C & F FINANCIAL CORP
Form 10-K
March 07, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2016

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _________ to _________

Commission file number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	54-1680165
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

802 Main Street

West Point, VA 23181

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (804) 843-2360

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

Common Stock, $1.00 par value per share	The NASDAQ Stock Market LLC
Title of each class	Name of each exchange on which registered

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

NONE

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

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

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

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

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

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

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

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

The aggregate market value of common stock held by non-affiliates of the registrant as of June 30, 2016 was $143,766,479.

There were 3,485,272 shares of common stock outstanding as of February 28, 2017.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held April 18, 2017 are incorporated by reference in Part III of this report.

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PART I

ITEM 1.BUSINESS

General

C&F Financial Corporation (the Corporation) is a bank holding company that was incorporated in March 1994 under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of Citizens and Farmers Bank (the Bank or C&F Bank), which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. C&F Bank originally opened for business under the name Farmers and Mechanics Bank on January 22, 1927. C&F Bank has the following five wholly-owned subsidiaries, all incorporated under the laws of the Commonwealth of Virginia:

- C&F Mortgage Corporation and its wholly-owned subsidiary Certified Appraisals LLC
- C&F Finance Company and its wholly-owned subsidiary C&F Remarketing LLC
- C&F Wealth Management Corporation
- C&F Insurance Services, Inc.
- CVB Title Services, Inc.

On October 1, 2013, the Corporation acquired all of the outstanding common stock of Central Virginia Bankshares, Inc. (CVBK) in an all-cash transaction in which CVBK shareholders received $0.32 for each share of CVBK common stock they owned, or approximately $846,000 in the aggregate. In addition, the Corporation purchased from the U.S. Treasury for $3.4 million all of CVBK's preferred stock and warrants issued to the U.S. Treasury under the Capital Purchase Program (CPP). CVBK was a one-bank holding company incorporated under the laws of the Commonwealth of Virginia. CVBK owned all of the stock of Central Virginia Bank (CVB), which was an independent commercial bank chartered under the laws of the Commonwealth of Virginia. On March 22, 2014, CVBK was merged with and into C&F Financial Corporation and CVB was merged with and into C&F Bank.

The Corporation operates in a decentralized manner in three principal business activities: (1) retail banking through C&F Bank, (2) mortgage banking through C&F Mortgage Corporation (C&F Mortgage) and (3) consumer finance through C&F Finance Company (C&F Finance). For detailed information about the financial condition and results of operations of these segments, see “Note 18. Business Segments” in Item 8. “Financial Statements and Supplementary Data” in this report. The following general business discussion focuses on the activities within each of these segments.

In addition, the Corporation conducts brokerage activities through C&F Wealth Management Corporation, insurance activities through C&F Insurance Services, Inc. and title insurance services through CVB Title Services, Inc. The financial position and operating results of any one of these subsidiaries are not significant to the Corporation as a whole and are not considered principal activities of the Corporation at this time.

The Corporation also owns three non-operating subsidiaries, C&F Financial Statutory Trust II (Trust II) formed in December 2007, C&F Financial Statutory Trust I (Trust I) formed in July 2005, and Central Virginia Bankshares Statutory Trust I (CVBK Trust I) formed in December 2003. These trusts were formed for the purpose of issuing $10.0 million each for Trust II and Trust I of the Corporation’s junior subordinated debt securities and $5.0 million for CVBK Trust I of junior subordinated debt securities originally issued by CVBK, and assumed by the Corporation when CVBK was merged into the Corporation on March 22, 2014, with all such issuances occurring in private placements to institutional investors. All three trusts are unconsolidated subsidiaries of the Corporation. The principal assets of these trusts are $10.3 million each for Trust II and Trust I and $5.2 million for CVBK Trust I of the Corporation’s junior subordinated debt securities (such securities of the Corporation referred to herein as “trust preferred capital notes”) that are reported as liabilities of the consolidated Corporation.

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Retail Banking

We provide retail banking services through C&F Bank. C&F Bank provides retail banking services at its main office in West Point, Virginia, and 24 Virginia branches located one each in Cartersville, Chester, Cumberland, Hampton, Mechanicsville, Newport News, Norge, Powhatan, Providence Forge, Quinton, Saluda, Sandston, West Point and Yorktown, two in Williamsburg, four in Richmond and four in Midlothian. These branches provide a wide range of banking services to individuals and businesses. These services include various types of checking and savings deposit accounts, as well as business, real estate, development, mortgage, home equity and installment loans. The Bank also offers ATMs, internet and mobile banking and debit and credit cards, as well as safe deposit box rentals, notary public, electronic transfer and other customary bank services to its customers. Revenues from retail banking operations consist primarily of interest earned on loans and investment securities and fees related to deposit services. At December 31, 2016, assets of the Retail Banking segment totaled $1.3 billion. For the year ended December 31, 2016, net income for this segment totaled $8.2 million.

Mortgage Banking

We conduct mortgage banking activities through C&F Mortgage, which was organized in September 1995. C&F Mortgage provides mortgage loan origination services through 10 locations in Virginia, two in Maryland and two in North Carolina. The Virginia offices are located one each in Charlottesville, Chesapeake, Fishersville, Fredericksburg, Glen Allen, Harrisonburg, Lynchburg, Midlothian, Newport News and Williamsburg. The Maryland offices are located in Annapolis and Waldorf. The North Carolina offices are located in Gastonia and Moyock. C&F Mortgage offers a wide variety of residential mortgage loans, which are originated for sale generally to the following investors: Penny Mac Corporation; Wells Fargo Home Mortgage; the Virginia Housing Development Authority (VHDA); Franklin American Mortgage Company; and Freedom Mortgage Corporation. C&F Mortgage does not securitize loans. C&F Bank may also purchase mortgage loans from C&F Mortgage. C&F Mortgage originates conventional mortgage loans, mortgage loans insured by the Federal Housing Administration (the FHA), and mortgage loans guaranteed by the United States Department of Agriculture (the USDA) and the Veterans Administration (the VA). A majority of the conventional loans are conforming loans that qualify for purchase by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). The remainder of the conventional loans are non-conforming in that they do not meet Fannie Mae or Freddie Mac guidelines, but are eligible for sale to various other investors. C&F Mortgage also has a division that provides certain mortgage loan origination functions to third parties and through its subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan origination services for residential appraisals. Revenues from mortgage banking operations consist principally of gains on sales of loans to investors in the secondary mortgage market, loan origination fee income and interest earned on mortgage loans held for sale. At December 31, 2016, assets of the Mortgage Banking segment totaled $65.4 million. For the year ended December 31, 2016, net income for this segment totaled $1.7 million.

Consumer Finance

We conduct consumer finance activities through C&F Finance. C&F Finance is a regional finance company providing automobile loans throughout Virginia and in portions of Alabama, Florida, Georgia, Illinois, Indiana, Kentucky, Maryland, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Texas and West Virginia through its offices in Richmond and Hampton, Virginia, in Nashville, Tennessee and in Hunt Valley, Maryland. C&F Finance is an indirect lender that provides automobile financing through lending programs that are designed to serve customers in the "non-prime" market who have limited access to traditional automobile financing. C&F Finance generally purchases automobile retail installment sales contracts from manufacturer-franchised dealerships with used-car operations and through selected independent dealerships. C&F Finance selects these dealers based on the types of vehicles sold. Specifically, C&F Finance prefers to finance later model, low mileage used vehicles because the initial depreciation on new vehicles is extremely high. The typical borrowers on the retail installment sales contracts purchased have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, C&F Finance typically charges interest at higher rates than those charged by traditional financing sources. In addition, because C&F Finance provides financing in a relatively high-risk market, it expects to experience a higher level of credit losses than traditional automobile financing sources. Revenues from consumer finance operations consist principally of interest earned on automobile loans. At December 31, 2016, assets of

the Consumer Finance segment totaled $306.0 million. For the year ended December 31, 2016, net income for this segment totaled $4.5 million.

Employees

At December 31, 2016, we employed 636 full-time equivalent employees. We consider relations with our employees to be excellent.

Competition

Retail Banking

In the Bank's market area, we compete with large national and regional financial institutions, savings associations and other independent community banks, as well as credit unions, mutual funds, brokerage firms and insurance companies. Increased competition has come from out-of-state banks through their acquisition of Virginia-based banks and interstate branching, and expansion of community and regional banks into our service areas.

The banking business in Virginia, and in the Bank's primary service area in the Hampton to Charlottesville corridor, is highly competitive for both loans and deposits, and is dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have are their ability to finance wide-ranging advertising campaigns, to maximize efficiencies through economies of scale and, by virtue of their greater total capitalization, to have substantially higher lending limits than the Bank.

Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution, affect competition for deposits and loans. We compete by emphasizing customer service, establishing long-term customer relationships, building customer loyalty, and providing traditional and digital products and services to address the specific needs of our customers. We target individual and small-to-medium size business customers.

No material part of the Bank's business is dependent upon a single or a few customers, and the loss of any single customer would not have a materially adverse effect upon the Bank's business.

Mortgage Banking

C&F Mortgage competes with large national and regional banks, credit unions, smaller regional mortgage lenders and small local broker operations. Due to the increased regulatory and compliance burden, the industry has seen a consolidation in the number of competitors in the marketplace. The agency guidelines for sales of mortgages in the secondary market business continue to be stringent.

The competitive factors faced by C&F Mortgage continue to evolve because of regulatory reforms and initiatives, including but not limited to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act affects many aspects of mortgage finance regulation, which has changed and may continue to result in changes to the competitive landscape in the future. The full effect of the regulatory reforms and initiatives associated with the Dodd-Frank Act, including as the result of on-going rulemaking processes, and the related compliance burden continues to evolve. The reforms to mortgage lending encompass broad new restrictions on lending practices and loan terms, amend price thresholds for certain lending segments, require new disclosure forms and procedures for all mortgages, and mandate stronger legal liabilities in connection with real estate finance. In addition, the Dodd-Frank Act authorizes the Consumer Financial Protection Bureau (the CFPB) to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay, and allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the Dodd-Frank Act and CFPB regulations. While C&F Mortgage has kept pace with all aspects of the regulations issued pursuant to the Dodd-Frank Act and by the CFPB, such legislation and regulations and other regulatory initiatives could materially and adversely affect the manner in which it conducts its mortgage business, result in heightened federal regulation and oversight of its business activities, and result in increased costs and potential litigation associated with its business activities. Given the far-reaching

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effect of the Dodd-Frank Act and CFPB regulations on mortgage finance, compliance with the requirements of the Dodd-Frank Act and CFPB regulations may require substantial changes to mortgage lending systems and processes and other implementation efforts. As an example of one such change, during 2015, C&F Mortgage implemented drastically new processes and systems in order to comply with the CFPB's Integrated Mortgage Disclosure Rules Under the Real Estate Settlement Procedures Act and the Truth in Lending Act (TRID), which became effective October 2015. TRID applies to most closed-end mortgage loans, which is the emphasis of C&F Mortgage's activities.

To operate profitably in this competitive and regulatory environment, lenders must have a high level of operational and risk management skills and be able to attract and retain top mortgage origination talent. C&F Mortgage competes by attracting the top people in sales and operations in the industry, expanding into new markets that offer strategic growth opportunities, providing an infrastructure that manages regulatory changes efficiently and effectively, offering a product menu that is both competitive in loan parameters as well as price, and providing consistently high quality customer service.

No material part of C&F Mortgage's business is dependent upon a single customer and the loss of any single customer would not have a materially adverse effect upon C&F Mortgage's business. Further, C&F Mortgage has implemented strategies to mitigate potential disruption in C&F Mortgage's direct or indirect access to the secondary market for residential mortgage loans. C&F Mortgage, like all residential mortgage lenders, would be affected by the inability of Fannie Mae, Freddie Mac, the FHA or the VA to purchase or guarantee loans. Although C&F Mortgage sells loans to various intermediaries, the ability of these aggregators to purchase or guarantee loans would be limited if these government-sponsored entities cease to exist or materially limit their purchases or guarantees of mortgage loans or suffer deteriorations in their financial condition.

Consumer Finance

The non-prime automobile finance business is highly competitive. The automobile finance market is highly fragmented and is served by a variety of financial entities, including the captive finance affiliates of major automotive manufacturers, banks, savings associations, credit unions and independent finance companies. Many of these competitors have substantially greater financial resources and lower costs of funds than our finance subsidiary. In addition, competitors often provide financing on terms that are more favorable to automobile purchasers or dealers than the terms C&F Finance offers. Many of these competitors also have long-standing relationships with automobile dealerships and may offer dealerships or their customers other forms of financing, including dealer floor plan financing and leasing, which we do not.

Over the past several years, a number of financial institutions and other lenders have increased focus on operations in the non-prime automobile finance markets resulting in intensified competition for loans and qualified personnel. In addition, certain competitors in the industry have (i) relaxed underwriting standards resulting in higher delinquencies

and charge-offs for the industry and (ii) used loan pricing strategies resulting in lower loan yields. To continue to operate profitably, lenders must have a high level of operational and risk management skills and access to competitive costs of funds.

Providers of automobile financing traditionally have competed on the basis of interest rates charged, the quality of credit accepted, the flexibility of loan terms offered and the quality of service provided to dealers and customers. To establish C&F Finance as one of the principal financing sources for the dealers it serves, we compete predominately by providing a high level of dealer service, building strong dealer relationships, offering flexible loan terms, and quickly funding loans purchased from dealers.

No material part of C&F Finance’s business is dependent upon any single dealer relationship, and the loss of any single dealer relationship would not have a materially adverse effect upon C&F Finance’s business.

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Regulation and Supervision

General

Bank holding companies, banks and their affiliates are extensively regulated under both federal and state law. The following summary briefly describes significant provisions of currently applicable federal and state laws and certain regulations and the potential impact of such provisions. This summary is not complete, and we refer you to the particular statutory or regulatory provisions or proposals for more information. Because regulation of financial institutions changes regularly and is the subject of constant legislative and regulatory debate, we cannot forecast how federal and state regulation and supervision of financial institutions may change in the future and affect the Corporation’s and the Bank’s operations.

Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other events led to the adoption of numerous laws and regulations that apply to, and focus on, financial institutions. The most significant of these laws is the Dodd-Frank Act, which was adopted on July 21, 2010 and, in part, is intended to implement significant structural reforms to the financial services industry. The Dodd-Frank Act is discussed in more detail below.

The Corporation continues to experience a period of rapidly changing regulations and an environment of constant regulatory reform. These regulatory changes could have a significant effect on how the Corporation conducts its business. The specific implications of the Dodd-Frank Act and other potential regulatory reforms cannot yet be fully predicted and will depend to a large extent on the specific regulations that are adopted in the future.

Regulation of the Corporation

As a bank holding company, the Corporation is subject to the Bank Holding Company Act of 1956 (the BHCA) and regulation and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Pursuant to the BHCA the Federal Reserve Board has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve Board has reasonable grounds to believe that continuation of such activity or ownership constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company. The Federal Reserve

Board and the Federal Deposit Insurance Corporation (the FDIC) have adopted guidelines and released interpretative materials that establish operational and managerial standards to promote the safe and sound operation of banks and bank holding companies. These standards relate to the institution's key operating functions, including but not limited to capital management, internal controls, internal audit system, information systems, data and cybersecurity, loan documentation, credit underwriting, interest rate exposure and risk management, vendor management, executive management and its compensation, asset growth, asset quality, earnings, liquidity and risk management.

The BHCA generally limits the activities of a bank holding company and its subsidiaries to that of banking, managing or controlling banks, or any other activity that is closely related to banking or to managing or controlling banks, and permits interstate banking acquisitions subject to certain conditions, including national and state concentration limits. The Federal Reserve Board has jurisdiction under the BHCA to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. A bank holding company must be well capitalized and well managed to engage in an interstate bank acquisition or merger, and banks may branch across state lines provided that the law of the state in which the branch is to be located would permit establishment of the branch if the bank were a state bank chartered by such state. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates.

Each of the Bank's depository accounts is insured by the FDIC against loss to the depositor to the maximum extent permitted by applicable law, and federal law and regulatory policy impose a number of obligations and restrictions on the Corporation and the Bank to reduce potential loss exposure to depositors and to the FDIC Deposit Insurance Fund (DIF). For example, pursuant to the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company must commit

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resources to support its subsidiary depository institutions, which is referred to as serving as a "source of strength." In addition, insured depository institutions under common control must reimburse the FDIC for any loss suffered or reasonably anticipated by the DIF as a result of the default of a commonly controlled insured depository institution. The FDIC may decline to enforce the provisions if it determines that a waiver is in the best interest of the DIF. An FDIC claim for damages is superior to claims of stockholders of an insured depository institution or its holding company but is subordinate to claims of depositors, secured creditors and holders of subordinated debt, other than affiliates, of the commonly controlled insured depository institution.

The Federal Deposit Insurance Act (the FDIA) provides that amounts received from the liquidation or other resolution of any insured depository institution must be distributed, after payment of secured claims, to pay the deposit liabilities of the institution before payment of any other general creditor or stockholder of that institution – including that institution's parent holding company. This provision would give depositors a preference over general and subordinated creditors and stockholders if a receiver is appointed to distribute the assets of a bank.

The Corporation also is subject to regulation and supervision by the State Corporation Commission of Virginia. The Corporation also must file annual, quarterly and other periodic reports with, and comply with other regulations of, the Securities and Exchange Commission (the SEC).

Capital Requirements

The Federal Reserve Board and the FDIC have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the Basel III Final Rules) that apply to banking institutions they supervise. For the purposes of these capital rules, (i) common equity tier 1 capital (CET1) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stocks and trust preferred securities; and (iii) Tier 2 capital consists principally of Tier 1 capital plus qualifying subordinated debt and preferred stock, and limited amounts of an institution's allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, importantly including applying higher risk weightings to certain commercial real estate loans. The Basel III Final Rules were effective January 1, 2015, and the Basel III Final Rules capital conservation buffer will be phased in from 2015 to 2019.

When fully phased in, the Basel III Final Rules require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%),

(ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

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

The Basel III Final Rules permanently include in Tier 1 capital trust preferred securities issued prior to May 19, 2010 by bank holding companies with less than $15 billion in total assets, subject to a limit of 25% of Tier 1 capital. The

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Corporation expects that its trust preferred securities will be included in the Corporation's Tier 1 capital until their maturity.

Limits on Dividends

The Corporation is a legal entity that is separate and distinct from the Bank. A significant portion of the revenues of the Corporation result from dividends paid to it by the Bank. Both the Corporation and C&F Bank are subject to laws and regulations that limit the payment of dividends, including limits on the sources of dividends and requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, Federal Reserve Board supervisory guidance indicates that the Federal Reserve Board may have safety and soundness concerns if a bank holding company pays dividends that exceed earnings for the period in which the dividend is being paid. Further, the FDIA prohibits insured depository institutions such as C&F Bank from making capital distributions, including paying dividends, if, after making such distribution, the institution would become undercapitalized as defined in the statute. We do not expect that any of these laws, regulations or policies will materially affect the ability of the Corporation or C&F Bank to pay dividends.

The Dodd-Frank Act

The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including changes that will affect all bank holding companies and banks, including the Corporation and the Bank. Provisions that significantly affect the business of the Corporation and the Bank include the following:

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

· Payment of Interest on Demand Deposits. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

·

Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the CFPB, which is discussed in more detail below.

· Debit Card Interchange Fees. The Dodd-Frank Act imposed limits for debit card interchange fees for issuers that have over $10 billion in assets, which could affect the amount of interchange fees collected by financial institutions with less than $10 billion in assets.

In addition, the Dodd-Frank Act implements other changes to financial regulations, including provisions that:

· Restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption.

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

· Require depository institutions with total consolidated assets of more than $10 billion to conduct regular stress tests and require large, publicly traded bank holding companies to create a risk committee responsible for the oversight of enterprise risk management.

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- Require loan originators to retain 5 percent of any loan sold or securitized, unless it is a "qualified residential mortgage," subject to certain exceptions.

