FIRST NATIONAL CORP /VA/
Form 10-Q
August 14, 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 June 30, 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	**54-1232965**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
112 West King Street, Strasburg, Virginia	**22657**
(Address of principal executive offices)	**(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 August 14, 2014, 4,902,582 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) June 30, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 6,587	$ 5,767
Interest-bearing deposits in banks	12,735	25,741
Securities available for sale, at fair value	108,884	103,301
Restricted securities, at cost	1,636	1,804
Loans, net of allowance for loan losses, 2014, $10,006; 2013, $10,644	357,484	346,449
Other real estate owned, net of valuation allowance, 2014, $1,588; 2013, $1,665	2,221	3,030
Premises and equipment, net	16,305	16,642
Accrued interest receivable	1,258	1,302
Bank owned life insurance	11,141	10,978
Other assets	7,072	7,876
Total assets	$ 525,323	$ 522,890
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	$ 99,396	$ 92,901
Savings and interest-bearing demand deposits	235,929	234,054
Time deposits	115,873	123,756
Total deposits	$ 451,198	$ 450,711
Other borrowings	6,039	6,052
Trust preferred capital notes	9,279	9,279
Accrued interest and other liabilities	2,151	3,288
Total liabilities	$ 468,667	$ 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, 4,902,582 shares; 2013, 4,901,464 shares		6,128		6,127
Surplus		6,821		6,813
Retained earnings		29,516		27,360
Accumulated other comprehensive loss, net		(404)		(1,304)
Total shareholders equity	$	56,656	$	53,560
Total liabilities and shareholders equity	$	525,323	$	522,890

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

Three months ended June 30, 2014 and 2013

(in thousands, except per share data)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Interest and Dividend Income		
Interest and fees on loans	$ 4,403	$ 4,816
Interest on deposits in banks	14	17
Interest and dividends on securities available for sale:		
Taxable interest	562	443
Tax-exempt interest	95	76
Dividends	21	19
Total interest and dividend income	$ 5,095	$ 5,371
Interest Expense		
Interest on deposits	$ 372	$ 632
Interest on trust preferred capital notes	54	55
Interest on other borrowings	30	30
Total interest expense	$ 456	$ 717
Net interest income	$ 4,639	$ 4,654
Provision for (recovery of) loan losses	(400)	2,500
Net interest income after provision for (recovery of) loan losses	$ 5,039	$ 2,154
Noninterest Income		
Service charges on deposit accounts	$ 643	$ 464
ATM and check card fees	365	365
Wealth management fees	472	375
Fees for other customer services	126	128
Net gains on sale of loans		65
Net gains on sale of securities available for sale	22	

Other operating income		97		640
Total noninterest income	$	1,725	$	2,037
Noninterest Expense				
Salaries and employee benefits	$	2,554	$	2,443
Occupancy		278		296
Equipment		295		288
Marketing		126		113
Stationery and supplies		94		81
Legal and professional fees		247		219
ATM and check card fees		163		168
FDIC assessment		122		180
Bank franchise tax		105		70
Other real estate owned, net		(70)		376
Telecommunications		73		78
Data processing		134		95
Loss on disposal of premises and equipment				3
Other operating expense		427		350
Total noninterest expense	$	4,548	$	4,760

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

(Continued)

Three months ended June 30, 2014 and 2013

(in thousands, except per share data)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Income (loss) before income taxes	$ 2,216	$ (569)
Income tax expense (benefit)	674	(830)
Net income	$ 1,542	$ 261
Effective dividend and accretion on preferred stock	261	230
Net income available to common shareholders	$ 1,281	$ 31
Earnings per common share, basic and diluted	$ 0.26	$ 0.01

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

Six months ended June 30, 2014 and 2013

(in thousands, except per share data)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Interest and Dividend Income		
Interest and fees on loans	$ 8,618	$ 9,749
Interest on deposits in banks	30	27
Interest and dividends on securities available for sale:		
Taxable interest	1,124	815
Tax-exempt interest	190	149
Dividends	42	38
Total interest and dividend income	$ 10,004	$ 10,778
Interest Expense		
Interest on deposits	$ 772	$ 1,338
Interest on trust preferred capital notes	108	111
Interest on other borrowings	59	59
Total interest expense	$ 939	$ 1,508
Net interest income	$ 9,065	$ 9,270
Provision for (recovery of) loan losses	(600)	2,250
Net interest income after provision for (recovery of) loan losses	$ 9,665	$ 7,020
Noninterest Income		
Service charges on deposit accounts	$ 1,273	$ 923
ATM and check card fees	700	698
Wealth management fees	956	827
Fees for other customer services	213	216
Net gains on sale of loans		124
Net gains on sale of securities available for sale	22	

