

NEW PEOPLES BANKSHARES INC  
Form 10-Q  
November 14, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

**Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2017

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

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

Commission file number: 000-33411

**NEW PEOPLES BANKSHARES, INC.**

(Exact name of registrant as specified in its charter)

**Virginia**

(State or other jurisdiction of  
incorporation or organization)

**31-1804543**

(I.R.S. Employer

Identification No.)

**67 Commerce Drive**

**Honaker, Virginia**

**24260**

(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code) **(276) 873-7000**

**n/a**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

| Class                          | Outstanding at November 13, 2017 |
|--------------------------------|----------------------------------|
| Common Stock, \$2.00 par value | 23,819,148                       |

**NEW PEOPLES BANKSHARES, INC.**

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## Part I Financial Information

## Item 1

## Financial Statements

**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

|  |          |          |
|--|----------|----------|
| INTEREST AND DIVIDEND INCOME                           | 2017     | 2016     |
| Loans including fees                                   | \$17,902 | \$16,910 |
| Federal funds sold                                     | 1        | —        |
| Interest-earning deposits with banks                   | 150      | 67       |
| Investments  | 1,122    | 1,161    |
| Dividends on equity securities (restricted)            | 105      | 99       |
| Total Interest and Dividend Income                     | 19,280   | 18,237   |
| INTEREST EXPENSE                                       |          |          |
| Deposits   |          |          |
| Demand   | 36       | 37       |
| Savings  | 137      | 122      |
| Time deposits  | 1,618    | 1,288    |
| FHLB advances  | 117      | 109      |
| Federal funds purchased                                | —        | 2        |
| Trust preferred securities                             | 437      | 373      |
| Total Interest Expense                                 | 2,345    | 1,931    |
| NET INTEREST INCOME                                    | 16,935   | 16,306   |
| PROVISION FOR LOAN LOSSES                              | —        | (500 )   |
| NET INTEREST INCOME AFTER<br>PROVISION FOR LOAN LOSSES | 16,935   | 16,806   |
| NONINTEREST INCOME                                     |          |          |
| Gain on sale and leaseback transactions                | 2,619    | —        |
| Service charges  | 2,655    | 1,926    |
| Fees, commissions and other income                     | 2,429    | 2,694    |
| Insurance and investment fees                          | 146      | 404      |
| Net realized gains on sale of investment securities    | —        | 240      |
| Life insurance investment income                       | 82       | 118      |
| Total Noninterest Income                               | 7,931    | 5,382    |

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|   |            |            |   |
|---|------------|------------|---|
| NONINTEREST EXPENSES                                  |            |            |   |
| Salaries and employee benefits                        | 10,135     | 9,954      |   |
| Occupancy and equipment expense                       | 3,376      | 3,042      |   |
| Lease expense – operating leases                      | 150        | —          |   |
| Advertising and public relations                      | 257        | 332        |   |
| Data processing and telecommunications                | 1,853      | 1,726      |   |
| FDIC insurance premiums                               | 298        | 407        |   |
| Other real estate owned and repossessed vehicles, net | 1,280      | 599        |   |
| Other operating expenses                              | 4,350      | 4,208      |   |
| Total Noninterest Expenses                            | 21,699     | 20,268     |   |
| <br>  |            |            |   |
| INCOME BEFORE INCOME TAXES                            | 3,167      | 1,920      |   |
| <br>  |            |            |   |
| INCOME TAX BENEFIT                                    | (9         | ) (6       | ) |
| <br>  |            |            |   |
| NET INCOME  | \$3,176    | \$1,926    |   |
| <br>  |            |            |   |
| Income Per Share                                      |            |            |   |
| Basic   | \$0.14     | \$0.08     |   |
| Fully Diluted   | \$0.14     | \$0.08     |   |
| <br>  |            |            |   |
| Average Weighted Shares of Common Stock               |            |            |   |
| Basic   | 23,355,611 | 23,354,092 |   |
| Fully Diluted   | 23,355,611 | 23,354,092 |   |

The accompanying notes are an integral part of this statement.

**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

|  |         |         |
|--|---------|---------|
| INTEREST AND DIVIDEND INCOME                           | 2017    | 2016    |
| Loans including fees                                   | \$6,123 | \$5,732 |
| Federal funds sold                                     | 1       | —       |
| Interest-earning deposits with banks                   | 58      | 23      |
| Investments  | 391     | 334     |
| Dividends on equity securities (restricted)            | 39      | 35      |
| Total Interest and Dividend Income                     | 6,612   | 6,124   |
| INTEREST EXPENSE                                       |         |         |
| Deposits   |         |         |
| Demand   | 11      | 13      |
| Savings  | 44      | 44      |
| Time deposits  | 591     | 441     |
| FHLB Advances  | 33      | 45      |
| Trust Preferred Securities                             | 154     | 128     |
| Total Interest Expense                                 | 833     | 671     |
| NET INTEREST INCOME                                    | 5,779   | 5,453   |
| PROVISION FOR LOAN LOSSES                              | —       | —       |
| NET INTEREST INCOME AFTER<br>PROVISION FOR LOAN LOSSES | 5,779   | 5,453   |
| NONINTEREST INCOME                                     |         |         |
| Service charges  | 934     | 854     |
| Fees, commissions and other income                     | 807     | 1,031   |
| Insurance and investment fees                          | 40      | 103     |
| Life insurance investment income                       | 27      | 55      |
| Total Noninterest Income                               | 1,808   | 2,043   |
| NONINTEREST EXPENSES                                   |         |         |
| Salaries and employee benefits                         | 3,413   | 3,405   |
| Occupancy and equipment expense                        | 1,115   | 1,121   |
| Lease expense – operating leases                       | 112     | —       |
| Advertising and public relations                       | 83      | 99      |
| Data processing and telecommunications                 | 630     | 569     |



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|   |            |            |
|---|------------|------------|
| FDIC insurance premiums                               | 86         | 137        |
| Other real estate owned and repossessed vehicles, net | 227        | 347        |
| Other operating expenses                              | 1,432      | 1,477      |
| Total Noninterest Expenses                            | 7,098      | 7,155      |
| <br>  |            |            |
| INCOME BEFORE INCOME TAXES                            | 489        | 341        |
| <br>  |            |            |
| INCOME TAX EXPENSE (BENEFIT)                          | 5          | (5 )       |
| <br>  |            |            |
| NET INCOME  | \$484      | \$346      |
| <br>  |            |            |
| Income Per Share                                      |            |            |
| Basic   | \$0.02     | \$0.01     |
| Fully Diluted   | \$0.02     | \$0.01     |
| <br>  |            |            |
| Weighted Average Shares of Common Stock               |            |            |
| Basic   | 23,355,580 | 23,354,111 |
| Fully Diluted   | 23,355,580 | 23,354,111 |

The accompanying notes are an integral part of this statement.

**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016**

(IN THOUSANDS)

(UNAUDITED)

|  | <b>For the three<br/>months<br/>ended</b> |             | <b>For the nine<br/>months ended</b> |             |
|--|---|-------------|--------------------------------------|-------------|
|  | <b>September</b>                          |             | <b>September 30,</b>                 |             |
|  | <b>2017</b>                               | <b>2016</b> | <b>2017</b>                          | <b>2016</b> |
| NET INCOME   | \$484                                     | \$346       | \$3,176                              | \$1,926     |
| Other comprehensive income (loss):                   |   |             |                                      |             |
| Investment Securities Activity                       |   |             |                                      |             |
| Unrealized gains (losses) arising during the period  | (216)                                     | (70 )       | 391                                  | 1,409       |
| Tax related to unrealized gains (losses)             | 73  | 24          | (133 )                               | (479 )      |
| Reclassification of realized gains during the period | —   | —           | —                                    | (240 )      |
| Tax related to realized gains                        | —   | —           | —                                    | 82          |
| TOTAL OTHER COMPREHENSIVE INCOME (LOSS)              | (143)                                     | (46 )       | 258                                  | 772         |
| TOTAL COMPREHENSIVE INCOME                           | \$341                                     | \$300       | \$3,434                              | \$2,698     |

The accompanying notes are an integral part of this statement.

