

Board of Governors of the Federal Reserve System

MAR 27 2019



Annual Report of Holding Companies—FR Y-6  
FRB RICHMOND

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The Annual Report of Holding Companies must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2018

Month / Day / Year

n/a

Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

I, John E Stringer

Name of the Holding Company Director and Official

President/CEO

Title of the Holding Company Director and Official

attest that the Annual Report of Holding Companies (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

Southwest Virginia Bankshares, Inc

Legal Title of Holding Company

102 W Main / P O Box 1067

(Mailing Address of the Holding Company) Street / P.O. Box

Marion

VA

24354

City

State

Zip Code

Physical Location (if different from mailing address)

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Person to whom questions about this report should be directed:

Chris Snodgrass

VP/CFO

Name

Title

276-783-3116

Area Code / Phone Number / Extension

276-782-9136

Area Code / FAX Number

chris@bomva.com

E-mail Address

www.bankofmarionva.com

Address (URL) for the Holding Company's web page

Signature of Holding Company Director and Official

03/25/2019

Date of Signature

For holding companies not registered with the SEC—

Indicate status of Annual Report to Shareholders:

- is included with the FR Y-6 report
- will be sent under separate cover
- is not prepared

For Federal Reserve Bank Use Only

RSSD ID

1132391

C.I.

Is confidential treatment requested for any portion of this report submission? .....

0=No

1=Yes

0

In accordance with the General Instructions for this report (check only one),

- 1. a letter justifying this request is being provided along with the report.....
- 2. a letter justifying this request has been provided separately ...

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

DECEMBER 31, 2018

SOUTHWEST VIRGINIA BANKSHARES INC.  
MARION, VA  
INCORPORATED IN VIRGINIA  
ORGANIZATION CHART Y-6

SOUTHWEST VIRGINIA BANKSHARES, INC  
No LEI  
MARION, VA  
INCORPORATED IN VIRGINIA

(100% Ownership)

THE BANK OF MARION  
LEI #254900V7NEE9M236MZ98  
MARION, VA  
INCORPORATED IN VIRGINIA

Shareholders of record as of December 31, 2018 and DURING the year that directly or indirectly own, control or hold with power to vote five percent or more of any class of voting securities of Southwest Virginia Bankshares, Inc

SHAREHOLDER	ADDRESS	#OF SHARES OWNED	PERCENTAGE
NONE			

Results: A list of branches for your depository institution: BANK OF MARION, THE (ID\_RSSD: 858528).  
 This depository institution is held by SOUTHWEST VIRGINIA BANKSHARES, INC. (1132391) of MARION, VA.  
 The data are as of 12/31/2018. Data reflects information that was received and processed through 01/06/2019.

**Reconciliation and Verification Steps**

1. In the **Data Action** column of each branch row, enter one or more of the actions specified below.
2. If required, enter the date in the **Effective Date** column.

**Actions**

OK: If the branch information is correct, enter "OK" in the **Data Action** column.  
 Change: If the branch information is incorrect or incomplete, revise the data, enter "Change" in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.  
 Close: If a branch listed was sold or closed, enter "Close" in the **Data Action** column and the sale or closure date in the **Effective Date** column.  
 Delete: If a branch listed was never owned by this depository institution, enter "Delete" in the **Data Action** column.  
 Add: If a reportable branch is missing, insert a row, add the branch data, and enter "Add" in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

**Submission Procedure**

When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.  
 If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

**Note:**

To satisfy the FR Y-10 reporting requirements, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.  
 The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - <https://y10online.federalreserve.gov>.

\* FDIC UNINUM, Office Number, and ID\_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK		Full Service (Head Office)	858528	BANK OF MARION, THE	102 WEST MAIN STREET	MARION	VA	24354	SMYTH	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	3373200	TRI-CITY COMMUNITY BANK-BRANCH OF THE BANK OF MARION	2867 BOONES CREEK ROAD	JOHNSON CITY	TN	37615	WASHINGTON	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	3818877	BANK OF ABINGDON, THE-BRANCH OF THE BANK OF MARION	201 VALLEY STREET NE	ABINGDON	VA	24210	WASHINGTON	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	3819043	BRISTOL BRANCH	7 CLEAR CREEK ROAD	BRISTOL	VA	24202	BRISTOL CITY	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	1364839	BANK OF CHILHOWIE, THE-BRANCH OF THE BANK OF MARION	1155 EAST LEE HIGHWAY	CHILHOWIE	VA	24319	SMYTH	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	3260579	BANK OF DAMASCUS, THE-BRANCH OF THE BANK OF MARION	744 NORTH BEAVER DAM AVENUE SUITE A	DAMASCUS	VA	24238	WASHINGTON	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	982227	SCOTT COUNTY GATE CITY, THE-BRANCH OF THE BANK OF MARION	181 EAST JACKSON ST	GATE CITY	VA	24751	SCOTT	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	1848188	BANK OF GLADE SPRING, THE-BRANCH OF THE BANK OF MARION	656 SOUTH MONTE VISTA DRIVE	GLADE SPRING	VA	24340	WASHINGTON	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	605723	BANK OF HONAKER, THE-BRANCH OF THE BANK OF MARION	36 LIBRARY DRIVE	HONAKER	VA	24160	RUSSELL	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	848979	ROYAL OAK BRANCH-BRANCH OF THE BANK OF MARION	1600 N. MAIN STREET	MARION	VA	24354	SMYTH	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	759223	WASHINGTON AVENUE BRANCH-BRANCH OF THE BANK OF MARION	1028 SOUTH MAIN STREET	MARION	VA	24354	SMYTH	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	2935487	FORT CHISWELL BRANCH-BRANCH OF THE BANK OF MARION	787 FORT CHISWELL ROAD, SUITE 7	MAX MEADOWS	VA	24360	WYTHE	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	2373221	BANK OF RURAL RETREAT, THE-BRANCH OF THE BANK OF MARION	512 NORTH MAIN STREET	RURAL RETREAT	VA	24368	WYTHE	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	2760474	BANK OF SALTVILLE, THE-BRANCH OF THE BANK OF MARION	101 BANK ST	SALTVILLE	VA	24370	SMYTH	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	
OK		Full Service	603924	BANK OF SCOTT COUNTY, THE - WEBER CITY-BRANCH OF THE BANK OF MARION	2768 US HIGHWAY 23 NORTH	WEBER CITY	VA	24290	SCOTT	UNITED STATES	Not Required	Not Required	BANK OF MARION, THE	858528	

