

OLD POINT FINANCIAL CORP

Form 10-Q

August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-12896

OLD POINT FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

VIRGINIA

(State or other jurisdiction of incorporation or organization) 54-1265373 (I.R.S. Employer Identification No.)

1 West Mellen Street, Hampton, Virginia 23663

(Address of principal executive offices) (Zip Code)

(757) 728-1200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

5,181,106 shares of common stock (\$5.00 par value) outstanding as of July 25, 2018

---

OLD POINT FINANCIAL CORPORATION

FORM 10-Q

INDEX

PART I - FINANCIAL INFORMATION

	Page
Item 1. <u>Financial Statements</u>	1
<u>Consolidated Balance Sheets as of June 30, 2018 (unaudited) and December 31, 2017</u>	1
<u>Consolidated Statements of Income (unaudited) for the three and six months ended June 30, 2018 and 2017</u>	2
<u>Consolidated Statements of Comprehensive Income (Loss) (unaudited) for the three and six months ended June 30, 2018 and 2017</u>	3
<u>Consolidated Statements of Changes in Stockholders' Equity (unaudited) for the six months ended June 30, 2018 and 2017</u>	4
<u>Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2018 and 2017</u>	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	34
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	45
Item 4. <u>Controls and Procedures</u>	45
PART II - OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	46
Item 1A. <u>Risk Factors</u>	46
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
Item 3. <u>Defaults Upon Senior Securities</u>	46
Item 4. <u>Mine Safety Disclosures</u>	46
Item 5. <u>Other Information</u>	46
Item 6. <u>Exhibits</u>	47

Signatures

47

i

---

## GLOSSARY OF DEFINED TERMS

ALLL	Allowance for Loan and Lease Losses
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Bank	The Old Point National Bank of Phoebus
CET1	Common Equity Tier 1
Citizens	Citizens National Bank
Company	Old Point Financial Corporation
CRA	Community Reinvestment Act
ESPP	Employee Stock Purchase Plan
EVE	Economic Value of Equity
FASB	Financial Accounting Standards Board
FHLB	Federal Home Loan Bank
FOMC	Federal Open Market Committee
Federal Reserve	Board of Governors of the Federal Reserve System
FRB	Federal Reserve Bank
GAAP	Generally Accepted Accounting Principles
Incentive Stock Plan	Old Point Financial Corporation 2016 Incentive Stock Plan
IRS	Internal Revenue Service
OAEM	Other Assets Especially Mentioned
OCC	Office of the Comptroller of the Currency
OPM	Old Point Mortgage
OREO	Other Real Estate Owned
SEC	Securities and Exchange Commission
TDR	Troubled Debt Restructuring
Trust	Old Point Trust & Financial Services N.A.
VIE	Variable Interest Entities

---

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Balance Sheets

	June 30, 2018	December 31, 2017
	(in thousands except per share data)	
	(unaudited)	*
<b>Assets</b>		
Cash and due from banks	\$20,079	\$ 13,420
Interest-bearing due from banks	15,305	908
Federal funds sold	1,902	84
Cash and cash equivalents	37,286	14,412
Securities available-for-sale, at fair value	142,981	157,121
Restricted securities, at cost	3,869	3,846
Loans held for sale	849	779
Loans, net	766,344	729,092
Premises and equipment, net	37,775	37,197
Bank-owned life insurance	26,363	25,981
Goodwill	1,620	621
Other real estate owned, net	251	-
Core deposit intangible, net	429	-
Other assets	14,363	12,777
<b>Total assets</b>	<b>\$1,032,130</b>	<b>\$981,826</b>
<b>Liabilities &amp; Stockholders' Equity</b>		
<b>Deposits:</b>		
Noninterest-bearing deposits	\$245,069	\$225,716
Savings deposits	360,478	345,053
Time deposits	234,788	212,825
<b>Total deposits</b>	<b>840,335</b>	<b>783,594</b>
Federal funds purchased	-	10,000
Overnight repurchase agreements	26,048	20,693
Federal Home Loan Bank advances	60,000	67,500
Other borrowings	2,850	-
Accrued expenses and other liabilities	3,604	3,651
<b>Total liabilities</b>	<b>932,837</b>	<b>885,438</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
	25,847	25,087

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

Common stock, \$5 par value, 10,000,000 shares authorized; 5,181,106 and 5,019,703 shares outstanding (includes 12,083 and 2,245 shares of nonvested restricted stock, respectively)

Additional paid-in capital	20,568	17,270
Retained earnings	55,767	54,738
Accumulated other comprehensive loss, net	(2,889 )	(707 )
Total stockholders' equity	99,293	96,388
Total liabilities and stockholders' equity	\$1,032,130	\$981,826

See Notes to Consolidated Financial Statements.

\* Derived from audited Consolidated Financial Statements

Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(unaudited, in thousands except per share data)			
Interest and Dividend Income:				
Interest and fees on loans	\$8,688	\$7,110	\$16,583	\$13,890
Interest on due from banks	22	3	26	8
Interest on federal funds sold	8	2	10	5
Interest on securities:				
Taxable	499	491	993	987
Tax-exempt	302	420	646	847
Dividends and interest on all other securities	75	35	135	49
Total interest and dividend income	9,594	8,061	18,393	15,786
Interest Expense:				
Interest on savings deposits	141	73	245	137
Interest on time deposits	698	520	1,314	1,039
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	42	8	52	13
Interest on Federal Home Loan Bank advances	287	72	611	72
Total interest expense	1,168	673	2,222	1,261
Net interest income	8,426	7,388	16,171	14,525
Provision for loan losses	575	1,000	1,100	1,650
Net interest income, after provision for loan losses	7,851	6,388	15,071	12,875
Noninterest Income:				
Fiduciary and asset management fees	916	951	1,899	1,917
Service charges on deposit accounts	1,078	916	1,948	1,843
Other service charges, commissions and fees	1,164	1,075	2,231	2,091
Bank-owned life insurance income	173	199	382	397
Mortgage banking income	236	284	377	290
Gain on sale of securities, net	40	87	120	87
Gain on acquisition of Old Point Mortgage	-	550	-	550
Other operating income	40	29	45	79
Total noninterest income	3,647	4,091	7,002	7,254
Noninterest Expense:				
Salaries and employee benefits	5,935	5,449	11,412	10,546
Occupancy and equipment	1,487	1,454	2,964	2,903
Data processing	596	441	1,112	855
FDIC insurance	186	98	377	194
Customer development	135	154	317	298
Professional services	537	520	1,025	893
Employee professional development	208	219	400	455
Other taxes	142	138	312	281
ATM and other losses	157	155	254	332
Loss (gain) on other real estate owned	86	(18)	86	(18)



Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

Merger expenses	391	-	596	-
Other operating expenses	581	660	1,215	1,237
Total noninterest expense	10,441	9,270	20,070	17,976
Income before income taxes	1,057	1,209	2,003	2,153
Income tax expense	65	48	69	50
Net income	\$992	\$1,161	\$1,934	\$2,103
Basic earnings per share:				
Weighted average shares outstanding	5,177,233	4,984,151	5,099,088	4,980,728
Net income per share of common stock	\$0.19	\$0.23	\$0.38	\$0.42
Diluted earnings per share:				
Weighted average shares outstanding	5,177,233	4,996,880	5,099,124	4,993,916
Net income per share of common stock	\$0.19	\$0.23	\$0.38	\$0.42

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Comprehensive Income (Loss)

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2017		2017	
	(unaudited, in thousands)			
Net income	\$992	\$1,161	\$1,934	\$2,103
Other comprehensive income (loss), net of tax				
Net unrealized gain (loss) on available-for-sale securities	(120)	1,093	(1,871)	1,521
Reclassification for gain included in net income	(32 )	(57 )	(95 )	(57 )
Other comprehensive income (loss), net of tax	(152)	1,036	(1,966)	1,464
Comprehensive income (loss)	\$840	\$2,197	\$(32 )	\$3,567

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Changes in Stockholders' Equity

	Shares of Common Stock (unaudited, in thousands except share and per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
SIX MONTHS ENDED JUNE 30, 2018						
Balance at beginning of period	5,017,458	\$25,087	\$17,270	\$54,738	\$ (707 )	\$96,388
Net income	-	-	-	1,934	-	1,934
Other comprehensive loss, net of tax	-	-	-	-	(1,966 )	(1,966 )
Issuance of common stock related to acquisition	149,625	750	3,207	-	-	3,957
Reclassification of the stranded income tax effects of the Tax Cuts and Jobs Act from AOCI	-	-	-	139	(139 )	-
Reclassification of net unrealized gains on equity securities from AOCI per ASU 2016-01	-	-	-	77	(77 )	-
Employee Stock Purchase Plan share issuance	1,940	10	38	-	-	48
Stock-based compensation expense	-	-	53	-	-	53
Cash dividends (\$0.22 per share)	-	-	-	(1,121 )	-	(1,121 )
Balance at end of period	5,169,023	\$25,847	\$20,568	\$55,767	\$ (2,889 )	\$99,293
SIX MONTHS ENDED JUNE 30, 2017						
Balance at beginning of period	4,961,258	\$24,806	\$16,427	\$56,965	\$ (4,208 )	\$93,990
Net income	-	-	-	2,103	-	2,103
Other comprehensive income, net of tax	-	-	-	-	1,464	1,464
Exercise of stock options	24,806	124	373	-	-	497
Employee Stock Purchase Plan share issuance	1,687	9	38	-	-	47
Repurchase and retirement of common stock	(3,600 )	(18 )	(80 )	-	-	(98 )
Cash dividends (\$0.22 per share)	-	-	-	(1,095 )	-	(1,095 )
Balance at end of period	4,984,151	\$24,921	\$16,758	\$57,973	\$ (2,744 )	\$96,908

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Cash Flows

	Six Months Ended June 30,	
	2018	2017
	(unaudited, dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$1,934	\$2,103
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,250	1,394
Accretion related to acquisition, net	(121 )	-
Provision for loan losses	1,100	1,650
Gain on sale of securities, net	(120 )	(87 )
Net amortization of securities	928	1,178
Increase in loans held for sale, net	(70 )	(1,600 )
Net loss on disposal of premises and equipment	9	4
Net (gain) loss on write-down/sale of other real estate owned	86	(18 )
Income from bank owned life insurance	(382 )	(397 )
Stock compensation expense	53	-
Deferred tax benefit	-	(352 )
(Increase) decrease in other assets	(41 )	335
Decrease in accrued expenses and other liabilities	(371 )	(560 )
Net cash provided by operating activities	4,255	3,650
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of available-for-sale securities	(9,815 )	(22,899)
Proceeds from redemption (cash used in purchases) of restricted securities, net	254	(2,132 )
Proceeds from maturities and calls of available-for-sale securities	6,470	44,555
Proceeds from sales of available-for-sale securities	11,039	6,480
Paydowns on available-for-sale securities	5,014	4,770
Proceeds from sale of loans held for investment	8,746	-
Net increase in loans held for investment	(4,417 )	(77,092)
Proceeds from sales of other real estate owned	93	1,084
Purchases of premises and equipment	(317 )	(444 )
Cash paid in acquisition	(3,164 )	-
Cash acquired in acquisition	2,304	-
Net cash provided by (used in) investing activities	16,207	(45,678)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase (decrease) in noninterest-bearing deposits	13,040	(3,856 )
Increase in savings deposits	8,050	3,771
Decrease in time deposits	(8,310 )	(7,237 )
Increase (decrease) in federal funds purchased, repurchase agreements and other borrowings, net	(1,795 )	4,517
Increase in Federal Home Loan Bank advances	78,000	80,000
Repayment of Federal Home Loan Bank advances	(85,500)	(30,000)
Proceeds from exercise of stock options and ESPP issuance	48	544
Repurchase and retirement of common stock	-	(98 )

