FIRST NATIONAL CORP /VA/
Form 10-Q
May 12, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

or

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

For the transition period from __________ to __________

Commission File Number: 0-23976

(Exact name of registrant as specified in its charter)

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

(540) 465-9121

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of May 9, 2014, 4,901,464 shares of common stock, par value $1.25 per share, of the registrant were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements
FIRST NATIONAL CORPORATION

Consolidated Balance Sheets

(in thousands, except per share data)

	(unaudited) March 31, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 7,106	$ 5,767
Interest-bearing deposits in banks	27,017	25,741
Securities available for sale, at fair value	110,561	103,301
Restricted securities, at cost	1,636	1,804
Loans, net of allowance for loan losses, 2014, $10,283; 2013, $10,644	349,250	346,449
Other real estate owned, net of valuation allowance, 2014, $1,686; 2013, $1,665	2,992	3,030
Premises and equipment, net	16,470	16,642
Accrued interest receivable	1,305	1,302
Bank owned life insurance	11,052	10,978
Other assets	7,206	7,876
Total assets	$ 534,595	$ 522,890
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	$ 101,813	$ 92,901
Savings and interest-bearing demand deposits	239,725	234,054
Time deposits	120,151	123,756
Total deposits	$ 461,689	$ 450,711
Other borrowings	6,046	6,052
Trust preferred capital notes	9,279	9,279
Accrued interest and other liabilities	2,614	3,288
Total liabilities	$ 479,628	$ 469,330

Shareholders Equity		
Preferred stock, $1,000 per share liquidation preference; authorized 1,000,000 shares; 14,595 shares issued and outstanding, net of discount	$ 14,595	$ 14,564
Common stock, par value $1.25 per share; authorized 8,000,000 shares; issued and outstanding, 2014 and 2013, 4,901,464 shares	6,127	6,127
Surplus	6,813	6,813
Retained earnings	28,286	27,360
Accumulated other comprehensive loss, net	(854)	(1,304)
Total shareholders equity	$ 54,967	$ 53,560
Total liabilities and shareholders equity	$ 534,595	$ 522,890

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

Three months ended March 31, 2014 and 2013

(in thousands, except per share data)

	(unaudited) March 31, 2014	(unaudited) March 31, 2013
Interest and Dividend Income		
Interest and fees on loans	$ 4,215	$ 4,933
Interest on deposits in banks	16	10
Interest and dividends on securities available for sale:		
Taxable interest	562	372
Tax-exempt interest	95	73
Dividends	21	19
Total interest and dividend income	$ 4,909	$ 5,407
Interest Expense		
Interest on deposits	$ 400	$ 706
Interest on trust preferred capital notes	54	56
Interest on other borrowings	29	29
Total interest expense	$ 483	$ 791
Net interest income	$ 4,426	$ 4,616
Recovery of loan losses	(200)	(250)
Net interest income after recovery of loan losses	$ 4,626	$ 4,866
Noninterest Income		
Service charges on deposit accounts	$ 630	$ 459
ATM and check card fees	335	333
Wealth management fees	484	452
Fees for other customer services	87	88
Net gains on sale of loans		59
Other operating income	80	107

Total noninterest income	$	1,616	$	1,498
Noninterest Expense				
Salaries and employee benefits	$	2,509	$	2,634
Occupancy		315		378
Equipment		304		299
Marketing		109		110
Stationery and supplies		80		75
Legal and professional fees		202		179
ATM and check card fees		163		158
FDIC assessment		172		341
Bank franchise tax		94		68
Other real estate owned, net		31		107
Telecommunications		71		62
Data processing		115		83
Loss on disposal of premises and equipment		2		206
Other operating expense		446		410
Total noninterest expense	$	4,613	$	5,110

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

(Continued)

Three months ended March 31, 2014 and 2013

(in thousands, except per share data)