Southwest Virginia Bankshares, Inc.									
Directors and Officers									
December 31, 2018									
FR Y 6									
Report Item # 4									
(3)c									
Title & Position									
with Other									
(4)(a)									
Businesses									
Percentage of									
Voting Shares in									
Bank Holding									
Company									
Notes									
(4)(b)									
Percentage of									
Voting Shares in									
Subsidiaries									
(Include names									
of subsidiaries)									
held (List names									
of companies and									
percentage of									
voting securities									
held)									
Shares									
(1)	(2)	(3)(e)	(3)(b)	(4)(a)	(4)(b)	(4)(c)	(4)(c)	(4)(c)	(4)(c)
Names & Address (City, State, Country)	Principal Occupation if other than with Bank Holding Company	Title & Position with Bank Holding Co.	Title & Position with Subsidiaries (include names of subsidiaries)	Businesses (include names of other businesses)	Percentage of Voting Shares in Bank Holding Company	Notes	Percentage of Voting Shares in Subsidiaries (Include names of subsidiaries)	held (List names of companies and percentage of voting securities held)	Shares
John E. Stringer Marion, VA USA	N/A	Director & President/CEO	Director & President/CEO The Bank of Marion	N/A	0.9044 0.1154	*Owned jointly with Cynthia H. Stringer (wife) *Primevest Financial Services FBO John E. Stringer	N/A	N/A	8,165 1,042
Estelle C Johnson Bluefield VA USA	Retired Educator	Director	Director The Bank of Marion	N/A	0.0221		NA	NA	200
E C Johnson Revocable Declaration of Trust					0.7806				7,047
Don Taylor Marion, VA USA	Retired Businessman	Director	Director The Bank of Marion	Board of Director - H.S. Williams Co., Inc Partner - Cregger & Taylor	1.08	*Owned by Don and Barbara Taylor	N/A	H.S. Williams Co., Inc. - 46% Cregger & Taylor - 50%	9,750
Everette Umbarger Marion, VA USA	Dairy Farmer	Director	Director The Bank of Marion		0.1929		N/A		1,742
Thomas E. Copenhaver Marion, VA USA	Radio Broadcasting Tower Ownership	Secretary	Director The Bank of Marion	President - Laura Copenhaver Industries Owner - TECO Structures	0.4021		N/A	Laura Copenhaver Industries - 100% T.E.C.O. Broadcasting - 100%	3,630
Cameron L. Wolfe, Jr. Marion, VA USA	Architect	Director	Director The Bank of Marion	Owner- Cameron L Wolfe Jr Architect	0.0912 1.6239 0.2361		N/A	Cameron L Wolfe JR AIA-100%	824 14,660 2,132
					0.0706	*Cameron L. Wolfe & Nancy D. Wolfe *Owned by Cameron L. Wolfe, Jr. or Caitlin Taylor Wolfe (grandchild) or Cameron Tyler Wolfe *Cameron L. Wolfe & Cameron Jay Wolfe (son)			638
Perry D. Mowbray, Jr. Marion, VA USA	Retired Orthodontist	Director	Director The Bank of Marion	P D Mowbray Jr DDS LTD-President Littrell Mowbray Bldg	0.1711 3.164		N/A	P D Mowbray Jr DDS LTD - 100.00 Littrell & Mowbray - 50%	1,545 28,562
Charles C. Clark, Jr. Saltville, VA USA	Farmer	Director	Director The Bank of Marion	Owner - C.C. Clark, Jr. Farms	1.0169 0.0987		N/A	*Owned by Charles Champ Clark III (son) & Jane P Clark (wife) Custodian C.C. Clark, Jr. Farms - 100%	9,180 891
Bob Shults Marion, VA USA	C.P.A.	Director	Director The Bank of Marion	President - Shults, Kiser & Associates, P.C.	0.2326		N/A	Shults, Kiser & Associates, P.C. - 60%	2,100
Joseph S Tate Marion VA USA	Retired Judge	Director	Director The Bank of Marion	Retired	0.1342 0.0287	Joseph S Tate/Jerilyn B Tate Cetera Inv Services FBO	NA	N/A	1,212 260
Kyra Bishop Chilhowie VA USA	C.P.A.	Director	Director The Bank of Marion	Bishop Rentals, LLC Berry Enterprises Inc Oakstone Properties Inc West VA Recycling	0.0137		NA NA NA	Bishops Rentals LLC -50% Berry Enterprises Inc--97% Oakstone Properties--28% WVA Recycling Inc--29.7%	124
Cameron Bell Abingdon VA USA	Attorney	Director	Director The Bank of Marion	Virginia Highlands Brewery Co Wolfe's Den LLC	0.0132			Virginia Highlands Brewery Co--33.3% Wolfe's Den LLC 33.3%	120

**SOUTHWEST VIRGINIA BANKSHARES, INC.  
AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders  
Southwest Virginia Bankshares, Inc.  
and Subsidiaries  
Marion, Virginia

We have audited the accompanying consolidated financial statements of Southwest Virginia Bankshares, Inc., and Subsidiaries, which comprise the consolidated statements of financial condition as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southwest Virginia Bankshares, Inc. and Subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Brown, Edwards & Company, S. L. P.*

CERTIFIED PUBLIC ACCOUNTANTS

Kingsport, Tennessee  
March 5, 2019

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

**December 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 8,169,556	\$ 6,262,473
Federal funds sold	12,479	835,000
Total cash and cash equivalents	8,182,035	7,097,473
Investment securities available-for-sale	110,195,563	127,142,928
Annuity investments	1,247,685	1,242,447
Equity investments, at cost	521,450	493,350
Interest bearing time deposits in banks	3,572,000	14,824,000
Loans, net	229,996,256	211,416,707
Foreclosed assets	231,000	206,500
Premises and equipment, net	7,303,131	7,138,809
Accrued interest receivable	1,887,887	1,901,221
Income tax receivable	434,837	-
State tax credit	589,149	-
Deferred income taxes, net	1,159,816	527,976
Bank owned life insurance	11,123,467	10,762,170
Other assets	597,761	597,016
Total assets	\$ 377,042,037	\$ 383,350,597
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits		
Interest bearing	\$ 263,099,779	\$ 270,150,399
Noninterest bearing	65,640,593	66,810,889
Total deposits	328,740,372	336,961,288
Federal funds purchased	1,274,000	-
Accrued interest and other liabilities	3,622,390	3,330,694
Total liabilities	333,636,762	340,291,982
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$5 per share, 2,000,000 shares authorized; 902,717 and 923,138 outstanding, net of 297,283 and 276,862 treasury shares at par in 2018 and 2017, respectively	4,513,585	4,615,690
Surplus	1,234,440	1,234,440
Retained earnings	38,745,200	36,554,050
Accumulated other comprehensive income (loss)		
Net unrealized gain (loss) on securities	(1,087,950)	654,435
Total stockholders' equity	43,405,275	43,058,615
Total liabilities and stockholders' equity	\$ 377,042,037	\$ 383,350,597

The Notes to Consolidated Financial Statements are an integral part of these statements.

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**  
**Years Ended December 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
<b>INTEREST INCOME</b>		
Interest and fees on loans	\$ 11,818,972	\$ 10,728,635
Interest on available-for-sale securities	3,300,530	2,937,124
Interest on other investments	183,673	414,594
Total interest income	15,303,175	14,080,353
<b>INTEREST EXPENSE</b>		
Interest on deposits	746,588	682,919
Interest federal funds purchased and FHLB advances	142,089	22,213
Total interest expense	888,677	705,132
Net interest income	14,414,498	13,375,221
Provision for loan losses	1,100,000	940,000
Net interest income, after provision for loan losses	13,314,498	12,435,221
<b>NONINTEREST INCOME</b>		
Debit card interchange income	1,066,774	799,545
Service charges on deposit accounts	67,589	67,443
Net nonsufficient fund income	2,073,868	1,906,797
Income from bank owned life insurance	318,845	323,823
Net gains (losses) on sale of securities available for sale	(109,484)	8,468
Investment services income	236,651	199,779
Other income	265,961	253,396
Total noninterest income	3,920,204	3,559,251
<b>NONINTEREST EXPENSE</b>		
Salaries and wages	5,248,101	4,931,240
Pensions and other employee benefits	1,425,652	1,388,125
Occupancy expenses	646,275	594,620
Equipment depreciation and maintenance	1,077,856	912,179
Advertising and marketing	561,782	578,981
Director fees	266,906	254,888
Other taxes	313,117	283,713
Debit and credit card processing fees	565,129	338,656
Professional and consulting fees	439,164	604,678
Lending expense and real estate fees	345,026	97,782
Impairment of tax credit investment	333,032	-
Other operating expenses	1,505,724	1,484,156
Total noninterest expenses	12,727,764	11,469,018
<b>INCOME BEFORE INCOME TAXES</b>	4,506,938	4,525,454
Income taxes	108,253	1,525,435
<b>NET INCOME</b>	\$ 4,398,685	\$ 3,000,019

The Notes to Consolidated Financial Statements are an integral part of these statements.

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**Years Ended December 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
NET INCOME	\$ 4,398,685	\$ 3,000,019
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX		
Unrealized holding gains (losses) arising during the period for securities available-for-sale	(2,315,035)	1,127,478
Reclassification adjustment for gains included in net gains on sale of securities in net income	109,484	(8,468)
	(2,205,551)	1,119,010
INCOME TAX EFFECT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME (LOSS)	463,166	(255,461)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	\$ (1,742,385)	\$ 863,549
COMPREHENSIVE INCOME	\$ 2,656,300	\$ 3,863,568

The Notes to Consolidated Financial Statements are an integral part of these statements.