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

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

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

Insurance of Accounts, Assessments and Regulation by the FDIC

The Bank's deposits are insured by the DIF of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. The basic limit on FDIC deposit insurance coverage is $250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations as an insured institution, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

Deposit Insurance Assessments. The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target "designated reserve ratio" (described in more detail below) of 2 percent for the DIF and established a lower assessment rate schedule when the reserve ratio reaches 1.15 percent and, in lieu of dividends, provides for a lower assessment rate schedule, when the reserve ratio reaches 2 percent and 2.5 percent. An institution's assessment rate is based on a statistical analysis of financial ratios that estimates the likelihood of failure over a three year period, which considers the institution's weighted average CAMELS component rating, and is subject to further adjustments including those related to levels of unsecured debt and brokered deposits (not applicable to banks with less than $10 billion in assets). At December 31, 2016, total base assessment rates for institutions that have been insured for at least five years range from 1.5 to 40 basis points, with rates of 1.5 to 30 basis points applying to banks with less than $10 billion in assets.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the "designated reserve ratio." Among other changes, the Dodd-Frank Act (i) raised the minimum designated reserve ratio to 1.35 percent and removed the upper limit on the designated reserve ratio, (ii) requires that the designated reserve ratio reach 1.35 percent by September 2020, and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than $10 billion of raising the designated reserve ratio from 1.15 percent to 1.35 percent – which requirement was met by rules adopted by the FDIC during 2016. On June 30, 2016, the designated reserve ratio rose to 1.17 percent, which triggered three major changes to deposit insurance assessments for the third quarter of 2016: (i) the range of initial assessment rates for all institutions declined from 5 to 35 basis points to 3 to 30 basis points (which are included in the total base assessment rates in the above paragraph); (ii) surcharges equal to an annual rate of 4.5 basis points began for insured depository institutions with total consolidated assets of $10 billion or more; and (iii) the revised assessment method described above was implemented. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis. The FDIC has adopted a DIF restoration plan to ensure that the fund reserve ratio reaches 1.35 percent by September 30, 2020, as required by the Dodd-Frank Act.

Regulation of the Bank and Other Subsidiaries

The Bank is subject to supervision, regulation and examination by the Virginia State Corporation Commission Bureau of Financial Institutions (VBFI) and its primary federal regulator, the FDIC. The various laws and regulations issued and administered by the regulatory agencies (including the CFPB) affect corporate practices, such as the payment of dividends, the incurrence of debt and the acquisition of financial institutions and other companies, and affect business practices and operations, such as the payment of interest on deposits, the charging of interest on loans, the types of business

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conducted, the products and terms offered to customers and the location of offices. Prior approval of the applicable primary federal regulator and the VBFI is required for a Virginia chartered bank or bank holding company to merge with another bank or bank holding company, or purchase the assets or assume the deposits of another bank or bank holding company, or acquire control of another bank or bank holding company. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the financial condition, capital position and any asset concentrations (including commercial real estate loan concentrations) of the constituent organizations and the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act (CRA) and fair housing initiatives, the data security and cybersecurity infrastructure of the constituent organizations and the combined organization, and the applicant’s compliance with and the effectiveness of the subject organizations in combating money laundering activities and complying with Bank Secrecy Act requirements.

Community Reinvestment Act. The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution’s efforts in meeting community credit needs are assessed based on specified factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility. In 2014, the Bank received a “Satisfactory” CRA rating.

Federal Home Loan Bank of Atlanta. The Bank is a member of the Federal Home Loan Bank (FHLB) of Atlanta, which is one of 12 regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each FHLB makes loans to members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, the Bank must purchase and maintain stock in the FHLB. At December 31, 2016, the Bank owned $3.3 million of FHLB stock.

Consumer Protection. The CFPB is the federal regulatory agency that is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. The CFPB supervises and regulates providers of consumer financial products and services, and has rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth-in-Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA)).

Because the Corporation and the Bank are smaller institutions (i.e., with assets of $10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Corporation by the Federal Reserve Board and to the Bank by the FDIC. However, the CFPB may include its own examiners in regulatory examinations by a small institution’s principal regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and

banks, could influence how the Federal Reserve Board and FDIC apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise effect of the CFPB's consumer protection activities on the Corporation and the Bank cannot be determined with certainty.

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

The Bank's mortgage origination activities are also subject to Regulation Z, which implements TILA. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified

and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined as mortgage loans without negative amortization, interest-only payments, balloon payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3% of the total loan amount. Higher-priced qualified mortgages (e.g., sub-prime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Corporation's Mortgage Banking segment predominately originates mortgage loans that comply with Regulation Z's "qualified mortgage" rules.

In addition to certain regulations applicable to the Bank's mortgage origination activities, C&F Mortgage is subject to the rules and regulations of, and examination by, the Department of Housing and Urban Development (HUD), the FHA, the USDA, the VA and state regulatory authorities with respect to originating, processing and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers and, in some cases, restrict certain loan features and fix maximum interest rates and fees.

Consumer Financing Regulation. C&F Finance also is regulated by the VBFI and the states and jurisdictions in which it operates, and its lending operations are subject to numerous federal regulations over which the CFPB has rulemaking authority and regarding which enforcement authority is shared by the Federal Reserve Board, the FDIC, the Department of Justice and the Federal Trade Commission. The VBFI regulates and enforces laws relating to consumer lenders and sales finance agencies such as C&F Finance. Such rules and regulations generally provide for licensing of sales finance agencies; limitations on amounts, duration and charges, including interest rates, for various categories of loans; requirements as to the form and content of finance contracts and other documentation; and restrictions on collection practices and creditors' rights.

Certain federal regulatory agencies, and in particular, the CFPB, the Federal Trade Commission, and the Federal Reserve Board, have recently become more active in investigating the products, services and operations of banks and other finance companies engaged in auto finance activities. These investigations have extended to banks that engage in indirect automobile lending, and the CFPB has released regulatory guidance that deems automobile lenders within the CFPB's jurisdiction responsible for ECOA noncompliance even if such noncompliance is a result of dealer lending practices. As of January 1, 2017, the Corporation and C&F Finance are not subject to supervision by the CFPB.

Other Regulations

Prompt Correction Action. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly

undercapitalized" or "critically undercapitalized." These terms are defined under uniform regulations issued by each of the federal banking agencies regulating these institutions. An insured depository institution which is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities. As of December 31, 2016, the Bank was considered "well capitalized."

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

In 2016, the SEC and the federal banking agencies proposed rules that prohibit covered financial institutions (including bank holding companies and banks) from establishing or maintaining incentive-based compensation

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arrangements that encourage inappropriate risk taking by providing covered persons (consisting of senior executive officers and significant risk takers, as defined in the rules) with excessive compensation, fees or benefits that could lead to material financial loss to the financial institution. The proposed rules outline factors to be considered when analyzing whether compensation is excessive and whether an incentive-based compensation arrangement encourages inappropriate risks that could lead to material loss to the covered financial institution, and establishes minimum requirements that incentive-based compensation arrangements must meet to be considered to not encourage inappropriate risks and to appropriately balance risk and reward. The proposed rules also impose additional corporate governance requirements on the boards of directors of covered financial institutions and imposes additional record-keeping requirements. The comment period for these proposed rules has closed and a final rule has not yet been published.

Confidentiality and Required Disclosures of Customer Information. The Corporation is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure. In 2016, the CFPB proposed rules that provide an exception to the requirement to deliver an annual privacy notice if a financial institution only provides nonpublic personal information to unaffiliated third parties under limited exceptions under the Gramm-Leach-Bliley Act and related regulations, and has not changed its policies and practices regarding disclosure of nonpublic personal financial information from those disclosed in the most recent privacy notice provided to the customer.

The Corporation is also subject to various laws and regulations that attempt to combat money laundering and terrorist financing. The Bank Secrecy Act requires all financial institutions to, among other things, create a system of controls designed to prevent money laundering and the financing of terrorism, and imposes recordkeeping and reporting requirements. The USA Patriot Act added regulations to facilitate information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering, and requires financial institutions to establish anti-money laundering programs. The Office of Foreign Assets Control (OFAC), which is a division of the Treasury, is responsible for helping to ensure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name of an "enemy" of the United States on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds into a blocked account, and report it to OFAC.

Although these laws and programs impose compliance costs and create privacy obligations and, in some cases, reporting obligations, and compliance with all of the laws, programs, and privacy and reporting obligations may require significant resources of the Corporation and the Bank, these laws and programs do not materially affect the Bank's products, services or other business activities.

Stress Testing. As required by the Dodd-Frank Act, the federal banking agencies have implemented stress testing requirements for certain financial institutions, including bank holding companies and state chartered banks, with more than $10 billion in total consolidated assets. Although these requirements do not apply to institutions with less than $10 billion in total consolidated assets, the federal banking agencies emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential effect of adverse market conditions or outcomes on the organization’s financial condition. Based on existing regulatory guidance, the Corporation and the Bank will be expected to consider the institution’s interest rate risk management, commercial real estate loan concentrations and other credit-related information, and funding and liquidity management during this analysis of adverse market conditions or outcomes.

Volcker Rule. The Dodd-Frank Act prohibits bank holding companies and their subsidiary banks from engaging in proprietary trading except in limited circumstances, and places limits on ownership of equity investments in private equity and hedge funds (the Volcker Rule). The Corporation believes that its financial condition and its operations are not and will not be significantly affected by the Volcker Rule or its implementing regulations.

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Future Regulation

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

Available Information

The Corporation's SEC filings are filed electronically and are available to the public over the Internet at the SEC's web site at http://www.sec.gov. In addition, any document filed by the Corporation with the SEC can be read and copied at the SEC's public reference facilities at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Copies of documents can be obtained at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1 800-SEC-0330. The Corporation's SEC filings also are available through our web site at http://www.cffc.com under "Investor Relations/SEC Filings" as of the day they are filed with the SEC. Copies of documents also can be obtained free of charge by writing to the Corporation's secretary at P.O. Box 391, West Point, VA 23181 or by calling 804-843-2360.

ITEM 1A.RISK FACTORS

Risks Related to the Corporation's Operations

Deterioration in the soundness of our counterparties or disruptions to credit markets could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing,

counterparty or other relationships, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could create another market-wide liquidity crisis similar to that experienced in late 2008 and early 2009 and could lead to losses or defaults by us or by other institutions. In addition, temporary disruptions in the credit and liquidity markets could restrict the flow of capital to credit markets and financial institutions, and future disruptions could restrict our ability to engage in routine funding transactions and adversely affect our liquidity. There is no assurance that the failure of our counterparties would not materially adversely affect the Corporation's results of operations.

We are subject to interest rate risk and fluctuations in interest rates may negatively affect our financial performance.

Our profitability depends in substantial part on our net interest margin, which is the difference between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits and borrowings divided by total interest-earning assets. Changes in interest rates will affect our net interest margin in diverse ways, including the pricing of loans and deposits, the levels of prepayments and asset quality. We are unable to predict actual fluctuations of market interest rates because many factors influencing interest rates are beyond our control. We believe that our current interest rate exposure is manageable and does not indicate any significant exposure to interest rate changes. On December 14, 2016, the Federal Open Market Committee (FOMC) approved its second increase in a decade to the target range for the federal funds rate, which is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight, to 0.50%-0.75%. We believe this change demonstrated the FOMC's increasing optimism about the U.S. economy and signaled interest rates would rise at a faster pace than previously projected. The FOMC's monetary policy remains accommodative after this increase, thereby supporting some further strengthening in labor markets and a

return to two percent inflation. Despite this 25 basis point increase in the federal funds rate, we are expecting continued pressure on our net interest margin due to continued low market rates and intense competition for loans and deposits from both local and national financial institutions. In addition, a significant portion of C&F Finance's funding is indexed to short-term interest rates and reprices as short-term interest rates change. An upward movement in interest rates may result in an unfavorable pricing disparity between C&F Finance's fixed rate loan portfolio and its adjustable-rate borrowings. Continued pressure on our net interest margin could adversely affect our results of operations.

Our business is subject to various lending and other economic risks that could adversely affect our results of operations and financial condition.

Deterioration in economic conditions could adversely affect our business. Our business is directly affected by general economic and market conditions; broad trends in industry and finance; legislative and regulatory changes; changes in governmental monetary and fiscal policies; and inflation, all of which are beyond our control. A deterioration in economic conditions, in particular a prolonged economic slowdown within our geographic region, could result in the following consequences, any of which could hurt our business materially: an increase in loan delinquencies; an increase in problem assets and foreclosures; a decline in demand for our products and services; and a deterioration in the value of collateral for loans made by our various business segments.

Adverse changes in economic conditions in our market areas or adverse conditions in an industry on which a local market in which we do business could adversely affect our results of operations and financial condition.

We provide full service banking and other financial services in the Hampton to Charlottesville corridor in Virginia. Our loan and deposit activities are directly affected by, and our financial success depends on, economic conditions within these markets, as well as conditions in the industries on which those markets are economically dependent. A deterioration in local economic conditions or in the condition of an industry on which a local market depends, such as the U.S. military and related defense contractors and industries, could adversely affect such factors as unemployment rates, business formations and expansions and housing market conditions. Adverse developments in any of these factors could result in among other things, a decline in loan demand, a reduction in the number of creditworthy borrowers seeking loans, an increase in delinquencies, defaults and foreclosures, an increase in classified and nonaccrual loans, a decrease in the value of loan collateral, and a decline in the financial condition of borrowers and guarantors, any of which could adversely affect our financial condition or business.

Our level of credit risk is higher due to the concentration of our loan portfolio in commercial loans and in consumer finance loans.

At December 31, 2016, 39 percent of our loan portfolio consisted of commercial, financial and agricultural loans, which include loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity and residential loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans and to borrowers in similar lines of business, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans.

At December 31, 2016, 30 percent of our loan portfolio consisted of consumer finance loans that provide automobile financing for customers in the non-prime market. During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses may increase in this portfolio. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed automobiles or delay the timing of these sales. Because we focus on non-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on these loans are higher than those experienced in the general automobile finance industry and could be dramatically affected by a general economic downturn. In addition, our servicing costs may increase without a corresponding increase in our finance charge income. While we manage the higher risk inherent in loans made to non-prime borrowers through our underwriting criteria for installment sales contracts we purchase and collection methods, we cannot guarantee that these criteria or methods will ultimately provide adequate protection against these risks.

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Competition from other financial institutions and financial intermediaries may adversely affect our profitability.

We face substantial competition in originating loans and in attracting deposits. Our competition in originating loans and attracting deposits comes principally from other banks, mortgage banking companies, consumer finance companies, savings associations, credit unions, brokerage firms, insurance companies and other institutional lenders and purchasers of loans. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger clients. These institutions may be able to offer the same loan products and services that we offer at more competitive rates and prices. Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could adversely affect our profitability.

Weakness in the secondary residential mortgage loan markets will adversely affect income from our mortgage company.

One of the components of our strategic plan is to generate significant noninterest income from C&F Mortgage, which originates a variety of residential loan products for sale into the secondary market. Interest rates, low housing inventory, cash buyers, new mortgage lending regulations and other market conditions have a direct effect on loan originations across the industry.

In addition, deterioration in economic conditions may also cause borrowers to default on their mortgages. This may result in potential repurchase or indemnification liability to C&F Mortgage on residential mortgage loans originated and sold into the secondary market in the event of claims by investors of borrower misrepresentation, fraud, early-payment default, or underwriting error, as investors attempt to minimize their losses. We cannot be assured that a prolonged period of payment defaults and foreclosures will not result in an increase in requests for repurchases or indemnifications, or that established reserves will be adequate, which could adversely affect the Corporation’s net income.

Our risk management framework may not be effective in mitigating risk and loss.

We maintain an enterprise risk management program that is designed to identify, quantify, monitor report and control the risks we face. These risks include, but are not limited to, interest rate, credit, liquidity, operational, reputation, legal, compliance, economic and litigation risk. Although we assess our risk management program on an ongoing basis and make identified improvements to it, we can give no assurance that this approach and risk management framework (including related controls) will effectively mitigate the risks listed above or limit losses that we may incur. If our risk management program has flaws or gaps, or if our risk management controls do not function

effectively, our results of operations, financial condition or business may be adversely affected.

Our home lending profitability could be significantly reduced if we are not able to originate and sell a high volume of mortgage loans.

The existence of an active secondary market is a critical component of C&F Mortgage's ability to generate income from the sale of loans to investors. Active secondary markets for residential mortgages depend upon the continuation of programs currently offered by government-sponsored enterprises (GSEs) (such as Fannie Mae and Freddie Mac), the FHA, the VA, the USDA, and state bond programs, which account for a substantial portion of the secondary market in residential mortgage loans. Because the largest participants in the secondary market are GSEs whose activities are governed by federal law, any future changes in laws that significantly affect the activity of the GSEs could adversely affect our mortgage company's operations. Further, in September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the U.S. government. Although to date, the conservatorship has not had a significant or adverse effect on our operations, it is unclear whether further changes or reforms would adversely affect our operations. Although we sell loans to various intermediaries, the ability of these aggregators to purchase loans would be limited if the GSEs cease to exist or materially limit their purchases of mortgage loans.

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Compliance with the CFPB regulations aimed at the mortgage banking industry may require substantial changes to mortgage lending systems and processes that may adversely affect income from our mortgage company.

Pursuant to the Dodd-Frank Act and the subsequent final rules issued by the CFPB in January 2013 amending Regulation Z, as implemented by the Truth in Lending Act, effective January 2014 mortgage lenders are responsible for making a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. These CFPB rules require a mortgage lender to either (i) originate "qualified mortgages," defined as loans that do not include negative amortization, interest-only payments, balloon payments, or terms longer than 30 years; or (ii) originate loans that consider eight separate underwriting factors that are identified in the CFPB rules to evaluate each borrower's ability to repay. In June 2015, the CFPB issued rules that combined disclosures previously established by TILA and RESPA into a single disclosure referred to as the TILA-RESPA Integrated Disclosure, or TRID. During 2015, C&F Mortgage implemented drastically new processes and systems in order to comply with TRID. TRID applies to most closed-end mortgage loans and overhauls the manner in which mortgage loan origination disclosures are made pursuant to TILA (Regulation Z) and RESPA. These CFPB rules, in addition to other previously-issued and to-be-issued CFPB regulations, could materially affect our ability to originate and sell a high volume of mortgage loans, which could adversely affect our financial condition and results of operations.

An increase in interest rates may reduce our mortgage revenues, which would negatively affect our noninterest income.

Our Mortgage Banking segment provides a significant portion of our noninterest income. We generate gains on sales of mortgage loans primarily from sales of mortgage loans that we originate. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors. This would result in a decrease in noninterest income. In addition, our results of operations are affected by the amount of noninterest expenses (including for personnel and systems infrastructure) associated with mortgage banking activities. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in mortgage loan origination activity.

If our allowance for loan losses becomes inadequate, our results of operations may be adversely affected.

Making loans is an essential element of our business. The risk of nonpayment is affected by a number of factors, including but not limited to: the duration of the credit; credit risks of a particular customer; changes in economic and industry conditions; and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans may not be repaid. We attempt to maintain an appropriate allowance for loan losses to provide for losses in our loan portfolio. Our allowance for loan losses at our Retail Banking segment is determined by analyzing numerous

factors about the loan portfolio including historical loan losses for relevant periods of time, current trends in delinquencies and charge-offs, current economic conditions that may affect a borrower’s ability to repay and the value of collateral, changes in the size and composition of the loan portfolio and industry information. Also included in our estimates for loan losses at this segment are qualitative considerations with respect to the effect of potential economic events, the outcome of which are uncertain.

Our allowance for loan losses at our Consumer Finance segment is determined by analyzing delinquency rates and trends in deferrals, defaults, repossessions and loans charged off. Allowance factors also include an analysis of charge-off history for relevant periods of time, which can vary depending on economic conditions and our judgment based on the overall analysis of the lending environment.

Because any estimate of loan losses is necessarily subjective and the accuracy of any estimate depends on the outcome of future events, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. Additions to the allowance for loan losses would result in a decrease of our net income. Although we believe our allowance for loan losses is adequate to absorb probable losses in our loan portfolio, we cannot predict such losses or that our allowance will be adequate in the future.

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Our real estate lending business can result in increased costs associated with foreclosed properties.

