155
Assets acquired less liabilities assumed	$ 14,270,806	$ 7,256,465	$ 21,527,271

The fair value of certain assts and certain liabilities acquired were based on quoted market prices from reliable market sources. When quoted market prices were not available, the estimated fair values were based upon the best information available, including obtained prices for similar assets and liabilities, and the results using other valuation technologies. The prominent other valuation techniques used were the present value technique and appraisal/third party valuations.

The following are the unaudited pro forma consolidated results of operations of the Company for the years ended December 31, 2008 and 2007 as though River City Bank had been acquired on January 1, 2007:

	2008	2007
Total interest income	$ 35,673,912	$ 33,493,266
Total interest expense	19,758,823	17,984,800
Net interest income	15,915,089	15,508,466
Provision for loan losses	3,430,633	1,752,482
Net interest income after provision for loan losses	12,484,456	13,755,984
Total noninterest income	4,569,844	3,029,936
Total noninterest expense	17,445,828	15,707,388
Income (loss) before income taxes	(391,528)	1,078,532
Income tax expense (1)	(133,120)	366,701
Net income (loss)	$ (258,408)	$ 711,831
Basic earnings per share	$ 0.11	$ 0.27
Diluted earnings per share	$ 0.11	$ 0.27

(1) Tax effects are reflected at an assumed rate of 34%

Note 3. Investment securities available-for-sale

The amortized cost and estimated fair value of investment securities available-for-sale as of December 31, 2008 and 2007 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2008				
U.S. Government agencies	$16,865,586	$ 184,251	$ (4,347)	$17,045,490
Mortgage-backed securities	5,491,571	15,914	(37,981)	5,469,504
Other investments	1,969,943	-	(183,975)	1,785,968
Total	$24,327,100	$ 200,165	$ (226,303)	$24,300,962
December 31, 2007				
U.S. Government agencies	$11,668,925	$ 74,819	$ (5,164)	$11,738,580
Mortgage-backed securities	40,409	518	-	40,927
Other investments	1,967,589	-	(35,697)	1,931,892

Total	$13,676,923	$ 75,337	$ (40,861)	$13,711,399

Investment securities with book values of approximately $12,000,000 and $2,000,000 at December

31, 2008 and 2007, respectively, were pledged to secure municipal deposits.

Investment securities available for sale that have an unrealized loss position at December 31, 2008 and December 31, 2007 are detailed below:

	Securities in a loss Position for less than 12 Months		Securities in a loss Position for more than 12 Months		Total	
December 31, 2008	Fair Value	Unrealized Losses	Fair Value (Loss)	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Investment Securities available for sale						
US Government Agencies	$ 1,350	$ (9)			$ 1,350	$ (9)
Mortgage-backed securities	3,044	(33)			3,044	(33)
Other investments	1,786	(184)	-	-	1,786	(184)
Total	$ 6,180	$ (226)	$ -	$ -	$ 6,180	$ (226)

	Securities in a loss Position for less than 12 Months		Securities in a loss Position for more than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value (Loss)	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2007						
	(In Thousands)					
Investment Securities available for sale						
US Government Agencies	$ 1,577	$ (2)	$ 357	$ (3)	$ 1,934	$ (5)
Mortgage-backed securities					-	-
Other investments	1,932	(37)	-	-	1,932	(37)
Total	$ 3,509	$ (39)	$ 357	$ (3)	$ 3,866	$ (42)

Management does not believe that any individual unrealized loss as of December 31, 2008 is other than a

temporary impairment. These unrealized losses are primarily attributable to changes in interest rates. The

Company has the ability to hold these securities for a time necessary to recover the amortized cost or

until maturity when full repayment would be received.

The amortized cost and estimated fair value of investment securities available-for-sale as of December 31, 2008, by contractual maturity, are as follows:

	Amortized Cost	Estimated Fair Value
Within one year	$ 1,459,569	$ 1,471,136
One to five years	-	-
More than five years	22,867,531	22,829,826
Total	$ 24,327,100	$ 24,300,962

During 2008 and 2007, investment securities available-for-sale totaling $16,336,000 and $22,641,000 respectively, were called or matured with no net losses.

Note 4. Loans

Loans classified by type as of December 31, 2008 and 2007 are as follows:

	2008	2007
Commercial	$ 52,438,487	$ 23,151,755
Real estate - residential	84,611,678	51,281,168
Real estate - commercial	220,399,707	140,175,939
Real estate - construction	103,161,425	106,555,724
Consumer	10,306,885	6,611,243
Total loans	470,918,182	327,775,829
Less: unearned income, net	(195,896)	(432,816)
Less: Allowance for loan losses	(6,059,272)	(3,469,273)
	$464,663,014	$323,873,740

Gross gains on the sale of loans totaling approximately $2,381,000, $1,513,000 and $1,519,000 were realized during the years ended December 31, 2008, 2007 and 2006, respectively.

Forty-three loans totaling $6,197,000 at December 31, 2008 were past due 90 days or more yet interest was still being accrued.