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**Years Ended December 31, 2018 and 2017**

	<u>Common Stock</u>	<u>Surplus</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
BALANCE, December 31, 2016	\$ 4,708,620	\$ 1,234,440	\$ 35,395,790	\$ (191,803)	\$ 41,147,047
Net income	-	-	3,000,019	-	3,000,019
Other comprehensive income, net of tax	-	-	-	863,549	863,549
Tax rate change effect	-	-	17,311	(17,311)	-
Purchase of treasury shares of Southwest Virginia Bankshares, Inc. (18,586 shares)	(92,930)	-	(743,440)	-	(836,370)
Cash dividends (\$1.20 per common share)	-	-	(1,115,630)	-	(1,115,630)
BALANCE, December 31, 2017	4,615,690	1,234,440	36,554,050	654,435	43,058,615
Net income	-	-	4,398,685	-	4,398,685
Other comprehensive loss, net of tax	-	-	-	(1,742,385)	(1,742,385)
Purchase of treasury shares of Southwest Virginia Bankshares, Inc. (20,421 shares)	(102,105)	-	(843,814)	-	(945,919)
Cash dividends (\$1.50 per common share)	-	-	(1,363,721)	-	(1,363,721)
BALANCE, December 31, 2018	<u>\$ 4,513,585</u>	<u>\$ 1,234,440</u>	<u>\$ 38,745,200</u>	<u>\$ (1,087,950)</u>	<u>\$ 43,405,275</u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Years Ended December 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 4,398,685	\$ 3,000,019
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	459,738	410,611
Loss on sale of foreclosed assets	6,060	649
(Gain) on sale of premises and equipment	(18,000)	(11,500)
Net amortization of securities	738,691	886,672
Realized loss (gain) on sales of available-for-sale securities, net	109,484	(8,468)
Provision for loan losses	1,100,000	940,000
Increase in cash value of life insurance	(361,297)	(916,275)
Deferred income tax expense (benefit)	(168,674)	169,191
(Increase) decrease in:		
Income tax receivable	(434,837)	733,517
State tax credit	(589,149)	-
Accrued interest receivable	13,334	(274,597)
Other assets	(745)	(88,374)
Increase (decrease) in:		
Accrued interest and other liabilities	291,696	708,681
	<u>5,544,986</u>	<u>5,550,126</u>
Net cash provided by operating activities		
<b>INVESTING ACTIVITIES</b>		
Activity in available-for-sale securities:		
Sales	28,719,062	12,105,460
Maturities, prepayments, and calls	7,317,940	3,713,056
Purchases	(22,143,363)	(38,531,422)
Decrease in interest-bearing time deposits in other banks	11,252,000	9,660,000
(Increase) in annuities	(5,238)	(1,242,447)
(Increase) decrease in equity investments at cost	(28,100)	2,700
Loan originations and principal collections, net	(20,030,549)	(12,710,648)
Proceeds from sales of foreclosed assets	320,440	417,751
Proceeds from sales of premises and equipment	18,000	11,500
Additions to premises and equipment	(624,060)	(655,612)
	<u>4,796,132</u>	<u>(27,229,662)</u>
Net cash provided by (used in) investing activities		

(Continued)

The Notes to Consolidated Financial Statements are an integral part of these statements.

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Years Ended December 31, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
<b>FINANCING ACTIVITIES</b>		
Net (decrease) increase in deposits	\$ (8,220,916)	\$ 21,365,601
Purchase of Southwest Virginia Bankshares, Inc. treasury stock	(945,919)	(836,370)
Dividends paid	(1,363,721)	(1,115,630)
Increase in federal funds purchased	<u>1,274,000</u>	<u>-</u>
Net cash (used in) provided by financing activities	<u>(9,256,556)</u>	<u>19,413,601</u>
Increase (decrease) in cash and cash equivalents	1,084,562	(2,265,935)
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning	<u>7,097,473</u>	<u>9,363,408</u>
Ending	<u>\$ 8,182,035</u>	<u>\$ 7,097,473</u>
<b>NON-CASH TRANSACTIONS</b>		
Transfer of loans to foreclosed assets	<u>\$ 351,000</u>	<u>\$ 161,500</u>
<b>SUPPLEMENTAL DISCLOSURES OF</b>		
Cash paid for interest	<u>\$ 891,456</u>	<u>\$ 703,282</u>
Cash paid for income taxes	<u>\$ 998,982</u>	<u>\$ 825,000</u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

## SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018

#### Note 1. Nature of Business and Significant Accounting Policies

The accounting and reporting policies of Southwest Virginia Bankshares, Inc. and Subsidiaries (collectively the "Company") conform to accounting principles generally accepted in the United States of America and accepted accounting and reporting practices within the banking industry. The significant accounting policies are summarized as follows:

##### Nature of operations

Southwest Virginia Bankshares, Inc. is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, The Bank of Marion. BOM Investments, Inc., a wholly owned subsidiary of The Bank of Marion, was formed in 2017 with a specific and separate business purpose of acquiring and managing certain municipal bond investments with the input of an investment advisor. BOM Tax Credits, LLC, a wholly owned subsidiary of The Bank of Marion, was formed in 2018 with a specific and separate business purpose of investing in a partnership to purchase and obtain benefits from federal and state historic tax credits.

The Bank provides a variety of financial services throughout locations within its primary lending area in Southwest Virginia and East Tennessee. The Bank's primary source of revenue is from real estate and consumer loans within the Bank's primary market.

##### Principles of consolidation

The consolidated statements include the accounts of Southwest Virginia Bankshares, Inc., and each of its subsidiaries described above. All significant intercompany balances and transactions have been eliminated in consolidation.

##### Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, the valuation of foreclosed real estate, the valuation of deferred tax assets, other-than-temporary impairments of securities, and the fair value of financial instruments.

##### Cash and cash equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing deposits in other banks, cash items in process of clearing, and federal funds sold, all of which mature within ninety days. Accounts in financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At times, cash balances may exceed these limits; however, the Company does not believe it is subject to any significant credit risk as a result of these deposits. Excess cash reserves are held at the Community Bankers Bank.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Investment securities

The Bank's investments in securities are classified and accounted for as follows:

Available-for-sale: Government and government agency bonds, notes, and certificates are classified available-for-sale when the Bank anticipates that the securities could be sold in response to rate changes, prepayment risk, liquidity, availability of and the yield on alternative investments and other market and economic factors. Securities available-for-sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in noninterest income and reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary, result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Annuity investments: Investments in annuities are carried at initial cost of the investment plus accumulated earnings, as reported by the issuer of the contract.

Loans

The Bank's primary market is Southwest Virginia and East Tennessee. The Bank grants commercial, consumer, and real estate loans to its customers, most of whom are located within the Bank's primary market. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the Bank's primary market economic conditions, particularly in the real estate sector. The concentration of credit in the regional economy is taken into consideration by management in determining the allowance for loan losses.

Loans are either secured or unsecured based on the type of loan and the financial condition of the borrower. The loans are generally expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrower; however, the Bank is exposed to risk of loss on any or all loans due to the borrower's difficulties, which can arise from any number of factors including problems within the respective industry or economic conditions within the Bank's primary market.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances, less the allowance for loan losses and net deferred loan fees and unearned discounts. Interest income is accrued on the unpaid principal balance. Unearned discounts on installment loans are recognized as income over the term of the loans using a method that approximates the interest method.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Loans (Continued)

Loan origination and commitment fees, as well as certain direct origination costs, are deferred and amortized as a yield adjustment over the lives of the related loans using the interest method. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

The accrual of interest on loans of \$25,000 or more is discontinued at the time the loan is ninety days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for loan losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are also considered impaired, an allowance is established when the discounted cash flows or collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Allowance for loan losses (Continued)

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not considered impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Off-balance sheet credit related financial instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Premises and equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally by the straight-line methods. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations:

Premises and equipment are depreciated over the following lives:

Buildings and improvements	5-40 years
Furniture, equipment, and software	3-10 years

Bank owned life insurance

The Bank is the owner and beneficiary of life insurance policies on bank officers and members of the Board of Directors. These policies are carried at their cash surrender value.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Foreclosed assets

Foreclosed assets consist of other real estate owned (OREO). OREO represents real estate properties acquired through or in lieu of loan foreclosure. OREO is held for sale and is initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-down based on the asset's fair value at the time of transfer to OREO is charged to the allowance for loan losses. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value, with charges to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell. Costs of significant property improvements are capitalized; whereas, costs relating to holding property are expensed.

Advertising costs

Advertising costs are expensed in the period incurred.

Compensated absences

Compensated absences for sick day and personal time have not been accrued since they cannot be reasonably estimated. The Bank's policy is to recognize these costs when actually paid.