Because we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we are exposed to the risks inherent in the ownership of real estate. The amount that we, as a mortgagee, may realize after a default is dependent upon factors outside of our control, included, but not limited to general or local economic conditions, environmental cleanup liability, neighborhood values, interest rates, real estate tax rates, operating expenses of the mortgaged properties, and supply of and demand for properties. Certain expenditures associated with the ownership of income-producing real estate, principally real estate taxes and maintenance costs, may adversely affect the net cash flows generated by the real estate. Therefore, the cost of operating income-producing real property may exceed the rental income earned from such property, and we may have to advance funds in order to protect our investment or we may be required to dispose of the real property at a loss.

Our deposit insurance premiums could increase in the future, which may adversely affect our future financial performance.

The FDIC insures deposits at FDIC insured financial institutions, including the Bank. The FDIC charges insured financial institutions premiums to maintain the DIF at a certain level. Economic conditions since 2008 increased the rate of bank failures, requiring the FDIC to make payments for insured deposits from the DIF and prepare for future payments from the DIF. A depository institution’s deposit insurance assessment is calculated based on the institution’s total assets less tangible equity, rather than the previous base of total deposits. The Bank’s FDIC insurance premiums could increase in future periods if the Bank’s asset size increases, if the FDIC raises base assessment rates, or if the FDIC takes other actions to replenish the DIF.

We may incur losses on purchased loans that are materially greater than reflected in our fair value adjustments.

We accounted for the CVBK acquisition under the acquisition method of accounting, recording the acquired assets and liabilities of CVBK at fair value based on acquisition accounting adjustments. We recorded at fair value all purchased credit-impaired loans acquired based on the present value of their expected cash flows. We estimated cash flows using specific credit reviews of certain loans, quantitative credit risk, interest rate risk and prepayment risk models, and qualitative economic and environmental assessments, each of which uses assumptions about matters that are inherently uncertain, and involves the exercise of our best judgment in making those assumptions. We may not realize the estimated cash flows or fair value of these loans. In addition, although the difference between the pre-acquisition carrying value of purchased credit-impaired loans and their expected cash flows - the nonaccretable difference - is available to absorb future charge-offs, we may be required to increase our allowance for loan losses and related provision expense due to subsequent additional credit deterioration in these loans.

For more information see, “Critical Accounting Policies – Loans Acquired in a Business Combination” in Item 7. “Management's Discussion and Analysis of Financial Condition and Results of Operations” in this report.

Acquisition of CVBK’s assets and assumption of CVBK’s liabilities may expose us to intangible asset risk, which could affect our result of operations and financial condition.

In connection with accounting for the acquisition of CVBK, we recorded assets acquired and liabilities assumed at their fair value, which resulted in us recording certain intangible assets, including goodwill. Adverse conditions in our business climate, including a significant decline in future operating cash flows, a significant change in our stock price or market capitalization, or a deviation from our expected growth rate and performance, may significantly affect the fair value of any goodwill (including goodwill related to the CVBK acquisition) and may trigger impairment losses, which could be materially adverse to our results of operations, financial condition and stock price.

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We rely substantially on deposits made by customers in our target markets to provide liquidity and support growth.

Our business strategies are based on access to funding from local customer deposits. Deposit levels may be affected by a number of factors, including interest rates paid by competitors, general interest rate levels, returns available to customers on alternative investments and general economic conditions. If our deposit levels fall, we could lose a relatively low cost source of funding and our interest expense would likely increase as we obtain alternative funding to replace lost deposits. If local customer deposits are not sufficient to fund our normal operations and growth, we will look to outside sources, such as borrowings from the FHLB, which is a secured funding source. Our ability to access borrowings from the FHLB will be dependent upon whether and the extent to which we can provide collateral to secure FHLB borrowings. We may also look to federal funds purchased and brokered deposits, although the use of brokered deposits may be limited or discouraged by our banking regulators. We may also seek to raise funds through the issuance of shares of our common stock, or other equity or equity-related securities, or debt securities incluing subordinated notes as additional sources of liquidity. If we are unable to access funding sufficient to support our business operations and growth strategies or are only able to access such funding on unattractive terms, we may not be able to implement our business strategies which may negatively affect our financial performance.

We are subject to security and operational risks relating to our use of technology that could damage our reputation and our business.

In the ordinary course of business, the Corporation collects and stores sensitive data, including proprietary business information and personally identifiable information of our customers and employees, in systems and on networks. The secure processing, maintenance and use of this information is critical to operations and the Corporation's business strategy. The Corporation has invested in information security technologies and continually reviews processes and practices that are designed to protect its networks, computers and data from damage or unauthorized access. Despite these security measures, the Corporation's computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Security breaches, including cyber incidents and hacking events, have been experienced by several of the world's largest financial institutions that utilize sophisticated security tools to prevent such breaches, incidents and events. Any security breach that we experience could expose us to possible liability and damage our reputation. We rely on standard security systems and procedures to provide the security and authentication necessary to effect secure collection, transmission and storage of sensitive data. These systems and procedures include but are not limited to (i) regular penetration testing of our network perimeter, (ii) regular employee training programs on sound security practices, (iii) deployment of tools to monitor our network including intrusion prevention and detection systems, electronic mail spam filters, anti-virus and anti-malware, resource logging and patch management, (iv) multifactor authentication for customers using treasury management tools, and (v) enforcement of security policies and procedures for the additions and maintenance of user access and rights to resources.

While most of our core data processing is conducted internally, certain key applications are outsourced to third party providers. If our third party providers encounter difficulties or if we have difficulty in communicating with such third parties, it will significantly affect our ability to adequately process and account for customer transactions, which would significantly affect our business operations and reputation. Additionally, in recent years banking regulators

have focused on the responsibilities of financial institutions to supervise vendors and other third-party service providers. We may have to dedicate significant resources to manage risks and regulatory burdens presented by our relationship with vendors and third-party service providers, including our data processing and cybersecurity service providers.

Business counterparties, over which the Corporation may have limited or no control, may experience disruptions that could adversely affect the Corporation.

Multiple major U.S. retailers have experienced data systems incursions in recent years reportedly resulting in the thefts of credit and debit card information, online account information, and other financial data of tens of millions of the retailers' customers. Retailer incursions may affect debit cards issued and deposit accounts maintained by many banks, including C&F Bank. Although the Corporation is not aware of any instance in which the Corporation's or the Bank's systems have been breached in a retailer incursion, these events can cause the Bank to reissue a significant number of cards and take other costly steps to avoid significant theft loss to the Bank and its customers. In some cases, the Bank may be required to reimburse customers for the losses they incur. Other possible points of intrusion or disruption not within the

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Corporation's nor the Bank's control include internet service providers, electronic mail portal providers, social media portals, distant-server (or "cloud") service providers, electronic data security providers, telecommunications companies and smart phone manufacturers.

Our business is technology dependent and an inability to invest in technological improvements may adversely affect results of operations and financial condition.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services, which may require substantial capital expenditures to modify or adapt existing products and services. In addition to enhancing customer service, the effective use of technology increases efficiency and results in reduced costs, although a financial institution's initial investment in a technology product or service may represent a significant incremental cost. Our future success will depend in part upon our ability to create synergies in our operations through the use of technology and to facilitate the ability of customers to engage in financial transactions in a manner that enhances the customer experience. We cannot assure that technological improvements will increase operational efficiency or that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers, which may cause the Corporation to lose market share or incur additional expense.

Changes in accounting standards and management's selection of accounting methods, including assumptions and estimates, could materially affect our financial statements.

From time to time, the SEC and the Financial Accounting Standards Board (FASB) change the financial accounting and reporting standards that govern the preparation of the Corporation's financial statements. These changes can be hard to predict and can materially affect how the Corporation records and reports its financial condition and results of operations. In some cases, the Corporation could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings. In addition, management is required to use certain assumptions and estimates in preparing our financial statements, including determining the fair value of certain assets and liabilities, among other items. If the assumptions or estimates are incorrect, the Corporation may experience unexpected material consequences.

We rely heavily on our management team and the unexpected loss of key officers may adversely affect our operations.

We believe that our growth and future success will depend in large part on the skills of our executive officers. We also depend upon the experience of the officers of our subsidiaries and on their relationships with the communities they serve. The loss of the services of one or more of these officers could disrupt our operations and impair our ability to

implement our business strategy, which could adversely affect our business, financial condition and results of operations.

The success of our business strategies depends on our ability to identify and recruit individuals with experience and relationships in our primary markets.

The successful implementation of our business strategy will require us to continue to attract, hire, motivate and retain skilled personnel to develop new customer relationships as well as new financial products and services. The market for qualified management personnel is competitive. In addition, the process of identifying and recruiting individuals with the combination of skills and attributes required to carry out our strategy is often lengthy, and we may not be able to effectively integrate these individuals into our operations. Our inability to identify, recruit and retain talented personnel to manage our operations effectively and in a timely manner could limit our growth, which could materially adversely affect our business.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the beneficial aspects fostered by our culture, which could harm our business.

We believe that a critical contributor to our success has been our corporate culture, which focuses on building personal relationships with our customers. As our organization grows, and we are required to implement more complex

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organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively affect our future success.

Risks Related to the Regulation of the Corporation

Compliance with laws, regulations and supervisory guidance, both new and existing, may adversely affect our business, financial condition and results of operations.

We are subject to numerous laws, regulations and supervision from both federal and state agencies. During the past few years, there has been an increase in regulation of the financial services industry. We expect this increased level of oversight to continue. Failure to comply with these laws and regulations could result in financial, structural and operational penalties, including receivership. In addition, establishing systems and processes to achieve compliance with these laws and regulations may increase our costs and/or limit our ability to pursue certain business opportunities.

Laws and regulations, and any interpretations and applications with respect thereto, generally are intended to benefit consumers, borrowers and depositors, but not stockholders. The legislative and regulatory environment is beyond our control, may change rapidly and unpredictably and may negatively influence our revenues, costs, earnings, and capital levels. Our success depends on our ability to maintain compliance with both existing and new laws and regulations.

The Dodd-Frank Act could continue to increase our regulatory compliance burden and associated costs, place restrictions on certain products and services, and limit our future capital raising strategies.

A wide range of regulatory initiatives directed at the financial services industry have been proposed in recent years. One of those initiatives, the Dodd-Frank Act, represents a sweeping overhaul of the financial services industry regulatory environment within the United States and implements significant changes in the financial regulatory landscape, including through regulations issued pursuant to the Dodd-Frank Act, that will affect all financial institutions, including the Corporation. The Dodd-Frank Act and regulations adopted pursuant and related thereto have increased and will likely continue to increase our regulatory compliance burden and may have a material adverse effect on us, by increasing the costs associated with our regulatory examinations and compliance measures. The federal regulatory agencies, and particularly bank regulatory agencies, have been given significant discretion in drafting the Dodd-Frank Act’s implementing rules and regulations, some of which have not been finalized. Consequently, the complete effect of the Dodd-Frank Act will depend on the final implementing rules and regulations, and it remains too early to fully assess the complete effect of the Dodd-Frank Act and related regulatory rulemaking processes on our business, financial condition or results of operations.

The Dodd-Frank Act increases regulatory supervision and examination of bank holding companies and their banking and non-banking subsidiaries, which could increase our regulatory compliance burden and costs and restrict our ability to generate revenues from non-banking operations. The Dodd-Frank Act imposes more stringent capital requirements on bank holding companies, which when considered in connection with the Basel III Final Rules and related regulatory capital rules could significantly limit our future capital strategies. The Dodd-Frank Act also increases regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate hedging transactions.

The Consumer Financial Protection Bureau may increase our regulatory compliance burden and could affect the consumer financial products and services that we offer.

Among the Dodd-Frank Act's significant regulatory changes, the Dodd-Frank Act created a new financial consumer protection agency, the CFPB. The CFPB is reshaping the consumer financial laws through rulemaking and enforcement of the Dodd-Frank Act's prohibitions against unfair, deceptive and abusive consumer finance products or practices, which are directly affecting the business operations of financial institutions offering consumer financial products or services, including the Corporation. This agency's broad rulemaking authority includes identifying practices or acts that are unfair, deceptive or abusive in connection with any consumer financial transaction or consumer financial product or service. Although the CFPB has jurisdiction over banks with $10 billion or greater in assets, rules, regulations and policies issued by the CFPB may also apply to the Corporation or its subsidiaries by virtue of the adoption of such policies and

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best practices applied by the Federal Reserve and the FDIC. Further, the CFPB may include its own examiners in regulatory examinations by the Corporation's primary regulators. The total costs and limitations related to this additional regulatory agency and the limitations and restrictions that will be placed upon the Corporation with respect to its consumer product and service offerings have yet to be determined in their entirety. However, these costs, limitations and restrictions are producing, and may continue to produce, significant, material effects on our business, financial condition and results of operations.

The Basel III Final Rules require higher levels of capital and liquid assets, which could adversely affect the Corporation's net income and return on equity.

The Basel III Final Rules represent the most comprehensive overhaul of the U.S. banking capital framework in over two decades. This new capital framework and related changes to the standardized calculations of risk-weighted assets are complex and create additional compliance burdens, especially for community banks. The Basel III Final Rules require bank holding companies and their subsidiaries, such as the Corporation and C&F Bank, to maintain significantly more capital as a result of higher required capital levels and more demanding regulatory capital risk weightings and calculations. As a result of the Basel III Final Rules, many community banks could be forced to limit banking operations, activities and growth of loan portfolios, in order to focus on retention of earnings to improve capital levels. The Corporation believes that it maintains sufficient levels of Tier 1 and Common Equity Tier 1 capital to comply with the Basel III Final Rules. However, the Corporation can offer no assurances with regard to the ultimate effect of the Basel III Final Rules, and satisfying increased capital requirements imposed by the Basel III Final Rules may require the Corporation to limit its banking operations, retain net income or reduce dividends to improve regulatory capital levels, which could negatively affect our business, financial condition and results of operations.

Our earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies.

The policies of the Federal Reserve affect us significantly. The Federal Reserve regulates the supply of money and credit in the United States. Its policies directly and indirectly influence the rate of interest earned on loans and paid on borrowings and interest-bearing deposits and can also affect the value of financial instruments we hold. Those policies determine to a significant extent our cost of funds for lending and investing. Changes in those policies are beyond our control and are difficult to predict. Federal Reserve policies can also affect our borrowers, potentially increasing the risk that they may fail to repay their loans. For example, a tightening of the money supply by the Federal Reserve could reduce the demand for a borrower's products and services. This could adversely affect the borrower's earnings and ability to repay a loan, which could have a material adverse effect on our financial condition and results of operations.

Risks Related to the Corporation's Common Stock

Our common stock price may be volatile, which could result in losses to our investors.

Our common stock price has been volatile in the past and several factors could cause the price to fluctuate in the future. These factors include, but are not limited to, actual or anticipated variations in earnings, changes in analysts' recommendations or projections with regard to our common stock or the markets and businesses in which we operate, operations and stock performance of other companies deemed to be peers, and reports of trends and concerns and other issues related to the financial services industry. Fluctuations in our common stock price may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices.

Future sales of our common stock by shareholders or the perception that those sales could occur may cause our common stock price to decline.

Although our common stock is listed for trading on NASDAQ Global Select Market, the trading volume in our common stock may be lower than that of other larger financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the potential for lower relative trading volume in

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our common stock, significant sales of the common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of these sales or perceptions.

Future issuances of our common stock could adversely affect the market price of the common stock and could be dilutive.

We may issue additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, shares of our common stock. Issuances of a substantial number of shares of our common stock, or the expectation that such issuances might occur, including in connection with acquisitions, could materially adversely affect the market price of the shares of our common stock and could be dilutive to shareholders. Any decision we make to issue common stock in the future will depend on market conditions and other factors, and we cannot predict or estimate the amount, timing, or nature of possible future issuances of our common stock. Accordingly, our common shareholders bear the risk that future issuances of our securities will reduce the market price of the common stock and dilute their stock holdings in the Corporation.

We rely on dividends from our subsidiaries for substantially all of our revenue

The Corporation is a bank holding company that conducts substantially all of its operations through the Bank and the Bank's subsidiaries. As a result, the Corporation relies on dividends from the Bank for substantially all of its revenues. There are various regulatory restrictions on the ability of the Bank to pay dividends or make other payments to the Corporation, and the Corporation's right to participate in a distribution of assets upon the Bank's liquidation or reorganization is subject to the prior claims of the Bank's creditors. If the Bank is unable to pay dividends to the Corporation, the Corporation may not be able to service its outstanding borrowings and other debt, pay its other obligations or pay a cash dividend to the holders of the Corporation's common stock, and the Corporation's business, financial condition and results of operations may be materially adversely affected. Further, although the Corporation has historically paid cash dividends to holders of its common stock, holders of common stock are not entitled to receive dividends and regulatory or economic factors may cause the Corporation's Board of Directors to consider, among other actions, the reduction of dividends paid on the Corporation's common stock even if the Bank continues to pay dividends to the Corporation.

ITEM 1B.UNRESOLVED STAFF COMMENTS

The Corporation has no unresolved comments from the SEC staff.

ITEM 2.PROPERTIES

The following describes the location and general character of the principal offices and other materially important physical properties of the Corporation.

C&F Bank owns a building located at Eighth and Main Streets in the business district of West Point, Virginia. The building, originally constructed in 1923, has three floors totaling 15,000 square feet. This building houses C&F Bank's Main Office and the main office of C&F Wealth Management Corporation.

C&F Bank owns a building located at 3600 LaGrange Parkway in Toano, Virginia. The building was acquired in 2004 and has 85,000 square feet. Portions of the building were renovated in 2005, 2014, and 2016 in order to house C&F Bank's operations center, which consists of C&F Bank's loan, deposit and administrative functions and staff.

C&F Bank owns a building located at 1400 Alverser Drive in Midlothian, Virginia. The building provides space for a branch office of C&F Bank and for a C&F Mortgage branch office, as well as C&F Mortgage's main administrative offices. This two-story building has 25,000 square feet and was constructed in 2001.

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C&F Bank owns 23 other retail banking branch locations and leases one retail banking branch location and one regional commercial lending office in Virginia. Rental expense for leased locations totaled $214,000 for the year ended December 31, 2016.

C&F Mortgage's Newport News loan production office is located on the second floor of C&F Bank's Newport News branch building. In addition, C&F Mortgage has 14 loan production offices leased from nonaffiliates including 10 in Virginia, two in North Carolina, and two in Maryland. Rental expense for leased locations totaled $737,000 for the year ended December 31, 2016.

The Hampton office of C&F Finance is located on the second floor of C&F Bank's Hampton branch building. C&F Finance has a lease agreement with an unrelated third party for approximately 17,000 square feet of office space in Richmond, Virginia, which is being used for C&F Finance's headquarters and its loan and administrative functions and staff. C&F Finance has two leased offices, one each in Maryland and Tennessee. Rental expense for leased locations totaled $441,000 for the year ended December 31, 2016.

All of the Corporation's properties are in good operating condition and are adequate for the Corporation's present and anticipated future needs.

ITEM 3.LEGAL PROCEEDINGS

The Corporation and its subsidiaries may be involved in certain litigation matters arising in the ordinary course of business. Although the ultimate outcome of these matters cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, we believe, based on current knowledge, that the resolution of any such matters arising in the ordinary course of business will not have a material adverse effect on the Corporation.

ITEM 4.MINE SAFETY DISCLOSURES

None.

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EXECUTIVE OFFICERS OF THE REGISTRANT

Name (Age) Present Position	Business Experience During Past Five Years
Larry G. Dillon (64) Chairman and Chief Executive Officer	Chairman and Chief Executive Officer of the Corporation and C&F Bank since December 2014; Chairman, President and Chief Executive Officer of the Corporation and C&F Bank from 1989 to December 2014; Chairman, President and Chief Executive Officer of CVBK and CVB from September 2013 through March 2014
Thomas F. Cherry (48) President and Secretary	Secretary of the Corporation and C&F Bank since 2002; Director of the Corporation and C&F Bank since April 2015; President of the Corporation and the Bank since April 2016; President and Chief Financial Officer of the Corporation and C&F Bank from December 2014 to March 2016; Executive Vice President and Chief Financial Officer of the Corporation and C&F Bank from December 2004 to December 2014; Executive Vice President and Chief Financial Officer of CVBK and CVB from September 2013 through March 2014
Jason E. Long (38) Senior Vice President and Chief Financial Officer	Senior Vice President and Chief Financial Officer of the Corporation and C&F Bank since March 2016; First Vice President of C&F Bank from October 2014 to March 2016; Various positions, most recently Principal from April 2013 through September 2014, at the accounting firm of Yount, Hyde & Barbour, P.C. since 2002 focusing on the financial services industry
John A. Seaman, III (59) Senior Vice President and Chief Credit Officer, C&F Bank	Senior Vice President and Chief Credit Officer of C&F Bank since October 2011 and of CVB from September 2013 through March 2014
Bryan E. McKernon (60)	President and Chief Executive Officer of C&F Mortgage since 1995; Director of C&F Bank since 1998

President and Chief
Executive Officer,

C&F Mortgage

S. Dustin Crone (48)	President of C&F Finance since 2010

President, C&F
Finance

PART II

ITEM 5.MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation’s common stock is listed for trading on the NASDAQ Global Select Market of the NASDAQ Stock Market under the symbol “CFFI.” As of February 28, 2017, there were approximately 2,200 shareholders of record. As of that date, the closing price of our common stock on the NASDAQ Global Select Stock Market was $47.50. Following are

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the high and low sales prices as reported by the NASDAQ Stock Market, along with the dividends that were declared quarterly in 2016 and 2015.