	(unaudited) March 31, 2014	(unaudited) March 31, 2013
Income before income taxes	$ 1,629	$ 1,254
Income tax expense	483	271
Net income	$ 1,146	$ 983
Effective dividend and accretion on preferred stock	220	226
Net income available to common shareholders	$ 926	$ 757
Earnings per common share, basic and diluted	$ 0.19	$ 0.15

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income

Three months ended March 31, 2014 and 2013

(in thousands)

	(unaudited) March 31, 2014	(unaudited) March 31, 2013
Net income	$ 1,146	$ 983
Other comprehensive income (loss), net of tax,		
Unrealized gains (losses) on available for sale securities	450	(132)
Total comprehensive income	$ 1,596	$ 851

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

Three months ended March 31, 2014 and 2013

(in thousands)

	(unaudited) March 31, 2014	(unaudited) March 31, 2013
Cash Flows from Operating Activities		
Net income	$ 1,146	$ 983
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	248	252
Origination of loans held for sale		(1,799)
Proceeds from sale of loans held for sale		2,361
Net gains on sales of loans held for sale		(59)
Recovery of loan losses	(200)	(250)
Provision for other real estate owned	23	174
Net gains on sale of other real estate owned	(1)	(116)
Losses on disposal of premises and equipment	2	206
Income from bank owned life insurance	(74)	(63)
Accretion of discounts and amortization of premiums on securities, net	160	278
Changes in assets and liabilities:		
(Increase) decrease in interest receivable	(3)	29
Decrease in other assets	437	470
Increase (decrease) in other liabilities	(674)	1,113
Net cash provided by operating activities	$ 1,064	$ 3,579
Cash Flows from Investing Activities		
Proceeds from sales of securities available for sale	$	$ 1,850
Proceeds from maturities, calls, and principal payments of securities available for sale	3,052	7,999
Purchase of securities available for sale	(9,790)	(9,892)
Proceeds from redemption of restricted securities	168	169
Purchase of premises and equipment	(77)	(226)
Proceeds from sale of premises and equipment		3
Proceeds from sale of other real estate owned	16	1,038
Net (increase) decrease in loans	(2,601)	1,121

Net cash provided by (used in) investing activities	$ (9,232)	$ 2,062
Cash Flows from Financing Activities		
Net increase in demand deposits and savings accounts	$ 14,583	$ 8,220
Net decrease in time deposits	(3,605)	(5,157)
Principal payments on other borrowings	(6)	(6)
Cash dividends paid on preferred stock	(189)	(189)
Net cash provided by financing activities	$ 10,783	$ 2,868
Increase in cash and cash equivalents	$ 2,615	$ 8,509
Cash and Cash Equivalents		
Beginning	$ 31,508	$ 31,028
Ending	$ 34,123	$ 39,537

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

(Continued)

Three months ended March 31, 2014 and 2013

(in thousands)

	(unaudited) March 31, 2014	(unaudited) March 31, 2013
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$ 500	$ 813
Supplemental Disclosures of Noncash Investing and Financing Activities		
Unrealized gains (losses) on securities available for sale	$ 682	$ (132)
Transfer from loans to other real estate owned	$	$ 65
Transfer from premises and equipment to other real estate owned	$	$ 224

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Changes in Shareholders Equity

Three months ended March 31, 2014 and 2013

(in thousands)

(unaudited)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2012	$ 14,409	$ 6,127	$ 6,813	$ 18,399	$ (859)	$ 44,889
Net income				983		983
Other comprehensive loss					(132)	(132)
Cash dividends on preferred stock				(189)		(189)
Accretion on preferred stock discount	37			(37)		
Balance, March 31, 2013	$ 14,446	$ 6,127	$ 6,813	$ 19,156	$ (991)	$ 45,551

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

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Notes to Consolidated Financial Statements

(unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of First National Corporation (the Company) and its subsidiaries, including First Bank (the Bank), have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at March 31, 2014 and December 31, 2013, the results of operations and comprehensive income for the three months ended March 31, 2014 and 2013 and the cash flows and changes in shareholders equity for the three months ended March 31, 2014 and 2013. The statements should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the three month period ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

Recent Accounting Pronouncements

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

In January 2014, the FASB issued ASU 2014-04, Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force). The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company does not expect the adoption of ASU 2014-04 to have an impact on its consolidated financial statements.