Retirement plan

The Bank provides for its employees a defined contribution pension plan, as well as a deferred compensation plan for directors.

Income taxes

Current income tax reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to taxable income or loss. Deferred taxes relate primarily to differences between the tax and book bases of certain assets and liabilities. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company files consolidated income tax returns with its subsidiaries.

Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized. The Company has not identified any uncertain income tax provisions. In the event of an adjustment to previously filed income tax returns, interest is recognized in interest expense and penalties, if any, are classified as other noninterest expense.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Comprehensive income (loss)

Comprehensive income (loss) consists of the total of all components of comprehensive income (loss) including net income (loss). Other comprehensive income (loss) refers to revenues, expenses, gains, and losses under U.S. generally accepted accounting principles that are included in comprehensive income (loss) but excluded from net income (loss). Currently, the Company's other comprehensive income (loss) consists of unrealized gains and losses on securities available-for-sale, net of deferred tax expense (benefit).

Subsequent events

Management has evaluated the accompanying consolidated financial statements for subsequent events and transactions through March 5, 2019, the date these financial statements were available for issue.

Reclassifications

Certain prior year amounts have been reclassified to conform with present year presentations.

Recent accounting pronouncements

In May 2014, the FASB issued *ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606)*. *ASU 2014-09* is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. *ASU 2014-09* also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. *ASU 2014-09* was effective for annual reporting periods beginning after December 15, 2017. *ASU No. 2015-14* issued in August 2015 deferred the effective date of this Update to annual reporting periods beginning after December 15, 2018. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The adoption of this ASU is not expected to have a material effect on the Bank's current financial position or results of operations; however, it may impact future financial statement disclosures.

In January 2016, *ASU No. 2016-01 Financial Instruments – Overall (Subtopic 825-10)* was issued by the FASB. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2018. The Bank is currently evaluating the impact of these amendments on its financial statements.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Recent accounting pronouncements (Continued)

In June 2016, *ASU No. 2016-13 Financial Instruments – Credit Losses (Topic 326)* was issued by the FASB. This standard is commonly referred to as CECL, because it employs the Current Expected Credit Loss model. The ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU is effective for the Bank in fiscal years beginning after December 15, 2021. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Bank is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

Other accounting standards have been issued by the FASB that are not currently applicable to the Bank or are not expected to have a material impact on its financial statements.

**Note 2. Investment Securities**

Available-for-sale

The amortized cost and fair value of securities are as follows:

	<b>2018</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Government agencies	\$ 60,309,621	\$ 18,739	\$ (854,015)	\$ 59,474,345
Corporations	1,992,006	-	(191,308)	1,800,698
States and political subdivisions	30,271,057	304,197	(89,522)	30,485,732
Mortgage-backed securities	17,850,008	454	(521,625)	17,328,837
Brokered CDs	1,150,021	-	(44,070)	1,105,951
	<b>\$ 111,572,713</b>	<b>\$ 323,390</b>	<b>\$ (1,700,540)</b>	<b>\$ 110,195,563</b>
	<b>2017</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Government agencies	\$ 68,662,039	\$ 217,092	\$ (303,368)	\$ 68,575,763
Corporations	2,991,140	8,611	(69,417)	2,930,334
States and political subdivisions	31,775,387	1,188,798	(21,494)	32,942,691
Mortgage-backed securities	21,230,501	39,309	(203,078)	21,066,732
Brokered CDs	1,655,462	-	(28,054)	1,627,408
	<b>\$ 126,314,529</b>	<b>\$ 1,453,810</b>	<b>\$ (625,411)</b>	<b>\$ 127,142,928</b>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 2. Investment Securities (Continued)**

The amortized cost and fair value of securities as of December 31, 2018, by expected cash flow date, are as follows:

	<b>Debt Securities Available-For-Sale</b>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
One year of less	\$ 1,117,303	\$ 1,009,915
After one year through five years	29,017,178	28,686,669
After five years through ten years	58,553,050	58,155,412
After ten years	<u>5,035,174</u>	<u>5,014,730</u>
	93,722,705	92,866,726
Mortgage backed securities	<u>17,850,008</u>	<u>17,328,837</u>
	<u>\$ 111,572,713</u>	<u>\$ 110,195,563</u>

The cash flow time period in the above table considers the likelihood of the cash being received on the call date given the current market interest rates versus the actual maturity date of the bond. The table also considers the pre-refunded status of the bond when determining the cash flow date.

The Company's unrealized losses on the above investments were the result of changes in market interest rates. The severity and duration of these unrealized losses will fluctuate with interest rates and the economy. Because the securities are issued by governments and their agencies and the Company has the ability and intent to hold them for a period of time sufficient to allow for an anticipated recovery, they are not considered to be other than temporarily impaired. The Company did not recognize any other-than-temporary impairment in 2018 and 2017. Previously recognized other-than-temporary impairments, related to securities still held by the Company, totaled approximately \$1,250,000.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 2. Investment Securities (Continued)**

Information pertaining to securities with gross unrealized losses as of December 31, 2018 and 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position is shown in the table below.

	December 31, 2018					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government agencies	\$ 5,747,476	\$ (13,872)	\$ 47,707,466	\$ (840,142)	\$ 53,454,942	\$ (854,014)
Corporations	-	-	1,800,698	(191,308)	1,800,698	(191,308)
State and political subdivisions	4,443,130	(63,749)	1,184,184	(25,773)	5,627,314	(89,522)
Mortgage-backed securities	1,441,487	(18,496)	15,808,822	(503,130)	17,250,309	(521,626)
Brokered CDs	-	-	1,105,950	(44,070)	1,105,950	(44,070)
	<u>\$ 11,632,093</u>	<u>\$ (96,117)</u>	<u>\$ 67,607,120</u>	<u>\$ (1,604,423)</u>	<u>\$ 79,239,213</u>	<u>\$ (1,700,540)</u>

  

	December 31, 2017					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government agencies	\$ 40,779,991	\$ (241,575)	\$ 1,995,477	\$ (61,793)	\$ 42,775,468	\$ (303,368)
Corporations	-	-	930,583	(69,417)	930,583	(69,417)
State and political subdivisions	498,110	(1,889)	697,681	(19,605)	1,195,791	(21,494)
Mortgage-backed securities	15,484,631	(143,148)	1,894,856	(59,930)	17,379,487	(203,078)
Brokered CDs	245,580	(1,419)	1,381,827	(26,635)	1,627,407	(28,054)
	<u>\$ 57,008,312</u>	<u>\$ (388,031)</u>	<u>\$ 6,900,424</u>	<u>\$ (237,380)</u>	<u>\$ 63,908,736</u>	<u>\$ (625,411)</u>

During 2018, sales, calls, and maturities of securities available-for-sale resulted in gross realized gains of \$103,568 and gross realized losses of \$213,052, with a net realized loss of \$109,484. During 2017, sales, calls, and maturities of securities available-for-sale resulted in gross realized gains of \$46,786 and gross realized losses of \$38,318, with a net realized gain of \$8,468.

Securities with a carrying value of \$54,535,081 and \$52,335,000 were pledged at December 31, 2018 and 2017, respectively, to secure certain deposits and for other purposes as required or permitted by law.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 2. Investment Securities (Continued)**

Annuity investments

Activity in annuity investments was as follows:

	<b>2018</b>	<b>2017</b>
January 1	\$ 1,242,447	\$ -
Purchases	-	1,132,251
Accumulated earnings on investments	5,238	110,196
December 31	\$ 1,247,685	\$ 1,242,447

Investments, at cost

The Bank is required to hold a minimum number of shares of stock in the Federal Home Loan Bank (FHLB) and the Federal Reserve Bank (FRB). These are considered restricted investments and are carried at cost on the balance sheet. Additional restricted investments the Bank is required to maintain and also carried at cost include Community Bankers Bank stock. The carrying amount of the restricted investments, at cost, are as follows:

	<b>2018</b>	<b>2017</b>
Federal Home Loan Bank	\$ 351,700	\$ 323,600
Federal Reserve Bank	45,000	45,000
Community Bankers Bank	124,750	124,750
	\$ 521,450	\$ 493,350

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses**

The Bank's loan portfolio consists of the following:

	<b>2018</b>	<b>2017</b>
Real estate loans:		
Residential 1-4 family	\$ 127,902,649	\$ 119,219,996
Nonresidential and multifamily	69,584,165	62,853,633
Construction and development	862,191	882,652
	198,349,005	182,956,281
Commercial	20,128,859	17,095,058
Consumer and other	14,240,216	13,284,884
Total loans	232,718,080	213,336,223
Less: allowance for loan losses	(2,683,539)	(1,874,981)
Less: allowance for overdraft losses	(38,285)	(44,535)
Loans, net	\$ 229,996,256	\$ 211,416,707

The Bank's consumer loans include \$418,829 and \$358,589 in overdrafts as of December 31, 2018 and 2017, respectively.