	2016			2015		
Quarter	High	Low	Dividends	High	Low	Dividends
First	$ 41.05	$ 37.02	$ 0.32	$ 39.75	$ 34.05	$ 0.30
Second	46.28	37.64	0.32	37.92	33.76	0.30
Third	47.00	40.22	0.32	38.00	33.20	0.30
Fourth	53.40	40.01	0.33	39.77	35.02	0.32

Payment of dividends is at the discretion of the Corporation's Board of Directors and is subject to various federal and state regulatory limitations. For further information regarding payment of dividends refer to Item 1, "Business," under the heading "Limits on Dividends."

Issuer Purchases of Equity Securities

The Corporation's Board of Directors authorized a share repurchase program for the Corporation's outstanding common stock (the Repurchase Program) in May 2014, which initially expired in May 2015. In both May 2015 and May 2016, the Corporation's Board of Directors reauthorized the Repurchase Program to authorize repurchases of up to $5.0 million of the Corporation's common stock through May 2016 and May 2017, respectively. Repurchases under the Repurchase Program may be made through privately-negotiated transactions, or open-market transactions, including pursuant to a trading plan in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934 (the Exchange Act) and/or Rule 10b-18 of the Exchange Act. As of December 31, 2016, $5.0 million of the Corporation's common stock may be purchased under the Repurchase Program.

The following table summarizes repurchases of the Corporation's common stock that occurred during the three months ended December 31, 2016.

Total Number of Shares Purchased as	Maximum (or Approx Dollar Val Shares tha

(Dollars in thousands, except for per share amounts)	Total Number of Shares Purchased	Average Price Paid per Share	Part of Publicly Announced Plans or Programs	Be Purcha Under the Programs
October 1, 2016 - October 31, 2016	—	$ —	—	$ 5,000
November 1, 2016 - November 30, 2016	—	—	—	5,000
December 1, 2016 - December 31, 2016[1]	5,179	50.00	—	5,000
Total	5,179	$ 50.00	—	$ 5,000

[1] These shares were withheld to satisfy tax withholding obligations arising upon the vesting of restricted shares. Accordingly, these shares are not included in the calculation of approximate dollar value of shares that may yet be purchased under the Repurchase Program.

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ITEM 6. SELECTED FINANCIAL DATA

Five Year Financial Summary

(Dollars in thousands, except share and per share amounts)	2016	2015	2014	2013	2012
Selected Year-End Balances:					
Total assets	$ 1,451,992	$ 1,405,076	$ 1,338,187	$ 1,312,536	$ 977,215
Total shareholders’ equity	139,214	131,059	123,610	113,180	102,394
Loans (net)	960,162	865,892	800,198	785,532	640,283
Total deposits	1,119,921	1,073,633	1,026,101	1,008,292	686,184
Summary of Operations:					
Interest income	$ 89,439	$ 87,049	$ 86,495	$ 80,212	$ 76,964
Interest expense	8,968	8,694	8,525	8,623	10,111
Net interest income	80,471	78,355	77,970	71,589	66,853
Provision for loan losses	18,040	15,512	16,330	15,085	12,405
Net interest income after provision for loan losses	62,431	62,843	61,640	56,504	54,448
Noninterest income	25,627	20,714	19,405	21,668	20,622
Noninterest expenses	70,140	66,174	63,557	56,599	51,042
Income before taxes	17,918	17,383	17,488	21,573	24,028
Income tax expense	4,459	4,853	5,144	7,129	7,646

Net income	13,459	12,530	12,344	14,444	16,382
Effective dividends on preferred stock	—	—	—	—	311
Net income available to common shareholders	$ 13,459	$ 12,530	$ 12,344	$ 14,444	$ 16,071
Per share:					
Earnings per common share—basic	$ 3.90	$ 3.68	$ 3.63	$ 4.37	$ 5.00
Earnings per common share—assuming dilution	3.89	3.68	3.59	4.19	4.86
Dividends per common share	1.29	1.22	1.19	1.16	1.08
Weighted average number of shares—assuming dilution	3,455,883	3,401,834	3,436,278	3,443,982	3,305,902
Significant Ratios:					
Return on average assets	0.96 %	0.92 %	0.93 %	1.35 %	1.71 %
Return on average common equity	9.90	9.87	10.32	13.39	17.05
Dividend payout ratio – common shares	33.08	33.20	32.80	26.61	21.60
Average common equity to average assets	9.65	9.29	9.02	10.07	10.03

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ITEM 7.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Corporation's expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute "forward-looking statements" as defined by federal securities laws and may include, but are not limited to, statements regarding future financial performance, liquidity, strategic business initiatives including personnel additions, expansion into new markets and the utilization of scorecard models, capital levels, the effect of future market and industry trends including competitive trends in the nonprime consumer finance markets, the Corporation's and each business segment's loan portfolio and business prospects related to each segment's loan portfolio, asset quality and adequacy of the allowances for loan losses and level of future charge-offs, trends regarding the provision for loan losses, trends regarding net loan charge-offs, trends regarding levels of nonperforming assets and troubled debt restructurings and expenses associated with nonperforming assets, the amount and timing of accretion associated with the fair value accounting adjustments recorded in connection with the 2013 acquisition of CVBK, adequacy of the allowance for indemnification losses, levels of noninterest income and expense, interest rates and yields including possible future changes in interest rate environments, the deposit portfolio including trends in deposit maturities and rates, interest rate sensitivity, market risk, regulatory developments, monetary policy implemented by the Federal Reserve Board including changes to the federal funds target rate, capital requirements, growth strategy, hedging strategy and financial and other goals and the effect of the inclusion of the Corporation's stock in the Russell 2000® Index. These statements may address issues that involve estimates and assumptions made by management and risks and uncertainties. Actual results could differ materially from historical results or those anticipated or implied by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

· interest rates, such as volatility in yields on U.S. Treasury bonds and increases or volatility in mortgage rates

· general business conditions, as well as conditions within the financial markets

· general economic conditions, including unemployment levels

· the legislative/regulatory climate, including regulatory initiatives with respect to financial institutions, products and services in accordance with the Dodd Frank Act, the CFPB and the regulatory and enforcement activities of the CFPB, and the application of the Basel III capital standards to the Corporation and the Bank

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monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, and the effect of these policies on interest rates and business in our markets

- the value of securities held in the Corporation’s investment portfolios

- demand for loan products

- the quality or composition of the loan portfolios and the value of the collateral securing those loans

- the commercial and residential real estate markets

- the inventory level and pricing of used automobiles, including sales prices of repossessed vehicles

- the level of net charge-offs on loans and the adequacy of our allowance for loan losses

- deposit flows

- demand in the secondary residential mortgage loan markets

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- the level of indemnification losses related to mortgage loans sold
- the strength of the Corporation’s counterparties and the economy in general
- competition from both banks and non-banks, including competition in the non-prime automobile finance markets
- demand for financial services in the Corporation’s market area
- the Corporation's expansion and technology initiatives
- reliance on third parties for key services
- accounting principles, policies and guidelines and elections made by the Corporation thereunder

These risks and uncertainties, and the risks discussed in more detail in Item 1A, “Risk Factors,” should be considered in evaluating the forward-looking statements contained herein. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report.

The following discussion supplements and provides information about the major components of the results of operations, financial condition, liquidity and capital resources of the Corporation. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires us to make estimates and assumptions. Those accounting policies with the greatest uncertainty and that require management’s most difficult, subjective or complex judgments affecting the application of these policies, and the likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are described below.

Allowance for Loan Losses: We establish the allowance for loan losses through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. Our judgment in determining the level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs for relevant periods of time, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower’s ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available. For more information, see the section titled “Asset Quality” within Item 7.

Allowance for Indemnifications: The allowance for indemnifications is established through charges to earnings in the form of a provision for indemnifications, which is included in other noninterest expenses. A loss is charged against the allowance for indemnifications when a purchaser of a loan (investor) sold by C&F Mortgage incurs a validated indemnified loss due to borrower misrepresentation, fraud, early default, or underwriting error. The allowance represents an amount that, in management’s judgment, will be adequate to absorb any losses arising from valid indemnification requests. Management’s judgment in determining the level of the allowance is based on the volume of loans sold, historical experience, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

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Impairment of Loans: We consider a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. We measure impairment on a loan-by-loan basis for commercial, construction and residential loans in excess of $500,000 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. Troubled debt restructurings (TDRs) are also considered impaired loans, even when the loan balance is less than $500,000. A TDR occurs when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. For more information see the section titled "Asset Quality" within Item 7.

Loans Acquired in a Business Combination: Loans acquired in the acquisition of CVBK and its subsidiary CVB were segregated between (i) purchased credit-impaired (PCI) loans and (ii) purchased performing loans and were recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses.

PCI loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments. When determining fair value, PCI loans were aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the "nonaccretable difference," is not recorded and is available to absorb future credit losses on those loans. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the "accretable" yield and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

Subsequent to acquisition, we evaluate on a quarterly basis our estimate of cash flows expected to be collected. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan, or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

The Corporation's PCI loans currently consist of loans acquired in connection with the acquisition of CVB. PCI loans that were classified as nonperforming by CVB are no longer classified as nonperforming so long as, at quarterly re-estimation periods, we believe we will fully collect the new carrying value of the pools of loans.

The Corporation accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. Because there is no allowance for loan losses established at the acquisition date, a provision for loan losses may be required in future periods for any deterioration in these loans subsequent to the acquisition.

Impairment of Securities: Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) we intend to sell the security or (ii) it is more-likely-than-not that we will be required to sell the security before recovery of its amortized cost basis. If, however, we do not intend to sell the security and it is not more-likely-than-not that we will be required to sell the security before recovery, we must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities, impairment is considered to be other-than-temporary based on our ability and intent to hold the investment until a recovery of fair

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value. Other-than-temporary impairment of an equity security results in a write-down that must be included in net income. We regularly review each investment security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, our best estimate of the present value of cash flows expected to be collected from debt securities, our intention with regard to holding the security to maturity and the likelihood that we would be required to sell the security before recovery.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further deterioration in market conditions.

Goodwill: The Corporation's goodwill was recognized in connection with the Corporation's acquisition of CVBK in October 2013 and C&F Bank's acquisition of C&F Finance Company in September 2002. The Corporation reviews the carrying value of goodwill at least annually or more frequently if certain impairment indicators exist. In assessing the recoverability of the Corporation’s goodwill, major assumptions used in determining impairment are increases in future income, sales multiples in determining terminal value and the discount rate applied to future cash flows. If an impairment test is performed, we will prepare a sensitivity analysis by increasing the discount rate, lowering sales multiples and reducing increases in future income.

Retirement Plan: C&F Bank maintains a non-contributory, defined benefit pension plan for eligible full-time employees as specified by the plan. Plan assets, which consist primarily of mutual funds invested in marketable equity securities and corporate and government fixed income securities, are valued using market quotations. C&F Bank’s actuary determines plan obligations and annual pension expense using a number of key assumptions. Key assumptions may include the discount rate, the interest crediting rate, the estimated future return on plan assets and the anticipated rate of future salary increases. Changes in these assumptions in the future, if any, or in the method under which benefits are calculated may affect pension assets, liabilities or expense.

Derivative Financial Instruments: The Corporation uses derivatives primarily to manage risk associated with changing interest rates and to assist customers with their risk management objectives. The Corporation’s derivative financial instruments may include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be held for sale and related forward sales commitments, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify as cash flow hedges of the Corporation’s trust preferred capital notes. The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the consolidated balance sheet. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are classified as free standing derivatives, adjustments to reflect unrealized gains and losses resulting from changes in fair value of these instruments are reported in the income

statement. The effective portion of the gain or loss on the Corporation’s cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings.

Income Taxes: Determining the Corporation’s effective tax rate requires judgment. The Corporation’s net deferred tax asset is determined annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, there may be transactions and calculations for which the ultimate tax outcomes are uncertain and the Corporation’s tax returns are subject to audit by various tax authorities. Although we believe that the estimates are reasonable, no assurance can be given that the final tax outcome will not be materially different than that which is reflected in the income tax provision and accrual.

For further information concerning accounting policies, refer to Item 8, “Financial Statements and Supplementary Data,” under the heading “Note 1: Summary of Significant Accounting Policies.”

OVERVIEW

Our primary financial goals are to maximize the Corporation’s earnings and to deploy capital in profitable growth initiatives that will enhance long-term shareholder value. We track three primary financial performance measures in order to assess the level of success in achieving these goals: (i) return on average assets (ROA), (ii) return on average common equity (ROE), and (iii) growth in earnings. In addition to these financial performance measures, we track the performance of the Corporation’s three principal business activities: retail banking, mortgage banking, and consumer finance. We also actively manage our capital through growth, dividends and share repurchases, while considering the need to maintain a strong regulatory capital position.

Financial Performance Measures

Net income for the Corporation was $13.5 million in 2016, or $3.89 per common share assuming dilution, compared with net income of $12.5 million in 2015, or $3.68 per common share assuming dilution. The change in financial results for 2016, as compared to 2015, was attributable to increases in earnings at the Retail Banking and Mortgage Banking segments, offset in part by decreases in earnings at the Consumer Finance segment and the Bank’s wealth management subsidiary. See “Principal Business Activities” below for additional discussion.

The Corporation’s ROE and ROA were 9.90 percent and 0.96 percent, respectively, for the year ended December 31, 2016, compared to 9.87 percent and 0.92 percent, respectively, for the year ended December 31, 2015. The increase in these ratios during 2016 resulted primarily from earnings growth, which outpaced the growth in average equity and average assets. Average equity increased due to internal capital growth and average assets increased primarily due to the 10.0 percent increase in average loans.

2017 Outlook

Management believes the Corporation’s financial performance in 2017 will be affected by (i) lower accretion income related to the fair value accounting adjustments for the CVBK acquisition, partially offset by an increase in interest income from growth in average loans outstanding, (ii) an uncertain interest rate environment and potential fluctuations in interest rates that may depress loan production levels in the Mortgage Banking segment, and (iii) continued elevated charge-off levels and competition in the Consumer Finance segment. The following additional factors could influence the Corporation’s financial performance in 2017:

- Retail Banking: Growth in higher-yielding earning assets, specifically loans, will be our primary focus at the Bank during 2017. With commercial and small business lending teams already in our targeted markets in Charlottesville, Hampton, Newport News, Richmond and Williamsburg, Virginia and the continued resurgence in the real estate development and construction sectors in our markets, we expect to continue to grow our loan portfolio during 2017. However, the general economic trends in the Bank's markets and the current low interest rate environment have contributed to increased competition and lower yields on both the loan and investment portfolios. It will be challenging to maintain the Retail Banking segment's net interest margin at its current level as the net accretion of the fair value accounting adjustments recorded in connection with the CVB acquisition decline and as the recent increase in the federal funds rate provides stimulus for higher-costing deposits. Also in 2017, we will continue to focus on our digital strategy because online and mobile access are quickly becoming the primary means of banking for many businesses and individuals, and we believe our digital strategy commitment is critical to remaining competitive within the financial services industry.

- Mortgage Banking: C&F Mortgage generates significant noninterest income from the sale of residential loan products into the secondary market. Although earnings increased at the Mortgage Banking segment in 2016, compared to 2015, increasing future profitability at the current origination levels will be challenging due to the fixed costs of maintaining the personnel, compliance and technology infrastructure required to support mortgage banking activities. While our goal is to increase origination volume through internal growth in existing markets and through strategic initiatives, such as our recent expansion into Chesapeake, Virginia and Moyock, North Carolina, our ability to maintain a level of loan production in 2017 sufficient to sustain profitability will be dependent on market factors beyond our control, such as the interest rate environment and

changes in interest rates, housing starts and loan demand. If mortgage interest rates continue to rise during 2017, C&F Mortgage may experience a lower loan demand, particularly for mortgage refinancings, which could negatively affect earnings of the Mortgage Banking segment in 2017. In addition, during 2017 C&F Mortgage anticipates it will continue to (i) compete to retain and attract qualified loan officers, (ii) incur costs associated with updating and enhancing our compliance management system and processes for originating residential loans to mitigate compliance and regulatory risks, as well as improving the quality of our loan origination process and (iii) utilize systems to their fullest capacity in order to realize efficiencies overall in our mortgage banking processes and to create opportunities for revenue generation.

- Consumer Finance: C&F Finance provides automobile financing through programs that are designed to serve customers in the non-prime market. As has been the case for the last several years, competition in the non-prime automobile loan business remains aggressive, resulting in lower interest rates and in many cases, less restrictive underwriting standards by several of our competitors. As a result, organic loan growth was difficult during 2016, and we expect organic loan growth to be equally as challenging in 2017. However, C&F Finance implemented strategic initiatives in 2016 to mitigate the effects of aggressive competition. During 2016, C&F Finance implemented a scorecard model that improved underwriting and pricing efficiencies and contributed to loan growth. We expect this model, along with personnel additions in certain major markets, will lead to loan growth in 2017. Further, we believe our scorecard model, which results in the purchase of loans with higher credit metrics, should help reduce future charge-offs at C&F Finance. However, we believe it will be challenging to maintain the Consumer Finance segment's net interest margin at its current level as competition in the non-prime market causes yields to decline and the recent increase in the federal funds rate triggers higher-costing variable-rate borrowings. During 2017, we expect to continue investing in technology at C&F Finance in order to capture more business, improve efficiencies, and manage the rigorous regulatory burdens and evolving compliance issues in the indirect auto lending industry.

Principal Business Activities

An overview of the financial results for each of the Corporation's principal segments is presented below. A more detailed discussion is included in the section "Results of Operations."

Retail Banking: The Retail Banking segment reported net income of $8.2 million for the year ended December 31, 2016, compared to net income of $5.6 million for the year ended December 31, 2015. Net income for 2016 was positively influenced by (1) the effect of loan growth on interest income, as average loans at the Retail Banking segment increased $72.9 million or 12.6 percent during 2016 over 2015, (2) an increase in non-interest income due to fees collected on loans closed under a new loan interest rate swap program initiated in 2016, (3) an increase in debit card interchange income, and (4) a lower cost of borrowings resulting from the maturity and restructuring of the Bank's higher-rate FHLB advances. Also contributing to the increase in earnings during 2016 were one-time revenue items in the second quarter of 2016 associated with a contract amendment for one of the Bank's debit card programs ($237,000 after tax), the Bank's bank-owned life insurance program ($493,000 after tax) and a gain on the sale of a Bank-owned property ($92,000 after tax). Partially offsetting these positive factors were (1) a decline in the yield on the investment portfolio due to replacing matured and called securities with lower-yielding securities, (2) a decline in the yield on loans due to the effects of the low interest rate and competitive loan environment, and (3) higher

operating expenses associated with strengthening C&F Bank's technology infrastructure, growing its commercial lending teams, expanding its product offerings and promoting brand awareness.

The results for both 2016 and 2015 for the Retail Banking segment have been affected by the fair value accounting adjustments recorded in connection with the 2013 acquisition of CVB. These adjustments resulted from marking assets and liabilities acquired from CVB to their fair values as of the acquisition date. As a result, yields on loans and investments acquired from CVB increased and the cost of certificates of deposit decreased, the benefits of which were partially offset by the (1) amortization of the core deposit intangible and (2) higher depreciation expense associated with the buildings acquired in the CVB merger. The aggregate net accretion attributable to these fair value accounting adjustments was $1.2 million, net of taxes for the year ended December 31, 2016, compared to $1.3 million, net of taxes for the year ended December 31, 2015.