**NEW PEOPLES BANKSHARES, INC.****CONSOLIDATED BALANCE SHEETS**

(IN THOUSANDS EXCEPT PER SHARE AND SHARE DATA)

| ASSETS                                   | September 30,<br>2017<br>(Unaudited) | December<br>31,<br>2016<br>(Audited) |
|--|--------------------------------------|--------------------------------------|
| Cash and due from banks                  | \$ 16,559                            | \$ 18,500                            |
| Interest-bearing deposits with banks     | 20,808                               | 16,816                               |
| Federal funds sold                       | 8                                    | 132                                  |
| Total Cash and Cash Equivalents          | 37,375                               | 35,448                               |
| Investment securities available-for-sale | 68,231                               | 70,011                               |
| Loans receivable                         | 501,390                              | 468,629                              |
| Allowance for loan losses                | (6,086 )                             | (6,072 )                             |
| Net Loans                                | 495,304                              | 462,557                              |
| Bank premises and equipment, net         | 26,454                               | 29,985                               |
| Equity securities (restricted)           | 2,570                                | 2,802                                |
| Other real estate owned                  | 7,506                                | 10,655                               |
| Accrued interest receivable              | 1,956                                | 1,848                                |
| Life insurance investments               | 12,356                               | 12,274                               |
| Deferred taxes, net                      | 5,152                                | 5,285                                |
| Right-of-use assets – operating leases   | 5,252                                | —                                    |
| Other assets                             | 3,080                                | 3,470                                |
| Total Assets                             | \$ 665,236                           | \$ 634,335                           |
| <b>LIABILITIES</b>                       |                                      |                                      |
| Deposits:                                |                                      |                                      |
| Demand deposits:                         |                                      |                                      |
| Noninterest bearing                      | \$ 159,475                           | \$ 151,914                           |
| Interest-bearing                         | 33,770                               | 40,213                               |
| Savings deposits                         | 121,088                              | 114,492                              |
| Time deposits                            | 267,283                              | 247,819                              |
| Total Deposits                           | 581,616                              | 554,438                              |
| Federal Home Loan Bank advances          | 7,858                                | 13,758                               |
| Lease liabilities – operating leases     | 5,252                                | —                                    |
| Accrued interest payable                 | 394                                  | 331                                  |
| Accrued expenses and other liabilities   | 3,265                                | 2,395                                |
| Trust preferred securities               | 16,496                               | 16,496                               |

|  |           |           |
|--|-----------|-----------|
| Total Liabilities  | 614,881   | 587,418   |
| Commitments and contingencies  |           |           |
| STOCKHOLDERS' EQUITY   |           |           |
| Common stock - \$2.00 par value; 50,000,000 shares authorized;<br>23,356,632 and 23,354,457 shares issued and outstanding at |           |           |
| September 30, 2017 and December 31, 2016, respectively   | 46,714    | 46,709    |
| Common stock warrants  | 762       | 764       |
| Additional paid-in-capital   | 13,966    | 13,965    |
| Retained deficit   | (10,889 ) | (14,065 ) |
| Accumulated other comprehensive loss   | (198 )    | (456 )    |
| Total Stockholders' Equity   | 50,355    | 46,917    |
| Total Liabilities and Stockholders' Equity   | \$665,236 | \$634,335 |

The accompanying notes are an integral part of this statement.

## NEW PEOPLES BANKSHARES, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

## FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016

(IN THOUSANDS INCLUDING SHARE DATA)

(UNAUDITED)

|  | Shares of<br>Common<br>Stock | Common<br>Stock | Common<br>Stock<br>Warrants | Additional<br>Paid-in-<br>Capital | Retained<br>Deficit | Accum-ulated<br>Other<br>Compre-hensiv<br>Income (Loss) | Total<br>Stockholders'<br>Equity |
|--|------------------------------|-----------------|-----------------------------|-----------------------------------|---------------------|---|----------------------------------|
| Balance, December 31,<br>2015                | 23,354                       | \$46,708        | \$ 764                      | \$ 13,965                         | \$ (15,023 )        | \$ (327 )   | \$ 46,087                        |
| Net income                                   | —                            | —               | —                           | —                                 | 1,926               | —   | 1,926                            |
| Other comprehensive<br>income,<br>net of tax | —                            | —               | —                           | —                                 | —                   | 772   | 772                              |
| Balance, September 30,<br>2016*              | 23,354                       | \$46,708        | \$ 764                      | \$ 13,965                         | \$ (13,097 )        | \$ 445  | \$ 48,785                        |
| Balance, December 31,<br>2016                | 23,354                       | \$46,709        | \$ 764                      | \$ 13,965                         | \$ (14,065 )        | \$ (456 )   | \$ 46,917                        |
| Net income                                   | —                            | —               | —                           | —                                 | 3,176               | —   | 3,176                            |
| Exercise of common<br>stock warrants         | 3                            | 5               | (2 )                        | 1                                 | —                   | —   | 4                                |
|  | —                            | —               | —                           | —                                 | —                   | 258   | 258                              |

Other comprehensive  
income,

net of tax

|                                |        |          |        |           |            |   |         |   |           |
|--------------------------------|--------|----------|--------|-----------|------------|---|---------|---|-----------|
| Balance, September 30,<br>2017 | 23,357 | \$46,714 | \$ 762 | \$ 13,966 | \$ (10,889 | ) | \$ (198 | ) | \$ 50,355 |
|--------------------------------|--------|----------|--------|-----------|------------|---|---------|---|-----------|

\*During the third quarter of 2016, 175 shares of common stock were issued in connection with common stock warrants being exercised.

The accompanying notes are an integral part of this statement.

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NEW PEOPLES BANKSHARES, INC.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016

(IN THOUSANDS)

(UNAUDITED)

|   | 2017     | 2016     |
|---|----------|----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |          |          |
| Net income  | \$3,176  | \$1,926  |
| Adjustments to reconcile net income to net cash provided by operating activities: |          |          |
| Depreciation  | 1,911    | 1,815    |
| Provision for loan losses   | —        | (500 )   |
| Income on life insurance  | (82 )    | (118 )   |
| Gain on sale of securities available-for-sale                                     | —        | (240 )   |
| Gain on sale and leaseback transactions   | (2,619 ) | —        |
| Gain on sale of premises and equipment  | (2 )     | (67 )    |
| (Gain) loss on sale of foreclosed assets  | 29       | (290 )   |
| Adjustment of carrying value of foreclosed real estate                            | 668      | 165      |
| Accretion of bond premiums/discounts  | 589      | 711      |
| Deferred tax benefit  | —        | (95 )    |
| Net change in:  |          |          |
| Interest receivable   | (108 )   | (108 )   |
| Other assets  | 390      | (1,261 ) |
| Accrued interest payable  | 63       | 6        |
| Accrued expenses and other liabilities  | 826      | 668      |
| Net Cash Provided by Operating Activities   | 4,841    | 2,612    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |          |          |
| Net increase in loans   | (29,348) | (27,362) |
| Purchase of securities available-for-sale   | (13,032) | (9,708 ) |
| Proceeds from sales and maturities of securities available-for-sale               | 14,614   | 37,487   |
| Net sale (purchase) of equity securities (restricted)                             | 232      | (172 )   |
| Payments for the purchase of premises and equipment                               | (1,866 ) | (4,469 ) |
| Proceeds from sales and leaseback transactions                                    | 1,042    | —        |
| Proceeds from sale of premises and equipment                                      | 5        | 735      |
| Proceeds from insurance claims on other real estate owned                         | 12       | —        |
| Proceeds from sales of other real estate owned                                    | 4,145    | 2,379    |
| Net Cash Used In Investing Activities   | (24,196) | (1,110 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |          |          |
| Exercise of common stock warrants   | 4        | —        |