The following is a summary of loans directly or indirectly with executive officers or directors of the Company for the years ended December 31, 2008 and 2007:

	2008	2007
Beginning balance	$ 5,434,997	$ 4,252,125
Additions	10,178,165	5,983,654
Reductions	(5,627,676)	(4,800,782)
Ending balance	$ 9,985,486	$ 5,434,997

Executive officers and directors also had unused credit lines totaling $4,411,000 and $4,012,000 at December 31, 2008 and 2007, respectively. All loans and credit lines to executive officers and directors were made in the ordinary course of business at the Company's normal credit terms, including interest rate and collateralization prevailing at the time for comparable transactions with other persons.

Note 5. Allowance for loan losses

Activity in the allowance for loan losses in 2008, 2007 and 2006 was as follows:

	2008	2007	2006
Beginning balance	$ 3,469,273	$2,552,608	$ 1,930,999
Provision for loan losses	2,005,633	1,187,482	796,006
River City Bank, acquisition	2,403,551	-	-
Charge-offs	(2,242,761)	(271,016)	(255,616)
Recoveries	423,576	199	81,219
Ending balance	$ 6,059,272	$3,469,273	$ 2,552,608

As of December 31, 2008, 2007 and 2006, the Company had impaired loans of $1,369,000, $959,000 and $1,242,000, respectively, which were on nonaccrual status. These loans had valuation allowances of $235,000, $200,000 and $160,000 as of December 31, 2008, 2007 and 2006, respectively. The Company does not record interest income on impaired loans. Interest income that would have been recorded had impaired loans been performing would have been $95,000, $93,000 and $77,000 for 2008, 2007 and 2006, respectively.

Note 6. Premises and equipment

The following is a summary of premises and equipment as of December 31, 2008 and 2007:

	2008	2007
Land	$ 6,318,761	$ 5,930,361
Buildings and improvements	20,747,905	7,492,132
Furniture, fixtures and equipment	4,858,610	3,653,850
Total premises and equipment	31,925,276	17,076,343
Less: Accumulated depreciation and amortization	(3,751,758)	(2,890,138)
	28,173,518	14,186,205
Construction in progress	-	4,975,849
Premises and equipment, net	$ 28,173,518	$ 19,162,054

Depreciation and amortization of premises and equipment for 2008, 2007 and 2006 amounted to $799,000, $673,000 and $478,000 respectively. The decrease in construction in progress was due to the completion of the Company’s headquarters building in July 2008.

Note 7. Investment in Bank Owned Life Insurance

The Bank is owner and designated beneficiary on life insurance policies in the face amount of $15,391,000 covering certain of its directors and executive officers. The earnings from these policies are used to offset expenses related to retirement plans. The cash surrender value of these policies at December 31, 2008 and 2007 was $5,099,000 and $3,991,000, respectively.

63

Note 8. Deposits

Deposits as of December 31, 2008 and 2007 were as follows:

	2008	2007
Demand accounts	$ 34,483,360	$ 23,223,246
Interest checking accounts	17,427,061	10,517,393
Money market accounts	30,002,756	22,060,316
Savings accounts	5,387,828	3,372,986
Time deposits of $100,000 and over	148,172,837	101,986,846
Other time deposits	230,758,201	178,136,471
Total	$ 466,232,043	$ 339,297,258

The following are the scheduled maturities of time deposits as of December 31, 2008:

Year Ending December 31,	Less Than $100,000	Greater than or Equal to $100,000	Total
2009	$ 182,698,580	$ 118,501,913	$ 301,200,493
2010	21,668,765	12,426,915	34,095,680
2011	17,865,039	12,435,740	30,300,779
2012	5,729,264	3,609,950	9,339,214
2013	2,796,553	1,198,319	3,994,872
	$ 230,758,201	$ 148,172,837	$ 378,931,038

Deposits held at the Company by related parties, which include officers, directors, greater than 5% shareholders and companies in which directors of the Board have a significant ownership interest, approximated $2,437,000 and $2,138,000 at December 31, 2007 and 2006, respectively.

Note 9. Borrowings

The Company uses both short-term and long-term borrowings to supplement deposits when they are available at a lower overall cost to the Company or they can be invested at a positive rate of return.

On September 12, 2007, the Company entered into a promissory note payable to Community Bankers' Bank for $11,000,000 bearing interest at thirty day LIBOR plus 2.375% and maturing September 12, 2009. Interest on any outstanding balance is paid monthly with principal due at maturity. Proceeds advanced under the promissory note were used to finance the construction of the Company's new principal administrative

offices in Chesterfield County which was completed in July 2008. On September 24, 2008 the Company obtained a note payable from Virginia Community Bank for $2,250,000 bearing interest at 5% payable quarterly and maturing September 24, 2009.

As a member of the Federal Home Loan Bank of Atlanta, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances from the FHLB. The Company held $1,818,000 in FHLB stock at December 31, 2008 which is held at cost and included in other assets. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. The FHLB borrowings are secured by the pledge of

64

U.S. Government agency securities, FHLB stock and qualified single family first mortgage loans. The FHLB advances held at December 31, 2008 mature $5,000,000 on April 19, 2010, $10,000,000 on June 28, 2010, $5,000,000 on April 11, 2011 and $5,000,000 April 9, 2012.