The Retail Banking segment's nonperforming assets were $4.4 million at December 31, 2016, compared to $7.1 million at December 31, 2015. Nonperforming assets at December 31, 2016 included $4.2 million in nonaccrual loans, compared to $6.2 million at December 31, 2015, and $195,000 in OREO, compared to $942,000 at December 31, 2015. The decrease in nonaccrual loans during 2016 was primarily due to loan payoffs and transfers to OREO. The OREO decrease during 2016 was primarily due to the sale of several OREO properties and a shorter holding period for properties transferred to OREO during 2016. Management believes the current level of the allowance for loan losses is adequate to absorb probable losses inherent in the loan portfolio, based on the relevant history of charge-offs and recoveries, current economic conditions, overall portfolio quality, review of specific criticized loans and other factors analyzed by management. If loan concentrations within the Bank's loan portfolio result in higher credit risk or if economic conditions decline, a higher loan loss allowance may be warranted in future periods, which may require a provision for loan losses.

Mortgage Banking: The Mortgage Banking segment reported net income of $1.7 million for the year ended December 31, 2016, compared to $677,000 for the year ended December 31, 2015. The improvement in net income of the Mortgage Banking segment for 2016 resulted from an increase in the volume of mortgage loans originated and sold during 2016, compared to 2015. Loan volume increased due to successful strategic initiatives and benefited from favorable housing markets for both resale and new construction, as well as favorable interest rates. The higher loan volume resulted in higher gains on sales of loans and higher ancillary loan origination fees. These revenue increases were partially offset by higher employee compensation and loan production expenses, as well as costs associated with the mortgage banking segment's expansion into Chesapeake, Virginia and the Outer Banks of North Carolina, which began in the fourth quarter of 2016. Loan origination volume for the year ended December 31, 2016 increased to $674.3 million from $549.3 million for the year ended December 31, 2015. The amount of loan originations during 2016 for refinancings and home purchases were $152.7 million and $521.6 million, respectively, compared to $104.4 million and $444.9 million, respectively, during 2015.

Consumer Finance: The Consumer Finance segment reported net income of $4.5 million for the year ended December 31, 2016, compared to $7.2 million for the year ended December 31, 2015. The decline in net income for 2016, compared to 2015, was principally due to an increase in the provision for loan losses from $15.5 million in 2015 to $18.0 million in 2016 because of higher net charge-offs, as discussed below, and loan growth. Partially offsetting the effect of the higher provision for loan losses was the effect on net interest income of the $13.7 million increase in average loans during 2016, as compared to 2015. The increase in average loans was attributable to the purchase of a consumer finance loan portfolio at the end of the second quarter of 2015, along with organic loan growth during 2016. C&F Finance has implemented a scorecard model that is providing underwriting efficiencies and generating more competitive pricing, which, along with personnel additions in certain major markets, led to an increase in loan originations during 2016.

The results of the Consumer Finance segment included an increase of $2.6 million in the provision for loan losses from 2015 to 2016. The net charge-off ratio for 2016 was 5.59 percent, compared to 5.50 percent for 2015. Loans charged off increased during 2016 because of economic and competitive factors affecting non-prime consumer finance customers. The allowance for loan losses to total loans increased to 8.40 percent at December 31, 2016, compared to 8.21 percent at December 31, 2015. Management believes that the current allowance for loan losses is adequate to

absorb probable losses in the loan portfolio. If factors influencing the consumer finance segment result in a higher net charge-off ratio in the future, C&F Finance Company may need to increase the level of its allowance for loan losses, which could negatively affect future earnings.

Other and Eliminations: The other segment, which principally includes the Corporation's holding company operations and wealth management subsidiary, reported an aggregate net loss of $975,000 for the year ended December 31, 2016, compared to a net loss of $955,000 for the year ended December 31, 2015. The higher loss during 2016 was due to lower earnings at the Corporation's wealth management subsidiary due to stock market volatility during 2016, as well as costs associated with the wealth management subsidiary's addition of a new wealth management group in Williamsburg, Virginia. We expect the addition of this wealth management group will increase revenue in future periods. Other segments also included a $229,000 and $163,000 tax benefit during the year and the fourth quarter of 2016, respectively, associated with the adoption of a new accounting standard.

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Capital Management

Total shareholders' equity was $139.2 million at December 31, 2016, compared to $131.1 million at December 31, 2015. Capital growth resulted from earnings for the year ended December 31, 2016 and stock option exercises, offset in part by dividends during the year.

The Corporation's Board of Directors continued its policy of paying dividends in 2016. For the year ended December 31, 2016, the Corporation declared dividends of $1.29 per share, which was a six percent increase over dividends of $1.22 per share declared in 2015. The dividend payout ratio was 33.1 percent of basic earnings per share for the year ended December 31, 2016, compared to 33.2 percent in 2015. The Board of Directors of the Corporation continually reviews the amount of cash dividends per share and the resulting dividend payout ratio in light of changes in economic conditions, capital levels, expected future earnings, and regulatory capital requirements.

During the second quarter of 2016, the Corporation's Board of Directors reauthorized a share repurchase program for the Corporation's outstanding common stock (the Repurchase Program) to purchase up to $5.0 million of the Corporation's common stock through May 2017. As of December 31, 2016, the Corporation had not used any of this authority and remained authorized to purchase up to $5.0 million of the Corporation's common stock under the Repurchase Program.

During the second quarter of 2016, the Corporation qualified for inclusion in the Russell 2000® Index, which serves as a benchmark for small-cap stocks in the United States. Management believes that inclusion in the Russell 2000® has the potential to raise the Corporation's profile and generate greater interest in the Corporation's stock at an institutional investor level.

RESULTS OF OPERATIONS

NET INTEREST INCOME

The following table shows the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for each of the years ended December 31, 2016, 2015 and 2014. Loans include loans held for sale. Loans placed on a nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Accretion and amortization of fair value purchase adjustments are included in the computation of yields on loans and investments and on the cost of

deposits and borrowings acquired in connection with the purchase of CVB. The CVB accretion contributed approximately 24 basis points to the yield on loans and 17 basis points to the yield on interest earning assets and net interest margin for the year ended December 31, 2016 compared to approximately 25 basis points to the yield on loans and 18 basis points to both the yield on interest earning assets and the net interest margin for the year ended December 31, 2015 and approximately 32 basis points to the yield on loans, 22 basis points to the yield on interest earning assets and 23 basis points to the net interest margin for the year ended December 31, 2014. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid using the federal corporate income tax rate of 34 percent in all three years presented).

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TABLE 1: Average Balances, Income and Expense, Yields and Rates

(Dollars in thousands)	2016 Average Balance	Income/ Expense	Yield/ Rate		2015 Average Balance	Income/ Expense	Yield/ Rate		2014 Average Balance	Income/ Expense
Assets										
Securities:										
Taxable	$ 99,564	$ 2,237	2.25	%	$ 99,611	$ 2,422	2.43	%	$ 96,286	$ 2,493
Tax-exempt	109,979	5,670	5.16		116,414	6,305	5.42		118,221	6,693
Total securities	209,543	7,907	3.77		216,025	8,727	4.04		214,507	9,186
Total loans	994,808	83,036	8.35		905,616	80,177	8.85		854,948	79,246
Interest-bearing deposits in other banks	105,293	509	0.48		146,622	364	0.25		157,205	378
Total earning assets	1,309,644	91,452	6.98		1,268,263	89,268	7.04		1,226,660	88,810
Allowance for loan losses	(36,192)				(35,349)				(35,090)	
Total non-earning assets	135,615				133,030				132,785	
Total assets	$ 1,409,067				$ 1,365,944				$ 1,324,355	
Liabilities and Shareholders' Equity										
Time and savings deposits:										
Interest-bearing demand deposits	$ 211,441	$ 425	0.20	%	$ 203,614	$ 448	0.22	%	$ 186,548	$ 439
Money market deposit accounts	213,793	571	0.27		204,597	563	0.28		181,530	493
Savings accounts	102,899	82	0.08		99,585	79	0.08		97,643	83
Certificates of deposit, $100 or more	142,115	1,496	1.04		139,878	1,282	0.92		139,502	1,299
	198,061	1,818	0.91		209,909	1,822	0.87		241,231	1,766

Other certificates of deposit											
Total time and savings deposits	868,309	4,392	0.50		857,583	4,194	0.49		846,454	4,080	
Borrowings	170,490	4,576	2.68		173,187	4,500	2.60		170,101	4,445	
Total interest-bearing liabilities	1,038,799	8,968	0.86		1,030,770	8,694	0.84		1,016,555	8,525	
Demand deposits	210,520				185,774				166,928		
Other liabilities	23,842				22,491				21,261		
Total liabilities	1,273,161				1,239,035				1,204,744		
Shareholders' equity	135,906				126,909				119,611		
Total liabilities and shareholders' equity	$ 1,409,067				$ 1,365,944				$ 1,324,355		
Net interest income		$ 82,484				$ 80,574				$ 80,285	
Interest rate spread			6.12	%			6.20	%			
Interest expense to average earning assets			0.68	%			0.69	%			
Net interest margin			6.30	%			6.35	%			

Interest income and expense are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table shows the direct causes of the year-to-year changes in the components of net interest income on a taxable-equivalent basis. The Corporation calculates the rate and volume variances using a formula prescribed by the SEC. Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the relationship of the absolute dollar amounts of the change in each. Loans include both nonaccrual loans and loans held for sale.

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TABLE 2: Rate-Volume Recap

	2016 from 2015 Increase (Decrease) Due to		Total Increase	2015 from 2014 Increase (Decrease) Due to		Total Increase
(Dollars in thousands)	Rate	Volume	(Decrease)	Rate	Volume	(Decrease)
Interest income:						
Loans	$ (4,731)	$ 7,590	$ 2,859	$ (3,646)	$ 4,577	$ 931
Securities:						
Taxable	(184)	(1)	(185)	(155)	84	(71)
Tax-exempt	(298)	(337)	(635)	(287)	(101)	(388)
Interest-bearing deposits in other banks	270	(125)	145	12	(26)	(14)
Total interest income	(4,943)	7,127	2,184	(4,076)	4,534	458
Interest expense:						
Time and savings deposits:						
Interest-bearing demand deposits	(40)	17	(23)	(30)	39	9
Money market deposit accounts	(22)	30	8	7	63	70
Savings accounts	—	3	3	(6)	2	(4)
Certificates of deposit, $100 or more	191	23	214	(20)	3	(17)
Other certificates of deposit	91	(95)	(4)	303	(247)	56
Total time and savings deposits	220	(22)	198	254	(140)	114
Borrowings	146	(70)	76	(25)	80	55
Total interest expense	366	(92)	274	229	(60)	169
Change in net interest income	$ (5,309)	$ 7,219	$ 1,910	$ (4,305)	$ 4,594	$ 289

2016 Compared to 2015

Net interest income, on a taxable-equivalent basis, for 2016 increased to $82.5 million, compared to $80.6 million for 2015. The increase in net interest income for 2016, compared to 2015, was a result of an increase in average earning assets, offset in part by a decrease in net interest margin. The net interest margin for 2016 decreased five basis points to 6.30 percent, compared to 6.35 percent for 2015. The decrease resulted from a decline in the yield on interest-earning assets of six basis points, which was primarily attributable to decreases in the yields on the loan and investment securities portfolios, which was somewhat offset by a shift in the composition of earning assets as growth in the higher-yielding loan portfolio was funded in part by a decline in lower-yielding deposits in other banks. While the cost of interest-bearing liabilities in 2016 increased two basis points, deposits continued to shift from higher-cost term deposits to lower-cost non-term deposits, as described below.

Average loans, which includes both loans held for investment and loans held for sale, increased $89.2 million to $994.8 million for the year ended December 31, 2016, compared to 2015. Average loans held for sale increased $2.6 million, or 6.2 percent, during 2016, compared to 2015, due to a 22.8 percent increase in loan originations at the Mortgage Banking segment from 2015 to 2016 and fluctuations in the holding period between mortgage loan origination and sales to third-party investors. Average loans held for investment for the Retail Banking segment increased $72.9 million, or 12.6 percent, during 2016 because of growth in the commercial real estate, real estate mortgage and real estate construction segments of the loan portfolio, which was driven by investing in experienced commercial lending personnel over the past several years and the continued strong loan demand in the real estate development and construction sectors in our markets. Average loans held for investment at the Consumer Finance segment increased $13.7 million, or 4.8 percent, during 2016 because of the purchase of a consumer finance loan portfolio at the end the second quarter of 2015, along with organic loan growth during 2016.

The overall yield on average loans decreased 50 basis points to 8.35 percent during 2016, compared to 2015. The decrease in the average loan yield was due to (1) loan growth at the Retail Banking and Mortgage Banking segments, which have lower average yields, outpacing growth in higher-yielding loans at the Consumer Finance segment and (2) the decline in the average yield on loans at the Retail Banking and Consumer Finance segments. The Bank’s average yields

have declined due to the effects of the low interest rate and competitive environment on new originations and renewals. In addition, the yield on loans at the Retail Banking segment included the net accretion attributable to the acquisition accounting adjustments recorded in connection with the 2013 acquisition of CVB. The accretion contributed approximately 24 basis points to the yield on loans and 17 basis points to the yield on interest earning assets and net interest margin for 2016, compared to approximately 25 basis points to the yield on loans and 18 basis points to the yield on interest earning assets and net interest margin for 2015. The Consumer Finance segment's yield has been negatively affected by the continued competitive pressure during 2016 on loan pricing strategies and a strategic decision to purchase loans with higher credit quality metrics, but lower yields.

Average securities available for sale decreased $6.5 million during 2016, compared to 2015, because securities maturities, sales and calls outpaced purchases of investment securities. The average yield on the securities portfolio decreased due to the (1) purchase of lower-yielding shorter-term securities to replace maturities and calls of longer-term, higher yielding securities and (2) the current interest rate environment. The Corporation continued its strategy of investing in lower-yielding, shorter-term securities, including mortgage-backed securities, to limit exposure to a potential future rising interest rate environment by limiting the security portfolio's duration.

Average interest-bearing deposits in other banks, consisting primarily of excess reserves maintained at the Federal Reserve Bank, decreased $41.3 million during 2016, compared to 2015, because the Corporation used these funds to partially fund loan growth during 2016. The average yield on these overnight funds increased 23 basis points during 2016 because of the Federal Reserve Bank's increase in the interest rate on excess reserve balances from 0.25 percent to 0.50 percent in December 2015. In December 2016, the Federal Reserve Bank once again raised the interest rate from 0.50 percent to 0.75 percent, which had a minimal effect on average yields during 2016.

Average interest-bearing time and savings deposits and average demand deposits increased $10.7 million and $24.7 million, respectively, during 2016, compared to 2015. The average cost of interest-bearing deposits increased one basis point during 2016. The increase in the cost of jumbo certificates of deposit during 2016, compared to 2015, was due to the accretion in 2015 of the CVB fair value accounting adjustment, which lowered the cost of jumbo certificates of deposit during that year. This acquisition adjustment was fully accreted in the second quarter of 2015 and had no effect on the average cost of interest-bearing deposits during 2016. However, the average cost of interest-bearing deposits during 2016 benefited from a shift in composition from time deposits to non-term savings, money market and interest-bearing demand deposits, which pay lower interest rates.

Average borrowings decreased $2.7 million for the year ended December 31, 2016, compared to 2015. The decrease resulted from the repayment during 2016 of the borrowings used to purchase a consumer finance loan portfolio at the end of the second quarter of 2015. The average cost of borrowings increased eight basis points during 2016, compared to 2015, because of increases in one-month LIBOR to which variable-rate borrowing at the Consumer Finance segment is indexed, which was offset in part by a lower cost of borrowings at the Bank resulting from the maturity and restructuring of higher-rate FHLB advances.

It will be challenging to maintain the Retail Banking segment's net interest margin at its current level, even with anticipated loan growth during 2017, because the current low interest rate environment has contributed to lower yields on both the loan and investment portfolios. In addition, the recent increase in the federal funds rate may provide stimulus for higher-costing deposits, which reprice faster than loans and investments when interest rates rise. The net interest margin at the Consumer Finance segment will be most affected by continued market competition and lower yields on higher-quality loans and the recent increase in the federal funds rate triggering higher-costing variable-rate borrowings.

2015 Compared to 2014

Net interest income, on a taxable-equivalent basis, for the year ended December 31, 2015 was $80.6 million, compared to $80.3 million for the year ended December 31, 2014. The increase in net interest income for 2015, compared to 2014, was a result of an increase in average earning assets, offset in part by a decrease in net interest margin. Net interest margin decreased 20 basis points to 6.35 percent for 2015 as compared to 2014. The decrease resulted from a decline in the yield on interest-earning assets of 20 basis points, which was primarily attributable to decreases in the yields on the loan and investment securities portfolios, as described below. While the cost of interest-bearing liabilities in 2015 remained

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level with 2014, deposits continued to shift from higher-cost term deposits to lower-cost deposits, including interest-bearing demand deposits and money market accounts and noninterest-bearing demand deposits.

Average loans, which includes both loans held for investment and loans held for sale, increased $50.7 million to $905.6 million for the year ended December 31, 2015, compared to 2014. Average loans held for sale increased $12.2 million, or 42.1 percent, during 2015, compared to 2014, due to a 14.8 percent increase in loan originations from 2014 to 2015 and fluctuations in the period of time between mortgage loan origination and sales to third-party investors.   Average loans held for investment for the Retail Banking segment increased $37.1 million, or 7.0 percent, for 2015 due to growth in commercial real estate lending, commercial business lending and real estate mortgage segments of the loan portfolio, which was driven by investing in experienced commercial lending personnel and the resurgence in the real estate development and construction sectors in our markets. Average loans held for investment at the Consumer Finance segment increased $705,000, or 0.25 percent, for 2015 due to the purchase of a loan portfolio in the second quarter of 2015, which was acquired to improve interest income in light of the lack of internally generated loan growth.

The overall yield on average loans decreased 42 basis points to 8.85 percent for year ended December 31, 2015, compared to 2014. The decrease in the average loan yield is due to the decline in the average yield at both the Retail Banking and Consumer Finance segments. At the Retail Banking segment the decrease in yield is the result of the effects of the low interest rate environment, coupled with a decline in the net accretion attributable to fair value accounting adjustments recorded in connection with the 2013 acquisition of CVB. The accretion contributed approximately 25 basis points to the yield on loans and 18 basis points to the yield on interest earning assets and net interest margin for 2015 compared to approximately 32 basis points to the yield on loans, 22 basis points to the yield on interest earning assets and 23 basis points to the net interest margin for 2014. At the Consumer Finance segment, the decrease in yield is the result of increased competition and loan pricing strategies that competitors have used to grow market share. Partially offsetting the decrease in the yield is the incremental interest income from the Consumer Finance segment’s higher-yielding acquired loan portfolio that was purchased in the second quarter of 2015.

Average securities available for sale increased $1.5 million for the year ended December 31, 2015, compared to 2014. The average yield on the securities portfolio decreased due to the (1) purchase of lower-yielding shorter-term securities to replace maturities and calls of longer-term, higher yielding securities and (2) the current interest rate environment. The Corporation has utilized the strategy of investing in lower-yielding, shorter-term securities, including mortgage-backed securities, to limit exposure to a potential future rising interest rate environment by limiting the security portfolio’s duration.

Average interest-bearing deposits in other banks, consisting primarily of excess reserves maintained at the Federal Reserve Bank, and federal funds sold decreased $10.6 million for the year ended December 31, 2015, compared to the same period of 2014. These decreases occurred as the Corporation used these funds to partially fund loan growth during 2015. The average yield on these overnight funds increased one basis point during 2015. Effective December 17, 2015, the Federal Reserve Bank increased the interest rate on excess reserve balances from 0.25 percent to 0.50

percent, which had a minimal effect on yield for the year ended December 31, 2015.