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

Cash dividends paid on common stock	(1,121 )	(1,095 )
Net cash provided by financing activities	2,412	46,546
Net increase in cash and cash equivalents	22,874	4,518
Cash and cash equivalents at beginning of period	14,412	25,854
Cash and cash equivalents at end of period	\$37,286	\$30,372

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash payments for:

Interest	\$2,128	\$1,236
----------	---------	---------

SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS

Unrealized gain (loss) on securities available-for-sale	\$(2,585 )	\$2,218
Loans transferred to other real estate owned	\$203	\$-

TRANSACTIONS RELATED TO ACQUISITIONS

Assets acquired	\$50,446	\$-
Liabilities assumed	\$44,324	\$-
Common stock issued in acquisition	\$3,957	\$-

See Notes to Consolidated Financial Statements.

5

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### Note 1. Accounting Policies

The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (NASDAQ: OPOF) (the Company) and its subsidiaries have been prepared in accordance with U.S. GAAP for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial position at June 30, 2018 and December 31, 2017, the statements of income and comprehensive income for the three and six months ended June 30, 2018 and 2017, and the statements of changes in stockholders' equity and cash flows for the six months ended June 30, 2018 and 2017. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2017 annual report on Form 10-K. Certain previously reported amounts have been reclassified to conform to current period presentation, none of which were material in nature.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services N.A. (Trust). All significant intercompany balances and transactions have been eliminated in consolidation.

### BUSINESS COMBINATIONS

On April 1, 2018, the Company completed its acquisition of Citizens National Bank (Citizens) based in Windsor, Virginia for a purchase price of approximately \$7.1 million. Under the terms of the merger agreement, Citizens common stockholders received 0.1041 shares of the Company's common stock and \$2.19 in cash for each share of Citizens common stock, resulting in the Company issuing 149,625 shares of the Company's common stock.

In connection with the acquisition, the Company recorded \$999 thousand in goodwill and \$440 thousand of amortizable assets, which relate to core deposit intangibles. The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition.

### NATURE OF OPERATIONS

Old Point Financial Corporation is a holding company that conducts substantially all of its operations through two subsidiaries, the Bank and Trust. The Bank serves individual and commercial customers, the majority of which are in Hampton Roads, Virginia. As of June 30, 2018, the Bank had 19 branch offices. The Bank offers a full range of deposit and loan products to its retail and commercial customers, including mortgage loan products offered through its Old Point Mortgage (OPM) division. A full array of insurance products is also offered through Old Point Insurance, LLC in partnership with Morgan Marrow Company. Trust offers a full range of services for individuals and businesses. Products and services include retirement planning, estate planning, financial planning, estate and trust administration, retirement plan administration, tax services and investment management services.

## RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements. As the Company owns the majority of its buildings, management does not anticipate that the ASU will have a material impact.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements and has formed a committee to oversee the adoption of the new standard. The ALLL model currently in use by the Company already provides it with the ability to archive prior period information and contains loan balance and charge-off information beginning with September 30, 2011. The committee has reviewed the data included in each monthly archive file and has added fields to enhance its data analysis capabilities under the new standard.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

During March 2017, the FASB issued ASU No. 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The amendments in this ASU modify the designation and measurement guidance for hedge accounting as well as provide for increased transparency regarding the presentation of economic results on both the financial statements and related footnotes. Certain aspects of hedge effectiveness assessments will also be simplified upon implementation of this update. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Company does not expect the adoption of ASU 2017-12 to have a material impact on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments provide targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically, the amendments include clarifications related to: measurement elections, transition requirements, and adjustments associated with equity securities without readily determinable fair values; fair value measurement requirements for forward contracts and purchased options on equity securities; presentation requirements for hybrid financial liabilities for which the fair value option has been elected; and measurement requirements for liabilities denominated in a foreign currency for which the fair value option has been elected. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-03 to have a material impact on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, "Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting." The amendments expand the scope of Topic 718 to include share-based payments issued to non-employees for goods or services, which were previously excluded. The amendments will align the accounting for share-based payments to non-employees and employees more similarly. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-07 to have a material impact on its consolidated financial statements.



## ACCOUNTING STANDARDS ADOPTED IN 2018

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU requires an entity to, among other things: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. The ASU provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The ASU also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company adopted ASU No. 2016-01 on January 1, 2018, and during the first quarter of 2018, measured its equity investments at fair value through net income and reclassified \$77 thousand of AOCI to retained earnings, with no effect on total stockholders' equity. During the second quarter of 2018, the Company sold the equity investments, recognizing an additional gain on sale of \$24 thousand, net of tax. The Company also measured the fair value of its loan portfolio and time deposits at June 30, 2018 using an exit price notion (see Note 9. Fair Value Measurements).

In February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments provide financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income (AOCI) to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Organizations should apply the proposed amendments either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company has elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act in the consolidated financial statements for the period ending March 31, 2018. The reclassification decreased AOCI and increased retained earnings by \$139 thousand, with no effect on total stockholders' equity.

On January 1, 2018 the Company adopted ASU 2014-09 "Revenue from Contracts with Customers" and all subsequent amendments to the ASU (collectively, "ASC 606"). The majority of the Company's revenues are associated with financial instruments, including loans and securities, to which ASC 606 does not apply. ASC 606 is applicable to certain noninterest revenues including services charges on deposit accounts, interchange fees, merchant services income, trust and asset management income, and the sale of other real estate owned. However, the recognition of these revenue streams did not change upon adoption of ASC 606. Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of ASC 606 are discussed below.