The Company uses federal funds purchased and repurchase agreements for short-term borrowing needs. Federal funds purchased represent unsecured borrowings from other banks and generally mature daily. Securities sold under agreements to repurchase, which totaled $9,425,000 as of December 31, 2008, are classified as borrowings in accordance with the provisions of FAS 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” and 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.

Information related to borrowings is as follows:

	Year Ended December 31,	
	2008	2007
Maximum outstanding during the year		
FHLB advances	$ 25,000,000	$ 12,000,000
Federal funds purchased	29,405,248	8,803,000
Community Bankers' Bank	6,962,518	2,836,090
Balance outstanding at end of year		
FHLB advances	25,000,000	12,000,000
Virginia Community Bank	2,250,000	-
Community Bankers' Bank	10,021,871	2,836,090
Average amount outstanding during the year		
FHLB advances	20,620,438	7,945,205
Federal funds purchased	2,329,358	814,674
Community Bankers' Bank	6,962,518	260,774
Average interest rate during the year		
FHLB advances	4.04%	4.28%
Federal funds purchased	1.78%	5.46%
Community Bankers' Bank	2.94%	7.54%
Average interest rate at end of year		
FHLB advances	3.41%	3.25%
Federal funds purchased	-	-
Community Bankers' Bank	2.82%	7.60%
Virginia Community Bank	5.05%	-

Note 10. Income taxes

The following summarizes the tax effects of temporary differences which compose net deferred tax assets and liabilities at December 31, 2008, 2007 and 2006:

65

Explanation of Responses:

	2008	2007	2006
Deferred tax assets			
Allowance for loan losses	$ 1,771,460	$ 1,099,684	$ 815,466
Unrealized loss on available-for-sale securities	-	-	10,864
Pension expense	66,279	70,695	75,112
Goodwill	-	6,781	3,864
Total deferred tax assets	1,837,739	1,177,160	905,306
Deferred tax liabilities			
Depreciation	467,219	235,447	216,605
Unrealized gain on available-for-sale securities	94,219	11,722	-
Amortization of intangibles	19,613	-	-
Goodwill	33,857	-	-
Other, net	16,209	15,048	9,830
Total deferred tax liabilities	631,117	262,217	226,435
Net deferred tax asset	$ 1,206,622	$ 914,943	$ 678,871

The income tax expense (benefit) charged to operations for the years ended December 31, 2008, 2007 and 2006 consists of the following:

	2008	2007	2006
Current tax expense	$ 532,776	$ 778,775	$ 932,391
Deferred tax benefit	(291,679)	(263,076)	(229,401)
Provision for income taxes	$ 241,097	$ 515,699	$ 702,990

A reconciliation of income taxes computed at the federal statutory income tax rate to total income taxes is as follows for the years ended December 31, 2008, 2007 and 2006:

Income (loss) before income taxes	$ 709,186	$ 1,516,762	$ 2,102,209
Computed "expected" tax expense	$ 241,123	$ 515,699	$ 714,751
Cash surrender value of life insurance	(36,894)	(28,148)	(17,764)
Nondeductible expenses	19,504	17,580	14,222
Other	17,363	10,568	(8,219)

Provision for income taxes	$ 241,096	$ 515,699	$ 702,990

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded franchise tax expense of $180,000, $210,000 and $122,000 for 2008, 2007 and 2006, respectively.

Note 11. Lease commitments

Certain premises and equipment are leased under various operating leases. Total rent expense charged to operations was $455,000, $406,000 and $348,000 in 2008, 2007 and 2006, respectively. At December 31, 2008, the minimum total rental commitment under such non-cancelable operating leases was as follows:

2009	$ 429,000
2010	423,000
2011	408,000
2012	387,000
2013	394,000
	$ 2,041,000

Note 12. Commitments and contingencies

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the financial statements. The contract amounts of these instruments reflect the extent of involvement that the Company has in particular classes of instruments.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit, and to potential credit loss associated with letters of credit issued, is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for loans and other such on-balance sheet instruments.

At December 31, 2008, the Company had outstanding the following approximate off-balance-sheet financial instruments whose contract amounts represent credit risk:

	Contract Amount
Undisbursed credit lines	$ 70,659,000
Commitments to extend or originate credit	14,109,000
Standby letter of credit	4,124,000
Total commitments to extend credit	$ 88,892,000

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 the payment of a fee. Historically, many

commitments expire without being drawn upon; therefore, the total commitment amounts shown in the above table are not necessarily indicative of future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include personal or income-producing commercial real estate, accounts receivable, inventory and equipment.

Concentrations of credit risk – All of the Company’s loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company’s market area. Although the Company is building a diversified loan portfolio, a substantial portion of its clients’ ability to honor contracts is reliant upon the economic stability of the Richmond, Virginia area, including the real estate markets in the area. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding.