Other operating income		177		747
Total noninterest income	$	3,341	$	3,535
Noninterest Expense				
Salaries and employee benefits	$	5,063	$	5,077
Occupancy		593		674
Equipment		599		587
Marketing		235		223
Stationery and supplies		174		156
Legal and professional fees		449		398
ATM and check card fees		326		326
FDIC assessment		294		521
Bank franchise tax		199		138
Other real estate owned, net		(39)		483
Telecommunications		144		140
Data processing		249		178
Loss on disposal of premises and equipment		2		3
Loss on land lease termination				206
Other operating expense		873		760
Total noninterest expense	$	9,161	$	9,870

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

(Continued)

Six months ended June 30, 2014 and 2013

(in thousands, except per share data)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Income before income taxes	$ 3,845	$ 685
Income tax expense (benefit)	1,157	(559)
Net income	$ 2,688	$ 1,244
Effective dividend and accretion on preferred stock	481	455
Net income available to common shareholders	$ 2,207	$ 789
Earnings per common share, basic and diluted	$ 0.45	$ 0.16

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FIRST NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income (Loss)

Three months ended June 30, 2014 and 2013

(in thousands)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Net income	$ 1,542	$ 261
Other comprehensive income (loss), net of tax,		
Unrealized holding gains (losses) on available for sale securities, net of tax $239 and $0, respectively	465	(2,561)
Reclassification adjustment for gains included in net income, net of tax ($7) and $0, respectively	(15)	
Total other comprehensive income (loss)	450	(2,561)
Total comprehensive income (loss)	$ 1,992	$ (2,300)

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FIRST NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income (Loss)

Six months ended June 30, 2014 and 2013

(in thousands)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Net income	$ 2,688	$ 1,244
Other comprehensive income (loss), net of tax,		
Unrealized holding gains (losses) on available for sale securities, net of tax $471 and $0, respectively	915	(2,693)
Reclassification adjustment for gains included in net income, net of tax ($7) and $0, respectively	(15)	
Total other comprehensive income (loss)	900	(2,693)
Total comprehensive income (loss)	$ 3,588	$ (1,449)

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

Six months ended June 30, 2014 and 2013

(in thousands)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Cash Flows from Operating Activities		
Net income	$ 2,688	$ 1,244
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	494	492
Origination of loans held for sale		(2,567)
Proceeds from sale of loans held for sale		3,194
Net gains on sales of loans held for sale		(124)
Provision for (recovery of) loan losses	(600)	2,250
Provision for other real estate owned	86	448
Net gains on sale of securities available for sale	(22)	
Net gains on sale of other real estate owned	(160)	(64)
Losses on disposal of premises and equipment	2	3
Income from bank owned life insurance	(163)	(130)
Accretion of discounts and amortization of premiums on securities, net	322	504
Changes in assets and liabilities:		
Decrease in interest receivable	44	34
(Increase) decrease in other assets	342	(766)
Increase (decrease) in other liabilities	(1,137)	841
Net cash provided by operating activities	$ 1,896	$ 5,359
Cash Flows from Investing Activities		
Proceeds from sales of securities available for sale	$ 3,453	$ 1,850
Proceeds from maturities, calls, and principal payments of securities available for sale	6,247	13,461
Purchase of securities available for sale	(14,219)	(34,216)
Proceeds from redemption of restricted securities	168	169
Purchase of premises and equipment	(160)	(122)
Proceeds from sale of other real estate owned	1,021	1,927
Net (increase) decrease in loans	(10,574)	3,043

Net cash used in investing activities	$	(14,064)	$	(13,888)
Cash Flows from Financing Activities				
Net increase in demand deposits and savings accounts	$	8,370	$	17,990
Net decrease in time deposits		(7,883)		(8,949)
Principal payments on other borrowings		(13)		(12)
Cash dividends paid on preferred stock		(379)		(379)
Cash dividends paid on common stock, net of reinvestment		(113)		
Net cash provided by (used in) financing activities	$	(18)	$	8,650
Increase (decrease) in cash and cash equivalents	$	(12,186)	$	121
Cash and Cash Equivalents				
Beginning	$	31,508	$	31,028
Ending	$	19,322	$	31,149