#### Fiduciary and Asset Management Fees

Fiduciary and asset management income is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the applicable fee schedule or contract terms. Payment is generally received immediately or in the following month. The Company does not earn performance-based incentives. Additional services such as tax return preparation services are transactional-based, and the performance obligation is generally satisfied, and related revenue recognized, as incurred. Payment is received shortly after services are rendered.

#### Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

#### Other Service Charges, Commissions and Fees

Other service charges, commissions and fees are primarily comprised of debit card income, ATM fees, merchant services income, investment services income, and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Investment services income relates to commissions earned on brokered trades of investment securities. Other service charges include revenue from processing wire transfers, safe deposit box rentals, cashier's checks, and other services. The Company's performance obligation for other service charges, commission and fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

#### Other Operating Income

Other operating income mainly consists of check sales to customers and fees charged for the early redemption of time deposits. Other operating income is largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment is generally received immediately.

## Note 2. Acquisitions

On April 1, 2018, the Company completed its acquisition of Citizens. Under the terms of the merger agreement, Citizens shareholders received 0.1041 shares of the Company's common stock and \$2.19 in cash for each share of Citizens common stock, resulting in the Company issuing 149,625 shares of the Company's common stock at a fair value of \$4.0 million, for a total purchase price of \$7.1 million. Citizens is operating as a division of the Bank.

The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition, in accordance with ASC 350, Intangibles-Goodwill and Other. The following table provides a preliminary assessment of the consideration transferred, assets acquired, and liabilities assumed as of the date of the acquisition (dollars in thousands):

	As Recorded by Citizens	Fair Value Adjustments	As Recorded by the Company
Consideration paid:			
Cash			\$ 3,164
Company common stock			3,957
Total purchase price			7,121
Identifiable assets acquired:			
Cash and cash equivalents	\$ 2,304	\$ -	\$ 2,304
Securities available for sale	1,959	-	1,959
Restricted securities, at cost	278	-	278
Loans, net	42,824	(34 )	42,790
Premises and equipment	1,070	450	1,520
Other real estate owned	237	(11 )	226
Core deposit intangibles	-	440	440
Other assets	1,055	(126 )	929
Total assets	\$ 49,727	\$ 719	\$ 50,446
Identifiable liabilities assumed:			
Deposits	\$ 43,754	\$ 246	\$ 44,000
Other liabilities	324	-	324
Total liabilities	\$ 44,078	\$ 246	\$ 44,324
Net assets acquired			\$ 6,122
Preliminary goodwill			\$ 999

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. Purchased intangible assets subject to amortization, such as the core deposit intangible asset, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The acquired loans were recorded at fair value at the acquisition date without carryover of Citizens' allowance for loan losses. The fair value of the loans was determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected on the loans and then applying a market-based discount rate to those cash flows. In this regard, the acquired loans were segregated into pools based on call code with other key inputs identified such as payment structure, rate type, remaining maturity, and credit risk characteristics including risk rating groups (pass rated loans and adversely classified loans), and past due status.

The acquired loans were divided into loans with evidence of credit quality deterioration which are accounted for under ASC 310-30, Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality, (acquired impaired) and loans that do not meet these criteria, which are accounted for under ASC 310-20, Receivables - Nonrefundable Fees and Other Costs, (acquired performing). The fair values of the acquired performing loans were \$42.1 million and the fair value of the acquired impaired loans were \$710 thousand.

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

The following table presents the acquired impaired loans receivable at the acquisition date (dollars in thousands):

Contractually required principal and interest payments	\$ 1,031
Nonaccretable difference	(211 )
Cash flows expected to be collected	820
Accretable difference	(110 )
Fair value of loans acquired impaired loans	\$ 710

The amortization and accretion of premiums and discounts associated with the Company's acquisition accounting adjustments related to the Citizens acquisition had the following impact on the consolidated Statements of Income during the three months ended June 30, 2018 (dollars in thousands). The acquisition occurred on April 1, 2018, therefore the first quarter of 2018 and the comparative 2017 periods had no impact.

	Three Months Ended June 30, 2018
Acquired performing loans	\$ 92
Acquired impaired loans	1
Certificate of deposit valuation	39
Amortization of core deposit intangible	(11 )
Net impact to income before taxes	\$ 121

Note 3. Securities

Amortized costs and fair values of securities available-for-sale as of the dates indicated are as follows:

	Amortized Cost (in thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018				
U.S. Treasury securities	\$6,844	\$ -	\$ (26 )	\$6,818
Obligations of U.S. Government agencies	11,519	-	(160 )	11,359
Obligations of state and political subdivisions	51,846	111	(716 )	51,241
Mortgage-backed securities	71,152	-	(2,893 )	68,259
Money market investments	1,326	-	-	1,326
Corporate bonds and other securities	3,950	44	(16 )	3,978
Total	\$146,637	\$ 155	\$ (3,811 )	\$142,981
December 31, 2017				
Obligations of U.S. Government agencies	\$9,530	\$ 27	\$ (122 )	\$9,435
Obligations of state and political subdivisions	64,413	489	(137 )	64,765
Mortgage-backed securities	75,906	-	(1,610 )	74,296
Money market investments	1,194	-	-	1,194
Corporate bonds and other securities	7,049	195	(10 )	7,234
Other marketable equity securities	100	97	-	197
Total	\$158,192	\$ 808	\$ (1,879 )	\$157,121

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

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

The Company has not recorded impairment charges through income on securities for the three or six months ended June 30, 2018 or the year ended December 31, 2017.