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|  |          |          |
|--|----------|----------|
| Net increase (decrease) in Federal Home Loan Bank advances                   | (5,900 ) | 6,100    |
| Net change in:   |          |          |
| Demand deposits  | 1,118    | 13,588   |
| Savings deposits   | 6,596    | (6,069 ) |
| Time deposits  | 19,464   | (9,022 ) |
| Net Cash Provided by Financing Activities                                    | 21,282   | 4,597    |
| Net increase in cash and cash equivalents                                    | 1,927    | 6,099    |
| Cash and Cash Equivalents, Beginning of Period                               | 35,448   | 26,338   |
| Cash and Cash Equivalents, End of Period                                     | \$37,375 | \$32,437 |
| Supplemental Disclosure of Cash Paid During the Period for:                  |          |          |
| Interest   | \$2,282  | \$1,925  |
| Taxes  | \$—      | \$95     |
| Supplemental Disclosure of Non Cash Transactions:                            |          |          |
| Right-of-use assets obtained in exchange for new operating lease liabilities | \$5,252  | \$—      |
| Loan made to finance sale of premises and equipment                          | \$4,935  | \$—      |
| Other real estate acquired in settlement of foreclosed loans                 | \$2,761  | \$3,851  |
| Loans made to finance sale of foreclosed real estate                         | \$1,225  | \$676    |
| Transfer of premises and equipment to other real estate                      | \$125    | \$—      |
| Transfer of other real estate to premises and equipment                      | \$—      | \$125    |
| Change in unrealized gains (losses) on securities available-for-sale         | \$391    | \$1,169  |

The accompanying notes are an integral part of this statement.



NEW PEOPLES BANKSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 1 NATURE OF OPERATIONS:**

New Peoples Bankshares, Inc. (“The Company”) is a financial holding company whose principal activity is the ownership and management of a community bank. New Peoples Bank, Inc. (“Bank”) was organized and incorporated under the laws of the Commonwealth of Virginia on December 9, 1997. The Bank commenced operations on October 28, 1998, after receiving regulatory approval. As a state-chartered member bank, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve Bank. The Bank provides general banking services to individuals, small and medium size businesses and the professional community of southwestern Virginia, southern West Virginia, and eastern Tennessee. On June 9, 2003, the Company formed two wholly-owned subsidiaries; NPB Financial Services, Inc. and NPB Web Services, Inc. On July 7, 2004 the Company established NPB Capital Trust I for the purpose of issuing trust preferred securities. On September 27, 2006, the Company established NPB Capital Trust 2 for the purpose of issuing additional trust preferred securities. NPB Financial Services, Inc. was a subsidiary of the Company until January 1, 2009 when it became a subsidiary of the Bank. In June 2012 the name of NPB Financial Services, Inc. was changed to NPB Insurance Services, Inc. which operates solely as an insurance agency. On March 4, 2016 the Federal Reserve Bank of Richmond approved the Company’s election to become a financial holding company. In July 2016, the Bank and its wholly-owned subsidiary NPB Insurance Services, Inc. announced that it was forming a business relationship with The Hilb Group of Virginia dba CSE Insurance Services, a division of the Hilb Group, LLC (“CSE”), located in Abingdon, Virginia, to provide insurance services for its current and future customers. Effective July 1, 2016, NPB Insurance Services, Inc. sold its existing book of business to CSE. These customers are now serviced by CSE and the Bank refers future insurance needs of its customers to CSE. On June 7, 2017, NPB Insurance Services, Inc. purchased a 39% membership interest in Lonesome Pine Title Agency, LLC, which provides title insurance. Another member of the agency is a related party to the Company.

**NOTE 2 ACCOUNTING PRINCIPLES:**

These consolidated financial statements conform to U. S. generally accepted accounting principles and to general industry practices. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the Company’s financial position at September 30, 2017 and December 31, 2016, and the results of operations for the three and nine month periods ended September 30, 2017 and 2016. The notes included herein should be read in conjunction with the notes to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. The results of operations for the three and nine month periods ended September 30, 2017 and 2016 are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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. The determination of the adequacy of the allowance for loan losses and the determination of the deferred tax asset and related valuation allowance are based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions.

**NOTE 3 EARNINGS PER SHARE:**

Basic earnings per share computations are based on the weighted average number of shares outstanding during each period. Dilutive earnings per share reflect the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued related to outstanding common stock warrants are determined by the Treasury method. For the three and nine months ended September 30, 2017 and 2016, potential common shares of 879,803 and 882,178, respectively, were anti-dilutive and were not included in the calculation. Basic and diluted net income per common share calculations follows:

| (Amounts in Thousands, Except<br>Share and Per Share Data) | For the three months<br>ended September 30, |            | For the nine months<br>ended September 30, |            |
|--|---|------------|--|------------|
|  | 2017  | 2016       | 2017                                       | 2016       |
| Net income   | \$484                                       | \$346      | \$3,176                                    | \$1,926    |
| Weighted average shares outstanding                        | 23,355,580                                  | 23,354,111 | 23,355,611                                 | 23,354,092 |
| Dilutive shares for stock options and warrants             | —   | —          | —  | —          |
| Weighted average dilutive shares outstanding               | 23,355,580                                  | 23,354,111 | 23,355,611                                 | 23,354,092 |
| Basic and diluted income per share                         | \$0.02                                      | \$0.01     | \$0.14                                     | \$0.08     |

**NOTE 4 CAPITAL:****Capital Requirements and Ratios**

The Bank is subject to various capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and, possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined) to risk-weighted assets (as defined), Tier 1 capital (as defined) to average assets (as defined), and Common Equity Tier 1 capital (as defined) to risk-weighted assets (as defined). As of September 30, 2017, the Bank meets all capital adequacy requirements to which it is subject.

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board's Small Bank Holding Company Policy Statement issued in February 2015, and is no longer obligated to report consolidated regulatory capital. The Bank's actual capital amounts and ratios are presented in the following table as of September 30, 2017 and December 31, 2016, respectively. These ratios comply with Federal Reserve rules to align with the Basel III Capital requirements effective January 1, 2015.

|   | Actual |         | Minimum Capital Requirement |       | Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---|--------|---------|-----------------------------|-------|--|--------|
|   | Amount | Ratio   | Amount                      | Ratio | Amount   | Ratio  |
| (Dollars are in thousands)              |        |         |                             |       |  |        |
| September 30, 2017:                     |        |         |                             |       |  |        |
| Total Capital to Risk Weighted Assets:  |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 70,084 | 15.96 % | \$35,119                    | 8.0 % | \$43,899   | 10.0 % |
| Tier 1 Capital to Risk Weighted Assets: |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 64,590 | 14.71 % | 26,339                      | 6.0 % | 35,119   | 8.0 %  |
| Tier 1 Capital to Average Assets:       |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 64,590 | 9.84 %  | 26,249                      | 4.0 % | 32,811   | 5.0 %  |
| Common Equity Tier 1 Capital            |        |         |                             |       |  |        |
| to Risk Weighted Assets:                |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 64,590 | 14.71 % | 19,754                      | 4.5 % | 28,534   | 6.5 %  |
| <b>December 31, 2016:</b>               |        |         |                             |       |  |        |
| Total Capital to Risk Weighted Assets:  |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 67,549 | 16.64 % | \$32,476                    | 8.0 % | \$40,595   | 10.0 % |
| Tier 1 Capital to Risk Weighted Assets: |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 62,462 | 15.39 % | 24,357                      | 6.0 % | 32,476   | 8.0 %  |
| Tier 1 Capital to Average Assets:       |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 62,462 | 9.93 %  | 25,149                      | 4.0 % | 31,436   | 5.0 %  |
| Common Equity Tier 1 Capital            |        |         |                             |       |  |        |
| to Risk Weighted Assets:                |        |         |                             |       |  |        |
| New Peoples Bank, Inc.                  | 62,462 | 15.39 % | 18,268                      | 4.5 % | 26,386   | 6.5 %  |

As of September 30, 2017, the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage, and Common Equity Tier 1 ratios as set forth in the above tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

Under Basel III Capital requirements, a capital conservation buffer of 0.625% became effective beginning on January 1, 2016. The capital conservation buffer is 1.25% as of September 30, 2017 and the Bank met that requirement with a buffer of 7.96%. The capital conservation buffer will be gradually increased through January 1, 2019 to 2.50%. Banks will be required to maintain levels that meet the required minimum plus the capital conservation buffer in order to make distributions, such as dividends, or discretionary bonus payments.