Loans are presented at the net of any unamortized deferred loan fees and origination costs, which consist of the following at December 31, 2018 and 2017:

	<b>2018</b>	<b>2017</b>
Deferred loan fees	\$ (39,445)	\$ (25,531)
Deferred loan costs	201,741	182,515
Net deferred loan fees and costs	\$ 162,296	\$ 156,984

**Impaired loans**

Loan impairment and any valuation allowances are determined under the provisions established by Accounting Standards Codification Topic 310, *Receivables*. Impaired loans without a valuation allowance represent loans for which management believes that the discounted cash flows, collateral value, or observable market price of the impaired loan is higher than the carrying value of the loan.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses (Continued)**

Impaired loans (Continued)

The following table presents impaired loans individually evaluated by class of loans at December 31, 2018 and 2017:

	2018				
	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential 1-4 family	\$ 334,641	\$ 334,641	\$ -	\$ 330,354	\$ 15,408
Nonresidential and multifamily	631,500	631,500	-	1,146,002	46,662
Construction and development	-	-	-	-	-
Commercial	349,476	349,476	-	374,868	19,024
Consumer and other	-	-	-	-	-
With an allowance recorded:					
Residential 1-4 family	-	-	-	-	-
Nonresidential and multifamily	2,469,152	2,469,152	1,120,00	2,486,300	71,754
Construction and development	-	-	-	-	-
Commercial	-	-	-	-	-
Consumer and other	-	-	-	-	-
Total impaired loans, individually evaluated	<u>\$ 3,784,769</u>	<u>\$ 3,784,769</u>	<u>\$ 1,120,000</u>	<u>\$ 4,337,524</u>	<u>\$ 152,848</u>
2017					
	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential 1-4 family	\$ 348,482	\$ 248,482	\$ -	\$ 345,404	\$ 14,843
Nonresidential and multifamily	2,319,352	2,319,352	-	2,357,828	98,883
Construction and development	-	-	-	-	-
Commercial	48,769	48,769	-	63,214	2,845
Consumer and other	-	-	-	-	-
With an allowance recorded:					
Residential 1-4 family	-	-	-	-	-
Nonresidential and multifamily	1,404,748	1,404,748	83,200	1,396,506	56,073
Construction and development	-	-	-	-	-
Commercial	347,799	347,799	350,000	344,168	14,848
Consumer and other	-	-	-	-	-
Total impaired loans, individually evaluated	<u>\$ 4,469,150</u>	<u>\$ 4,469,150</u>	<u>\$ 433,200</u>	<u>\$ 4,507,120</u>	<u>\$ 187,492</u>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses (Continued)**

Allowance for loan loss

The following table outlines the changes in the allowance for loan losses by portfolio, the allowances for loans individually and collectively evaluated for impairment, and the year end balance of the loans individually and collectively evaluated for impairment as of December 31, 2018 and 2017:

	<b>December 31, 2018</b>						
	<b>Residential 1-4 Family</b>	<b>Nonresidential and Multifamily</b>	<b>Construction and Development</b>	<b>Commercial</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance for loan losses</b>							
Beginning balance, January 1, 2018	\$ 388,401	\$ 417,098	\$ 4,315	\$ 373,259	\$ 281,642	\$ 410,266	\$ 1,874,981
Charge-offs	(111,294)	(50,817)	-	(2,618)	(245,514)	-	(410,243)
Recoveries	4,178	-	12,573	-	102,050	-	118,801
Provision	137,336	1,173,215	(9,615)	(338,594)	159,551	(21,893)	1,100,000
Ending balance, December 31, 2018	<u>\$ 418,621</u>	<u>\$ 1,539,496</u>	<u>\$ 7,273</u>	<u>\$ 32,047</u>	<u>\$ 297,729</u>	<u>\$ 388,373</u>	<u>\$ 2,683,539</u>
Portion of ending balance							
Individually evaluated for impairment	\$ -	\$ 1,120,000	\$ -	\$ -	\$ -	\$ -	\$ 1,120,000
Collectively evaluated for impairment	418,621	419,496	7,273	32,047	297,729	388,373	1,563,539
Total ALLL evaluated for impairment	<u>\$ 418,621</u>	<u>\$ 1,539,496</u>	<u>\$ 7,273</u>	<u>\$ 32,047</u>	<u>\$ 297,729</u>	<u>\$ 388,373</u>	<u>\$ 2,683,539</u>
<b>Loans Receivable</b>							
Ending balance, December 31, 2018	<u>\$ 127,902,649</u>	<u>\$ 69,584,165</u>	<u>\$ 862,191</u>	<u>\$ 20,128,859</u>	<u>\$ 14,240,216</u>	<u>N/A</u>	<u>\$ 232,718,080</u>
Portion of ending balance							
Individually evaluated for impairment	\$ 334,641	\$ 3,100,652	\$ -	\$ 349,476	\$ -	N/A	\$ 3,784,769
Collectively evaluated for impairment	127,568,008	66,483,513	862,191	19,779,383	14,240,216	N/A	228,933,311
Total loans evaluated for impairment	<u>\$ 127,902,649</u>	<u>\$ 69,584,165</u>	<u>\$ 862,191</u>	<u>\$ 20,128,859</u>	<u>\$ 14,240,216</u>	<u>N/A</u>	<u>\$ 232,718,080</u>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses (Continued)**

Allowance for loan loss (Continued)

	December 31, 2017						
	Residential 1-4 Family	Nonresidential and Multifamily	Construction and Development	Commercial	Consumer	Unallocated	Total
<b>Allowance for loan losses</b>							
Beginning balance, January 1, 2017	\$ 359,705	\$ 335,727	\$ 5,622	\$ 75,946	\$ 280,376	\$ 189,201	\$ 1,246,577
Charge-offs	(43,342)	-	-	(8,230)	(341,524)	-	(393,096)
Recoveries	271	-	-	5,000	76,229	-	81,500
Provision	71,767	81,371	(1,307)	300,543	266,561	221,065	940,000
Ending balance, December 31, 2017	<u>\$ 388,401</u>	<u>\$ 417,098</u>	<u>\$ 4,315</u>	<u>\$ 373,259</u>	<u>\$ 281,642</u>	<u>\$ 410,266</u>	<u>\$ 1,874,981</u>
Portion of ending balance							
Individually evaluated for impairment	\$ -	\$ 83,200	\$ -	\$ 350,000	\$ -	\$ -	\$ 433,200
Collectively evaluated for impairment	<u>388,401</u>	<u>333,898</u>	<u>4,315</u>	<u>23,259</u>	<u>281,642</u>	<u>410,266</u>	<u>1,441,781</u>
Total ALLL evaluated for impairment	<u>\$ 388,401</u>	<u>\$ 417,098</u>	<u>\$ 4,315</u>	<u>\$ 373,259</u>	<u>\$ 281,642</u>	<u>\$ 410,266</u>	<u>\$ 1,874,981</u>
<b>Loans Receivable</b>							
Ending balance, December 31, 2017	<u>\$ 119,219,996</u>	<u>\$ 62,853,633</u>	<u>\$ 882,652</u>	<u>\$ 17,095,058</u>	<u>\$ 13,284,884</u>	<u>\$ N/A</u>	<u>\$ 213,336,223</u>
Portion of ending balance							
Individually evaluated for impairment	\$ 348,482	\$ 3,724,100	\$ -	\$ 396,568	\$ -	N/A	\$ 4,469,150
Collectively evaluated for impairment	<u>118,871,514</u>	<u>59,129,533</u>	<u>882,652</u>	<u>16,698,490</u>	<u>13,284,884</u>	<u>N/A</u>	<u>208,867,073</u>
Total loans evaluated for impairment	<u>\$ 119,219,996</u>	<u>\$ 62,853,633</u>	<u>\$ 882,652</u>	<u>\$ 17,095,058</u>	<u>\$ 13,284,884</u>	<u>N/A</u>	<u>\$ 213,336,223</u>