Average interest-bearing time and savings deposits increased $11.1 million for the year ended December 31, 2015, compared to the same period in 2014. The average cost of interest-bearing deposits increased 1 basis point during 2015. The average cost of interest-bearing deposits benefited from the shift in deposit composition from time deposits to non-term savings, money market and interest-bearing demand deposits, which pay lower interest rates. However, the rate on other certificates of deposit increased 14 basis points in 2015 over 2014 primarily due to only a partial year of CVB purchase accretion during 2015. The fair value adjustment on the CVB certificates of deposit was fully accreted during the second quarter of 2015. Time deposit accretion related to the accounting adjustment to the CVB time deposits reduced cost by 4 basis points 2015, compared to 13 basis points in 2014.

Average borrowings increased $3.1 million for the year ended December 31, 2015, compared to the same period of 2014. This increase resulted from borrowings related to the purchase of a consumer finance loan portfolio in the second quarter of 2015. The average cost of borrowings declined one basis point during 2015, as a result of the maturity of higher interest rate FHLB advances, which were replaced with lower rate FHLB advances.

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NONINTEREST INCOME

TABLE 3: Noninterest Income

	Year Ended December 31, 2016				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	$ —	$ 8,120	$ —	$ —	$ 8,120
Service charges on deposit accounts	4,262	—	—	—	4,262
Other service charges and fees	5,139	3,404	10	—	8,553
Net gains on calls and sales of available for sale securities	52	—	—	—	52
Investment services income	—	—	—	1,165	1,165
BOLI income	828	—	99	—	927
Swap fee income	418	—	—	—	418
Other income	701	509	812	108	2,130
Total noninterest income	$ 11,400	$ 12,033	$ 921	$ 1,273	$ 25,627

	Year Ended December 31, 2015				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	$ —	$ 6,336	$ —	$ —	$ 6,336
Service charges on deposit accounts	4,322	—	—	—	4,322
Other service charges and fees	4,176	2,597	14	—	6,787
Net gains on calls and sales of available for sale securities	29	—	—	—	29
Investment services income	—	—	—	1,481	1,481
BOLI income	345	—	109	—	454
Swap fee income	—	—	—	—	—
Other income	211	24	972	98	1,305
Total noninterest income	$ 9,083	$ 8,957	$ 1,095	$ 1,579	$ 20,714

	Year Ended December 31, 2014				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	$ —	$ 5,086	$ —	$ —	$ 5,086
Service charges on deposit accounts	4,468	—	—	—	4,468
Other service charges and fees	3,901	2,314	14	17	6,246
Net gains on calls of available for sale securities	29	—	—	—	29
BOLI income	388	—	109	—	497
Swap fee income	—	—	—	—	—
Investment services income	—	—	—	1,229	1,229
Other income	384	250	1,104	112	1,850
Total noninterest income	$ 9,170	$ 7,650	$ 1,227	$ 1,358	$ 19,405

2016 Compared to 2015

Total noninterest income increased $4.9 million, or 23.7 percent, for the year ended December 31, 2016, compared to the same period in 2015. The increase in total noninterest income for 2016 was attributable to (1) a higher volume of loans originated and sold during 2016 at the Mortgage Banking segment, which resulted in higher gains on sales of loans and ancillary loan origination fees, (2) higher debit card interchange income at the Retail Banking segment, and (3) swap fee income at the Retail Banking segment related to the new interest rate swap program initiated in 2016. Also contributing to the increase in noninterest income during 2016 were one-time revenue items at the Retail Banking segment in the second quarter of 2016 associated with a contract amendment for one of the Bank's debit card programs ($237,000 after tax), the Bank's BOLI program ($493,000 after tax) and a gain on the sale of a Bank-owned property ($92,000 after tax). Other income for both the Retail Banking and Mortgage Banking segments increased due to the inclusion of net unrealized

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appreciation in noninterest income related to the non-qualified deferred compensation plan during 2016, compared to net depreciation recognized in noninterest expense during 2015. These increases were partially offset by (1) declines in overdraft fees at the Retail Banking segment, (2) lower loan servicing fees at the Consumer Finance segment and (3) lower investment services income at the Corporation's wealth management subsidiary due to stock market volatility during 2016.

2015 Compared to 2014

Total noninterest income increased $1.3 million, or 6.7 percent, for the year ended December 31, 2015, compared to the same period in 2014. The increase in total noninterest income for 2015 was attributable to (1) higher loan production at the Mortgage Banking segment resulting in higher gains on sales of loans and ancillary loan origination fees and (2) higher investment services income at the Corporation's wealth management subsidiary. These increases were partially offset by lower noninterest income at (1) the Retail Banking segment due to a decline in overdraft and maintenance fees, which was offset in part by higher debit card interchange income and other branch fee income and (2) lower loan servicing fees at the Consumer Finance segment. Other income for both the Retail Banking and Mortgage Banking segments decreased due to the inclusion of net unrealized depreciation in noninterest expense related to the non-qualified deferred compensation plan during 2015, compared to net appreciation included in noninterest income during 2014.

NONINTEREST EXPENSE

TABLE 4: Noninterest Expense

	Year Ended December 31, 2016				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	$ 24,613	$ 5,664	$ 10,102	$ 1,546	$ 41,925
Occupancy expense	6,916	1,820	907	17	9,660
Other expenses:					
OREO expenses	158	—	—	—	158
Provision for indemnification losses	—	290	—	—	290
Other expenses	10,359	2,705	4,530	513	18,107

Total noninterest expense	$ 42,046	$ 10,479	$ 15,539	$ 2,076	$ 70,140

	Year Ended December 31, 2015				
	Retail	Mortgage	Consumer	Other and	
(Dollars in thousands)	Banking	Banking	Finance	Eliminations	Total
Salaries and employee benefits	$ 23,185	$ 4,594	$ 9,758	$ 1,389	$ 38,926
Occupancy expense	6,255	1,850	713	10	8,828
Other expenses:					
OREO expenses	71	—	—	—	71
Provision for indemnification losses	—	274	—	—	274
Other expenses	10,829	2,439	4,257	550	18,075
Total noninterest expense	$ 40,340	$ 9,157	$ 14,728	$ 1,949	$ 66,174

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	Year Ended December 31, 2014				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	$ 22,944	$ 3,568	$ 8,962	$ 836	$ 36,310
Occupancy expense	6,250	1,832	717	7	8,806
Other expenses:					
OREO expenses	6	—	—	—	6
Provision for indemnification losses	—	240	—	—	240
Other expenses	11,302	2,370	4,022	501	18,195
Total noninterest expense	$ 40,502	$ 8,010	$ 13,701	$ 1,344	$ 63,557

2016 Compared to 2015

Total noninterest expenses increased $4.0 million, or 6.0 percent, for the year ended December 31, 2016, compared to the same period in 2015. The increase in total noninterest expenses for 2016 resulted primarily from higher personnel costs during 2016 (1) at C&F Bank because of increased staff levels and support positions associated with personnel dedicated to growing C&F Bank's commercial and small business loan portfolios, including its expansion into Charlottesville, Virginia in June 2016, (2) at C&F Mortgage because of higher loan production and the Mortgage Banking segment’s expansion into Chesapeake, Virginia and Moyock, North Carolina, which began in the fourth quarter of 2016, (3) at C&F Finance because of personnel additions in certain major markets, competition for qualified personnel and staffing increases for compliance and asset quality processes, and (4) at the Corporation’s wealth management subsidiary because of its expansion initiatives in Williamsburg and Newport News, Virginia beginning in the fourth quarter of 2016. Noninterest expense also increased because of operating expenses associated with (1) strengthening the Bank’s technology infrastructure and expanding its product offerings and promoting brand awareness, (2) updating and enhancing C&F Mortgage’s compliance management system and processes for originating residential loans and improving the quality of its loan origination process and (3) investing in technology at C&F Finance to improve efficiencies, help manage the rigorous regulatory burdens, and strengthen its compliance management system, which the Corporation anticipates will contribute to capturing more business.These increases were offset in part because noninterest expenses for both the Retail Banking and Mortgage Banking segments included net unrealized depreciation related to the non-qualified deferred compensation plan during 2015, compared to net appreciation included in noninterest income during 2016.

2015 Compared to 2014

Total noninterest expenses increased $2.6 million, or 4.1 percent, for the year ended December 31, 2015, compared to the same period in 2014. The increase in total noninterest expenses for 2015 resulted primarily from higher personnel costs during 2015 (1) at C&F Bank due to increased staff levels and support positions associated with personnel dedicated to growing C&F Bank's commercial and small business loan portfolios, (2) at C&F Mortgage due to higher production-based compensation associated with the higher loan volume and (3) at C&F Finance due to entry into new markets over the past several years, competition for qualified personnel and staffing increases for compliance and asset quality processes. Other expenses at C&F Finance increased due to higher (1) collection expenses, (2) loan application volume and (3) conversion costs related to data processing and front-end lending systems to enhance our ability to capture a larger share of the market and support future growth. Other expenses for both the Retail Banking and Mortgage Banking segments included net unrealized depreciation related to the non-qualified deferred compensation plan during 2015, compared to net appreciation included in noninterest income during 2014. The other segment, which principally includes the Corporation’s holding company operations and wealth management subsidiary, experienced increases in general corporate expenses. Cost savings related to the integration of CVB into the Bank’s infrastructure contributed to the decline in total noninterest expense at the Retail Banking segment.

INCOME TAXES

Income tax expense on 2016 earnings was $4.5 million, resulting in an effective tax rate of 24.9 percent, compared with $4.9 million, or 27.9 percent, in 2015 and $5.1 million, or 29.4 percent, in 2014. As described in Item 8. “Financial Statement and Supplementary Data,” under the heading “Note 2: Adoption of New Accounting Standards,” effective

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January 1, 2015, the Corporation began recognizing amortization of its investments in qualified affordable housing projects as a component of income taxes. As required by ASU 2014-01, noninterest expense and income tax expense for 2014 has been restated for the retrospective application of this standard. Accordingly, income tax expense included $406,000 and $415,000 of amortization of its investments in qualified affordable housing projects during the years ended December 31, 2015 and 2014, respectively. The Corporation's effective tax rate has progressively declined over the past three years as a result of earnings growth at the Retail Banking segment, which is exempt from state income taxes and has substantial tax-exempt income on securities issued by states and political subdivisions.

As described in Item 8. "Financial Statement and Supplementary Data," under the heading "Note 2: Adoption of New Accounting Standards," during the fourth quarter of 2016, the Corporation began recognizing excess tax benefits and deficiencies related to share-based payments, including tax benefits of dividends on share-based payment awards, within income tax expense. In accordance with the adoption provisions of ASU 2016-09, income tax expense for 2016 was reduced by $229,000, which was the aggregate excess tax benefits for the entire year and contributed to the decline in the Corporation's effective tax rate for 2016.

ASSET QUALITY

Allowance and Provision for Loan Losses

Allowance for Loan Losses Methodology – Retail Banking and Mortgage Banking. We conduct an analysis of the collectibility of the loan portfolio on a regular basis. This analysis does not apply to PCI loans, loans carried at fair value, loans held for sale or off-balance sheet credit exposure (e.g., unfunded loan commitments and standby letters of credit). We use this analysis to assess the sufficiency of the allowance for loan losses and to determine the necessary provision for loan losses.

The analysis, at a minimum, considers the following factors:

- Changes in lending policies and procedures, including underwriting, collection, charge-off and recovery;
- Changes in international, national, regional and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;
- Changes in the nature and volume of the portfolio and in the terms of loans;
- Changes in the experience, ability and depth of lending management and other relevant staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans and the volume and severity of adversely classified or graded loans;

- Changes in the quality of our loan review system;
- Changes in the value of the underlying collateral for collateral-dependent loans;
- The existence and effect of any concentrations of credit and changes in the level of such concentrations;
- The effect of other external factors, such as competition;
- Historical trends of actual loan losses based on volume and types of loans; and
- Significant one-time transactions affecting the allowance for loan losses.

In conjunction with the factors described above, we consider the following risk elements that are inherent in the loan portfolio as part of the analysis:

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

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- Commercial, financial and agricultural 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 the 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 precision.

- Equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

- Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

The review process generally begins with loan officers or management identifying problem loans to be reviewed on an individual basis for impairment. In addition to these loans, all substandard commercial, construction and residential loans in excess of $500,000 and all troubled debt restructurings are considered for individual impairment testing. We consider a loan impaired when it is probable that we will be unable to collect all interest and principal payments as scheduled in the loan agreement. A loan is not considered impaired during a period of delay in payment if the ultimate collectibility of all amounts due is expected. If a loan is considered impaired, impairment is measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. When a loan is determined to be impaired, we follow a consistent process to measure that impairment in our loan portfolio. We then establish a specific allowance for impaired loans based on the difference between the carrying value of the loan and its estimated fair value. For collateral dependent loans we obtain an updated appraisal if we do not have a current one on file. Appraisals are performed by independent third party appraisers with relevant industry experience. We may make adjustments to the appraised value based on recent sales of similar properties or general market conditions when appropriate. We also estimate costs to sell collateral in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan.

The remaining non-impaired loans are grouped by loan type (e.g., commercial real estate, commercial, residential mortgage, consumer). We assign each loan type an allowance factor based on the historical loss rate for that type of loan and an evaluation of the qualitative factors mentioned above to determine a general allowance. We assign classified loans (i.e., special mention, substandard, doubtful, loss) a higher allowance factor than non-classified loans within a particular loan type based on our concerns regarding collectibility. Our allowance factors increase with the severity of classification. Allowance factors used for unclassified loans are based on our analysis of charge-off history for relevant periods of time which can vary depending on economic conditions, and our judgment based on the overall analysis of the lending environment including the general economic conditions. Our analysis of charge-off history also considers economic cycles and the trends during those cycles. Those cycles that more closely match the current environment are considered more relevant during our review. The allowance for loan losses is the aggregate of specific allowances and the general allowance for each portfolio type.

As discussed above we segregate loans meeting the criteria for special mention, substandard, doubtful and loss from non-classified, or pass rated, loans. We review the characteristics of each rating at least annually, generally during the first quarter. The characteristics of these ratings are as follows:

- Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.

- Special mention loans have a specific defined weakness in the borrower's operations and the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history may be characterized by late payments. The Corporation's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.

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- Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet the Corporation's definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.

- Substandard nonaccrual loans have the same characteristics as substandard loans; however they have a non-accrual classification because it is probable that the Corporation will not be able to collect all amounts due.

- Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but 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 possibility of loss is extremely high.

- Loss rated loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

Allowance for Loan Losses Methodology - PCI Loans - As previously described, on a quarterly basis we evaluate our estimate of cash flows expected to be collected on PCI loans. These evaluations require the continued assessment of key assumptions and estimates similar to the initial estimate of fair value, such as the effect of collateral value changes, changing loss severities, estimated and experienced prepayment speeds and other relevant factors. Subsequent decreases to the expected cash flows to be collected on a PCI loan will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. For a more detailed description, see "Critical Accounting Policies" in this Item 7.

Allowance for Loan Losses Methodology – Consumer Finance. The Consumer Finance segment's loans consist of non-prime automobile loans. These loans carry risks associated with (1) the continued credit-worthiness of borrowers who may be unable to meet the credit standards imposed by most traditional automobile financing sources and (2) the value of rapidly-depreciating collateral. These loans do not lend themselves to a classification process because of the short duration of time between delinquency and repossession. Therefore, the loan loss allowance review process generally focuses on the levels of and trends in delinquencies, deferrals, defaults, repossessions and losses. Allowance factors also include an analysis of charge-off history for relevant periods of time which can vary depending on economic conditions and competition, and our judgment based on the overall analysis of the lending environment. Loans are segregated between performing and nonperforming loans. Performing loans are those that have made timely payments in accordance with the terms of the loan agreement and that are not past due 90 days or more. Nonperforming loans are those that do not accrue interest and are greater than 90 days past due.

In accordance with its policies and guidelines and consistent with industry practices, C&F Finance, at times, offers payment deferrals to borrowers, whereby the borrower is allowed to move up to two payments within a twelve-month rolling period to the end of the loan. A fee will be collected for extensions only in states that permit it. An account for which all delinquent payments are deferred is classified as current at the time the deferment is granted and therefore is not included as a delinquent account. Thereafter, such an account is aged based on the timely payment of future installments in the same manner as any other account. We evaluate the results of this deferment strategy based upon the amount of cash installments that are collected on accounts after they have been deferred versus the extent to which the collateral underlying the deferred accounts has depreciated over the same period of time. Based on this evaluation, we believe that payment deferrals granted according to our policies and guidelines are an effective portfolio management technique and result in higher ultimate cash collections. Payment deferrals may affect the ultimate timing of when an account is charged off. Increased use of deferrals may result in a lengthening of the loss confirmation period, which would increase expectations of credit losses inherent in the portfolio and therefore increase the allowance for loan losses and related provision for loan losses. The average amounts deferred, as a percentage of loans outstanding, was 2.21 percent in 2016, 2.13 percent in 2015 and 2.10 percent in 2014.

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The allowance for loan losses represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. The provision for loan losses increases the allowance, and loans charged off, net of recoveries, reduce the allowance. The following table presents the Corporation’s loan loss experience for the periods indicated:

TABLE 5: Allowance for Loan Losses

	Year Ended December 31,									
(Dollars in thousands)	2016		2015		2014		2013		2012	
Allowance, beginning of period	$ 35,569		$ 35,606		$ 34,852		$ 35,907		$ 33,677	
Provision for loan losses:										
Retail Banking segment	—		—		—		1,030		2,400	
Mortgage Banking segment	—		45		60		90		165	
Consumer Finance segment	18,040		15,467		16,270		13,965		9,840	
Total provision for loan losses	18,040		15,512		16,330		15,085		12,405	
Loans charged off:										
Real estate—residential mortgage	(82)		(144)		(161)		(849)		(793)	
Real estate—construction1	—		—		—		—		—	
Commercial, financial and agricultural2	(87)		(21)		(271)		(2,298)		(2,074)	
Equity lines	(57)		(19)		(80)		(126)		(159)	
Consumer	(281)		(317)		(312)		(399)		(337)	
Consumer finance	(20,663)		(19,816)		(19,022)		(16,398)		(10,134)	
Total loans charged off	(21,170)		(20,317)		(19,846)		(20,070)		(13,497)	
Recoveries of loans previously charged off:										
Real estate—residential mortgage	163		257		59		106		35	
Real estate—construction1	—		—		—		3		—	
Commercial, financial and agricultural2	206		31		210		227		121	
Equity lines	—		1		—		28		79	
Consumer	236		268		250		173		207	
Consumer finance	4,022		4,211		3,751		3,393		2,880	
Total recoveries	4,627		4,768		4,270		3,930		3,322	
Net loans charged off	(16,543)		(15,549)		(15,576)		(16,140)		(10,175)	
Allowance, end of period	$ 37,066		$ 35,569		$ 35,606		$ 34,852		$ 35,907	
Ratio of net (recoveries) charge-offs to average total loans outstanding during period for Retail Banking	(0.02)	%	(0.01)	%	0.06	%	0.73	%	0.72	%
	5.59	%	5.50	%	5.39	%	4.59	%	2.76	%

Ratio of net charge-offs to average total loans outstanding during period for Consumer Finance[3]

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[1] Includes the Corporation’s real estate construction lending and consumer real estate lot lending.

[2] Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

[3] The consumer finance loan portfolio purchased during the second quarter of 2015 had the effect of increasing the net charge-off ratio by 38 basis points and 56 basis points for the years ended December 31, 2016 and 2015, respectively.

For further information regarding the adequacy of our allowance for loan losses, refer to “Nonperforming Assets” within this Item 7.

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The allocation of the allowance for loan losses at December 31 for the years indicated and the ratio of corresponding outstanding loan balances to total loans are as follows:

TABLE 6: Allocation of Allowance for Loan Losses

	December 31,				
(Dollars in thousands)	2016	2015	2014	2013	2012
Allocation of allowance for loan losses:					
Real estate—residential mortgage	$ 2,559	$ 2,471	$ 2,313	$ 2,355	$ 2,358
Real estate—construction 1	816	94	434	434	424
Commercial, financial and agricultural 2	7,393	7,755	7,744	7,805	9,824
Equity lines	685	1,052	812	892	885
Consumer	261	243	211	273	283
Consumer finance	25,352	23,954	24,092	23,093	22,133
Total allowance for loan losses	$ 37,066	$ 35,569	$ 35,606	$ 34,852	$ 35,907
Ratio of loans to total period-end loans:					
Real estate—residential mortgage	19 %	21 %	21 %	23 %	22 %
Real estate—construction 1	6	1	1	1	1
Commercial, financial and agricultural 2	39	39	37	35	30
Equity lines	5	6	6	6	5
Consumer	1	1	1	1	1
Consumer finance	30	32	34	34	41
	100 %	100 %	100 %	100 %	100 %

[1] Includes the Corporation's real estate construction lending and consumer real estate lot lending.