**NOTE 5 INVESTMENT SECURITIES:**

The amortized cost and estimated fair value of securities (all available-for-sale (“AFS”)) are as follows:

| (Dollars are in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Approximate Fair Value |
|----------------------------|----------------|------------------------|-------------------------|------------------------|
| <b>September 30, 2017</b>  |                |                        |                         |                        |
| U.S. Government Agencies   | \$24,363       | \$103                  | \$155                   | \$24,311               |
| Taxable municipals         | 2,318          | 7                      | 32                      | 2,293                  |
| Corporate bonds            | 3,906          | 191                    | -                       | 4,097                  |
| Mortgage backed securities | 37,944         | 23                     | 437                     | 37,530                 |
| Total Securities AFS       | \$68,531       | \$324                  | \$624                   | \$68,231               |

**December 31, 2016**

|                            |          |       |       |          |
|----------------------------|----------|-------|-------|----------|
| U.S. Government Agencies   | \$24,821 | \$80  | \$269 | \$24,632 |
| Taxable municipals         | 2,340    | 2     | 50    | 2,292    |
| Corporate bonds            | 3,600    | 149   | -     | 3,749    |
| Mortgage backed securities | 39,941   | 25    | 628   | 39,338   |
| Total Securities AFS       | \$70,702 | \$256 | \$947 | \$70,011 |

The following table details unrealized losses and related fair values in the available-for-sale portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2017 and December 31, 2016.

| (Dollars are in thousands) | Fair Value | Less than 12 Months Unrealized Losses | 12 Months or More Fair Value | 12 Months or More Unrealized Losses | Total Fair Value | Total Unrealized Losses |
|----------------------------|------------|---------------------------------------|------------------------------|-------------------------------------|------------------|-------------------------|
| <b>September 30, 2017</b>  |            |                                       |                              |                                     |                  |                         |
| U.S. Government Agencies   | \$12,043   | \$134                                 | \$1,681                      | \$21                                | \$13,724         | \$155                   |
| Taxable municipals         | 1,055      | 28                                    | 262                          | 4                                   | 1,317            | 32                      |
| Corporate bonds            | —          | —                                     | —                            | —                                   | —                | —                       |
| Mtg. backed securities     | 21,749     | 230                                   | 9,980                        | 207                                 | 31,729           | 437                     |
| Total Securities AFS       | \$34,847   | \$392                                 | \$11,923                     | \$232                               | \$46,770         | \$624                   |
| <b>December 31, 2016</b>   |            |                                       |                              |                                     |                  |                         |
| U.S. Government Agencies   | \$12,081   | \$250                                 | \$2,449                      | \$19                                | \$14,530         | \$269                   |
| Taxable municipals         | 1,561      | 50                                    | —                            | —                                   | 1,561            | 50                      |
| Corporate bonds            | 500        | —                                     | —                            | —                                   | 500              | —                       |

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|                        |          |        |         |        |          |        |
|------------------------|----------|--------|---------|--------|----------|--------|
| Mtg. backed securities | 28,680   | 543    | 4,655   | 85     | 33,335   | 628    |
| Total Securities AFS   | \$42,822 | \$ 843 | \$7,104 | \$ 104 | \$49,926 | \$ 947 |

At September 30, 2017, the available-for-sale portfolio included 107 investments for which the fair market value was less than amortized cost. At December 31, 2016, the available-for-sale portfolio included 107 investments for which the fair market value was less than amortized cost. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial conditions and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Based on the Company's analysis, the Company concluded that no securities had an other-than-temporary impairment.



Investment securities with a carrying value of \$10.6 million and \$11.3 million at September 30, 2017 and December 31, 2016, respectively, were pledged as collateral to secure public deposits and for other purposes required by law.

Gross proceeds on the sale of investment securities were \$3.2 million and \$24.8 million, respectively, for the nine months ended September 30, 2017 and 2016. Gross realized gains and losses pertaining to the sale of investment securities available for sale are detailed as follows:

|                            | For the<br>three<br>months<br>ended<br>September<br>30, |      | For the nine<br>months<br>ended<br>September<br>30, |       |
|----------------------------|---|------|---|-------|
| (Dollars are in thousands) | 2017  | 2016 | 2017  | 2016  |
| Gross gains realized       | \$30  | \$ — | \$30  | \$275 |
| Gross losses realized      | (30)  | —    | (30)  | (35)  |
| Net realized gains         | \$—   | \$ — | \$—   | \$240 |

The amortized cost and fair value of investment securities at September 30, 2017, by contractual maturity, are shown in the following schedule. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollars are in thousands)             | Amortized | Fair     | Weighted |
|--|-----------|----------|----------|
| <u>Securities Available-for-Sale</u>   | Cost      | Value    | Average  |
|  |           |          | Yield    |
| Due in one year or less                | \$11      | \$11     | 1.57%    |
| Due after one year through five years  | 3,636     | 3,622    | 2.03%    |
| Due after five years through ten years | 14,853    | 14,977   | 3.03%    |
| Due after ten years                    | 50,031    | 49,621   | 2.14%    |
| Total                                  | \$68,531  | \$68,231 | 2.32%    |

The Bank, as a member of the Federal Reserve Bank and the Federal Home Loan Bank, is required to hold stock in each. The Bank also owns stock in CBB Financial Corp., which is a correspondent of the Bank. These equity securities are restricted from trading and are recorded at a cost of \$2.6 million and \$2.8 million as of September 30, 2017 and December 31, 2016, respectively.

**NOTE 6 LOANS:**

Loans receivable outstanding are summarized as follows:

| (Dollars are in thousands)        | September<br>30, 2017 | December<br>31, 2016 |
|-----------------------------------|-----------------------|----------------------|
| Real estate secured:              |                       |                      |
| Commercial                        | \$ 114,880            | \$ 103,331           |
| Construction and land development | 30,878                | 25,755               |
| Residential 1-4 family            | 254,234               | 249,700              |
| Multifamily                       | 14,790                | 12,582               |
| Farmland                          | 23,287                | 24,948               |
| Total real estate loans           | 438,069               | 416,316              |
| Commercial                        | 36,382                | 26,955               |
| Agriculture                       | 3,733                 | 3,164                |
| Consumer installment loans        | 22,519                | 22,188               |
| All other loans                   | 687                   | 6                    |
| Total loans                       | \$ 501,390            | \$ 468,629           |

Loans receivable on nonaccrual status are summarized as follows:

| (Dollars are in thousands)                  | September<br>30, 2017 | December<br>31, 2016 |
|---|-----------------------|----------------------|
| Real estate secured:                        |                       |                      |
| Commercial                                  | \$ 2,040              | \$ 3,403             |
| Construction and land development           | 274                   | 319                  |
| Residential 1-4 family                      | 6,640                 | 8,355                |
| Multifamily                                 | 155                   | 166                  |
| Farmland                                    | 1,062                 | 1,003                |
| Total real estate loans                     | 10,171                | 13,246               |
| Agriculture                                 | 7                     | 83                   |
| Consumer installment loans                  | 45                    | 76                   |
| Total loans receivable on nonaccrual status | \$ 10,223             | \$ 13,405            |

Total interest income not recognized on nonaccrual loans for the nine months ended September 30, 2017 and 2016 was \$456 thousand and \$397 thousand, respectively.