The following table summarizes net realized gains and losses on the sale of investment securities during the periods indicated (dollars in thousands):

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
Securities Available-for-sale				
Realized gains on sales of securities	\$51	\$87	\$131	\$87
Realized losses on sales of securities	(11)	-	(11)	-
Net realized gain	\$40	\$87	\$120	\$87

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired as of June 30, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of the dates indicated:

June 30, 2018

	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
(dollars in thousands)						
Securities Available-for-Sale						
U.S. Treasury securities	\$26	\$6,818	\$-	\$-	\$26	\$6,818
Obligations of U.S. Government agencies	37	7,678	123	3,481	160	11,159
Obligations of state and political subdivisions	332	20,739	384	10,625	716	31,364
Mortgage-backed securities	130	4,170	2,763	64,089	2,893	68,259
Corporate bonds	4	996	12	188	16	1,184
Total securities available-for-sale	\$529	\$40,401	\$3,282	\$78,383	\$3,811	\$118,784

December 31, 2017

	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
(dollars in thousands)						
Securities Available-for-Sale						
Obligations of U.S. Government agencies	\$11	\$3,189	\$111	\$3,089	\$122	\$6,278
Obligations of state and political subdivisions	32	11,141	105	10,999	137	22,140
Mortgage-backed securities	67	9,742	1,543	64,554	1,610	74,296
Corporate bonds	2	1,098	8	792	10	1,890
Total securities available-for-sale	\$112	\$25,170	\$1,767	\$79,434	\$1,879	\$104,604

The number of investments at an unrealized loss position as of June 30, 2018 and December 31, 2017 were 103 and 77, respectively. Certain investments within the Company's portfolio had unrealized losses for more than twelve months at June 30, 2018 and December 31, 2017, as shown in the tables above. The unrealized losses were caused by increases in market interest rates. Because the Company does not intend to sell the investments and management believes it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at June 30, 2018 or December 31, 2017.

#### Restricted Securities

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



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

The following is a summary of the balances in each class of the Company's portfolio of loans held for investment as of the dates indicated:

	June 30, 2018	December 31, 2017
	(in thousands)	
Mortgage loans on real estate:		
Residential 1-4 family	\$ 109,961	\$ 101,021
Commercial	301,241	289,682
Construction	36,929	27,489
Second mortgages	18,007	17,918
Equity lines of credit	55,250	56,610
Total mortgage loans on real estate	521,388	492,720
Commercial and industrial loans	64,701	60,398
Consumer automobile loans	125,866	119,251
Other consumer loans	52,109	54,974
Other	12,153	11,197
Total loans, net of deferred fees (1)	776,217	738,540
Less: Allowance for loan losses	(9,873 )	(9,448 )
Loans, net of allowance and deferred fees and costs (1)	\$ 766,344	\$ 729,092

(1) Net deferred loan fees totaled \$925 thousand and \$916 thousand at June 30, 2018 and December 31, 2017, respectively.

Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts totaled \$613 thousand and \$594 thousand at June 30, 2018 and December 31, 2017, respectively.

Acquired Loans

The Company had no acquired loans as of December 31, 2017. The outstanding principal balance and the carrying amount of acquired loans included in the consolidated balance sheet as of June 30, 2018 are as follows:

	June 30, 2018 (in thousands)
Outstanding principal balance	\$ 37,528
Carrying amount	36,923

The outstanding principal balance and related carrying amount of acquired impaired loans, for which the Company applies FASB ASC 310-30 to account for interest earned, as of June 30, 2018 are as follows:

	June 30, 2018 (in thousands)
Outstanding principal balance	\$ 686

Carrying amount 458

The following table presents changes in the accretable yield on acquired impaired loans, for which the Company applies FASB ASC 310-30, at June 30, 2018:

	June 30, 2018 (in thousands)
Balance at January 1, 2018	\$ -
Additions from acquisition of Citizens	110
Accretion	(11 )
Other changes, net	-
Balance at end of period	\$ 99

## CREDIT QUALITY INFORMATION

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

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

Pass: Loans are of acceptable risk.

Other Assets Especially Mentioned (OAEM): Loans have potential weaknesses that deserve management's close attention.

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

Doubtful: Loans have all the weaknesses inherent in a substandard loan with added characteristics that make collection or liquidation in full based on currently existing facts, conditions and values highly questionable or improbable.

Loss: Loans have been identified for charge-off because they are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

The following table presents credit quality exposures by internally assigned risk ratings as of the dates indicated:

## Credit Quality Information

As of June 30, 2018

(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$ 107,835	\$-	\$ 2,126	\$ -	\$ 109,961
Commercial	275,700	6,147	19,394	-	301,241
Construction	36,135	73	721	-	36,929
Second mortgages	17,250	413	344	-	18,007
Equity lines of credit	54,896	-	354	-	55,250
Total mortgage loans on real estate	491,816	6,633	22,939	-	521,388
Commercial and industrial loans	62,297	1,932	472	-	64,701
Consumer automobile loans	125,506	-	360	-	125,866
Other consumer loans	52,063	-	46	-	52,109
Other	12,153	-	-	-	12,153
Total	\$ 743,835	\$ 8,565	\$ 23,817	\$ -	\$ 776,217

## Credit Quality Information

As of December 31, 2017

(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$ 98,656	\$-	\$ 2,365	\$ -	\$ 101,021
Commercial	264,275	10,526	14,881	-	289,682
Construction	26,694	74	721	-	27,489
Second mortgages	17,211	431	276	-	17,918
Equity lines of credit	56,318	-	292	-	56,610
Total mortgage loans on real estate	463,154	11,031	18,535	-	492,720

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

Commercial and industrial loans	58,091	1,469	838	-	60,398
Consumer automobile loans	119,211	-	40	-	119,251
Other consumer loans	54,926	-	48	-	54,974
Other	11,197	-	-	-	11,197
Total	\$706,579	\$12,500	\$ 19,461	\$ -	\$738,540