Note 13. Stockholders’ equity and regulatory matters

In September and October 2002, the Company completed an offering of its common stock through the sale of 817,200 shares at a price of $8.50 per share. Proceeds to the Company from the offering (net of offering expenses of $624,000) were $6,322,000. Attached to each share was a warrant to purchase one share of common stock, at a price of $10.20 per share, at any time through September 27, 2007, unless the warrants are cancelled. The warrants may be cancelled after December 31, 2003 by the Company in whole or in part upon 30 days’ written notice if for 20 or more trading days within any period of 30 consecutive trading days, including the last day of the period, the bid price of the stock exceeds $12.75 per share. The Company also issued 40,860 warrants to the underwriter of the offering. On April 26, 2006, the Company announced that it would be cancelling these warrants effective June 13, 2006 under this provision of the agreement covering the warrants and, on June 13, 2006, the warrants that were not exercised following this announcement were canceled. The cancellation of the common stock warrants resulted in the issuance of 672,638 shares of common stock and the addition of $6,860,908 in capital in the second quarter of 2006.

The acquisition of River City Bank was consummated as of October 1, 2008 and resulted in an addition of $5,464,000 of common stock. The company also issued 106,250 shares of common stock to the Company’s largest shareholder for proceeds of $850,000 during the fourth quarter of 2008.

The Organizational Investors Warrant Plan made available 140,000 warrants for grant to the Company’s initial (organizational) investors for certain risks associated with the establishment of the Bank. The warrants have an exercise price of $10 per share (which approximates the fair value per share of common stock at issuance date) and expired on April 30, 2008. Prior to expiration, warrants to purchase 47,000 shares were exercised resulting in $475,000 in additional capital.

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank’s financial statements. Under the capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures are established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 Capital to average assets (the Leverage ratio). Management believes that as of December 31, 2008, the Bank meets all capital adequacy requirements to which it is subject.

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, under capitalized, significantly under capitalized, and critically

68

under capitalized. The Bank meets the criteria to be categorized as an “well capitalized” institution as of December 31, 2008.

The capital amounts and ratios at December 31, 2008 and 2007 for the Company and the Bank are presented in the table below:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2008						
Total capital (to risk-weighted assets)						
Consolidated	$ 53,245,000	10.63%	$ 40,055,000	8.00%	$ 50,069,000	10.00%
Village Bank	49,834,000	10.27%	38,835,000	8.00%	48,544,000	10.00%
Tier 1 capital (to risk-weighted assets)						
Consolidated	47,186,000	9.42%	20,028,000	4.00%	30,041,000	6.00%
Village Bank	43,775,000	9.02%	19,418,000	4.00%	29,126,000	6.00%
Leverage ratio (Tier 1 capital to average assets)						
Consolidated	47,186,000	8.40%	21,959,000	4.00%	27,449,000	5.00%
Village Bank	43,775,000	8.20%	21,344,000	4.00%	26,681,000	5.00%
December 31, 2007						
Total capital (to risk-weighted assets)						
Consolidated	$ 38,296,000	10.13%	$ 30,242,000	8.00%	$ 37,802,000	10.00%
Village Bank	32,940,000	8.90%	29,616,000	8.00%	37,020,000	10.00%
Tier 1 capital (to risk-weighted assets)						
Consolidated	34,827,000	9.21%	15,121,000	4.00%	22,681,000	6.00%
Village Bank	29,471,000	7.96%	14,808,000	4.00%	22,212,000	6.00%
Leverage ratio (Tier 1 capital to average assets)						
Consolidated	34,827,000	9.14%	15,485,000	4.00%	19,357,000	5.00%
Village Bank	29,471,000	7.61%	15,485,000	4.00%	19,357,000	5.00%

In addition, banking regulations limit the amount of cash dividends that may be paid without prior approval of the Bank’s regulatory agencies. Such dividends are limited to the lesser of the Bank’s retained earnings or the net income of the previous two years combined with the current year net income.

Explanation of Responses:

Note 14. Stock incentive plan

SFAS 123 (Revised 2004) requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost is recognized over the period during which an employee is required to provide service in exchange for the award rather than disclosed in the financial statements. During the years ended December 31, 2008, 2007 and 2006 the Company granted 84,325, 1,000 and 16,500 stock options, respectively, resulting in an expense of $489,481, $7,638 and $115,140 in 2008, 2007 and 2006 respectively. The options granted during 2008 are related to the purchase agreement of River City Bank.

The following table summarizes options outstanding under the stock incentive plan at the indicated dates:

	Year Ended December 31,							
	2008				2007			
	Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	247,410	$ 10.26	$ 4.70		251,910	$ 10.22	$ 4.67	
Granted	84,325	10.45	6.11		1,000	13.96	8.04	
Forfeited	(2,250)	11.77	5.29		-	-	-	
Exercised	(59,885)	8.36	4.64	$ 20,923	(5,500)	8.74	4.07	$ 96,246
Options outstanding, end of period	269,600	$ 10.73	$ 5.15	$ -	247,410	$ 10.26	$ 4.70	$ 1,295,438
Options exercisable, end of period	252,100				229,910			

	Year Ended December 31,			
	2006			
	Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value Per Share	Intrinsic Value
Options outstanding,				
beginning of period				
Granted	241,660	$ 9.80	$ 4.47	
Forfeited	16,500	12.50	7.35	
Exercised	(250)	11.77	5.29	
Options outstanding,	(6,000)	8.20	3.93	$ 27,450
end of period				
Options exercisable,	251,910	$ 10.26	$ 4.67	$ 1,002,602
end of period				
	235,410			

The fair value of each option granted is estimated on the date of grant using the Black-Sholes option pricing model with the following assumptions used for grants for the years indicated:

	Year Ended December 31,		
	2008	2007	2006
Risk-free interest rate	2.88%	4.81%	4.99%
Dividend yield	0%	0%	0%
Expected weighted average term	7 years	7 years	7 years
Volatility	50%	50%	50%

The following table summarizes information about stock options outstanding at December 31, 2008:

Options Outstanding

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
$7.68 - $9.24	74,675	2.6	$ 8.53	74,675	$ 8.53
$11.20 - $13.96	194,925	7.5	11.58	177,425	11.46
	269,600	6.12		252,100	10.59

During the first quarter of 2007, the Company granted to certain officers 5,725 restricted shares of common stock and 5,725 performance shares of common stock with a weighted average fair market value of $15.95 at the date of grant. During the second quarter an additional 175 restricted shares of common stock and 175 performance shares of common stock were granted with a weighted average fair market value of $16.75 at the date of grant. These restricted stock awards have three-year graded vesting and the performance shares cliff vest at the end of three years. The number of performance shares that ultimately vest is dependent upon achieving specific performance targets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock and performance share awards was 8,709 and 11,800 at December 31, 2008 and 2007, respectively.

Stock-based compensation expense was $555,367 and $59,735 for the years ended December 31, 2008 and 2007, respectively. The fair value of the stock is calculated under the same methodology as stock options and the expense is recognized over the vesting period. Unamortized stock-based compensation related to nonvested share based compensation arrangements granted under the Incentive Plan as of December 31, 2008 and 2007 was $173,031 and $228,527, respectively. Of the $173,031 of unamortized compensation at December 31, 2008, $91,055 relates to performance based restricted stock awards. The time based unamortized compensation of $81,976 is expected to be recognized over a weighted average period of .93 years. The total fair value of shares vested during the years ended December 31, 2008, 2007 and 2006 was $65,886, $59,735 and $23,007, respectively. There were 350 stock option forfeitures in 2008 and none in either 2007 or 2006.

Note 15. Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled

71

underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate was 4.97% and 7.14% at December 31, 2008 and 2007, respectively. The securities may be redeemed at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. The principal asset of the Trust is $5.2 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly –owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a five year fixed interest rate of 6.29% payable quarterly, converting after five years to a LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.4%) which adjusts and is also payable quarterly. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. The principal asset of the Trust is $3.6 million of the Company's junior subordinated securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust's obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends.

Note 16. Retirement plans

401K Plan: The Bank provides a qualified 401K plan to all eligible employees which is administered through the Virginia Bankers Association Benefits Corporation. Employees are eligible to participate in the plan after three months of employment. Eligible employees may, subject to statutory limitations, contribute a portion of their salary to the plan through payroll deduction. The Bank provides a matching contribution of $.50 for every $1.00 the participant contributes up to the first 4% of their salary. Participants are fully vested in their own contributions and vest equally over three years of service in the Bank's matching contributions. Total contributions to the plan for the years ended December 31, 2008, 2007 and 2006 were $107,918, $98,705 and $76,591, respectively.

Supplemental Executive Retirement Plan: The Bank established the Village Bank Supplemental Executive Retirement Plan (the "SERP") on January 1, 2005 to provide supplemental retirement income to certain executive officers as designated by the Personnel Committee and approved by the Board of Directors. The SERP is an unfunded employee pension plan under the provisions of ERISA. An eligible employee, once designated by the Committee and approved by the Board of Directors in writing to participate in the SERP, becomes a participant in the SERP 60 days following such approval (unless an earlier participation date is approved). There are currently four executive officers who participate in the SERP. The retirement benefit to be received by a participant is determined by the Committee and approved by the Board of Directors and is payable in equal monthly installments over a 15 year period, commencing on the first day of the month following a participant's retirement or termination of employment, provided the participant has been employed by the Bank for a minimum of 10 years (6 years in the case of one participant). The Personnel Committee, in its sole discretion, may choose to treat a participant who has experienced a termination of employment on or after attaining age 65 but prior to completing his service requirement as having completed his service

requirement. The costs associated with this plan are offset by earnings attributable to the Bank's purchase of Bank Owned Life Insurance ("BOLI") on the lives of the participants. At December 31, 2008 and 2007, the Bank's liability under the SERP was $328,880 and $216,421, respectively, and expense for the years ended December 31, 2008, 2007 and 2006 was to $112,459, $166,495 and $30,263, respectively. The increase in cash surrender value of the BOLI related to the participants was $81,101, $62,410 and $35,909 for the years ended December 31, 2008, 2007 and 2006, respectively.