Credit quality indicators

The Bank utilizes five classifications to rate loans: pass, special mention, substandard, doubtful, and loss. "Pass assets" have at least a reasonable credit risk. "Special mention assets" are those assets with a higher risk than normal with a potential weakness that need management attention; however, the concerns have not yet warranted a reclassification to substandard. "Substandard assets" have unsatisfactory characteristics that cause a more than acceptable level of risk and have one or more well-defined weaknesses that could jeopardize the repayment of the debt. "Doubtful assets" contain weaknesses such that collection or liquidation in full is questionable. Doubtful loans are normally placed on the non-accrual list, regardless of past due status. "Loss assets" are considered uncollectible and of such little value that their continuance as an active bank asset is not warranted. The Bank does not rate every loan. For those loans not rated, they have been classified as performing or nonperforming. A nonperforming loan is one that is 90 or greater days past due.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses (Continued)**

Credit quality indicators (Continued)

The following tables outline the category of the loans that receive a risk rating and the status of the loans that are not rated as of December 31, 2018 and 2017:

	Credit Quality Indicators for Rated Loans					Total
	Pass	Special Mention	Substandard	Doubtful	Loss	
<b>December 31, 2018</b>						
Residential 1-4 family	\$ 18,265,740	\$ -	\$ 712,848	\$ -	\$ -	\$ 18,978,588
Nonresidential and multifamily	59,850,679	-	3,565,996	-	-	63,416,675
Construction and development	806,583	-	-	-	-	806,583
Commercial	19,446,419	349,476	-	-	-	19,795,895
Consumer and other	7,112	-	68,564	-	-	75,676
	<u>\$ 98,376,533</u>	<u>\$ 349,476</u>	<u>\$ 4,347,408</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 103,073,417</u>
<b>December 31, 2017</b>						
Residential 1-4 family	\$ 18,152,355	\$ 132,538	\$ 1,269,776	\$ -	\$ -	\$ 19,554,669
Nonresidential and multifamily	58,389,654	-	3,724,099	-	-	62,113,753
Construction and development	818,990	-	-	-	-	818,990
Commercial	12,015,417	396,568	-	-	-	12,411,985
Consumer and other	11,995	-	48,803	-	-	60,798
	<u>\$ 89,388,411</u>	<u>\$ 529,106</u>	<u>\$ 5,042,678</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 94,960,195</u>

	Non-Rated Loans		
	Performing	Nonperforming	Total
<b>December 31, 2018</b>			
Residential 1-4 family	\$ 108,251,855	\$ 672,206	\$ 108,924,061
Nonresidential and multifamily	6,167,490	-	6,167,490
Construction and development	55,608	-	55,608
Commercial	328,662	4,302	332,964
Consumer and other	14,164,540	-	14,164,540
	<u>\$ 128,968,155</u>	<u>\$ 676,508</u>	<u>\$ 129,644,663</u>
<b>December 31, 2017</b>			
Residential 1-4 family	\$ 99,096,200	\$ 569,127	\$ 99,665,327
Nonresidential and multifamily	739,880	-	739,880
Construction and development	63,662	-	63,662
Commercial	4,677,028	6,045	4,683,073
Consumer and other	13,202,452	21,634	13,224,086
	<u>\$ 117,779,222</u>	<u>\$ 596,806</u>	<u>\$ 118,376,028</u>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses (Continued)**

Past due loans

The following tables present an aged analysis of past due loans and loans on nonaccrual status by loan type as of December 31, 2018 and 2017:

	<u>Current</u>	<u>30 – 59 Days Past Due</u>	<u>60 – 89 Days Past Due</u>	<u>90+ Days Past Due</u>	<u>Total Past Due</u>	<u>Total Loans</u>	<u>Non-Accrual Loans</u>	<u>Recorded Investment &gt; 90 Days and Accruing</u>
<b>December 31, 2018</b>								
Residential 1-4 family	\$ 122,637,900	\$ 2,355,164	\$ 1,524,531	\$ 1,385,054	\$ 5,264,749	\$ 127,902,649	\$ -	\$ 1,385,054
Nonresidential and multifamily	67,390,312	443,981	580,651	1,169,221	2,193,853	69,584,165	1,169,221	-
Construction and development	853,574	8,617	-	-	8,617	862,191	-	-
Commercial	19,934,415	159,977	30,165	4,302	194,444	20,128,859	-	4,302
Consumer and other	13,830,547	225,923	116,878	66,868	409,669	14,240,216	-	66,868
	<u>\$ 224,646,748</u>	<u>\$ 3,193,662</u>	<u>\$ 2,252,225</u>	<u>\$ 2,625,445</u>	<u>\$ 8,071,332</u>	<u>\$ 232,718,080</u>	<u>\$ 1,169,221</u>	<u>\$ 1,456,224</u>
<b>December 31, 2017</b>								
Residential 1-4 family	\$ 113,497,993	\$ 2,194,127	\$ 1,688,973	\$ 1,838,903	\$ 5,722,003	\$ 119,219,996	\$ -	\$ 1,838,903
Nonresidential and multifamily	60,607,198	1,482,831	601,906	161,698	2,246,435	62,853,633	104,817	56,881
Construction and development	882,652	-	-	-	-	882,652	-	-
Commercial	16,954,199	131,703	3,111	6,045	140,859	17,095,058	-	6,045
Consumer and other	12,862,335	218,380	133,732	70,437	422,549	13,284,884	-	70,437
	<u>\$ 204,804,377</u>	<u>\$ 4,027,041</u>	<u>\$ 2,427,722</u>	<u>\$ 2,077,083</u>	<u>\$ 8,531,846</u>	<u>\$ 213,336,223</u>	<u>\$ 104,817</u>	<u>\$ 1,972,266</u>

Troubled debt restructuring

A modification of a loan constitutes a troubled debt restructuring (“TDR”) when a borrower is experiencing financial difficulty and the modification constitutes a concession. By granting the concession, the Bank expects to increase the probability of collection by more than would be expected by not granting the concession. The Bank’s determination of whether a modification is a TDR considers the facts and circumstances surrounding each respective modification. The following represents information related to loans modified as TDR as of December 31, 2018.

	<u>Number of Contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Residential 1-4 family	1	\$ 489,901	\$ 489,901
Nonresidential and multifamily	3	68,128	68,128
	<u>4</u>	<u>\$ 558,029</u>	<u>\$ 558,029</u>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 3. Loans and Allowance for Loan Losses (Continued)**

Troubled debt restructuring (Continued)

The four TDR loans were modified during 2017 and were all part of the same borrower relationship. In 2017, the borrower discontinued operations with plans to sell enough assets to pay off the above loans. For that reason, the Bank converted all four loans to single-pay notes and moved them to TDR status. The largest loan, having a balance of \$489,901 as of December 31, 2018, has a 90% USDA guarantee and sufficient collateral value, reducing the risk of a loss to the Bank.

**Note 4. Premises and Equipment**

Premises and equipment are as follows:

	<b>2018</b>	<b>2017</b>
Land	\$ 3,025,768	\$ 3,025,768
Building and improvements	6,540,382	6,425,200
Furniture, equipment, and software	3,715,122	3,758,434
	13,281,272	13,209,402
Less: accumulated depreciation	(5,978,141)	(6,070,593)
	<b>\$ 7,303,131</b>	<b>\$ 7,138,809</b>

Depreciation and amortization expense of premises and equipment for 2018 and 2017 was \$459,738 and \$410,611, respectively.

**Note 5. Foreclosed Assets**

Foreclosed properties as of December 31, 2018 included four residential real estate properties with a total carrying amount of \$141,000 and one commercial real estate property with a total carrying amount of \$90,000.

As of December 31, 2018, there was one residential real estate property with a carrying amount of \$62,226 for which the foreclosure process had begun but had yet to be completed.

**Note 6. Lease Agreements**

The Bank leases three of its office facilities. One of the leases is on a month-to-month basis. Minimum annual rental commitments under the other two leases as of December 31, 2018 are as follows:

2019	\$	51,828
2020		51,828
2021		51,828
2022		51,828
2023		46,988
	<b>\$</b>	<b>254,300</b>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 6. Lease Agreements (Continued)**

The Bank has renewal options to renew these leases at the end of the lease terms.