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(unaudited)

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The amendments in this ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization s operations and financial results and include disposals of a major geographic area, a major line of business, or a major equity method investment. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. Additionally, the new guidance requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-08 to have an impact on its consolidated financial statements.

Note 2. Securities

The Company invests in U.S. agency and mortgage-backed securities, obligations of state and political subdivisions and corporate equity securities. Amortized costs and fair values of securities available for sale at March 31, 2014 and December 31, 2013 were as follows:

	March 31, 2014 *(in thousands)*			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. agency and mortgage-backed securities	$ 89,067	$ 769	$ (1,736)	$ 88,100
Obligations of states and political subdivisions	22,523	397	(466)	22,454
Corporate equity securities	1	6		7
	$ 111,591	$ 1,172	$ (2,202)	$ 110,561

	December 31, 2013 *(in thousands)*			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. agency and mortgage-backed securities	$ 86,365	$ 670	$ (2,138)	$ 84,897
Obligations of states and political subdivisions	18,647	350	(598)	18,399
Corporate equity securities	1	4		5
	$ 105,013	$ 1,024	$ (2,736)	$ 103,301

At March 31, 2014 and December 31, 2013, investments in an unrealized loss position that were temporarily impaired were as follows:

	March 31, 2014 *(in thousands)*					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
U.S. agency and mortgage-backed securities	$ 44,471	$ (1,248)	$ 13,026	$ (488)	$ 57,497	$ (1,736)
Obligations of states and political subdivisions	7,289	(201)	4,294	(265)	11,583	(466)
	$ 51,760	(1,449)	$ 17,320	$ (753)	$ 69,080	$ (2,202)

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Notes to Consolidated Financial Statements

(unaudited)

	December 31, 2013 (in thousands)					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
U.S. agency and mortgage-backed securities	$ 49,810	$ (1,755)	$ 10,180	$ (383)	$ 59,990	$ (2,138)
Obligations of states and political subdivisions	7,165	(422)	2,663	(176)	9,828	(598)
	$ 56,975	$ (2,177)	$ 12,843	$ (559)	$ 69,818	$ (2,736)

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

At March 31, 2014, there were thirty-nine U.S. agency and mortgage-backed securities and twenty-four obligations of state and political subdivisions in an unrealized loss position. One hundred percent of the Company s investment portfolio is considered investment grade. The weighted-average re-pricing term of the portfolio was 4.4 years at March 31, 2014. At December 31, 2013, there were forty U.S. agency and mortgage-backed securities and twenty-one obligations of states and political subdivisions in an unrealized loss position. One hundred percent of the Company s investment portfolio was considered investment grade at December 31, 2013. The weighted-average re-pricing term of the portfolio was 4.5 years at December 31, 2013. The unrealized losses at March 31, 2014 in the U.S. agency and mortgage-backed securities portfolio and the obligation of states and political subdivisions portfolio were related to changes in market interest rates and not credit concerns of the issuers.

Federal Home Loan Bank, Federal Reserve Bank and Community Bankers Bank stock are generally viewed as long-term investments and as restricted securities, which are carried at cost, because there is a minimal market for the stock. Therefore, when evaluating restricted securities for impairment, their value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2014, and no impairment has been recognized. Restricted securities are not part of the available for sale securities portfolio.