The following table presents information concerning the Company's investment in loans considered impaired as of September 30, 2017 and December 31, 2016:

| <b>As of September 30, 2017</b>     | Recorded        | Unpaid Principal Balance | Related        |
|-------------------------------------|-----------------|--------------------------|----------------|
| (Dollars are in thousands)          | Investment      |                          | Allowance      |
| With no related allowance recorded: |                 |                          |                |
| Real estate secured:                |                 |                          |                |
| Commercial                          | \$2,497         | \$2,581                  | \$—            |
| Construction and land development   | —               | —                        | —              |
| Residential 1-4 family              | 3,813           | 4,112                    | —              |
| Multifamily                         | 285             | 326                      | —              |
| Farmland                            | 1,501           | 1,884                    | —              |
| Commercial                          | —               | —                        | —              |
| Agriculture                         | 18              | 18                       | —              |
| Consumer installment loans          | 8               | 8                        | —              |
| All other loans                     | —               | —                        | —              |
| With an allowance recorded:         |                 |                          |                |
| Real estate secured:                |                 |                          |                |
| Commercial                          | 2,322           | 2,420                    | 339            |
| Construction and land development   | 202             | 447                      | 69             |
| Residential 1-4 family              | 564             | 593                      | 104            |
| Multifamily                         | 1,310           | 1,377                    | 194            |
| Farmland                            | 609             | 621                      | 245            |
| Commercial                          | 496             | 496                      | 181            |
| Agriculture                         | —               | —                        | —              |
| Consumer installment loans          | —               | —                        | —              |
| All other loans                     | —               | —                        | —              |
| <b>Total</b>                        | <b>\$13,625</b> | <b>\$14,883</b>          | <b>\$1,132</b> |
| <br>                                |                 |                          |                |
| <b>As of December 31, 2016</b>      | Recorded        | Unpaid Principal Balance | Related        |
| (Dollars are in thousands)          | Investment      |                          | Allowance      |
| With no related allowance recorded: |                 |                          |                |
| Real estate secured:                |                 |                          |                |
| Commercial                          | \$3,636         | \$4,055                  | \$—            |
| Construction and land development   | 5               | 5                        | —              |
| Residential 1-4 family              | 3,861           | 4,182                    | —              |
| Multifamily                         | 301             | 342                      | —              |

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|                                   |          |          |       |
|-----------------------------------|----------|----------|-------|
| Farmland                          | 3,895    | 4,601    | —     |
| Commercial                        | —        | —        | —     |
| Agriculture                       | 19       | 19       | —     |
| Consumer installment loans        | 26       | 43       | —     |
| All other loans                   | —        | —        | —     |
| With an allowance recorded:       |          |          |       |
| Real estate secured:              |          |          |       |
| Commercial                        | 1,191    | 1,270    | 65    |
| Construction and land development | 240      | 469      | 106   |
| Residential 1-4 family            | 555      | 565      | 56    |
| Multifamily                       | —        | —        | —     |
| Farmland                          | 591      | 602      | 299   |
| Commercial                        | 67       | 67       | 18    |
| Agriculture                       | 5        | 5        | 5     |
| Consumer installment loans        | 9        | 9        | 3     |
| All other loans                   | —        | —        | —     |
| Total                             | \$14,401 | \$16,234 | \$552 |

The following table presents information concerning the Company's average impaired loans and interest recognized on those impaired loans, for the periods indicated:

|                                     | Nine Months Ended  |                    | September 30, 2016 |                    |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                     | September 30, 2017 | September 30, 2016 | September 30, 2016 | September 30, 2016 |
|                                     | Average Interest   | Average Interest   | Average Interest   | Average Interest   |
|                                     | Recorded Income    | Recorded Income    | Recorded Income    | Recorded Income    |
| (Dollars are in thousands)          | Investmen          | Recognized         | Investmen          | Recognized         |
| With no related allowance recorded: |                    |                    |                    |                    |
| Real estate secured:                |                    |                    |                    |                    |
| Commercial                          | \$2,976            | \$ 73              | \$4,222            | \$ 77              |
| Construction and land development   | 2                  | —                  | 89                 | —                  |
| Residential 1-4 family              | 3,827              | 152                | 3,716              | 140                |
| Multifamily                         | 402                | 15                 | 288                | 14                 |
| Farmland                            | 2,538              | 52                 | 4,211              | 163                |
| Commercial                          | —                  | —                  | —                  | —                  |
| Agriculture                         | 19                 | 1                  | 29                 | 2                  |
| Consumer installment loans          | 13                 | —                  | 24                 | —                  |
| All other loans                     | —                  | —                  | —                  | —                  |
| With an allowance recorded:         |                    |                    |                    |                    |
| Real estate secured:                |                    |                    |                    |                    |
| Commercial                          | 1,208              | 80                 | 1,539              | 6                  |
| Construction and land development   | 222                | —                  | 271                | —                  |
| Residential 1-4 family              | 634                | 14                 | 939                | 18                 |
| Multifamily                         | 660                | 48                 | 100                | —                  |
| Farmland                            | 673                | 26                 | 572                | 18                 |
| Commercial                          | 282                | 24                 | 71                 | 2                  |
| Agriculture                         | 2                  | —                  | 107                | 1                  |
| Consumer installment loans          | 2                  | —                  | 30                 | 1                  |
| All other loans                     | —                  | —                  | —                  | —                  |
| Total                               | \$13,460           | \$ 485             | \$16,208           | \$ 442             |

|                                     | Three Months Ended |                    | September 30, 2016 |                    |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                     | September 30, 2017 | September 30, 2016 | September 30, 2016 | September 30, 2016 |
|                                     | Average Interest   | Average Interest   | Average Interest   | Average Interest   |
|                                     | Recorded Income    | Recorded Income    | Recorded Income    | Recorded Income    |
| (Dollars are in thousands)          | Investmen          | Recognized         | Investmen          | Recognized         |
| With no related allowance recorded: |                    |                    |                    |                    |

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|                                   |          |        |          |        |
|-----------------------------------|----------|--------|----------|--------|
| Real estate secured:              |          |        |          |        |
| Commercial                        | \$2,757  | \$ 9   | \$3,965  | \$ 4   |
| Construction and land development | —        | —      | 7        | —      |
| Residential 1-4 family            | 3,833    | 50     | 3,833    | 37     |
| Multifamily                       | 287      | 4      | 307      | 3      |
| Farmland                          | 1,193    | 26     | 4,274    | 61     |
| Commercial                        | —        | —      | —        | —      |
| Agriculture                       | 18       | —      | 23       | —      |
| Consumer installment loans        | 9        | —      | 22       | (2 )   |
| All other loans                   | —        | —      | —        | —      |
| With an allowance recorded:       |          |        |          |        |
| Real estate secured:              |          |        |          |        |
| Commercial                        | 1,516    | 74     | 1,309    | 6      |
| Construction and land development | 209      | —      | 259      | —      |
| Residential 1-4 family            | 567      | 5      | 606      | 7      |
| Multifamily                       | 1,321    | 16     | 83       | (4 )   |
| Farmland                          | 756      | 10     | 504      | 6      |
| Commercial                        | 497      | 8      | 68       | —      |
| Agriculture                       | —        | —      | 97       | 3      |
| Consumer installment loans        | —        | —      | 32       | 1      |
| All other loans                   | —        | —      | —        | —      |
| Total                             | \$12,963 | \$ 202 | \$15,389 | \$ 122 |

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An age analysis of past due loans receivable is below. At September 30, 2017 and December 31, 2016, there were no loans over 90 days past due that were accruing.