13

---

## AGE ANALYSIS OF PAST DUE LOANS BY CLASS

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

## Age Analysis of Past Due Loans as of June 30, 2018

	30 - 59 Days Past Due (in thousands)	60 - 89 Days Past Due	90 or More Days Past Due	Acquired Impaired	Total Current Loans <sup>(1)</sup>	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
Mortgage loans on real estate:							
Residential 1-4 family	\$503	\$-	\$941	\$ 350	\$108,167	\$109,961	\$ 262
Commercial	626	-	3,235	108	297,272	301,241	-
Construction	-	-	721	-	36,208	36,929	-
Second mortgages	13	-	95	-	17,899	18,007	52
Equity lines of credit	29	20	53	-	55,148	55,250	-
Total mortgage loans on real estate	1,171	20	5,045	458	514,694	521,388	314
Commercial loans	-	-	-	-	64,701	64,701	-
Consumer automobile loans	925	63	95	-	124,783	125,866	95
Other consumer loans	850	151	1,880	-	49,228	52,109	1,880
Other	79	11	6	-	12,057	12,153	6
Total	\$3,025	\$245	\$7,026	\$ 458	\$765,463	\$776,217	\$ 2,295

<sup>(1)</sup> For purposes of this table, Total Current Loans includes loans that are 1 - 29 days past due.

In the table above, the other consumer loans category includes student loans with principal and interest amounts that are 97 - 98% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$2.7 million at June 30, 2018.

## Age Analysis of Past Due Loans as of December 31, 2017

	30 - 59 Days Past Due (in thousands)	60 - 89 Days Past Due	90 or More Days Past Due	Total Current Loans <sup>(1)</sup>	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
Mortgage loans on real estate:						
Residential 1-4 family	\$229	\$153	\$1,278	\$99,361	\$101,021	\$ 261
Commercial	194	771	1,753	286,964	289,682	-
Construction	-	-	721	26,768	27,489	-
Second mortgages	15	-	163	17,740	17,918	45
Equity lines of credit	75	19	53	56,463	56,610	-

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

Total mortgage loans on real estate	513	943	3,968	487,296	492,720	306
Commercial loans	709	-	1,060	58,629	60,398	471
Consumer automobile loans	517	122	41	118,571	119,251	41
Other consumer loans	2,222	544	2,360	49,848	54,974	2,360
Other	84	9	4	11,100	11,197	4
Total	\$4,045	\$1,618	\$7,433	\$725,444	\$738,540	\$ 3,182

<sup>(1)</sup> For purposes of this table, Total Current Loans includes loans that are 1 - 29 days past due.

In the table above, the other consumer loans category includes student loans with principal and interest amounts that are 97 - 98% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$4.2 million at December 31, 2017.

14

---

Although the portion of the student loan portfolio that is 90 days or more past due would normally be considered impaired, the Company does not include these loans in its impairment analysis. Because the federal government has provided guarantees of repayment of these student loans in an amount ranging from 97% to 98% of the total principal and interest of the loans, management does not expect significant increases in past due student loans to have a material effect on the Company.

## NONACCRUAL LOANS

The Company generally places commercial loans (including construction loans and commercial loans secured and not secured by real estate) in nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred or the loan reaches 90 days past due, unless the credit is well-secured and in the process of collection.

Under regulatory rules, consumer loans, which are loans to individuals for household, family and other personal expenditures, and consumer loans secured by real estate (including residential 1 - 4 family mortgages, second mortgages, and equity lines of credit) are not required to be placed in nonaccrual status. Although consumer loans and consumer loans secured by real estate are not required to be placed in nonaccrual status, the Company may elect to place these loans in nonaccrual status, if necessary to avoid a material overstatement of interest income. Generally, consumer loans secured by real estate are placed in nonaccrual status only when payments are 120 days past due.

Generally, consumer loans not secured by real estate are placed in nonaccrual status only when part of the principal has been charged off. If a charge-off has not occurred sooner for other reasons, a consumer loan not secured by real estate will generally be placed in nonaccrual status when payments are 120 days past due. These loans are charged off or written down to the net realizable value of the collateral when deemed uncollectible, when classified as a "loss," when repayment is unreasonably protracted, when bankruptcy has been initiated, or when the loan is 120 days or more past due unless the credit is well-secured and in the process of collection.

When management places a loan in nonaccrual status, the accrued unpaid interest receivable is reversed against interest income and the loan is accounted for by the cash basis or cost recovery method, until it qualifies for return to accrual status or is charged off. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, or when the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments for at least six months.

The following table presents loans in nonaccrual status by class of loan as of the dates indicated:

### Nonaccrual Loans by Class

	June 30, 2018	December 31, 2017
	(in thousands)	
Mortgage loans on real estate		
Residential 1-4 family	\$1,540	\$ 1,447
Commercial	10,802	9,468
Construction	722	721
Second mortgages	154	118
Equity lines of credit	354	292
Total mortgage loans on real estate	13,572	12,046
Commercial loans	319	836
Total	\$13,891	\$ 12,882

No acquired impaired loans were on nonaccrual status at June 30, 2018.

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

	Six Months Ended June 30, 2018 2017	
	(in thousands)	
Interest income that would have been recorded under original loan terms	\$235	\$241
Actual interest income recorded for the period	173	180
Reduction in interest income on nonaccrual loans	\$62	\$61

15



## TROUBLED DEBT RESTRUCTURINGS

The Company's loan portfolio includes certain loans that have been modified in a troubled debt restructuring (TDR), where economic concessions have been granted to borrowers who are experiencing financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reduction in the interest rate below current market rates for borrowers with similar risk profiles, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. The Company defines a TDR as nonperforming if the TDR is in nonaccrual status or is 90 days or more past due and still accruing interest at the report date.

When the Company modifies a loan, management evaluates any possible impairment as stated in the impaired loan section below.

The following tables present TDRs during the periods indicated, by class of loan. There were no troubled debt restructurings in the three or six months ended June 30, 2018.