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

(Continued)

Six months ended June 30, 2014 and 2013

(in thousands, except per share data)

	(unaudited) June 30, 2014	(unaudited) June 30, 2013
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$ 965	$ 1,540
Income Taxes	$ 321	$ 310
Supplemental Disclosures of Noncash Investing and Financing Activities		
Unrealized gains (losses) on securities available for sale	$ 1,364	$ (2,693)
Transfer from loans to other real estate owned	$ 139	$ 191
Transfer from premises and equipment to other real estate owned	$	$ 224
Transfer from other assets to other real estate owned	$	$ 452
Issuance of common stock, dividend reinvestment plan	$ 9	$

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FIRST NATIONAL CORPORATION

Consolidated Statements of Changes in Shareholders Equity

Six months ended June 30, 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				1,244		1,244
Other comprehensive loss					(2,693)	(2,693)
Cash dividends on preferred stock				(379)		(379)
Accretion of preferred stock discount	76			(76)		
Balance, June 30, 2013	$ 14,485	$ 6,127	$ 6,813	$ 19,188	$ (3,552)	$ 43,061

	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				2,688		2,688
Other comprehensive income					900	900
Cash dividends on common stock ($0.025 per share)				(122)		(122)
Issuance of 1,118 shares common stock, dividend reinvestment plan		1	8			9
Cash dividends on preferred stock				(379)		(379)
Accretion of preferred stock discount	31			(31)		

Balance, June 30, 2014	$ 14,595	$ 6,128	$ 6,821	$ 29,516	$ (404)	$ 56,656

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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 June 30, 2014 and December 31, 2013, the results of operations and comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013 and the cash flows and changes in shareholders equity for the six months ended June 30, 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 and six month periods ended June 30, 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 a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606 . This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, Revenue Recognition , most industry-specific guidance, and some cost guidance included in Subtopic 605-35, Revenue Recognition Construction-Type and Production-Type Contracts . The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures . This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The Company does not expect the adoption of ASU 2014-11 to have an impact on its consolidated financial statements.

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In June 2014, the FASB issued ASU No. 2014-12, Compensation Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period . The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in Compensation Stock Compensation (Topic 718) , should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company is currently assessing the impact that ASU 2014-12 will have 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 June 30, 2014 and December 31, 2013 were as follows (in thousands):

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
U.S. agency and mortgage-backed securities	$ 87,515	$ 961	$ (1,410)	$ 87,066
Obligations of states and political subdivisions	21,716	374	(278)	21,812
Corporate equity securities	1	5		6
	$ 109,232	$ 1,340	$ (1,688)	$ 108,884

	December 31, 2013			
	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 June 30, 2014 and December 31, 2013, investments in an unrealized loss position that were temporarily impaired were as follows (in thousands):

	June 30, 2014					
	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	$ 16,702	$ (255)	$ 36,372	$ (1,155)	$ 53,074	$ (1,410)
Obligations of states and political subdivisions	2,795	(21)	6,999	(257)	9,794	(278)
	$ 19,497	$ (276)	$ 43,371	$ (1,412)	$ 62,868	$ (1,688)

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Notes to Consolidated Financial Statements

(unaudited)

	December 31, 2013					
	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 June 30, 2014, there were thirty-three U.S. agency and mortgage-backed securities and eighteen 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 4.2 years at June 30, 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 June 30, 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 June 30, 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 June 30, 2014 and December 31, 2013 was as follows (in thousands):

	June 30, 2014	December 31, 2013
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 June 30, 2014 and December 31, 2013 are summarized as follows (in thousands):

	June 30, 2014	December 31, 2013
Real estate loans:		
Construction and land development	$ 32,795	$ 34,060
Secured by 1-4 family residential	151,043	141,961
Other real estate loans	146,483	145,968
Commercial and industrial loans	24,797	22,803
Consumer and other loans	12,372	12,301
Total loans	$ 367,490	$ 357,093
Allowance for loan losses	(10,006)	(10,644)
Loans, net	$ 357,484	$ 346,449