Directors' Deferral Plan: The Bank established the Village Bank Outside Directors Deferral Plan (the "Directors Deferral Plan") on January 1, 2005 under which non-employee Directors of Village Bank have the opportunity to defer receipt of all or a portion of certain compensation until retirement or departure from the Board of Directors. Deferral of compensation under the Directors Deferral Plan is voluntary by non-employee Directors and to participate in the plan a director must file a deferral election as provided in the plan. A Director shall become an active participant with respect to a plan year (as defined in the plan) only if he is expected to have compensation during the plan year and he timely files a deferral election. A separate account is established for each participant in the plan and each account shall, in addition to compensation deferred at the election of the participant, be credited with interest on the balance of the account, the rate of such interest to be established by the Board of Directors in its sole discretion at the beginning of each plan year. The costs associated with this plan are partially offset by earnings attributable to the Bank's purchase of Bank Owned Life Insurance ("BOLI") on the lives of the participants. At December 31, 2008 and 2007, the Bank's liability under the Directors Deferral Plan was $263,472 and $180,913, respectively, and expense for the years ended December 31, 2008, 2007 and 2006 was $82,559, $74,607 and $53,946, respectively. The increase in cash surrender value of the BOLI related to the participants was $27,411, $20,378 and $16,554 for the years ended December 31, 2008, 2007 and 2006, respectively.

Note 17. Fair Value

Effective January 1, 2008, the Company adopted SFAS 157 and SFAS 159. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods to determine the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities are determined by quoted prices for similar assets or liabilities (Level 2).

Explanation of Responses:

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Impaired loans: The fair values of impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans on a nonrecurring basis. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The use of discounted cash flow models and management's best judgment are significant inputs in arriving at the fair value measure of the underlying collateral and are therefore classified within (Level 3).

Assets and liabilities measured at fair value under SFAS No. 157 on a recurring and non-recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

	Fair Value Measurement at December 31, 2008 Using (In Thousands)			
	Carrying Value	Quoted Prices in Active Markets for Indentical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets-Recurring				
Available for sale investment securities (1)	$ 24,301	-	$ 24,301	-
Residential loans held for sale	$ 4,326	-	$ 4,326	-
Financial Assets-Non-Recurring				
Impaired loans (2)	$ 8,528	-	-	$ 8,528

(1) Excludes restricted stock.
(2) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

The following tables present the changes in the Level 3 fair value category for the year ended December 31, 2008.

	Impaired Loans	**Total Assets**
Balance at January 1, 2008	$ 2,585	$ 2,585
Total realized and unrealized gains (losses)		
Included in earnings	-	-
Included in other comprehensive income	-	-
Transfers in and/or out of Level 3	5,943	5,943

Balance at December 31, 2008	$ 8,528	$ 8,528

The fair value information for financial instruments, which is provided below, is based on the

requirements of Financial Accounting Standard Board Statement of Financial Accounting Standards No. 107, “Disclosures about Fair Value of Financial Instruments,” and does not represent the aggregate net fair value of the Bank. Much of the information used to determine fair value is subjective and judgmental in nature; therefore, fair value estimates, especially for less marketable securities, may vary. The amounts actually realized or paid upon settlement or maturity could be significantly different. The Bank uses the following methods and assumptions in estimating fair values of financial instruments:

Cash and cash equivalents – The carrying amount of cash and cash equivalents approximates fair value.

Investment securities – The fair value of investment securities held-to-maturity and available-for-sale is estimated based on bid quotations received from independent pricing services. The carrying amount of other investments approximates fair value.

Loans – For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. For all other loans, fair values are calculated by discounting the contractual cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loans, or by using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits – The fair value of deposits with no stated maturity, such as demand, interest checking and money market, and savings accounts, is equal to the amount payable on demand at year-end. The fair value of certificates of deposit is based on the discounted value of contractual cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowings – The fair value of FHLB borrowings is based on the discounted value of contractual cash flows using the rates currently offered for borrowings of similar remaining maturities. The carrying amounts of federal funds purchased approximate their fair values. Other borrowings are short-term in nature and the carrying amounts approximate fair value.

Accrued interest – The carrying amounts of accrued interest receivable and payable approximate fair value.

Off-balance-sheet instruments – The fair value of off-balance-sheet lending commitments is equal to the amount of commitments outstanding at December 31, 2008 of $88,892,000. This is based on the fact that the Bank generally does not offer lending commitments or standby letters of credit to its customers for long periods, and therefore, the underlying rates of the commitments approximate market rates.

	2008		2007	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 26,612,829	$ 26,612,829	$ 22,115,004	$ 22,115,004
Investment securities available for sale	24,300,962	24,300,962	13,711,399	13,711,399
Loans held for sale	4,325,746	4,325,746	3,489,886	3,489,886
Loans	464,663,014	506,263,603	323,873,740	324,613,316
Accrued interest receivable	3,499,793	3,499,793	2,752,755	2,752,755
Financial liabilities				
Deposits	466,232,043	442,567,544	339,297,258	339,090,535
FHLB borrowings	25,000,000	24,977,639	12,000,000	11,918,833
Trust preferred securities	8,764,000	8,764,000	8,764,000	8,764,000
Other borrowings	23,962,898	23,962,898	3,972,804	3,972,804
Accrued interest payable	1,014,534	1,014,534	587,980	587,980
Off-balance-sheet instruments				
Undisbursed credit lines		70,659,000		80,040,000
Commitments to extend or originate credit		14,109,000		30,195,000
Standby letters of credit		4,124,000		5,413,000

Note 18. Parent corporation only financial statements

Village Bank and Trust Financial Corp.