[2] Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Loans by credit quality indicators as of December 31, 2016 were as follows:

TABLE 7A: Credit Quality Indicators *

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	$ 181,814	$ 2,037	$ 2,761	$ 1,652	$ 188,264
Real estate – construction 2	55,732	—	—	—	55,732
Commercial, financial and agricultural 3	356,301	7,469	24,868	1,750	390,388
Equity lines	51,186	480	177	757	52,600
Consumer	7,870	2	409	118	8,399
	$ 652,903	$ 9,988	$ 28,215	$ 4,277	$ 695,383

*Included in the table above are loans purchased in connection with the acquisition of CVB of $54.1 million pass rated, $2.6 million special mention, $5.7 million substandard and $196,000 substandard nonaccrual.

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	$ 301,280	$ 565	$ 301,845

[1] At December 31, 2016, the Corporation did not have any loans classified as Doubtful or Loss.
[2] Includes the Corporation's real estate construction lending and consumer real estate lot lending.
[3] Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

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Loans by credit quality indicators as of December 31, 2015 were as follows:

TABLE 7B: Credit Quality Indicators *

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	$ 181,107	$ 1,276	$ 2,083	$ 2,297	$ 186,763
Real estate – construction 2	7,687	72	—	—	7,759
Commercial, financial and agricultural 3	317,720	9,080	26,302	2,960	356,062
Equity lines	48,392	617	221	881	50,111
Consumer	8,760	116	116	19	9,011
	$ 563,666	$ 11,161	$ 28,722	$ 6,157	$ 609,706

*Included in the table above are loans purchased in connection with the acquisition of CVB of $71.1 million pass rated, $4.1 million special mention, $5.2 million substandard and $542,000 substandard nonaccrual.

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	$ 290,925	$ 830	$ 291,755

[1] At December 31, 2015, the Corporation did not have any loans classified as Doubtful or Loss.
[2] Includes the Corporation’s real estate construction lending and consumer real estate lot lending.
[3] Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

The Retail Banking segment’s allowance for loan losses increased $98,000 since December 31, 2015 as a result of net recoveries during 2016. There was no provision for loan losses at the Retail Banking segment during 2016 because of the overall improvement in the quality of the loan portfolio as indicated by the decline in nonaccrual loans and the decline in accruing loans past due for 90 days or more. The allowance for loan losses to total loans, excluding purchased credit impaired loans, declined to 1.63 percent at December 31, 2016, compared to 1.86 percent at

December 31, 2015. We believe that the current level of the allowance for loan losses at C&F Bank is adequate to absorb probable losses inherent in the loan portfolio, based on the relevant history of charge-offs and recoveries, current economic conditions, overall portfolio quality and review of specific criticized loans. If loan concentrations within the Bank’s loan portfolio result in higher credit risk or if economic conditions begin to worsen, a higher loan loss allowance may be warranted in future periods, which may require a provision for loan losses.

The Consumer Finance segment’s allowance for loan losses increased by $1.4 million to $25.4 million at December 31, 2016 from $24.0 million at December 31, 2015, and its provision for loan losses increased $2.6 million for the year ended December 31, 2016, as compared to 2015. The higher provision resulted from an increase in charge-offs and loan growth during 2016. Loans charged off increased during 2016 because of economic conditions affecting non-prime consumer finance customers and competitive factors in the market for non-prime consumer finance loans. The net charge-off ratio for the year ended December 31, 2016 was 5.59 percent, compared to 5.50 percent for the year ended December 31, 2015. The allowance for loan losses as a percentage of loans increased to 8.40 percent at December 31, 2016, compared to 8.21 percent at December 31, 2015. The inclusion of the purchased consumer finance loans, which were recorded at a discount, had the effect of reducing this ratio 14 and 32 basis points at December 31, 2016 and 2015, respectively. While we expect the purchase discount accretion on this portfolio to mitigate the potential effect of losses on the purchased portfolio, this portfolio is routinely re-evaluated as part of the segment’s overall analysis of the adequacy of the allowance for loan losses. Additionally, in 2016, the Consumer Finance segment began purchasing more loan contracts with higher credit quality metrics, which management expects will help reduce future charge-offs. As previously described, the Consumer Finance segment, at times, offers payment deferrals to borrowers as a management technique to achieve higher ultimate cash collections on select loan accounts. Payment deferrals may affect the ultimate timing of when an account is charged off. A significant reliance on deferrals as a means of managing collections may result in a lengthening of the loss

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confirmation period, which would increase expectations of credit losses inherent in the portfolio. The average amounts deferred, as a percentage of average loans outstanding during 2016 was 2.21%, compared to 2.13% during 2015.

We believe that the current level of the allowance for loan losses at the Consumer Finance segment is adequate to absorb probable losses inherent in the loan portfolio. However, if factors influencing the Consumer Finance segment result in higher net charge-off ratio in future periods, the Consumer Finance segment may need to increase the level of its allowance for loan losses, which could negatively affect future earnings of the Consumer Finance segment.

Nonperforming Assets

A loan's past due status is based on the contractual due date of the most delinquent payment due. Loans are generally placed on nonaccrual status when the collection of principal or interest is 90 days or more past due, or earlier, if collection is uncertain based on an evaluation of the net realizable value of the collateral and the financial strength of the borrower. Loans greater than 90 days past due may remain on accrual status if management determines it has adequate collateral to cover the principal and interest. For those loans that are carried on nonaccrual status, payments are first applied to principal outstanding. A loan may be returned to accrual status if the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms of the loan and there is reasonable assurance the borrower will continue to make payments as agreed. These policies are applied consistently across our loan portfolio, including purchased loans.

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of like properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. We may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further deterioration in market conditions. Revenue and expenses from operations and changes in the property valuations are included in net expenses from foreclosed assets and improvements are capitalized.

Because C&F Finance focuses on non-prime borrowers, the anticipated rates of delinquencies, defaults, repossessions and losses on the consumer finance loans are higher than those experienced in the general automobile finance industry and could be more dramatically affected by a general economic downturn. During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses generally increase at the Consumer Finance segment. These periods also may be accompanied by decreased consumer demand for used automobiles and declining values of automobiles securing outstanding loans, which weakens collateral coverage and increases the amount of a loss in the event of default. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed automobiles or delay the timing of these sales. While we

manage the higher risk inherent in loans made to non-prime borrowers through the underwriting criteria and collection methods employed by C&F Finance, we cannot guarantee that these criteria or methods will afford adequate protection against these risks. However, we believe that the current allowance for loan losses is appropriate to absorb any losses on existing Consumer Finance segment loans that may become uncollectible.

At the Consumer Finance segment, the automobile repossession process is generally initiated after a loan becomes more than 60 days delinquent. Repossessions are handled by independent repossession firms engaged by C&F Finance. After the prescribed waiting period, the repossessed automobile is sold in a third-party auction. We credit the proceeds from the sale of the automobile, and any other recoveries, against the balance of the loan and related fees. Proceeds from the sale of the repossessed vehicle and other recoveries are usually not sufficient to cover the outstanding balance of the loan, and the resulting deficiency is charged off. The charge-off represents the difference between the actual net sale proceeds minus collections and repossession expenses and the principal balance of the delinquent loan. C&F Finance pursues collection of deficiencies, as allowed by state law, when it deems such action to be appropriate.

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Table 8 summarizes nonperforming assets at December 31 of each of the past five years.

TABLE 8: Nonperforming Assets

Retail Banking Segment

(Dollars in thousands)	2016	2015	2014	2013	2012
Loans, excluding purchased loans	$ 629,523	$ 525,283	$ 447,614	$ 402,755	$ 395,664
Purchased performing loans1	53,329	67,022	80,146	104,471	—
Purchased credit impaired loans1	9,256	13,908	21,424	32,520	—
Total loans	$ 692,108	$ 606,213	$ 549,184	$ 539,746	$ 395,664
Nonaccrual loans2	$ 4,039	$ 5,615	$ 4,114	$ 3,740	$ 11,461
Purchased performing-nonaccrual loans3 9	196	542	603	651	—
Total nonaccrual loans	4,235	6,157	4,717	4,391	11,461
OREO4	195	942	786	2,768	6,236
Total nonperforming assets5	$ 4,430	$ 7,099	$ 5,503	$ 7,159	$ 17,697
Accruing loans past due for 90 days or more6 9	$ 6	$ 761	$ 14	$ 75	$ —
Troubled debt-restructurings (TDRs)2	$ 4,964	$ 5,080	$ 5,549	$ 5,217	$ 16,492
Purchased performing TDRs7 9	$ 861	$ 264	$ 278	$ 403	$ —
Allowance for loan losses (ALL)	$ 11,115	$ 11,017	$ 10,961	$ 11,266	$ 13,380
Nonperforming assets to total loans and OREO	0.64 %	1.17 %	1.00 %	1.34 %	4.40 %
ALL to total loans, excluding purchased credit impaired loans8	1.63	1.86	2.08	2.22	3.38
ALL to total nonaccrual loans	262.46	178.93	232.37	256.57	116.75
Net (recoveries) charge-offs to average total loans	(0.02)	(0.01)	0.06	0.73	0.72

1. The loans acquired from CVB are tracked in two separate categories – “purchased performing” and “purchased credit impaired.” The remaining discount for the purchased performing loans was $2.9 million at December 31, 2016, $4.0 million at December 31, 2015, and $4.9 million at December 31, 2014. The remaining discount for the purchased credit impaired loans was $10.5 million at December 31, 2016, $11.8 million at December 31, 2015 and $15.1 million at December 31, 2014.

2. Nonaccrual loans include nonaccrual TDRs of $2.0 million at December 31, 2016, $2.5 million at December 31, 2015, $2.0 million at December 31, 2014, $2.6 million at December 31, 2013 and $9.8 million at December 31, 2012.
3. Purchased performing-nonaccrual loans are presented net of the remaining interest and credit marks totaling $137,000 at December 31, 2016, $247,000 at December 31, 2015 and $249,000 December 31, 2014.
4. OREO is recorded at its estimated fair value less cost to sell.
5. As required by acquisition accounting, purchased credit impaired loans that were considered nonaccrual and TDRs prior to the acquisition lose these designations and are not included in post-acquisition nonperforming assets as presented in this table.
6. Accruing loans past due for 90 days or more include purchased credit impaired loans of $0 at December 31, 2016 and $172,000 at December 31, 2015.
7. Purchased performing TDRs are accruing and are presented net of the remaining interest and credit marks totaling $11,300 at December 31, 2016, $8,300 at December 31, 2015 and $9,200 at December 31, 2014.
8. For the purpose of calculating this ratio, purchased performing loans are included in total loans. Purchased performing loans were marked to fair value on acquisition date; therefore, no allowance for loan losses was recorded for these loans.
9. Because the Corporation acquired CVB on October 1, 2013, information regarding CVB's nonperforming assets for periods prior to the acquisition is not included in Table 8. Further, as required by purchase accounting, PCI loans that were considered nonaccrual and TDRs prior to acquisition lose these designations and are not included in post-acquisition nonperforming assets in Table 8.

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Mortgage Banking Segment

(Dollars in thousands)	2016	2015	2014	2013	2012
Nonaccrual loans	$ 41	$ —	$ 187	$ —	$ —
Total loans	$ 3,275	$ 3,493	$ 3,288	$ 2,914	$ 2,340
Allowance for loan losses	$ 598	$ 598	$ 553	$ 493	$ 393
Nonaccrual loans to total loans	0.01 %	— %	5.69 %	— %	— %
Allowance for loan losses to total loans	18.26	17.12	16.82	16.92	16.79
Allowance for loan losses to nonaccrual loans	14.59	—	295.72	—	—

Consumer Finance Segment

(Dollars in thousands)	2016	2015	2014	2013	2012
Nonaccrual loans	$ 565	$ 830	$ 1,040	$ 1,187	$ 655
Accruing loans past due for 90 days or more	$ —	$ —	$ —	$ —	$ —
Total loans	$ 301,845	$ 291,755	$ 283,333	$ 277,724	$ 278,186
Allowance for loan losses	$ 25,353	$ 23,954	$ 24,092	$ 23,093	$ 22,133
Nonaccrual loans to total loans	0.19 %	0.28 %	0.37 %	0.43 %	0.24 %
Allowance for loan losses to total loans1	8.40	8.21	8.50	8.32	7.96
Net charge-offs to average total loans	5.59	5.50	5.39	4.59	2.76

1The consumer finance loan portfolio purchased during the second quarter of 2015 had the effect of decreasing the allowance to total loans ratio by 14 basis points at December 31, 2016 and 32 basis points at December 31, 2015.

Table 9 presents the changes in the OREO balance for 2016 and 2015

TABLE 9: OREO Changes

(Dollars in thousands)	Year Ended December 31, 2016	2015
Balance at the beginning of year, gross	$ 998	$ 815
Transfers between loans and other real estate owned	618	824
Capitalized expenses	21	—
Charge-offs	(106)	(63)
Sales proceeds	(1,384)	(706)
Gain on disposition	134	242
Deferred gain on disposition	—	(114)
Balance at the end of year, gross	281	998
Less valuation allowance	(86)	(56)
Balance at the end of year, net	$ 195	$ 942

Nonperforming assets of the Retail Banking segment totaled $4.4 million at December 31, 2016, compared to $7.1 million at December 31, 2015, a 37.6 percent decrease during 2016. Nonperforming assets at December 31, 2016 included $4.2 million of nonaccrual loans, compared to $6.2 million at December 31, 2015, and $195,000 of OREO compared to $942,000 at December 31, 2015. The ratio of the allowance for loan losses to nonaccrual loans increased to 262.46 percent at December 31, 2016 from 178.93 percent at December 31, 2015. The decrease in nonaccrual loans since December 31, 2015 was primarily due to loan payoffs and transfers to OREO.

The Corporation's aggregate OREO properties were $195,000 at December 31, 2016, compared to $942,000 at December 31, 2015, and primarily consisted of residential lots. These properties have been written down to their estimated fair values less cost to sell. The decrease in OREO during 2016 was primarily due to the sale of several OREO properties and a shorter holding period for properties transferred to OREO during 2016.

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Nonaccrual loans at the Consumer Finance segment decreased to $565,000 at December 31, 2016 from $830,000 at December 31, 2015. As noted above, the allowance for loan losses at the Consumer Finance segment increased from $24.0.million at December 31, 2015 to $25.4 million at December 31, 2016, and the ratio of the allowance for loan losses to total consumer finance loans was 8.40 percent as of December 31, 2016, compared to 8.21 percent at December 31, 2015. Nonaccrual consumer finance loans remain low relative to the allowance for loan losses and the total consumer finance loan portfolio because the Consumer Finance segment generally initiates repossession of loan collateral once a loan is 60 days or more past due but before the loan reaches 90 days or more past due and is evaluated for nonaccrual status. At December 31, 2016, repossessed assets totaled $3.1 million, compared to $2.1 million at December 31, 2015.

If interest on nonaccrual loans had been recognized, we would have recorded additional gross interest income of $304,000 for 2016, $531,000 for 2015, and $413,000 for 2014. Interest received on nonaccrual loans was $247,000 for 2016, $246,000 in 2015, $233,000 in 2014.

As discussed above, we measure impaired loans based on the present value of expected future cash flows discounted at the effective interest rate of the loan or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. TDRs occur when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. These concessions typically are made for loss mitigation purposes and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs are considered impaired loans.

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2016, were as follows:

TABLE 10A: Impaired Loans

(Dollars in thousands)	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	$ 3,539	$ 1,676	$ 1,732	$ 251	$ 3,446	$ 122
Commercial, financial and agricultural:						

Commercial real estate lending	1,967	430	1,272	261	1,746	29
Commercial business lending	167	89	74	46	181	8
Equity lines	32	32	—	—	32	1
Consumer	520	—	520	94	521	8
Total	$ 6,225	$ 2,227	$ 3,598	$ 652	$ 5,926	$ 168

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2015, were as follows:

TABLE 10B: Impaired Loans

(Dollars in thousands)	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	$ 2,828	$ 173	$ 2,516	$ 360	$ 2,718	$ 97
Commercial, financial and agricultural:						
Commercial real estate lending	2,522	61	2,258	438	2,361	35
Commercial business lending	99	—	99	28	108	1
Equity lines	32	30	—	—	30	1
Consumer	207	—	207	23	208	7
Total	$ 5,688	$ 264	$ 5,080	$ 849	$ 5,425	$ 141

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TDRs at December 31, 2016 and 2015 were as follows:

TABLE 11: Troubled Debt Restructurings

	December 31,	
(Dollars in thousands)	2016	2015
Accruing TDRs	$ 3,851	$ 2,810
Nonaccrual TDRs[1]	1,974	2,534
Total TDRs[2]	$ 5,825	$ 5,344

[1] Included in nonaccrual loans in Table 8: Nonperforming Assets.
[2] Included in impaired loans in Tables 10A and 10B: Impaired Loans.

While TDRs are considered impaired loans, not all TDRs are on nonaccrual status. If a loan was on nonaccrual status at the time of the TDR modification, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on the Corporation's policy for returning loans to accrual status. If a loan was accruing prior to being modified as a TDR and if the Corporation concludes that the borrower is able to make such modified payments, and there are no other factors or circumstances that would cause it to conclude otherwise, the TDR will remain on an accruing status.

FINANCIAL CONDITION

SUMMARY

A financial institution's primary sources of revenue are generated by its earning assets and sales of financial assets, while its major expenses are produced by the funding of those assets with interest-bearing liabilities, provisions for loan losses and compensation to employees. Effective management of these sources and uses of funds is essential in attaining a financial institution's maximum profitability while maintaining an acceptable level of risk.

At December 31, 2016, the Corporation had total assets of $1.45 billion compared to $1.41 billion at December 31, 2015. The significant components of the Corporation's balance sheet are discussed below.

LOAN PORTFOLIO

General

Through the Retail Banking segment, we engage in a wide range of lending activities, which include the origination, primarily in the Retail Banking segment's market area, of (1) one-to-four family and multi-family residential mortgage loans, (2) commercial real estate loans, (3) construction loans, (4) land acquisition and development loans, (5) consumer loans and (6) commercial business loans. We engage in non-prime automobile lending through the Consumer Finance segment and in residential mortgage lending through the Mortgage Banking segment with the majority of the loans originated through the Mortgage Banking segment sold to third-party investors. At December 31, 2016, the Corporation's loans held for investment in all categories, net of the allowance for loan losses, totaled $960.2 million and loans held for sale had a fair value of $52.0 million.

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Tables 12 and 13 present information pertaining to the composition of loans held for investment and maturity/repricing of certain loans held for investment.

TABLE 12: Summary of Loans Held for Investment

	December 31,				
(Dollars in thousands)	2016	2015	2014	2013	2012
Real estate—residential mortgage	$ 188,264	$ 186,763	$ 179,817	$ 188,455	$ 149,257
Real estate—construction 1	55,732	7,759	7,325	5,810	5,062
Commercial, financial, and agricultural 2	390,388	356,062	306,845	288,593	205,052
Equity lines	52,600	50,111	50,321	50,795	33,324
Consumer	8,399	9,011	8,163	9,007	5,309
Consumer finance	301,845	291,755	283,333	277,724	278,186
Total loans	997,228	901,461	835,804	820,384	676,190
Less allowance for loan losses	(37,066)	(35,569)	(35,606)	(34,852)	(35,907)
Total loans, net	$ 960,162	$ 865,892	$ 800,198	$ 785,532	$ 640,283

[1] Includes the Corporation’s real estate construction lending and consumer real estate lot lending.
[2] Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

TABLE 13: Maturity/Repricing Schedule of Loans Held for Investment

	December 31, 2016	
(Dollars in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction
Variable Rate:		
Within 1 year	$ 75,396	$ 720
1 to 5 years	29,315	2,668
After 5 years	39,748	—
Fixed Rate:		
Within 1 year	$ 28,924	$ 19,662

1 to 5 years	139,559	32,682
After 5 years	77,446	—

The increase in total loans from December 31, 2015 to December 31, 2016 was primarily due to loan growth at the Retail Banking segment, especially in the commercial and real estate construction portfolios, as well as organic loan growth in the Consumer Finance segment during 2016. The increase in total loans of the Retail Banking segment was driven by successful investments in our commercial lending personnel and strength in commercial lending in our local markets, as well as expansion into new markets. The increase in total loans of the Consumer Finance segment resulted primarily from the implementation of a scorecard model at the Consumer Finance segment in 2016 that contributed to the growth through underwriting and pricing efficiencies.