Net deferred loan fees included in the above loan categories were $79 thousand and $18 thousand at June 30, 2014 and December 31, 2013, respectively. Consumer and other loans included $229 thousand and $279 thousand of demand deposit overdrafts at June 30, 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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The following table provides a summary of loan classes and an aging of past due loans as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014							
	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	$ 2,277	$ 72	$ 3,454	$ 5,803	$ 26,992	$ 32,795	$ 5,451	$ 167
1-4 family residential	1,417	650	378	2,445	148,598	151,043	1,025	158
Other real estate loans	590	277	1,327	2,194	144,289	146,483	4,592	
Commercial and industrial	329	19		348	24,449	24,797	153	
Consumer and other loans	10			10	12,362	12,372		
Total	$ 4,623	$ 1,018	$ 5,159	$ 10,800	$ 356,690	$ 367,490	$ 11,221	$ 325

	December 31, 2013							
	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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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 June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	$ 20,402	$ 2,939	$ 9,454	$	$ 32,795
Secured by 1-4 family residential	138,380	6,406	6,257		151,043
Other real estate loans	120,964	10,216	15,303		146,483
Commercial and industrial	24,066	246	485		24,797
Consumer and other loans	12,372				12,372
Total	$ 316,184	$ 19,807	$ 31,499	$	$ 367,490

	December 31, 2013				
	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 six months ended June 30, 2014 and 2013 and for the year ended December 31, 2013 were as follows (in thousands):

	June 30, 2014	December 31, 2013	June 30, 2013
Balance at beginning of year	$ 10,644	$ 13,075	$ 13,075
Provision charged to (recovery from) operating expense	(600)	(425)	2,250
Loan recoveries	507	2,486	498
Loan charge-offs	(545)	(4,492)	(3,345)
Balance at end of period	$ 10,006	$ 10,644	$ 12,478

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The following tables present, as of June 30, 2014, December 31, 2013 and June 30, 2013, the total allowance for loan losses, the allowance by impairment methodology and loans by impairment methodology (in thousands).

	June 30, 2014					
	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		(104)	(203)	(36)	(202)	(545)
Recoveries	40	7	339	3	118	507
Provision for (recovery of) loan losses	(636)	18	(167)	65	120	(600)
Ending Balance, June 30, 2014	$ 2,114	$ 2,896	$ 4,387	$ 474	$ 135	$ 10,006
Ending Balance:						
Individually evaluated for impairment	779	126	911	57		1,873
Collectively evaluated for impairment	1,335	2,770	3,476	417	135	8,133
Loans:						
Ending Balance	32,795	151,043	146,483	24,797	12,372	367,490
Individually evaluated for impairment	6,427	3,297	9,994	164		19,882
Collectively evaluated for impairment	26,368	147,746	136,489	24,633	12,372	347,608

	December 31, 2013					
						Total

	Construction and Land Development	Secured by 1-4 Family Residential	Other Real Estate	Commercial and Industrial	Consumer and Other Loans	
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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	June 30, 2013					
	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	(2,308)	(172)	(798)		(67)	(3,345)
Recoveries		6	206	176	110	498
Provision for (recovery of) loan losses	3,097	179	(561)	(399)	(66)	2,250
Ending Balance, June 30, 2013	$ 3,270	$ 3,725	$ 5,010	$ 385	$ 88	$ 12,478
Ending Balance:						
Individually evaluated for impairment	747	195	161	19		1,122
Collectively evaluated for impairment	2,523	3,530	4,849	366	88	11,356
Loans:						
Ending Balance	44,305	145,628	159,834	19,701	8,045	377,513
Individually evaluated for impairment	3,595	1,940	5,219	90		10,844
Collectively evaluated for impairment	40,710	143,688	154,615	19,611	8,045	366,669

Impaired loans and the related allowance at June 30, 2014, December 31, 2013 and June 30, 2013, were as follows (in thousands):

	June 30, 2014						
	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	$ 8,746	$ 4,022	$ 2,405	$ 6,427	$ 779	$ 6,607	$ 21
Secured by 1-4 family	4,230	2,766	531	3,297	126	3,248	62
Other real estate loans	10,501	7,347	2,647	9,994	911	10,998	125
Commercial and industrial	170	11	153	164	57	185	1
Consumer and other loans							
Total	$ 23,647	$ 14,146	$ 5,736	$ 19,882	$ 1,873	$ 21,038	$ 209