(Parent Corporation Only)

Balance Sheets
December 31,

	2008	2007
Assets		
Cash and due from banks	$ 721,617	$ 148,772
Receivable from subsidiary	-	411,667
Investment in subsidiaries	51,404,282	30,037,298
Investment in special purpose subsidiary	264,000	264,000
Premises and equipment, net	14,588,892	6,684,405
Prepaid expenses and other assets	1,263,948	1,145,382
	$ 68,242,739	$ 38,691,524
Liabilities and Stockholders' Equity		
Liabilities		
Long-term debt - trust preferred securities	$ 8,764,000	$ 8,764,000
Payable to subsidiary	700,737	-
Other borrowings	12,271,871	2,836,090
Other liabilities	343,557	198,135
Total liabilities	22,080,165	11,798,225
Stockholders' equity		
Preferred stock	-	-
Common stock	16,917,488	10,303,940
Additional paid-in capital	25,737,048	13,726,269
Accumulated other comprehensive income (loss)	54,250	(122,607)
Retained earnings	3,453,788	2,985,697
Total stockholders' equity	46,162,574	26,893,299
	$ 68,242,739	$ 38,691,524

Village Bank and Trust Financial Corp.
(Parent Corporation Only)

Statements of Income
Years Ended December 31,

	2008	2007	2006
Noninterest income			
Rental Income	265,515	-	-
Total noninterest income	265,515	-	-
Expenses			
Interest	$ 708,020	$ 447,381	$ 368,478
Occupancy	232,612	11,700	-
Equipment	7,140	-	-
Advertising and marketing	4,468	-	152
Supplies	52,953	33,850	44,393
Legal	897	15,029	64,741
Other outside services	17,050	6,389	-
Insurance	6,065	-	-
Telephone	44,942	-	-
Other	21,786	-	-
Total expenses	1,095,933	514,349	477,764
Net loss before undistributed equity in subsidiary	(830,418)	(514,349)	(477,764)
Undistributed equity in subsidiary	1,016,165	1,340,533	1,717,213
Income before income taxes	185,747	826,184	1,239,449
Income taxes (benefit)	(282,342)	(174,879)	(159,769)
	$ 468,089	$ 1,001,063	$ 1,399,218

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Statement of Cash Flows
Years Ended December 31,

	2008	2007	2006
Cash Flows from Operating Activities			
Net income	$ 468,089	$ 1,001,063	$ 1,399,218
Adjustments to reconcile net income to net cash			
provided by operating activities			
Depreciation and amortization	9,012	-	-
Undistributed earnings of subsidiary	(1,016,165)	(1,340,533)	(1,717,220)
Increase/decrease in other assets	293,101	1,004,831	(2,285,442)
Increase in other liabilities	1,335,642	(473,426)	546,410
Net cash provided by (used in) operations	1,089,679	191,935	(2,057,034)
Cash Flows from Investing Activities			
Payments for investments in and advances to subsidiaries	(20,108,076)	-	(6,000,000)
Purchase of premises and equipment	(7,913,499)	(6,684,405)	-
Net cash used in operations	(28,021,575)	(6,684,405)	(6,000,000)
Cash Flows from Financing Activities			
Proceeds from issuance of long-term debt	-	3,609,000	-
Proceeds from issuance of common stock	18,068,960	133,234	7,204,194
Net increase in other borrowings	9,435,781	2,836,090	-
Net cash provided by operations	27,504,741	6,578,324	7,204,194
Net increase in cash	572,845	85,854	(852,840)
Cash, beginning of period	148,772	62,918	915,758
Cash, end of period	$ 721,617	$ 148,772	$ 62,918

Note 19. Selected quarterly financial data (unaudited)

Condensed quarterly financial data is shown as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2008				
Interest income	$ 6,758,711	$ 6,869,527	$ 6,725,218	$ 8,718,690
Interest expense	3,973,172	3,681,656	3,628,988	4,685,967
Net interest income before provision for loan losses	2,785,539	3,187,871	3,096,230	4,032,723
Provision for loan losses	249,354	498,024	514,827	743,428
Gain on sale of loans	426,517	608,344	717,830	628,332
Fees and other noninterest income	331,874	373,782	579,737	611,661
Noninterest expenses	3,153,167	3,400,998	3,547,443	4,564,010
Income tax expense	48,078	92,131	112,719	(11,831)
Net income (loss)	93,331	178,844	218,808	(22,891)
Earnings (loss) per share				
Basic	$ 0.04	$ 0.07	$ 0.08	$ (0.01)
Diluted	$ 0.04	$ 0.07	$ 0.08	$ (0.01)
2007				
Interest income	$ 5,644,481	$ 6,202,242	$ 6,798,472	$ 7,020,040
Interest expense	2,917,955	3,251,891	3,731,366	3,905,503
Net interest income before provision for loan losses	2,726,526	2,950,351	3,067,106	3,114,537
Provision for loan losses	208,342	359,937	243,730	375,473
Gain on sale of loans	383,789	388,767	387,680	353,082
Fees and other noninterest income	281,119	295,990	263,989	312,540
Noninterest expenses	2,638,623	3,006,047	3,083,211	3,093,351
Income tax expense	185,120	91,501	133,224	105,854
Net income	359,349	177,623	258,610	205,481
Earnings per share				
Basic	$ 0.14	$ 0.07	$ 0.10	$ 0.08
Diluted	$ 0.13	$ 0.07	$ 0.09	$ 0.08

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Attached as exhibits to this Form 10-K are certifications of the Company’s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This “Controls and Procedures” section includes information concerning the controls and controls evaluation referred to in the certifications.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures pursuant to the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective in recording, processing, summarizing and timely reporting to management information relating to the Company (including its consolidated subsidiaries) required to be included in the Company’s reports that it files or submits under the Exchange Act.