The composition of restricted securities at March 31, 2014 and December 31, 2013 was as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Federal Home Loan Bank stock	$ 740	$ 908
Federal Reserve Bank stock	846	846
Community Bankers Bank stock	50	50
	$ 1,636	$ 1,804

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Notes to Consolidated Financial Statements

(unaudited)

Note 3. Loans

Loans at March 31, 2014 and December 31, 2013 are summarized as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Real estate loans:		
Construction and land development	$ 33,876	$ 34,060
Secured by 1-4 family residential	147,541	141,961
Other real estate loans	142,719	145,968
Commercial and industrial loans	23,381	22,803
Consumer and other loans	12,016	12,301
Total loans	$ 359,533	$ 357,093
Allowance for loan losses	(10,283)	(10,644)
Loans, net	$ 349,250	$ 346,449

Net deferred loan fees included in the above loan categories were $38 thousand and $18 thousand at March 31, 2014 and December 31, 2013, respectively. Consumer and other loans included $213 thousand and $279 thousand of demand deposit overdrafts at March 31, 2014 and December 31, 2013, respectively.

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

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

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

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

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

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Notes to Consolidated Financial Statements

(unaudited)

The following table provides a summary of loan classes and an aging of past due loans as of March 31, 2014 and December 31, 2013:

March 31, 2014
(in thousands)

	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual Loans	90 Days or More Past Due and Accruing
Real estate loans:								
Construction and land development	$ 1,233	$ 186	$ 3,269	$ 4,688	$ 29,188	$ 33,876	$ 5,676	$
1-4 family residential	2,329	403	259	2,991	144,550	147,541	1,186	34
Other real estate loans	1,913	1,532	377	3,822	138,897	142,719	4,675	77
Commercial and industrial	169	149		318	23,063	23,381	159	
Consumer and other loans	12	1		13	12,003	12,016		
Total	$ 5,656	$ 2,271	$ 3,905	$ 11,832	$ 347,701	$ 359,533	$ 11,696	$ 111

December 31, 2013
(in thousands)

30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual Loans	90 Days or More Past Due and Accruing

Real estate loans:								
Construction and land development	$ 161	$ 2,852	$ 3,339	$ 6,352	$ 27,708	$ 34,060	$ 5,811	$
1-4 family residential	1,561	316	136	2,013	139,948	141,961	953	27
Other real estate loans	1,077	1,636	74	2,787	143,181	145,968	4,756	
Commercial and industrial	165		22	187	22,616	22,803	144	22
Consumer and other loans	41	5		46	12,255	12,301	14	
Total	$ 3,005	$ 4,809	$ 3,571	$ 11,385	$ 345,708	$ 357,093	$ 11,678	$ 49

Credit Quality Indicators

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

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

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

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Notes to Consolidated Financial Statements

(unaudited)

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

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

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

The following tables provide an analysis of the credit risk profile of each loan class as of March 31, 2014 and December 31, 2013:

	March 31, 2014 *(in thousands)*				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	$ 20,371	$ 3,620	$ 9,885	$	$ 33,876
Secured by 1-4 family residential	135,686	5,393	6,462		147,541
Other real estate loans	114,659	11,367	16,693		142,719
Commercial and industrial	22,620	226	535		23,381
Consumer and other loans	12,016				12,016
Total	$ 305,352	$ 20,606	$ 33,575	$	$ 359,533

	December 31, 2013 *(in thousands)*				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					

Construction and land development	$ 19,724	$ 3,500	$ 10,836	$	$ 34,060
Secured by 1-4 family residential	130,048	5,378	6,535		141,961
Other real estate loans	118,663	10,227	17,078		145,968
Commercial and industrial	21,563	555	685		22,803
Consumer and other loans	12,287		14		12,301
Total	$ 302,285	$ 19,660	$ 35,148	$	$ 357,093

Note 4. Allowance for Loan Losses

Transactions in the allowance for loan losses for the three months ended March 31, 2014 and 2013 and for the year ended December 31, 2013 were as follows:

	March 31, 2014	December 31, 2013	March 31, 2013
		(in thousands)	
Balance at beginning of year	$ 10,644	$ 13,075	$ 13,075
Recovery of loan losses	(200)	(425)	(250)
Loan recoveries	78	2,486	209
Loan charge-offs	(239)	(4,492)	(278)
Balance at end of period	$ 10,283	$ 10,644	$ 12,756

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Notes to Consolidated Financial Statements

(unaudited)

The following tables present, as of March 31, 2014, December 31, 2013 and March 31, 2013, the total allowance for loan losses, the allowance by impairment methodology and loans by impairment methodology.