Troubled Debt Restructurings by Class  
For the Three Months Ended June 30, 2017

	Recorded Number of Prior to Modification (dollars in thousands)	Recorded Investment After Modification	Current Investment on June 30, 2017
Mortgage loans on real estate:			
Commercial	2 \$ 3,663	\$ 3,663	\$ 4

Troubled Debt Restructurings by Class  
For the Six Months Ended June 30, 2017

	Recorded Number of Prior to Modification (dollars in thousands)	Recorded Investment After Modification	Current Investment on June 30, 2017
Mortgage loans on real estate:			
Residential 1-4 family	1 \$ 142	\$ 142	\$ 142
Commercial	2 3,663	3,663	3,663
Total	3 \$ 3,805	\$ 3,805	\$ 3,805

The three loans restructured in the first six months ended June 30, 2017 were given below-market rates for debt with similar risk characteristics. At June 30, 2018 and December 31, 2017, the Company had no outstanding commitments to disburse additional funds on any TDR. At June 30, 2018 the Company had no loans secured by residential 1 - 4 family real estate that were in the process of foreclosure. At December 31, 2017, loans totaling \$77 thousand were in the process of foreclosure.

In the three and six months ended June 30, 2018 and 2017, there were no defaulting TDRs where the default occurred within twelve months of restructuring. The Company considers a TDR in default when any of the following occurs: the loan, as restructured, becomes 90 days or more past due; the loan is moved to nonaccrual status following the restructure; the loan is restructured again under terms that would qualify it as a TDR if it were not already so classified; or any portion of the loan is charged off.

All TDRs are factored into the determination of the allowance for loan losses and included in the impaired loan analysis, as discussed below.

## IMPAIRED LOANS

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

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

The following table includes the recorded investment and unpaid principal balances (a portion of which may have been charged off) for impaired loans, exclusive of acquired impaired loans, with the associated allowance amount, if applicable, as of the dates presented. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized for the periods presented. The average balances are calculated based on daily average balances.

## Impaired Loans by Class

	As of June 30, 2018				For the six months ended June 30, 2018	
	Unpaid Principal Balance	Recorded Investment Without Allowance	Recorded Investment With Allowance	Associated Allowance	Average Recorded Investment	Average Interest Recognized
	(in thousands)					
Mortgage loans on real estate:						
Residential 1-4 family	\$2,186	\$1,777	\$ 390	\$ 151	\$2,111	\$ 29
Commercial	15,619	13,254	608	111	14,807	131
Construction	817	721	94	20	815	5
Second mortgages	502	350	132	14	490	6
Equity lines of credit	355	102	253	24	335	1
Total mortgage loans on real estate	\$19,479	\$16,204	\$ 1,477	\$ 320	\$18,558	\$ 172
Commercial loans	357	319	-	-	583	-
Other consumer loans	32	-	-	-	85	-
Total	\$19,868	\$16,523	\$ 1,477	\$ 320	\$19,226	\$ 172

## Impaired Loans by Class

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

	As of December 31, 2017				For the Year Ended December 31, 2017	
	Recorded Investment					
	Unpaid Principal Balance (in thousands)	Without Valuation Allowance	With Valuation Allowance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Mortgage loans on real estate:						
Residential 1-4 family	\$2,873	\$2,499	\$ 316	\$ 52	\$2,525	\$ 90
Commercial	15,262	11,622	1,644	1	13,541	579
Construction	814	721	92	18	406	23
Second mortgages	473	318	135	14	464	20
Equity lines of credit	293	53	239	10	261	-
Total mortgage loans on real estate	\$19,715	\$15,213	\$ 2,426	\$ 95	\$17,197	\$ 712
Commercial loans	1,115	836	-	-	1,388	30
Other consumer loans	-	-	-	-	41	-
Total	\$20,830	\$16,049	\$ 2,426	\$ 95	\$18,626	\$ 742

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

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

## ALLOWANCE FOR LOAN LOSSES

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and probable losses inherent in the loan portfolio. The Company segments the loan portfolio into categories as defined by Schedule RC-C of the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income Form 041 (Call Report). Loans are segmented into the following pools: commercial, real estate-construction, real estate-mortgage, consumer and other loans. The Company also sub-segments the real estate-mortgage segment into four classes: residential 1-4 family, commercial real estate, second mortgages and equity lines of credit.

The Company uses an internally developed risk evaluation model in the estimation of the credit risk process. The model and assumptions used to determine the allowance are independently validated and reviewed to ensure that the theoretical foundation, assumptions, data integrity, computational processes and reporting practices are appropriate and properly documented.

Each portfolio segment has risk characteristics as follows:

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

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

**Real estate-mortgage:** Residential mortgage loans and equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral. Commercial real estate loans carry risks associated with the successful operation of a business if owner occupied. If non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts.

**Consumer loans:** Consumer loans carry risks associated with the continued credit-worthiness of the borrowers and the value of the collateral. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

**Other loans:** Other loans are loans to mortgage companies, loans for purchasing or carrying securities, and loans to insurance, investment and finance companies. These loans carry risks associated with the successful operation of a business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time, depend on interest rates or fluctuate in active trading markets.

Each segment of the portfolio is pooled by risk grade or by days past due. Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on

days past due, while all other loans, including loans to consumers that are secured by real estate, are segmented by risk grades. A historical loss percentage is then calculated by migration analysis and applied to each pool. The migration analysis applied to all pools is able to track the risk grading and historical performance of individual loans throughout a number of periods set by management, which provides management with information regarding trends (or migrations) in a particular loan segment. At June 30, 2018 and December 31, 2017 management used eight twelve-quarter migration periods.

Management also provides an allocated component of the allowance for loans that are specifically identified that may be impaired, and are individually analyzed for impairment. An allocated allowance is established when the present value of expected future cash flows from the impaired loan (or the collateral value or observable market price of the impaired loan) is lower than the carrying value of that loan.