Total rent expense under the operating leases was \$60,756 and \$60,111 for the years ended December 31, 2018 and 2017, respectively.

**Note 7. Deposits**

The composition of deposits as of December 31, 2018 and 2017 is as follows:

	<b>2018</b>	<b>2017</b>
Demand	\$ 178,274,755	\$ 180,865,863
Savings	71,647,738	69,951,016
Time certificates, \$250,000 or more	20,600,550	20,405,390
Other time certificates	58,217,329	65,739,019
	<b>\$ 328,740,372</b>	<b>\$ 336,961,288</b>

As of December 31, 2018, the scheduled maturities of time deposits are as follows:

2019	\$	34,832,031
2020		11,864,256
2021		8,157,489
2022		7,785,245
2023		16,036,536
Thereafter		142,322
	<b>\$</b>	<b>78,817,879</b>

**Note 8. Advances from the Federal Home Loan Bank**

The Bank has agreements with the Federal Home Loan Bank of Atlanta (FHLB) that are collateralized by all of the Bank's stock in the FHLB and by all of the Bank's loans secured by first mortgages on 1-4 family residential properties. Under the agreements, the Bank had an additional approximately \$36 million available to borrow as of December 31, 2018. There were no FHLB advances as of December 31, 2018 and 2017.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 9. Income Taxes**

The provision for income taxes consists of the following:

	<b>2018</b>	<b>2017</b>
Current tax expense	\$ 276,927	\$ 1,356,244
Deferred tax expense	(168,674)	169,191
	<b>\$ 108,253</b>	<b>\$ 1,525,435</b>

The provision for federal income taxes differs from that computed by applying federal statutory rates to income before federal income tax expense, as indicated in the following analysis:

	<b>2018</b>		<b>2017</b>	
	<b>Amount</b>	<b>Percentage</b>	<b>Amount</b>	<b>Percentage</b>
Expected tax	\$ 946,457	21.00 %	\$ 1,538,745	34.00 %
Tax effect of:				
Tax exempt income	(320,137)	(7.10)	(428,832)	(27.87)
Tax law change	-	-	451,845	29.36
Tax credits	(471,319)	(10.46)	-	-
Other	(46,748)	(1.04)	(36,323)	(2.36)
Income taxes	<b>\$ 108,253</b>	<b>2.40 %</b>	<b>\$ 1,525,435</b>	<b>33.13 %</b>

Historic tax credit investment

In 2018, the Company entered into a historic tax credit transaction through its wholly owned subsidiary BOM Tax Credits, LLC. The transaction consisted of an investment of \$848,375 in 2018 in the historic project, of which approximately \$127,000 remains payable at December 31, 2018. The investment was initially carried at cost. The investment's purpose is principally to secure federal and state tax credits of approximately \$1.06 million.

The project was placed in service in late 2018; therefore in 2018 the Company recognized federal tax credits of \$471,319 as a reduction to income tax expense, with an accompanying write off of the corresponding investment of \$333,032 through other expense, for a net gain of \$138,287.

The remainder of the investment has been recognized by recording state tax credits of \$589,149. The net gain of \$117,830 related to the state credits has been deferred in other liabilities and will be recognized over the approximately ten year period in which the state credit is expected to be recognized through a reduction to Virginia franchise taxes.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 9. Income Taxes (Continued)**

The net deferred tax asset consists of the following:

	<b>2018</b>	<b>2017</b>
Deferred tax assets:		
Allowance for loan losses	\$ 341,929	\$ 230,984
Deferred compensation	419,607	384,666
Deferred loan interest income	20,794	22,309
Non-accrual interest income	6,931	568
Other than temporary impairment of assets held	262,500	262,500
Unrealized loss on securities available-for-sale	289,202	-
Historic tax credit investments	62,638	-
	1,403,601	901,027
Deferred tax liabilities:		
Premises and equipment	180,663	134,696
Accretion on investment securities	29,040	31,518
Deferred loan costs, net	34,082	32,873
Unrealized gain on securities available-for-sale	-	173,964
	243,785	373,051
	\$ 1,159,816	\$ 527,976

At December 31, 2018, the Bank did not have a valuation allowance. Realization of deferred tax benefits is dependent upon sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income.

The Bank of Marion is exempt from state income taxes in Virginia as are all other banks in the State. Instead, banks are assessed a franchise tax based on an adjusted capital calculation. The Bank franchise tax expense was approximately \$289,000 and \$272,000 for the years ended December 31, 2018 and 2017, respectively. The Bank includes such accrued payable in other liabilities and the expense is included in noninterest expense as other taxes.

On December 22, 2017, President Trump signed into law new U.S. tax reform legislation. The Act makes significant changes to U.S. corporate income tax laws including a decrease in the corporate tax rate to 21% effective for tax years beginning after December 31, 2017. As a result of the change in tax rate, a deferred tax expense of \$451,845 was recorded in 2017.

In February 2018, FASB issued Accounting Standards Update 2018-02 *Income Statement – Reporting Comprehensive Income (Topic 22): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The standard is intended to help organizations reclassify certain stranded income tax effects in accumulated other comprehensive income results from the Tax Cuts and Jobs Act of 2017 (the “Act”). As such the Company has reclassified \$17,311 from accumulated other comprehensive income to retained earnings as of December 31, 2017.

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**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 10. Minimum Regulatory Capital Requirements**

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in at the rate of 0.625% per year from -0% in 2015 to 2.50% on January 1, 2019. The capital conservation buffer for 2018 is 1.875% and for 2017 is 1.25%. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes as of December 31, 2018, the Bank met all capital adequacy requirements to which it is subject. The Company is exempt from consolidated capital requirements as those requirements do not apply to certain companies with assets under \$1 billion.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year end 2018 and 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 10. Minimum Regulatory Capital Requirements (Continued)**

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2018 and 2017 are as follows (in thousands):

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<b>December 31, 2018</b>						
Total capital to risk weighted assets	\$ 47,044	20.82%	\$ 18,079	8.00%	\$ 22,599	10.00%
Consolidated	47,178	20.88	18,079	8.00	N/A	
Tier I capital to risk weighted assets	44,360	19.63	13,559	6.00	18,079	8.00
Consolidated	44,360	19.63	13,559	6.00	N/A	
Tier I leverage to average assets	44,360	11.62	15,270	4.00	19,087	5.00
Consolidated	44,360	11.61	15,281	4.00	N/A	
Common equity Tier I to: Risk weighted assets	44,360	19.63	10,170	4.50	14,689	6.50
Consolidated	44,494	19.69	10,170	4.50	N/A	
<b>December 31, 2017</b>						
Total capital to risk weighted assets	43,836	20.81	16,853	8.00	21,067	10.00
Consolidated	44,279	21.02	16,853	8.00	N/A	
Tier I capital to risk weighted assets	41,961	19.92	12,640	6.00	16,853	8.00
Consolidated	41,961	19.92	12,640	6.00	N/A	
Tier I leverage to average assets	41,961	11.02	15,227	4.00	19,033	5.00
Consolidated	41,961	11.01	15,240	4.00	N/A	
Common equity Tier I to: Risk weighted assets	41,961	19.92	9,480	4.50	13,693	6.50
Consolidated	42,404	20.13	9,480	4.50	N/A	

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## SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018

#### **Note 11. Dividend Payments and Regulatory Requirements**

The payment of dividends by the Company depends to a great extent on the ability of the Bank to pay dividends to the Holding Company. The Bank, as a Virginia banking corporation, may pay dividends only out of its retained earnings. The payment of dividends by any bank is dependent upon its earnings and financial condition and subject to the statutory power of certain federal and state regulatory agencies to act to prevent what they deem unsafe or unsound banking practices. Moreover, the Federal Reserve Board, the Comptroller of the Currency and the FDIC have issued policy statements which provide that bank holding companies and insured depository institutions generally should only pay dividends out of current operating earnings. The approval of the regulatory agency is required if the dividends declared in any year exceed net income for that year combined with the retained net income of the two preceding years. The payment of dividends by the Bank may also be affected or limited by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. As of December 31, 2018, there was \$2,186,620 of retained earnings available by the Bank for future dividend declaration without prior regulatory approval.