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	December 31, 2013						
	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

	June 30, 2013						
	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	$ 6,245	$ 2,678	$ 917	$ 3,595	$ 747	$ 5,059	$ 20
Secured by 1-4 family	2,864	856	1,084	1,940	195	3,047	14
Other real estate loans	6,242	3,877	1,342	5,219	161	8,682	90
Commercial and industrial	91		90	90	19	87	2
Consumer and other loans							
Total	$ 15,442	$ 7,411	$ 3,433	$ 10,844	$ 1,122	$ 16,875	$ 126

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 June 30, 2014, loans classified as troubled debt restructurings (TDRs) and included in impaired loans in the disclosure above totaled $2.0 million. At June 30, 2014, $978 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 six month period ended June 30, 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 June 30, 2014 and the three and six month periods ended June 30, 2013.

For the three and six months ended June 30, 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 or charged-off during the twelve month period subsequent to the modification.

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Note 5. Other Real Estate Owned (OREO)

At June 30, 2014 and December 31, 2013, OREO totaled $2.2 million and $3.0 million, respectively. 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 (in thousands):

	For the six months ended June 30, 2014	For the year ended December 31, 2013
Balance at the beginning of year, gross	$ 4,695	$ 7,764
Transfers in	139	2,036
Charge-offs	(163)	(1,564)
Sales proceeds	(1,021)	(3,618)
Gain on disposition	160	80
Depreciation	(1)	(3)
Balance at the end of period, gross	$ 3,809	$ 4,695
Less: valuation allowance	(1,588)	(1,665)
Balance at the end of period, net	$ 2,221	$ 3,030

Changes in the valuation allowance are as follows (in thousands):

	For the six months ended June 30, 2014	For the six months ended June 30, 2013	For the year ended December 31, 2013
Balance at beginning of year	$ 1,665	$ 2,174	$ 2,174
Provision for losses	86	448	1,055
Transfer in		62	
Charge-offs, net	(163)	(601)	(1,564)
Balance at end of period	$ 1,588	$ 2,083	$ 1,665

Net expenses applicable to OREO, other than the provision for losses, were $35 thousand and $99 thousand for the six months ended June 30, 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 $103.4 million and $108.4 million available with non-affiliated banks at June 30, 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 $63.7 million at June 30, 2014.

At June 30, 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 $30.0 million and $25.0 million at June 30, 2014 and December 31, 2013, respectively. The Bank had collateral pledged on the borrowings and the letter of credit at June 30, 2014 and December 31, 2013 including real estate loans totaling $66.9 million and $78.6 million, respectively, and Federal Home Loan Bank stock with a book value of $740 thousand and $908 thousand, respectively.

At June 30, 2014 and December 31, 2013, the Bank had a note payable totaling $39 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 June 30, 2014 and December 31, 2013 with the minimum regulatory guidelines were as follows (dollars in thousands):

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2014:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$ 69,455	18.64%	$ 29,803	8.00%	N/A	N/A
First Bank	$ 64,302	17.28%	$ 29,762	8.00%	$ 37,202	10.00%
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	$ 64,732	17.38%	$ 14,902	4.00%	N/A	N/A
First Bank	$ 59,586	16.02%	$ 14,881	4.00%	$ 22,321	6.00%
Tier 1 Capital (to Average Assets):						
Consolidated	$ 64,732	12.22%	$ 21,186	4.00%	N/A	N/A
First Bank	$ 59,586	11.26%	$ 21,171	4.00%	$ 26,463	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 June 30, 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 June 30, 2014 and December 31, 2013 was 1.83% and 1.85%, respectively. 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 June 30, 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 and six months ended June 30, 2014 and 2013 were as follows (in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Service cost	$ 87	$ 118	$ 174	$ 236
Interest cost	67	70	134	140
Expected return on plan assets	(79)	(76)	(158)	(152)
Amortization of net loss		27		54
Net periodic benefit cost	$ 75	$ 139	$ 150	$ 278

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 4,901,599 and 4,901,464 for the three months ended June 30, 2014 and 2013, respectively, and 4,901,532 and 4,901,464 for the six months ended June 30, 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 participa