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

December 31, 2013

(in thousands)

	Construction and Land Development	Secured by 1-4 Family Residential	Other Real Estate	Commercial and Industrial	Consumer and Other Loans	Total
Allowance for loan losses:						
Beginning Balance, December 31, 2012	$ 2,481	$ 3,712	$ 6,163	$ 608	$ 111	$ 13,075
Charge-offs	(2,962)	(260)	(1,070)	(37)	(163)	(4,492)
Recoveries		823	1,304	179	180	2,486
Provision for (recovery of) loan losses	3,191	(1,300)	(1,979)	(308)	(29)	(425)
Ending Balance, December 31, 2013	$ 2,710	$ 2,975	$ 4,418	$ 442	$ 99	$ 10,644
Ending Balance:						
Individually evaluated for impairment	882	190	263	44		1,379
Collectively evaluated for impairment	1,828	2,785	4,155	398	99	9,265
Loans:						
Ending Balance	34,060	141,961	145,968	22,803	12,301	357,093
Individually evaluated for impairment	6,862	3,431	11,143	258		21,694
Collectively evaluated for impairment	27,198	138,530	134,825	22,545	12,301	335,399

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	March 31, 2013 *(in thousands)*					
	Construction and Land Development	Secured by 1-4 Family Residential	Other Real Estate	Commercial and Industrial	Consumer and Other Loans	Total
Allowance for loan losses:						
Beginning Balance, December 31, 2012	$ 2,481	$ 3,712	$ 6,163	$ 608	$ 111	$ 13,075
Charge-offs		(149)	(82)		(47)	(278)
Recoveries		2	7	139	61	209
Provision for (recovery of) loan losses	(84)	134	(263)	(4)	(33)	(250)
Ending Balance, March 31, 2013	$ 2,397	$ 3,699	$ 5,825	$ 743	$ 92	$ 12,756
Ending Balance:						
Individually evaluated for impairment	604	156	903	261		1,924
Collectively evaluated for impairment	1,793	3,543	4,922	482	92	10,832
Loans:						
Ending Balance	45,783	143,765	162,742	22,743	7,306	382,339
Individually evaluated for impairment	6,098	2,959	7,654	2,509		19,220
Collectively evaluated for impairment	39,685	140,806	155,088	20,234	7,306	363,119

Impaired loans and the related allowance at March 31, 2014, December 31, 2013 and March 31, 2013, were as follows:

March 31, 2014
(in thousands)

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

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	December 31, 2013 (in thousands)						
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real estate loans:							
Construction and land development	$ 9,086	$ 4,259	$ 2,603	$ 6,862	$ 882	$ 5,397	$ 204
Secured by 1-4 family	4,341	2,515	916	3,431	190	2,864	146
Other real estate loans	12,385	9,455	1,688	11,143	263	7,079	441
Commercial and industrial	260	114	144	258	44	669	14
Consumer and other loans							
Total	$ 26,072	$ 16,343	$ 5,351	$ 21,694	$ 1,379	$ 16,009	$ 805

	March 31, 2013 *(in thousands)*						
	Unpaid Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Real estate loans:							
Construction and land development	$ 6,441	$ 4,988	$ 1,110	$ 6,098	$ 604	$ 4,244	$ 16
Secured by 1-4 family	3,898	1,024	1,935	2,959	156	4,116	23
Other real estate loans	9,443	1,645	6,009	7,654	903	9,151	70
Commercial and industrial	2,510		2,509	2,509	261	185	27
Consumer and other loans							
Total	$ 22,292	$ 7,657	$ 11,563	$ 19,220	$ 1,924	$ 17,696	$ 136