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

Acquired loans are recorded at their fair value at acquisition date without carryover of the acquiree's previously established ALL, as credit discounts are included in the determination of fair value. The fair value of the loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected on the loans and then applying a market-based discount rate to those cash flows. During evaluation upon acquisition, acquired loans are also classified as either acquired impaired or acquired performing.

Acquired impaired loans reflect credit quality deterioration since origination, as it is probable at acquisition that the Company will not be able to collect all contractually required payments. These acquired impaired loans are accounted for under ASC 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality. The acquired impaired loans are segregated into pools based on loan type and credit risk. Loan type is determined based on collateral type, purpose, and lien position. Credit risk characteristics include risk rating groups, nonaccrual status, and past due status. For valuation purposes, these pools are further disaggregated by maturity, pricing characteristics, and re-payment structure. Acquired impaired loans are written down at acquisition to fair value using an estimate of cash flows deemed to be collectible. Accordingly, such loans are no longer classified as nonaccrual even though they may be contractually past due because the Company expects to fully collect the new carrying values of such loans, which is the new cost basis arising from purchase accounting.

Acquired performing loans are accounted for under ASC 310-20, Receivables – Nonrefundable Fees and Other Costs. The difference between the fair value and unpaid principal balance of the loan at acquisition date (premium or discount) is amortized or accreted into interest income over the life of the loans. If the acquired performing loan has revolving privileges, it is accounted for using the straight-line method; otherwise, the effective interest method is used.

## ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The total allowance reflects management's estimate of losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$9.9 million adequate to cover probable loan losses inherent in the loan portfolio at June 30, 2018.

The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans for the periods presented. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

## ALLOWANCE FOR LOAN LOSSES AND RECORDED INVESTMENT IN LOANS

(in thousands)

For the Six Months Ended June 30, 2018	Commercial	Real Estate - Construction	Real Estate - Mortgage (1)	Consumer (2)	Other	Total
Allowance for Loan Losses:						
Balance at the beginning of period	\$ 1,889	\$ 541	\$5,217	\$1,644	\$157	\$9,448
Charge-offs	(81 )	-	(422 )	(344 )	(160 )	(1,007 )
Recoveries	67	-	80	139	46	332
Provision for loan losses	443	(258 )	732	60	123	1,100
Ending balance	\$ 2,318	\$ 283	\$5,607	\$1,499	\$166	\$9,873
Ending balance individually evaluated for impairment	\$ -	\$ 20	\$300	\$-	\$-	\$320
Ending balance collectively evaluated for impairment	2,318	263	5,307	1,499	166	9,553
Ending balance acquired impaired loans	-	-	-	-	-	-
Ending balance	\$ 2,318	\$ 283	\$5,607	\$1,499	\$166	\$9,873
Loan Balances:						
Ending balance individually evaluated for impairment	\$ 319	\$ 815	\$16,866	\$-	\$-	\$18,000
Ending balance collectively evaluated for impairment	64,274	36,114	467,243	177,975	12,153	757,759
Ending balance acquired impaired loans	108	-	350	-	-	458
Ending balance	\$ 64,701	\$ 36,929	\$484,459	\$177,975	\$12,153	\$776,217

For the Year Ended December 31, 2017	Commercial	Real Estate - Construction	Real Estate - Mortgage (1)	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at the beginning of period	\$ 1,493	\$ 846	\$5,267	\$455	\$184	\$8,245
Charge-offs	(807 )	-	(1,934 )	(279 )	(267 )	(3,287 )
Recoveries	37	104	45	56	88	330
Provision for loan losses	1,166	(409 )	1,839	1,412	152	4,160
Ending balance	\$ 1,889	\$ 541	\$5,217	\$1,644	\$157	\$9,448
Ending balance individually evaluated for impairment	\$ -	\$ 18	\$77	\$-	\$-	\$95
Ending balance collectively evaluated for impairment	1,889	523	5,140	1,644	157	9,353

Edgar Filing: OLD POINT FINANCIAL CORP - Form 10-Q

Ending balance	\$ 1,889	\$ 541	\$5,217	\$ 1,644	\$157	\$9,448
Loan Balances:						
Ending balance individually evaluated for impairment	\$ 836	\$ 813	\$16,826	\$-	\$-	\$18,475
Ending balance collectively evaluated for impairment	59,562	26,676	448,405	174,225	11,197	720,065
Ending balance	\$ 60,398	\$ 27,489	\$465,231	\$174,225	\$11,197	\$738,540

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

(2) The consumer segment includes consumer automobile loans.



## Note 5. Low-Income Housing Tax Credits

The Company was invested in 4 separate housing equity funds at both June 30, 2018 and December 31, 2017. The general purpose of these funds is to encourage and assist participants in investing in low-income residential rental properties located in the Commonwealth of Virginia; develop and implement strategies to maintain projects as low-income housing; deliver Federal Low Income Housing Credits to investors; allocate tax losses and other possible tax benefits to investors; and preserve and protect project assets.

The investments in these funds were recorded as other assets on the consolidated balance sheets and were \$3.4 million and \$3.5 million at June 30, 2018 and December 31, 2017, respectively. The expected terms of these investments and the related tax benefits run through 2033. Total projected tax credits to be received for 2018 are \$495 thousand, which is based on the most recent quarterly estimates received from the funds. Additional capital calls expected for the funds totaled \$1.1 million at June 30, 2018 and \$1.1 million at December 31, 2017, respectively, and are recorded in accrued expenses and other liabilities on the corresponding consolidated balance sheet.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	Affected Line Item on Consolidated Statements of Income (in thousands)			
Tax credits and other tax benefits				
Amortization of operating losses	\$80	\$98	\$160	\$178
Tax benefit of operating losses*	17	33	34	61
				Income tax expense
Tax credits	123	138		