|                                 | Loans   |         |         |         |           |           |
|---------------------------------|---------|---------|---------|---------|-----------|-----------|
|                                 | Loans   | Loans   | 90 or   |         |           |           |
|                                 | 30-59   | 60-89   | More    | Total   |           |           |
|                                 | Days    | Days    | Days    | Past    |           |           |
| <b>As of September 30, 2017</b> | Past    | Past    | Past    | Due     | Current   | Total     |
| (Dollars are in thousands)      | Due     | Due     | Due     | Loans   | Loans     | Loans     |
| Real estate secured:            |         |         |         |         |           |           |
| Commercial                      | \$203   | \$530   | \$528   | \$1,261 | \$113,619 | \$114,880 |
| Construction and land           | 19      | —       | 43      | 62      | 30,816    | 30,878    |
| development                     |         |         |         |         |           |           |
| Residential 1-4 family          | 3,523   | 1,076   | 1,121   | 5,720   | 248,514   | 254,234   |
| Multifamily                     | —       | —       | —       | —       | 14,790    | 14,790    |
| Farmland                        | 55      | —       | 284     | 339     | 22,948    | 23,287    |
| Total real estate loans         | 3,800   | 1,606   | 1,976   | 7,382   | 430,687   | 438,069   |
| Commercial                      | 127     | —       | —       | 127     | 36,255    | 36,382    |
| Agriculture                     | 1       | —       | 4       | 5       | 3,728     | 3,733     |
| Consumer installment            | 66      | 1       | 20      | 87      | 22,432    | 22,519    |
| Loans                           |         |         |         |         |           |           |
| All other loans                 | —       | —       | —       | —       | 687       | 687       |
| Total loans                     | \$3,994 | \$1,607 | \$2,000 | \$7,601 | \$493,789 | \$501,390 |

|                                | Loans |       |       |       |         |       |
|--------------------------------|-------|-------|-------|-------|---------|-------|
|                                | Loans | Loans | 90 or |       |         |       |
|                                | 30-59 | 60-89 | More  | Total |         |       |
|                                | Days  | Days  | Days  | Past  |         |       |
| <b>As of December 31, 2016</b> | Past  | Past  | Past  | Due   | Current | Total |
| (Dollars are in thousands)     | Due   | Due   | Due   | Loans | Loans   | Loans |



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|                         |          |         |         |          |           |           |
|-------------------------|----------|---------|---------|----------|-----------|-----------|
| Real estate secured:    |          |         |         |          |           |           |
| Commercial              | \$1,676  | \$307   | \$1,083 | \$3,066  | \$100,265 | \$103,331 |
| Construction and land   |          |         |         |          |           |           |
| development             | 103      | 17      | 44      | 164      | 25,591    | 25,755    |
| Residential 1-4 family  | 4,237    | 1,547   | 2,233   | 8,017    | 241,683   | 249,700   |
| Multifamily             | 1,367    | —       | —       | 1,367    | 11,215    | 12,582    |
| Farmland                | 2,987    | —       | —       | 2,987    | 21,961    | 24,948    |
| Total real estate loans | 10,370   | 1,871   | 3,360   | 15,601   | 400,715   | 416,316   |
| Commercial              | 20       | —       | —       | 20       | 26,935    | 26,955    |
| Agriculture             | 19       | —       | 78      | 97       | 3,067     | 3,164     |
| Consumer installment    |          |         |         |          |           |           |
|                         | 110      | 15      | 36      | 161      | 22,027    | 22,188    |
| Loans                   |          |         |         |          |           |           |
| All other loans         | —        | —       | —       | —        | 6         | 6         |
| Total loans             | \$10,519 | \$1,886 | \$3,474 | \$15,879 | \$452,750 | \$468,629 |

The Company categorizes loans receivable into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans receivable as to credit risk. The Company uses the following definitions for risk ratings:

**Pass** - Loans in this category are considered to have a low likelihood of loss based on relevant information analyzed about the ability of the borrowers to service their debt and other factors.

**Special Mention** - Loans in this category are currently protected but are potentially weak, including adverse trends in borrower's operations, credit quality or financial strength. Those loans constitute an undue and unwarranted credit risk but not to the point of justifying a substandard classification. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances. Special mention loans have potential weaknesses which may, if not checked or corrected, weaken the loan or inadequately protect the Company's credit position at some future date.

**Substandard** - A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful** - Loans classified Doubtful have all the weaknesses inherent in loans classified as Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable.

Based on the most recent analysis performed, the risk category of loans receivable was as follows:

| <b>As of September 30, 2017</b>   | Special   |         |             |           |
|-----------------------------------|-----------|---------|-------------|-----------|
| (Dollars are in thousands)        | Pass      | Mention | Substandard | Total     |
| Real estate secured:              |           |         |             |           |
| Commercial                        | \$106,115 | \$4,772 | \$3,993     | \$114,880 |
| Construction and land development | 29,757    | 847     | 274         | 30,878    |
| Residential 1-4 family            | 244,924   | 1,971   | 7,339       | 254,234   |
| Multifamily                       | 12,977    | 157     | 1,656       | 14,790    |
| Farmland                          | 19,491    | 2,049   | 1,747       | 23,287    |
| Total real estate loans           | 413,264   | 9,796   | 15,009      | 438,069   |

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|                            |           |          |          |           |
|----------------------------|-----------|----------|----------|-----------|
| Commercial                 | 33,665    | 2,221    | 496      | 36,382    |
| Agriculture                | 3,700     | 26       | 7        | 3,733     |
| Consumer installment loans | 22,459    | 3        | 57       | 22,519    |
| All other loans            | 687       | —        | —        | 687       |
| Total                      | \$473,775 | \$12,046 | \$15,569 | \$501,390 |

**As of December 31, 2016**

Special

| (Dollars are in thousands)        | Pass      | Mention  | Substandard | Total     |
|-----------------------------------|-----------|----------|-------------|-----------|
| Real estate secured:              |           |          |             |           |
| Commercial                        | \$92,562  | \$6,922  | \$3,847     | \$103,331 |
| Construction and land development | 23,905    | 1,531    | 319         | 25,755    |
| Residential 1-4 family            | 238,400   | 2,117    | 9,183       | 249,700   |
| Multifamily                       | 10,848    | 1,367    | 367         | 12,582    |
| Farmland                          | 19,070    | 1,545    | 4,333       | 24,948    |
| Total real estate loans           | 384,785   | 13,482   | 18,049      | 416,316   |
| Commercial                        | 26,197    | 691      | 67          | 26,955    |
| Agriculture                       | 3,076     | —        | 88          | 3,164     |
| Consumer installment loans        | 22,086    | —        | 102         | 22,188    |
| All other loans                   | 6         | —        | —           | 6         |
| Total                             | \$436,150 | \$14,173 | 18,306      | \$468,629 |

**NOTE 7 ALLOWANCE FOR LOAN LOSSES:**

The following table details activity in the allowance for loan losses by portfolio segment for the period ended September 30, 2017. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| As of September 30, 2017          | Beginning Charge |         |            |            | Ending Balance |
|-----------------------------------|------------------|---------|------------|------------|----------------|
|                                   | Balance          | Offs    | Recoveries | Provisions |                |
| (Dollars are in thousands)        |                  |         |            |            |                |
| Real estate secured:              |                  |         |            |            |                |
| Commercial                        | \$ 1,625         | \$(179) | \$ 191     | \$ (58 )   | \$ 1,579       |
| Construction and land development | 346              | —       | —          | (53 )      | 293            |
| Residential 1-4 family            | 2,376            | (369)   | 39         | 48         | 2,094          |
| Multifamily                       | 241              | —       | —          | 181        | 422            |
| Farmland                          | 428              | (49 )   | 358        | (309 )     | 428            |
| Total real estate loans           | 5,016            | (597)   | 588        | (191 )     | 4,816          |
| Commercial                        | 163              | (11 )   | 147        | 127        | 426            |
| Agriculture                       | 31               | —       | 4          | (10 )      | 25             |
| Consumer installment loans        | 123              | (134)   | 17         | 160        | 166            |
| All other loans                   | —                | —       | —          | 4          | 4              |
| Unallocated                       | 739              | —       | —          | (90 )      | 649            |
| Total                             | \$ 6,072         | \$(742) | \$ 756     | \$ —       | \$ 6,086       |

| As of September 30, 2017          | Allowance for Loan Losses             |                                       | Recorded Investment in Loans          |          |                                       |            |
|-----------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|----------|---------------------------------------|------------|
|                                   | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Individually Evaluated for Impairment |          | Collectively Evaluated for Impairment |            |
|                                   |                                       |                                       | Total                                 | Total    | Total                                 | Total      |
| (Dollars are in thousands)        |                                       |                                       |                                       |          |                                       |            |
| Real estate secured:              |                                       |                                       |                                       |          |                                       |            |
| Commercial                        | \$ 339                                | \$ 1,240                              | \$ 1,579                              | \$ 4,819 | \$ 110,061                            | \$ 114,880 |
| Construction and land development | 69                                    | 224                                   | 293                                   | 202      | 30,676                                | 30,878     |