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

As of March 31, 2014, loans classified as troubled debt restructurings (TDRs) and included in impaired loans in the disclosure above totaled $2.2 million. At March 31, 2014, $986 thousand of the loans classified as TDRs were performing under the restructured terms and were not considered non-performing assets. There were $1.9 million in TDRs at December 31, 2013, $829 thousand of which were performing under the restructured terms. Modified terms under TDRs may include rate reductions, extension of terms that are considered to be below market, conversion to interest only, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. There was one new other real estate loan modified under a TDR during the three month period ended March 31, 2014. The recorded investment for this loan prior to the modification totaled $283 thousand and the recorded investment after the modification totaled $344 thousand. There were no loans modified under TDRs during the three month period ended March 31, 2013.

For the three months ended March 31, 2014 and 2013, there were no troubled debt restructurings that subsequently defaulted within twelve months of the loan modification. Management defines default as over ninety days past due during the twelve month period subsequent to the modification.

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Note 5. Other Real Estate Owned (OREO)

At March 31, 2014 and December 31, 2013, OREO totaled $3.0 million. OREO is primarily comprised of residential lots, raw land, non-residential properties and residential properties, and are located primarily in the Commonwealth of Virginia. Changes in the balance for OREO are as follows:

	For the three months ended March 31, 2014	For the year ended December 31, 2013
	(in thousands)	
Balance at the beginning of year, gross	$ 4,695	$ 7,764
Transfers in		2,036
Charge-offs	(2)	(1,564)
Sales proceeds	(16)	(3,618)
Gain on disposition	1	80
Depreciation		(3)
Balance at the end of period, gross	$ 4,678	$ 4,695
Less: valuation allowance	(1,686)	(1,665)
Balance at the end of period, net	$ 2,992	$ 3,030

Changes in the allowance for OREO losses are as follows:

	For the three months ended		For the year ended
	March 31, 2014	March 31, 2013	December 31, 2013
		(in thousands)	
Balance at beginning of year	$ 1,665	$ 2,174	$ 2,174
Provision for losses	23	174	1,055
Transfer in		63	
Charge-offs, net	(2)	(191)	(1,564)

Balance at end of period	$ 1,686	$ 2,220	$ 1,665

Net expenses applicable to OREO, other than the provision for losses, were $9 thousand and $49 thousand for the three months ended March 31, 2014 and 2013, respectively and $150 thousand for the year ended December 31, 2013.

Note 6. Other Borrowings

The Bank had unused lines of credit totaling $110.5 million and $108.4 million available with non-affiliated banks at March 31, 2014 and December 31, 2013, respectively. This amount primarily consists of a blanket floating lien agreement with the Federal Home Loan Bank of Atlanta (FHLB) under which the Bank can borrow up to 19% of its total assets. The unused line of credit with FHLB totaled $70.5 million at March 31, 2014.

At March 31, 2014 and December 31, 2013, the Bank had borrowings from the FHLB system totaling $6.0 million which mature through December 28, 2018. The interest rate on these notes payable ranged from 1.78% to 2.04% and the weighted average rate was 1.91%. The Bank also had a letter of credit from the FHLB totaling $25.0 million at March 31, 2014 and December 31, 2013. The Bank had collateral pledged on these borrowings and letter of credit at March 31, 2014 and December 31, 2013 including real estate loans totaling $71.3 million and $78.6 million, respectively, and Federal Home Loan Bank stock with a book value of $740 thousand and $908 thousand, respectively.

At March 31, 2014 and December 31, 2013, the Bank had a note payable totaling $46 and $52 thousand, respectively, secured by a deed of trust, which requires monthly payments of $2 thousand and matures January 3, 2016. The fixed interest rate on this loan is 4.00%.