The Company’s management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in the Company’s internal control over financial reporting identified in connection with the evaluation of it that occurred during the Company’s last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Report on Management's Assessment of Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Management regularly monitors its internal control over financial reporting and takes appropriate action to correct any deficiencies that may be identified.

Management assessed the Company's internal control over financial reporting as of December 31, 2008. This assessment was based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2008.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, because of changes in conditions, internal control effectiveness may vary over time.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

/s/ Thomas W. Winfree

President and Chief Executive Officer

/s/ C. Harril Whitehurst, Jr.

Senior Vice President and Chief Financial Officer

March 27, 2009

Date

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required to be disclosed in this Item 10 is contained in the Company's Proxy Statement for the 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required to be disclosed in this Item 11 is contained in the Company's Proxy Statement for the 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

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

The information required to be disclosed in this Item 12 is contained in the Company's Proxy Statement for the 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required to be disclosed in this Item 13 is contained in the Company's Proxy Statement for the 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required to be disclosed in this Item 14 is contained in the Company's Proxy Statement for the 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

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

Report of Independent Registered Public Accounting Firm (BDO Seidman)

Consolidated Balance Sheets – December 31, 2008 and 2007

Consolidated Statements of Income – Years Ended December 31, 2008, 2007 and 2006 Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income – Years

Ended December 31, 2008, 2007 and 2006

Consolidated Statements of Cash Flows – Years Ended December 31, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

All schedules are omitted since they are not required, are not applicable, or the required information is shown in the consolidated 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 Number	Description
2.1	Agreement and Plan of Reorganization and Merger by and among Village Bank and Trust Financial Corp., Village Bank and River City Bank dated as of March 9, 2008 incorporated by reference from Annex A to the joint proxy statement/prospectus included in the Registration Statement on Form S-4/A filed with the Securities and Exchange Commission on August 5, 2008.
3.1	Articles of Incorporation of Village Bank and Trust Financial Corp. restated in electronic format only as of May 18, 2005.

3.2	Bylaws of Village Bank and Trust Financial Corp., incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 10, 2007.
10.1	Incentive Plan, as amended and restated May 23, 2006, incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-QSB for the period ended June 30, 2006. *
10.2	Organizational Investors Warrant Plan, incorporated by reference to Exhibit 10.2 of the Annual Report on Form 10-KSB for the year ended December 31, 2004.
10.3	Shareholder Loan Referral Warrant Plan, incorporated by reference to Exhibit 10.3 of the Annual Report on Form 10-KSB for the year ended December 31, 2004.

10.4	Executive Employment Agreement, effective as of April 1, 2001, between Thomas W. Winfree and Southern Community Bank & Trust, incorporated by reference to Exhibit 10.4 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *
10.5	Form of Incentive Stock Option Agreement, incorporated by reference to Exhibit 10.5 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *
10.6	Form of Non-Employee Director Non-Qualified Stock Option Agreement, incorporated by reference to Exhibit 10.6 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *
21	Subsidiaries of Village Bank and Trust Financial Corp.
31.1	Section 302 Certification by Chief Executive Officer.
31.2	Section 302 Certification by Chief Financial Officer.
32	Section 906 Certification.

____

* Management contracts and compensatory plans and arrangements.

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.

VILLAGE BANK AND TRUST FINANCIAL CORP.

Date: March 27, 2009

By: /s/ Thomas W. Winfree
Thomas W. Winfree
President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Thomas W. Winfree Thomas W. Winfree	President and Chief Executive Officer and Director (Principal Executive Officer)	March 27, 2009
/s/ C. Harril Whitehurst, Jr. C. Harril Whitehurst, Jr.	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 27, 2009
/s/ R. T. Avery, III R.T. Avery, III	Director	March 27, 2009

/s/ Donald J. Balzer, Jr. Donald J. Balzer, Jr.	Director and Vice Chairman of the Board	March 27, 2009
/s/ Craig D. Bell Craig D. Bell	Director and Chairman of the Board	March 27, 2009
/s/ William B. Chandler William B. Chandler	Director	March 27, 2009
/s/ R. Calvert Esleeck, Jr. R. Calvert Esleeck, Jr.	Director	March 27, 2009
/s/ George R. Whittemore George R. Whittemore	Director	March 27, 2009
/s/ Michael L. Toalson Michael L. Toalson	Director	March 27, 2009
/s/ O. Woodland Hogg, Jr. O. Woodland Hogg, Jr.	Director	March 27, 2009

/s/ Michael A. Katzen	Director	March 27, 2009
Michael A. Katzen		
/s/ Charles E. Walton	Director	March 27, 2009
Charles E. Walton		
/s/ John T. Wash, Sr.	Director	March 27, 2009
John T. Wash, Sr.		