Total loans at December 31, 2016 and 2015 included loans purchased in connection with the Corporation's acquisition of CVB on October 1, 2013. These loans were recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses. On the date of acquisition, the Corporation acquired PCI loans with a fair value of $35.3 million and purchased performing loans with a fair value of $111.8 million. The following tables present the outstanding principal balance and the carrying amount of purchased loans that are included in the Corporation's balance sheet at December 31, 2016 and 2015.

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TABLE 14: PCI and Purchased Performing Loans

	December 31, 2016		
(Dollars in thousands)	Purchased Credit Impaired	Purchased Performing	Total
Outstanding principal balance	$ 19,770	$ 56,213	$ 75,983
Carrying amount			
Real estate – residential mortgage	$ 1,219	$ 13,422	$ 14,641
Commercial, financial and agricultural	7,759	28,615	36,374
Equity lines	278	11,178	11,456
Consumer	—	114	114
Total acquired loans	$ 9,256	$ 53,329	$ 62,585

	December 31, 2015		
(Dollars in thousands)	Purchased Credit Impaired	Purchased Performing	Total
Outstanding principal balance	$ 25,701	$ 70,993	$ 96,694
Carrying amount			
Real estate – residential mortgage	$ 1,305	$ 15,478	$ 16,783
Commercial, financial and agricultural	12,317	37,287	49,604
Equity lines	286	13,969	14,255
Consumer	—	288	288
Total acquired loans	$ 13,908	$ 67,022	$ 80,930

See “Critical Accounting Policies” in this Item 7 for a description of the Corporation’s accounting for purchased performing and PCI loans.

Credit Policy

The Corporation’s credit policy establishes minimum requirements and provides for appropriate limitations on overall concentration of credit within the Corporation. The policy provides guidance in general credit policies, underwriting

policies and risk management, credit approval, and administrative and problem asset management policies. The overall goal of the Corporation's credit policy is to ensure that loan growth is accompanied by acceptable asset quality with uniform and consistently applied approval, administration, and documentation practices and standards.

Residential Mortgage Lending – Held for Sale

The Mortgage Banking segment's guidelines for underwriting conventional conforming loans comply with the underwriting criteria established by Fannie Mae, Freddie Mac and/or the applicable third party investor. The guidelines for non-conforming conventional loans are based on the requirements of private investors and information provided by third-party investors. The guidelines used by C&F Mortgage to originate FHA-insured, USDA-guaranteed and VA-guaranteed loans comply with the criteria established by HUD, the USDA, the VA and/or the applicable third party investor. The conventional loans that C&F Mortgage originates that have loan-to-value ratios greater than 80 percent at origination are generally insured by private mortgage insurance.

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Residential Mortgage Lending – Held for Investment

The Retail Banking segment originates residential mortgage loans secured by first and second liens on properties located in its primary market area in the Hampton to Charlottesville corridor in Virginia. The Bank offers various types of residential first mortgage loans in addition to traditional long-term, fixed-rate loans. The majority of such loans include 10, 15 and 30 year amortizing mortgage loans with fixed rates of interest and fixed-rate mortgage loans with terms of 20, 25 and 30 years but subject to call after five years at the Bank's option. Second mortgage loans are offered with fixed and adjustable rates. Second mortgage loans are granted for a fixed period of time, usually between five and 20 years. Call option provisions are included in the loan documents for some longer-term, fixed-rate second mortgage loans, and these provisions allow the Bank to make interest rate adjustments for such loans.

Loans associated with residential mortgage lending are included in the real estate—residential mortgage category in Table 12: Summary of Loans Held for Investment.

Construction Lending

The Retail Banking segment has a real estate construction lending program. We make loans primarily for the construction of one-to-four family residences and, to a lesser extent, multi-family dwellings. The Bank also makes construction loans for office and warehouse facilities and other nonresidential projects, generally limited to borrowers that present other business opportunities for the Retail Banking segment.

The amounts, interest rates and terms for construction loans vary, depending upon market conditions, the size and complexity of the project, and the financial strength of the borrower and any guarantors of the loan. The term for a typical construction loan ranges from nine months to 15 months for the construction of an individual residence and from 15 months to a maximum of three years for larger residential or commercial projects. We do not typically amortize construction loans, and the borrower pays interest monthly on the outstanding principal balance of the loan. The Bank offers fixed and variable interest rates on construction loans. We do not generally finance the construction of commercial real estate projects built on a speculative basis. For residential builder loans, we limit the number of models and/or speculative units allowed depending on market conditions, the builder's financial strength and track record and other factors. Generally, the maximum loan-to-value ratio for one-to-four family residential construction loans is 80 percent of the property's fair market value, or 85 percent of the property's fair market value if the property will be the borrower's primary residence. The fair market value of a project is determined on the basis of an appraisal of the project conducted by an appraiser approved by the Bank. For larger projects where unit absorption or leasing is a concern, we may also obtain a feasibility study or other acceptable information from the borrower or other sources about the likely disposition of the property following the completion of construction.

Construction loans for nonresidential projects and multi-unit residential projects are generally larger and involve a greater degree of risk to the Bank than residential mortgage loans. We attempt to minimize such risks (1) by making construction loans in accordance with our underwriting standards and to established customers in our primary market area and (2) by monitoring the quality, progress and cost of construction. Generally, our maximum loan-to-value ratio for non-residential projects and multi-unit residential projects is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis.

Loans associated with construction lending are included in the real estate—construction category in Table 12: Summary of Loans Held for Investment.

Consumer Lot Lending

The Retail Banking segment's consumer lot loans are made to individuals for the purpose of acquiring an unimproved building site for the construction of a residence that generally will be occupied by the borrower. Consumer lot loans are made only to individual borrowers, and each borrower generally must certify his or her intention to build and occupy a single-family residence on the lot. These loans typically have a maximum term of either three or five years with a balloon payment of the entire balance of the loan being due in full at the end of the initial term. The interest rate for these loans is fixed or variable at a rate that is slightly higher than prevailing rates for one-to-four family residential mortgage

loans. We do not believe consumer lot loans bear as much risk as land acquisition and development loans because such loans are not made for the construction of residences for immediate resale, are not made to developers and builders, and are not concentrated in any one subdivision or community.

Loans associated with consumer lot lending are included in the real estate—construction category in Table 12: Summary of Loans Held for Investment.

Commercial Real Estate Lending

The Retail Banking segment's commercial real estate loans are primarily secured by the value of real property. The proceeds of commercial real estate loans are generally used by the borrower to finance or refinance the cost of acquiring and/or improving a commercial property. The properties that typically secure these loans are office and warehouse facilities, hotels, apartment complexes, retail facilities, restaurants and other commercial properties. Present policy authorizes commercial real estate loans to borrowers who will occupy or use the financed property in connection with their normal business operations. We also will consider making commercial real estate loans secured by non-owner-occupied properties under the following two conditions: (1) the borrower is in strong financial condition and presents a substantial business opportunity for the Corporation and (2) the borrower has substantially pre-leased the improvements to high-caliber tenants.

Our commercial real estate loans are usually amortized over a period of time ranging from 15 years to 25 years and usually have a term to maturity ranging from five years to 15 years. These loans normally have provisions for interest rate adjustments after the loan is three to five years old. The maximum loan-to-value ratio for a commercial real estate loan is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis. Most commercial real estate loans are further secured by one or more unconditional personal guarantees.

In recent years, we have structured a portion of our commercial real estate loans as mini-permanent loans. The amortization period, term and interest rates for these loans vary based on borrower preferences and our assessment of the loan and the degree of risk involved. If the borrower prefers a fixed rate of interest, we usually offer a loan with a fixed rate of interest for a term of three to ten years with an amortization period of up to 25 years. The remaining balance of the loan is due and payable in a single balloon payment at the end of the initial term. We believe these loan terms provide some protection from changes in the borrower's business and income as well as changes in general economic conditions. In the case of fixed-rate commercial real estate loans, shorter maturities also provide an opportunity to adjust the interest rate on this type of interest-earning asset in accordance with our asset and liability management strategies. Certain commercial customers qualify for participation in an interest rate swap program that was initiated in 2016. This program provides flexible pricing structures for our larger borrowers who wish to pay a fixed rate of interest, while preserving a floating rate for the Bank thus protecting C&F Bank from exposure to rising interest rates.

Loans secured by commercial real estate are generally larger and involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate are usually dependent on successful operation or management of the properties securing such loans, repayment of such loans is subject to changes in both general and local economic conditions and the borrower's business and income. As a result, events beyond our control, such as a downturn in the local economy, could adversely affect the performance of the commercial real estate loan portfolio. We seek to minimize these risks by lending to established customers and generally restricting our commercial real estate loans to our primary market area. Emphasis is placed on the income producing characteristics and quality of the collateral.

Loans associated with commercial real estate lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Land Acquisition and Development Lending

The Retail Banking segment makes land acquisition and development loans to builders and developers for the purpose of acquiring unimproved land to be developed for residential building sites, residential housing subdivisions, multi-family dwellings and a variety of commercial uses. Our policy is to make land acquisition loans to borrowers for the

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purpose of acquiring developed lots for single-family, townhouse or condominium construction. We will make both land acquisition and development loans to residential builders, experienced developers and others in strong financial condition to provide additional construction and mortgage lending opportunities for the Bank.

We underwrite and process land acquisition and development loans in much the same manner as commercial construction loans and commercial real estate loans. For land acquisition and development loans, we use lower loan-to-value ratios, which are a maximum of 65 percent for raw land, 75 percent for land development and improved lots and 80 percent of the discounted appraised value of the property as determined in accordance with the appraisal policies for developed lots for single-family or townhouse construction. We can waive the maximum loan-to-value ratio for particularly strong borrowers on an exception basis. The term of land acquisition and development loans ranges from a maximum of two years for loans relating to the acquisition of unimproved land to, generally, a maximum of three years for other types of projects. All land acquisition and development loans generally are further secured by one or more unconditional personal guarantees. Because these loans are usually larger in amount and involve more risk than consumer lot loans, we carefully evaluate the borrower’s assumptions and projections about market conditions and absorption rates in the community in which the property is located and the borrower’s ability to carry the loan if the borrower’s assumptions prove inaccurate.

Loans associated with land acquisition and development lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Builder Line Lending

The Retail Banking segment offers builder lines of credit to residential home builders to support their land and lot inventory needs. A construction loan facility for a builder will typically have an expiration of 12 months or less. Each loan that is made under the master loan facility will have a stated maturity that allows time for the residential unit to be constructed and sold to a homebuyer under prevailing market conditions. Specific terms vary based on the purpose of the loan (e.g., lot inventory, spec or non pre-sold units, pre-sold units) and previous sales activity to new homebuyers in the particular development. Repayment relies upon the successful performance of the underlying residential real estate project. This type of lending carries a higher level of risk related to residential real estate market conditions, a functioning first and secondary market in which to sell residential properties, and the borrower’s ability to manage inventory and run projects. We manage this risk by lending to experienced builders and by using specific underwriting policies and procedures for these types of loans.

Loans associated with builder line lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Commercial Business Lending

The Retail Banking segment's commercial business loan products include revolving lines of credit to provide working capital, term loans to finance the purchase of vehicles and equipment, letters of credit to guarantee payment and performance, and other commercial loans. In general, these credit facilities carry the unconditional guaranty of the owners and/or stockholders.

Revolving and operating lines of credit are typically secured by all current assets of the borrower, provide for the acceleration of repayment upon any event of default, are monitored monthly or quarterly to ensure compliance with loan covenants, and are re-underwritten or renewed annually. Interest rates generally will float at a spread tied to the Bank's prime lending rate. Term loans are generally advanced for the purchase of, and are secured by, vehicles and equipment and are normally fully amortized over a term of two to five years, on either a fixed or floating rate basis.

Loans associated with commercial business lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

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Equity Line Lending

The Retail Banking segment offers its customers home equity lines of credit that enable customers to borrow funds secured by the equity in their homes. Currently, home equity lines of credit are offered with adjustable rates of interest that are generally priced at a spread to the prime lending rate. Home equity lines of credit are made on an open-end, revolving basis. Home equity loans generally do not present as much risk to the Bank as other types of consumer loans. These loans must satisfy our underwriting criteria, including loan-to-value and credit score guidelines.

Loans associated with equity line lending are included in the equity lines category in Table 12: Summary of Loans Held for Investment.

Consumer Lending

The Retail Banking segment offers a variety of consumer loans, including automobile, personal secured and unsecured, and loans secured by savings accounts or certificates of deposit. The shorter terms and generally higher interest rates on consumer loans help the Bank maintain a profitable spread between its average loan yield and its cost of funds. Consumer loans secured by collateral other than a personal residence generally involve more credit risk than residential mortgage loans because of the type and nature of the collateral or, in certain cases, the absence of collateral. However, we believe the higher yields generally earned on such loans compensate for the increased credit risk associated with such loans. These loans must satisfy our underwriting criteria, including loan-to-value, debt ratio and credit score guidelines.

Loans associated with consumer lending are included in the consumer category in Table 12: Summary of Loans Held for Investment.

Consumer Finance

The Consumer Finance segment has an extensive automobile dealer network through which it purchases installment contracts throughout its markets. Credit approval is centralized in two locations, which along with the application processing system, ensures that contract purchase decisions comply with C&F Finance's underwriting policies and procedures.

Finance contract application packages completed by prospective borrowers are submitted by the automobile dealers electronically through a third-party online automotive sales and finance platform to C&F Finance's automated origination and application system, which processes the credit bureau report, generates all relevant loan calculations and displays the requested contract structure. C&F Finance personnel with credit authority review the transaction and determine whether to approve or deny the purchase of the contract. The purchase decision is based primarily on the applicant's credit history with emphasis on prior auto loan history, current employment status, income, collateral type and mileage, and the loan-to-value ratio. In the first half of 2016, C&F Finance implemented a scorecard model that improved underwriting and pricing efficiencies.

The Consumer Finance segment's underwriting and collateral guidelines form the basis for the purchase decision. Exceptions to credit policies and authorities must be approved by a designated credit officer. C&F Finance's typical customers have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, we expect C&F Finance to sustain a higher level of credit losses than traditional automobile financing sources. However, C&F Finance generally purchases contracts with interest at higher rates than those charged by traditional financing sources. These higher rates should more than offset the increase in the provision for loan losses for this segment of the Corporation's loan portfolio.

Loans associated with automobile sales finance are included in the consumer finance category in Table 12: Summary of Loans Held for Investment.

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SECURITIES

The investment portfolio plays a primary role in the management of the Corporation’s interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, increases in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At December 31, 2016 and 2015, all securities in the Corporation’s investment portfolio were classified as available for sale.

Table 15 sets forth the composition of the Corporation’s securities available for sale in dollar amounts at fair value and as a percentage of the Corporation’s total securities available for sale at the dates indicated.

TABLE 15: Securities Available for Sale

	December 31, 2016		December 31, 2015	
(Dollars in thousands)	Amount	Percent	Amount	Percent
U.S. government agencies and corporations	$ 16,112	8 %	$ 18,501	9 %
Mortgage-backed securities	76,816	36	77,027	35
Obligations of states and political subdivisions	117,098	56	123,948	56
Total available for sale securities at fair value	$ 210,026	100 %	$ 219,476	100 %

The Corporation seeks to diversify its portfolio to minimize risk, including by purchasing shorter-duration mortgage-backed securities to reduce interest rate risk and for cash flow and reinvestment opportunities and securities issued by states and political subdivisions due to the tax benefits and the higher tax-adjusted yield obtained from these securities. All of the Corporation’s mortgage-backed securities are direct issues of United States government agencies or government-sponsored enterprises. The municipal bond sector, which is included in the Corporation’s obligations of states and political subdivisions category of securities, is the largest component within the securities portfolio. At December 31, 2016, approximately 97 percent of the Corporation’s obligations of states and political subdivisions, as measured by market value, were rated “A” or better by Standard & Poor’s or Moody’s Investors Service.

Table 16 presents additional information pertaining to the composition of the securities portfolio by the earlier of contractual maturity or expected maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

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TABLE 16: Maturity of Securities

	Year Ended December 31,								
	2016			2015			2014		
(Dollars in thousands)	Amortized Cost	Weighted Average Yield		Amortized Cost	Weighted Average Yield		Amortized Cost	Weighted Average Yield	
U.S. government agencies and corporations:									
Maturing within 1 year	$ 7,032	1.61	%	$ 8,600	2.35	%	$ 15,252	2.35	%
Maturing after 1 year, but within 5 years	1,849	1.65		—	—		998	0.74	
Maturing after 5 years, but within 10 years	7,645	2.04		10,159	2.23		6,160	2.21	
Maturing after 10 years	—	—		—	—		999	2.51	
Total U.S. government agencies and corporations	16,526	1.81		18,759	2.29		23,409	2.43	
Mortgage-backed securities:									
Maturing within 1 year	304	1.96		1	6.23		3	6.24	
Maturing after 1 year, but within 5 years	71,740	2.03		64,549	2.13		41,535	2.34	
Maturing after 5 years, but within 10 years	3,890	2.87		10,947	3.02		21,954	2.76	
Maturing after 10 years	1,276	2.72		1,460	2.71		3,224	2.86	
Total mortgage-backed securities	77,210	2.08		76,957	2.27		66,716	2.76	
States and municipals:1									
Maturing within 1 year	20,703	5.03		18,023	4.67		15,946	5.36	
Maturing after 1 year, but within 5 years	75,898	4.54		71,710	5.02		68,551	4.95	
Maturing after 5 years, but within 10 years	10,587	5.77		16,208	5.50		20,405	5.36	
Maturing after 10 years	6,969	6.11		12,448	6.35		19,410	6.45	
Total states and municipals	114,157	4.84		118,389	5.17		124,312	5.70	
Total securities:									
Maturing within 1 year	28,039	4.14		26,624	3.92		31,201	3.89	
Maturing after 1 year, but within 5 years	149,487	3.30		136,259	3.65		111,084	4.06	
Maturing after 5 years, but within 10 years	22,122	3.97		37,314	3.88		48,519	3.78	
Maturing after 10 years	8,245	5.59		13,908	5.97		23,633	5.79	

Total securities	$ 207,893	3.58 %	$ 214,105	3.87 %	$ 214,437	4.16 %

[1] Yields on tax-exempt securities have been computed on a taxable-equivalent basis using the federal corporate income tax rate of 34 percent.

DEPOSITS

The Corporation’s predominant source of funds is depository accounts, which are comprised of demand deposits, savings and money market accounts, and time deposits. The Corporation’s deposits are principally provided by individuals and businesses located within the communities served.

Deposits totaled $1.12 billion at December 31, 2016, compared to $1.07 billion at December 31, 2015. This increase primarily consisted of a $20.7 million increase in non-interest bearing demand deposits and a $20.9 million increase in savings, money market and interest-bearing demand deposits, which reflected depositors’ preferences for maintaining flexibility regarding their investment options and the availability of their funds in the event of an increase in interest rates.

The Corporation had $3.6 million in brokered money market deposits outstanding at December 31, 2016, compared to $2.9 million in brokered money market deposits at December 31, 2015. The source of these brokered deposits is uninvested cash balances held in third-party brokerage sweep accounts. The Corporation uses brokered deposits as a means of diversifying liquidity sources, as opposed to a long-term deposit gathering strategy.

Table 17 presents the average deposit balances and average rates paid for the years 2016, 2015 and 2014.

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TABLE 17: Average Deposits and Rates Paid

	Year Ended December 31,					
	2016		2015		2014	
(Dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits	$ 210,520		$ 185,774		$ 166,928	
Interest-bearing transaction accounts						