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Note 7. Capital Requirements

A comparison of the capital of the Company and the Bank at March 31, 2014 and December 31, 2013 with the minimum regulatory guidelines were as follows:

	Actual		*(dollars in thousands)* Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2014:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$ 67,687	18.49%	$ 29,285	8.00%	N/A	N/A
First Bank	$ 63,041	16.99%	$ 29,253	8.00%	$ 36,566	10.00%
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	$ 63,041	17.22%	$ 14,643	4.00%	N/A	N/A
First Bank	$ 57,470	15.72%	$ 14,626	4.00%	$ 21,939	6.00%
Tier 1 Capital (to Average Assets):						
Consolidated	$ 63,041	12.05%	$ 20,931	4.00%	N/A	N/A
First Bank	$ 57,470	10.99%	$ 20,917	4.00%	$ 26,146	5.00%
December 31, 2013:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$ 66,437	18.21%	$ 29,193	8.00%	N/A	N/A
First Bank	$ 60,578	16.62%	$ 29,160	8.00%	$ 36,450	10.00%
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	$ 61,800	16.94%	$ 14,597	4.00%	N/A	N/A
First Bank	$ 55,947	15.35%	$ 14,580	4.00%	$ 21,870	6.00%
Tier 1 Capital (to Average Assets):						
Consolidated	$ 61,800	11.75%	$ 21,047	4.00%	N/A	N/A
First Bank	$ 55,947	10.68%	$ 20,948	4.00%	$ 26,184	5.00%

Note 8. Trust Preferred Capital Notes

On June 8, 2004, First National (VA) Statutory Trust II (Trust II), a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable capital securities, commonly known as trust preferred securities. On

June 17, 2004, $5.0 million of trust preferred securities were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest. The interest rate at March 31, 2014 and December 31, 2013 was 2.83% and 2.84%, respectively. The securities have a mandatory redemption date of June 17, 2034, and were subject to varying call provisions that began September 17, 2009. The principal asset of Trust II is $5.2 million of the Company s junior subordinated debt securities with maturities and interest rates comparable to the trust preferred securities. The Trust s obligations under the trust preferred securities are fully and unconditionally guaranteed by the Company. The Company is current on its interest payments on the trust preferred securities.

On July 24, 2006, First National (VA) Statutory Trust III (Trust III), a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable capital securities. On July 31, 2006, $4.0 million of trust preferred securities were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest. The interest rate at March 31, 2014 and December 31, 2013 was 1.85%. The securities have a mandatory redemption date of October 1, 2036, and were subject to varying call provisions that began October 1, 2011. The principal asset of Trust III is $4.1 million of the Company s junior subordinated debt securities with maturities and interest rates comparable to the trust preferred securities. The Trust s obligations under the trust preferred securities are fully and unconditionally guaranteed by the Company. The Company is current on its interest payments on the trust preferred securities.

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While these securities are debt obligations of the Company, they are included in capital for regulatory capital ratio calculations. Under present regulations, the trust preferred securities may be included in Tier 1 capital for regulatory capital adequacy purposes as long as their amount does not exceed 25% of Tier 1 capital, including total trust preferred securities. The portion of the trust preferred securities not considered as Tier 1 capital, if any, may be included in Tier 2 capital. At March 31, 2014 and December 31, 2013, the total amount of trust preferred securities issued by the Trusts was included in the Company s Tier 1 capital.

Note 9. Benefit Plans

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

Components of the net periodic benefit cost of the plan for the three months ended March 31, 2014 and 2013 were as follows:

	For the three months ended March 31,	
	2014	2013
	(in thousands)	
Service cost	$ 87	$ 118
Interest cost	67	70
Expected return on plan assets	(79)	(76)
Amortization of net loss		27
Net periodic benefit cost	$ 75	$ 139

The Company previously disclosed in its consolidated financial statements in its Annual Report on Form 10-K for the year ended December 31, 2013, that it expected to make no contribution to its pension plan during the year ended December 31, 2014. There was no minimum annual contribution required.