#### **Note 12. Retirement Plan**

The Bank provides a defined contribution 401(k) plan for substantially all employees at date of employment. Participants may contribute up to 15% of compensation per year. The Bank matches 100% of each participant's contribution into the plan annually (an amount not to exceed 4% of the participant's compensation). Costs totaled \$124,883 and \$125,130 for the years ended December 31, 2018 and 2017, respectively.

#### **Note 13. Director's Deferred Compensation Plan**

The Bank has entered into deferred compensation agreements with certain members of the Bank's board of directors. Under the terms of the agreements, compensation which those directors would have received for services was deferred until a certain age as determined by the contract. At that time, the participant begins receiving monthly payments over 10 to 15 years.

The source of funds for these payments is provided through life insurance policies on the life of each director. The Bank is the owner and beneficiary of each life insurance policy. During the years ended December 31, 2018 and 2017, \$58,956 and \$64,688 was charged to expense under these plans, respectively. The deferred compensation arrangements are all for past director services, with no new amounts being deferred. The present value of the remaining payments is calculated using a discount rate of 8%, and is included in other liabilities. Such accruals amounted to approximately \$693,000 and \$759,000 at December 31, 2018 and 2017, respectively.

The Bank also provides supplemental retirement plans, including a phantom book value stock plan and an annuity based supplemental executive retirement plan for certain executive officers of the Bank. Under the terms of the phantom book value stock plan, these officers are awarded shares of phantom stock. Increases or decreases in the book value of the phantom shares are measured and paid out to participants upon retirement. The Bank also provides an intermediate phantom book value stock plan whereby certain officers are granted phantom shares of stock issued over five year incremental periods, each payable in cash at the end of a five-year vesting period. Under these plans, \$232,793 and \$143,725 was charged to expense for 2018 and 2017, respectively. Such accruals amounted to approximately \$1,305,000 and \$1,072,000 at December 31, 2018 and 2017, respectively.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 14. Commitments and Contingencies**

Financial instruments with off-balance-sheet risk

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance-sheet instruments. A summary of the Bank's commitments as of December 31 is as follows:

	<b>2018</b>	<b>2017</b>
Commitments to extend credit	\$ 45,106,896	\$ 47,214,351
Standby letters of credit	393,491	337,722
	\$ 45,500,387	\$ 47,552,073

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, crops, livestock, inventory, property and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

Concentrations of credit risk

All the Bank's loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Bank's market area. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit were granted primarily to commercial borrowers. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the manufacturing and agriculture economic sectors.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 14. Commitments and Contingencies**

Restrictions on cash and due from banks

Under agreements with correspondent banks, the Bank maintains deposit balances with the correspondents to cover various bank processing charges. In addition, the Bank must maintain average reserve balances related to customers' deposit balances as required by the Federal Reserve and a \$250,000 minimum balance as required by the Community Banker's Bank of Virginia.

As of December 31, 2018 and 2017, approximately \$3.8 million and \$2.3 million, respectively, of the cash and due from banks balance represents the deposits required to be maintained with the correspondent banks.

Legal contingencies

In the normal course of business, the Bank is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the Bank's financial statements.

**Note 15. Fair Value Disclosures**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value techniques or other valuation models or processes that use primarily market-based or independently-sourced market data, including interest rate yield curves, option volatilities and third party information.

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

- Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 – Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 15. Fair Value Disclosures (Continued)**

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

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 and December 31, 2017 are as follows:

<u>December 31, 2018</u>	<u>Fair Value</u>	<u>Fair Value Measurement at Reporting Date Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available-for-sale securities:				
U.S. government agencies	\$ 59,474,345	\$ -	\$ 59,474,345	\$ -
Corporations	1,800,698	-	1,800,698	-
State and political subdivisions	30,485,732	-	30,485,732	-
Mortgage-backed securities	17,328,837	-	17,328,837	-
Brokered CDs	1,105,951	-	1,105,951	-
	<u>\$ 110,195,563</u>	<u>\$ -</u>	<u>\$ 110,195,563</u>	<u>\$ -</u>

<u>December 31, 2017</u>	<u>Fair Value</u>	<u>Fair Value Measurement at Reporting Date Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available-for-sale securities:				
U.S. government agencies	\$ 68,575,763	\$ 1,967,174	\$ 66,608,589	\$ -
Corporations	2,930,334	-	2,930,334	-
State and political subdivisions	32,942,691	-	32,942,691	-
Mortgage-backed securities	21,066,732	-	21,066,732	-
Brokered CDs	1,627,408	-	1,627,408	-
	<u>\$ 127,142,928</u>	<u>\$ 1,967,174</u>	<u>\$ 125,175,754</u>	<u>\$ -</u>

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 15. Fair Value Disclosures (Continued)**

Assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2018 and 2017 are as follows:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>December 31, 2018</b>				
Impaired loans	\$ 3,784,769	\$ -	\$ -	\$ 3,784,769
Foreclosed assets	231,000	-	-	231,000
	<u>\$ 4,015,769</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,015,769</u>
<b>December 31, 2017</b>				
Impaired loans	\$ 4,469,150	\$ -	\$ -	\$ 4,469,150
Foreclosed assets	206,500	-	-	206,500
	<u>\$ 4,675,650</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,675,650</u>

The estimated fair values of the Bank's financial instruments are as follows:

	<u>December 31, 2018</u>		<u>December 31, 2017</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 8,182,035	\$ 8,182,035	\$ 7,097,473	\$ 7,097,473
Interest bearing deposits in banks	3,572,000	3,507,346	14,824,000	14,708,627
Securities available-for-sale	110,195,563	110,195,563	127,142,928	127,142,928
Annuity investments	1,247,685	1,247,685	1,242,447	1,242,447
Loans, net	229,996,256	239,318,718	211,416,707	219,794,559
Accrued interest receivable	1,887,887	1,887,887	1,901,221	1,901,221
Bank owned life insurance	11,123,467	11,123,467	10,762,170	10,762,170
<b>Financial liabilities:</b>				
Deposits	328,740,372	328,480,207	336,961,288	337,144,437
Accrued interest payable	32,444	32,444	35,224	35,224

The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments, along with a description of the valuation methodologies used for those instruments measured at fair value.

Cash and cash equivalents

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

(Continued)

**SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2018**

**Note 15. Fair Value Disclosures (Continued)**

Interest-bearing deposits in banks

The carrying amounts of interest-bearing deposits maturing within ninety days approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

Securities

The Bank obtains fair value measurements from an independent pricing service using quoted prices if available. If quoted market prices are not available, then fair value is estimated by using quoted prices of securities with similar characteristics; quoted prices in markets that are not active, or, other inputs that are observable or can be corroborated by observable market data from substantially the full term of the asset or liability.

The carrying value of the Federal Home Loan Bank (FHLB), Federal Reserve Bank (FRB), and Community Banker's Bank (CBB) stock approximate fair value based on redemption provisions.

Annuity investments are carried at initial cost of the investment plus accumulated earnings, which approximates fair value.

Loans receivable

For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one-to-four family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Impaired loans

The Bank does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, its fair value is estimated using several methods including collateral value, observable market value, and discounted cash flows.

(Continued)

## SOUTHWEST VIRGINIA BANKSHARES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018

#### Note 15. Fair Value Disclosures (Continued)

##### Impaired loans (Continued)

As of December 31, 2018, substantially all of the total impaired loans were evaluated (or impaired loans were primarily evaluated) based on the fair value of collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on the observable market price or a current appraised value, the Bank records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the impaired loan as nonrecurring Level 3. Most of the impaired loans at December 31, 2018 and 2017 were measured using an appraisal, with some discount applied and these are considered Level 3 measurements.

##### Deposit liabilities

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts, and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

##### Short-term borrowings

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

##### Accrued interest

The carrying amounts of accrued interest approximate fair value.

#### Note 16. Transactions with Related Parties

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal stockholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

The Bank has entered into transactions with certain directors, executive officers, stockholders, and their affiliates. Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. The aggregate amount of loans to such related parties as of December 31, 2018 and 2017 was \$5,730,569 and \$3,110,595, respectively. During 2018, new loans made to such related parties amount to \$3,246,148 and payments amounted to \$626,174. Total related party deposits held by the Bank as of December 31, 2018 and 2017 were \$3,256,387 and \$3,551,266, respectively.