In addition to the defined benefit pension plan, the Company maintains a 401(k) plan and an employee stock ownership plan (ESOP) for eligible employees. See Note 11 of the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013 for additional information about the Company s benefit plans.

Note 10. Earnings per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. There are no potential common shares that would have a dilutive effect. The average number of common shares outstanding used to calculate basic and diluted earnings per common share were 4,901,464 for the three months ended March 31, 2014 and 2013, respectively.

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Note 11. Fair Value Measurements

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

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

Fair Value Hierarchy

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

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

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

Level 3

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

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

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a recurring basis in the financial statements:

Securities available for sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

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The following tables present the balances of assets measured at fair value on a recurring basis as of March 31, 2014 and December 31, 2013.

		Fair Value Measurements at March 31, 2014 *(in thousands)*		
Description	Balance as of March 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available for sale				
U.S. agency and mortgage-backed securities	$ 88,100	$	$ 88,100	$
Obligations of states and political subdivisions	22,454		22,454	
Corporate equity securities	7	7		
	$ 110,561	$ 7	$ 110,554	$

		Fair Value Measurements at December 31, 2013 *(in thousands)*		
Description	Balance as of December 31, 2013	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

				(Level 1)				
Assets								
Securities available for sale								
U.S. agency and mortgage-backed securities	$	84,897	$		$	84,897	$	
Obligations of states and political subdivisions		18,399				18,399		
Corporate equity securities		5		5				
	$	103,301	$	5	$	103,296	$	

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

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The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans

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

Other real estate owned

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

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

		Fair Value Measurements at March 31, 2014 *(in thousands)*		
Description	Balance as of March 31, 2014	Quoted Prices in	Significant Other Observable	Significant Unobservable Inputs

		Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	(Level 3)
Assets				
Impaired loans, net	$ 3,598	$	$	$ 3,598
Other real estate owned, net	2,992			2,992

		Fair Value Measurements at December 31, 2013 *(in thousands)*		
Description	Balance as of December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans, net	$ 3,972	$	$	$ 3,972
Other real estate owned, net	3,030			3,030

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Quantitative information about Level 3 Fair Value Measurements for March 31, 2014
(dollars in thousands)

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted-Average)
Assets				
Impaired loans	$ 3,598	Property appraisals	Selling cost	10%
			Discount for lack of marketability and age of appraisal	0-41% (8%)
Other real estate owned	$ 2,992	Property appraisals	Selling cost	7%

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

Cash and Cash Equivalents and Federal Funds Sold

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

Restricted Securities

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

Loans

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

Deposit Liabilities

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Borrowings

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

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Bank Owned Life Insurance

The carrying amounts of bank owned life insurance approximate fair value.

Commitments and Unfunded Credits

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

The fair value of stand-by letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At March 31, 2014 and December 31, 2013, fair value of loan commitments and standby letters of credit was immaterial.

The carrying values and estimated fair values of the Company s financial instruments at March 31, 2014 and December 31, 2013 are as follows:

		(in thousands) Fair Value Measurements at March 31, 2014 Using			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Fair Value
Financial Assets					
Cash and short-term investments	$ 34,123	$ 34,123	$	$	$ 34,123
Securities	110,561	7	110,554		110,561
Restricted securities	1,636		1,636		1,636
Loans, net	349,250			356,181	356,181
Bank owned life insurance	11,052		11,052		11,052
Accrued interest receivable	1,305		1,305		1,305
Financial Liabilities					

Deposits	$ 461,689	$	$ 341,538	$ 120,569	$ 462,107
Other borrowings	6,046			6,103	6,103
Trust preferred capital notes	9,279			10,251	10,251