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|                            |         |         |         |          |           |           |
|----------------------------|---------|---------|---------|----------|-----------|-----------|
| Residential 1-4 family     | 104     | 1,990   | 2,094   | 4,377    | 249,857   | 254,234   |
| Multifamily                | 194     | 228     | 422     | 1,595    | 13,195    | 14,790    |
| Farmland                   | 245     | 183     | 428     | 2,110    | 21,177    | 23,287    |
| Total real estate loans    | 951     | 3,865   | 4,816   | 13,103   | 424,966   | 438,069   |
| Commercial                 | 181     | 245     | 426     | 496      | 35,886    | 36,382    |
| Agriculture                | -       | 25      | 25      | 18       | 3,715     | 3,733     |
| Consumer installment loans | -       | 166     | 166     | 8        | 22,511    | 22,519    |
| All other loans            | -       | 4       | 4       | -        | 687       | 687       |
| Unallocated                | -       | 649     | 649     | -        | -         | -         |
| Total                      | \$1,132 | \$4,954 | \$6,086 | \$13,625 | \$487,765 | \$501,390 |

The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2016. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| As of December 31, 2016           | Beginning Charge |           |            |            | Ending Balance |
|-----------------------------------|------------------|-----------|------------|------------|----------------|
|                                   | Balance          | Offs      | Recoveries | Provisions |                |
| (Dollars are in thousands)        |                  |           |            |            |                |
| Real estate secured:              |                  |           |            |            |                |
| Commercial                        | \$ 2,384         | \$(557 )  | \$ 220     | \$ (422 )  | \$ 1,625       |
| Construction and land development | 332              | (5 )      | 26         | (7 )       | 346            |
| Residential 1-4 family            | 2,437            | (720 )    | 87         | 572        | 2,376          |
| Multifamily                       | 232              | (18 )     | —          | 27         | 241            |
| Farmland                          | 675              | (2 )      | 103        | (348 )     | 428            |
| Total real estate loans           | 6,060            | (1,302)   | 436        | (178 )     | 5,016          |
| Commercial                        | 266              | (65 )     | 62         | (100 )     | 163            |
| Agriculture                       | 124              | —         | 7          | (100 )     | 31             |
| Consumer installment loans        | 128              | (83 )     | 24         | 54         | 123            |
| All other loans                   | 1                | —         | —          | (1 )       | —              |
| Unallocated                       | 914              | —         | —          | (175 )     | 739            |
| Total                             | \$ 7,493         | \$(1,450) | \$ 529     | \$ (500 )  | \$ 6,072       |

| As of December 31, 2016           | Allowance for Loan Losses             |                                       | Recorded Investment in Loans          |         |                                       |           |
|-----------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------|---------------------------------------|-----------|
|                                   | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Individually Evaluated for Impairment |         | Collectively Evaluated for Impairment |           |
|                                   |                                       |                                       | Total                                 | Total   | Total                                 | Total     |
| (Dollars are in thousands)        |                                       |                                       |                                       |         |                                       |           |
| Real estate secured:              |                                       |                                       |                                       |         |                                       |           |
| Commercial                        | \$65                                  | \$1,560                               | \$1,625                               | \$4,827 | \$98,504                              | \$103,331 |
| Construction and land development | 106                                   | 240                                   | 346                                   | 245     | 25,510                                | 25,755    |
| Residential 1-4 family            | 56                                    | 2,320                                 | 2,376                                 | 4,416   | 245,284                               | 249,700   |
| Multifamily                       | -                                     | 241                                   | 241                                   | 301     | 12,281                                | 12,582    |
| Farmland                          | 299                                   | 129                                   | 428                                   | 4,486   | 20,462                                | 24,948    |

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|                            |       |         |       |          |           |           |
|----------------------------|-------|---------|-------|----------|-----------|-----------|
| Total real estate loans    | 526   | 4,490   | 5,016 | 14,275   | 402,041   | 416,316   |
| Commercial                 | 18    | 145     | 163   | 67       | 26,888    | 26,955    |
| Agriculture                | 5     | 26      | 31    | 24       | 3,140     | 3,164     |
| Consumer installment loans | 3     | 120     | 123   | 35       | 22,153    | 22,188    |
| All other loans            | -     | -       | -     | -        | 6         | 6         |
| Unallocated                | -     | 739     | 739   | -        | -         | -         |
| Total                      | \$552 | \$5,520 | 6,072 | \$14,401 | \$454,228 | \$468,629 |

In determining the amount of our allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions, as well as the requirements of the written agreement and other regulatory input. If our assumptions prove to be incorrect, our current allowance may not be sufficient to cover future loan losses and we may experience significant increases to our provision.

**NOTE 8 TROUBLED DEBT RESTRUCTURINGS:**

At September 30, 2017 there were \$7.3 million in loans that are classified as troubled debt restructurings compared to \$9.6 million at December 31, 2016. The following table presents information related to loans modified as troubled debt restructurings during the nine and three months ended September 30, 2017 and 2016.

|                              | For the nine months ended |  |                                     | For the nine months ended |  |                                     |
|------------------------------|---------------------------|--|-------------------------------------|---------------------------|--|-------------------------------------|
|                              | September 30, 2017        |  |                                     | September 30, 2016        |  |                                     |
| Troubled Debt Restructurings | #                         | Pre-Mod.<br>Recorded<br>of Investment<br>Loans | Post-Mod.<br>Recorded<br>Investment | #                         | Pre-Mod.<br>Recorded<br>of Investment<br>Loans | Post-Mod.<br>Recorded<br>Investment |
| (Dollars are in thousands)   |                           |  |                                     |                           |  |                                     |
| Real estate secured:         |                           |  |                                     |                           |  |                                     |
| Commercial                   | —                         | \$ —   | \$ —                                | 1                         | \$ 341   | \$ 341                              |
| Construction and land        | —                         | —  | —                                   | —                         | —  | —                                   |
| Development                  |                           |  |                                     |                           |  |                                     |
| Residential 1-4 family       | —                         | —  | —                                   | —                         | —  | —                                   |
| Multifamily                  | —                         | —  | —                                   | —                         | —  | —                                   |
| Farmland                     | —                         | —  | —                                   | 1                         | 291  | 280                                 |
| Total real estate loans      | —                         | —  | —                                   | 2                         | 632  | 621                                 |
| Commercial                   | 1                         | 443  | 443                                 | —                         | —  | —                                   |
| Agriculture                  | —                         | —  | —                                   | —                         | —  | —                                   |
| Consumer installment loans   | —                         | —  | —                                   | —                         | —  | —                                   |
| All other loans              | —                         | —  | —                                   | —                         | —  | —                                   |
| Total                        | 1                         | \$ 443   | \$ 443                              | 2                         | \$ 632   | \$ 621                              |



During the nine months ended September 30, 2017, the Company modified the terms of one loan for which the modification was considered to be a troubled debt restructuring. The interest rate was not modified on this loan; however, the payment terms and maturity date were changed.

During the nine months ended September 30, 2016, the Company modified the terms of two loans for which the modification was considered to be a troubled debt restructuring. On one loan, the interest rate and maturity date were not modified; however, the payment terms were changed. On one loan, the interest rate was lowered and the payment terms and maturity date were changed.

During the three months ended September 30, 2017 and 2016, the Company modified no loans that were considered to be a troubled debt restructuring.

No loans previously modified as troubled debt restructurings defaulted during the nine months ended September 30, 2017. There was one commercial real estate loan with a recorded investment of \$302 thousand that had been modified as a troubled debt restructuring that defaulted during the nine months ended September 30, 2016, which was within twelve months of the loan's modification date.

There were no loans modified as troubled debt restructurings that defaulted during the three months ended September 30, 2017 and 2016, which were within twelve months of their modification date. Generally, a troubled debt restructuring is considered to be in default once it becomes 90 days or more past due following a modification.

In determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings in its estimate. The Company evaluates all troubled debt restructurings for possible further impairment. As a result, the allowance may be increased, adjustments may be made in the allocation of the allowance, or charge-offs may be taken to further writedown the carrying value of the loan.

**NOTE 9 OTHER REAL ESTATE OWNED:**

The following table summarizes the activity in other real estate owned for the nine months ended September 30, 2017 and the year ended December 31, 2016:

| (Dollars are in thousands)   | September<br>30,<br>2017 | December<br>31, 2016 |
|------------------------------|--------------------------|----------------------|
| Balance, beginning of period | \$ 10,655                | \$ 12,398            |

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|  |          |           |
|--|----------|-----------|
| Additions  | 2,761    | 4,577     |
| Purchases of/improvements to other real estate owned           | —        | 48        |
| Transfers of premises and equipment to other real estate owned | 125      | —         |
| Transfers of other real estate owned to premises and equipment | —        | (125 )    |
| Proceeds from sales of other real estate owned                 | (4,145 ) | (4,232 )  |
| Proceeds from insurance claims on other real estate owned      | (12 )    | —         |
| Loans made to finance sales of other real estate owned         | (1,225 ) | (818 )    |
| Adjustment of carrying value                                   | (668 )   | (1,414 )  |
| Deferred gain from sales                                       | 44       | —         |
| Gain (loss) from sales   | (29 )    | 221       |
| Balance, end of period   | \$ 7,506 | \$ 10,655 |

**NOTE 10 FAIR VALUES:**

The financial reporting standard, “Fair Value Measurements and Disclosures” provides a framework for measuring fair value under generally accepted accounting principles and requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans and other real estate acquired through foreclosure).

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair Value Measurements and Disclosures also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an exchange market, as well as U. S. Treasury, other U. S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2: Observable inputs other than Level 1 prices such as 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 assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and 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 the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

*Investment Securities Available-for-Sale* – Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices. The Company’s available-for-sale securities, totaling \$68.2 million and \$70.0 million at September 30, 2017 and December 31, 2016, respectively, are the only assets whose fair values are measured on a recurring basis using Level 2 inputs from an independent pricing service.

*Loans* - The Company does not record loans at fair value on a recurring basis. Real estate serves as collateral on a substantial majority of the Company’s loans. When a loan is considered impaired a specific reserve may be established. Loans which are deemed to be impaired and require a reserve are primarily valued on a non-recurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which management evaluates and determines whether or not the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or whether or not an appraised value does not include estimated costs of disposition. The Company records impaired loans as nonrecurring Level 3 assets. The aggregate carrying amounts of impaired loans carried at fair value were \$12.5 million and \$13.8 million at September 30, 2017 and December 31, 2016, respectively.

*Foreclosed Assets* – Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Foreclosed assets are carried at the lower of the carrying value or fair value. Fair value is based upon independent observable market prices or appraised values of the collateral with a third party less an estimate of disposition costs, which the Company considers to be level 2 inputs. When the appraised value is not available, management determines the fair value of the collateral if further impaired below the appraised value and there is no observable market price, or an appraised value does not include estimated costs of disposition and management must make an estimate, the Company records the foreclosed asset as nonrecurring Level 3. The aggregate carrying amounts of foreclosed assets were \$7.5 million and \$10.7 million at September 30, 2017 and December 31, 2016, respectively.

Assets and liabilities measured at fair value are as follows as of September 30, 2017 (for purpose of this table the impaired loans are shown net of the related allowance):

| (Dollars are in thousands)        | Quoted<br>market<br>price in<br>active<br>markets<br>(Level<br>1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|-----------------------------------|---|---|--|
| (On a recurring basis)            |   |   |  |
| Available-for-sale investments    |   |   |  |
| U.S. Government Agencies          | \$ —  | \$ 24,311   | \$ —   |
| Taxable municipals                | —   | 2,293   | —  |
| Corporate bonds                   | —   | 4,097   | —  |
| Mortgage backed securities        | —   | 37,530  | —  |
| (On a non-recurring basis)        |   |   |  |
| Other real estate owned           | —   | —   | 7,506  |
| Impaired loans:                   |   |   |  |
| Real estate secured:              |   |   |  |
| Commercial                        | —   | —   | 4,480  |
| Construction and land development | —   | —   | 133  |
| Residential 1-4 family            | —   | —   | 4,273  |
| Multifamily                       | —   | —   | 1,401  |
| Farmland                          | —   | —   | 1,865  |
| Commercial                        | —   | —   | 315  |
| Agriculture                       | —   | —   | 18   |
| Consumer installment loans        | —   | —   | 8  |
| All other loans                   | —   | —   | —  |
| Total                             | \$ —  | \$ 68,231   | \$ 19,999  |

Assets and liabilities measured at fair value are as follows as of December 31, 2016 (for purpose of this table the impaired loans are shown net of the related allowance):

| (Dollars are in thousands)     | Quoted<br>market<br>price in<br>active<br>markets<br>(Level<br>1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|--------------------------------|---|---|--|
| (On a recurring basis)         |   |   |  |
| Available-for-sale investments |   |   |  |

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|                                   |      |           |           |
|-----------------------------------|------|-----------|-----------|
| U.S. Government Agencies          | \$ — | \$ 24,632 | \$ —      |
| Taxable municipals                | —    | 2,292     | —         |
| Corporate bonds                   | —    | 3,749     | —         |
| Mortgage backed securities        | —    | 39,338    | —         |
| (On a non-recurring basis)        | —    | —         | 10,655    |
| Other real estate owned           | —    | —         | —         |
| Impaired loans:                   |      |           |           |
| Real estate secured:              |      |           |           |
| Commercial                        | —    | —         | 4,762     |
| Construction and land development | —    | —         | 139       |
| Residential 1-4 family            | —    | —         | 4,360     |
| Multifamily                       | —    | —         | 301       |
| Farmland                          | —    | —         | 4,187     |
| Commercial                        | —    | —         | 49        |
| Agriculture                       | —    | —         | 19        |
| Consumer installment loans        | —    | —         | 32        |
| All other loans                   | —    | —         | —         |
| Total                             | \$ — | \$ 70,011 | \$ 24,504 |

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of September 30, 2017 and December 31, 2016, the significant unobservable inputs used in the fair value measurements were as follows:

**For Level 3 assets measured at fair value on a recurring or non-recurring basis as of March 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:**

| (Dollars in thousands)  | Fair Value at September 30, 2017 | Fair Value at December 31, 2016 | Valuation Technique   | Significant Unobservable Inputs  | General Range of Significant Unobservable Input Values |
|-------------------------|----------------------------------|---------------------------------|---|--|--|
| Impaired Loans          | \$ 12,493                        | \$ 13,849                       | Appraised Value/Discounted Cash Flows/Market Value of Note                | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell | 0 – 18%  |
| Other Real Estate Owned | \$ 7,506                         | \$ 10,655                       | Appraised Value/Comparable Sales/Other Estimates from Independent Sources | Discounts to reflect current market conditions and estimated costs to sell                           | 0 – 18%  |

### Fair Value of Financial Instruments

Fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practical to estimate the value is based upon the characteristics of the instruments and relevant market information. Financial instruments include cash, evidence of ownership in an entity, or contracts that convey or impose on an entity that contractual right or obligation to either receive or deliver cash for another financial instrument.

The following summary presents the methodologies and assumptions used to estimate the fair value of the Company's financial instruments presented below. The information used to determine fair value is highly subjective and judgmental in nature and, therefore, the results may not be precise. Subjective factors include, among other things, estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of the balance sheet date, the amounts that will actually be realized or paid upon settlement or maturity on these various instruments could be significantly different.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2017 and December 31, 2016. This table excludes financial instruments for

which the carrying amount approximates fair value. The carrying value of cash and due from banks, federal funds sold, interest-bearing deposits, deposits with no stated maturities, trust preferred securities and accrued interest approximates fair value. The remaining financial instruments were valued based on the present value of estimated future cash flows, discounted at various rates in effect for similar instruments as of September 30, 2017 and December 31, 2016.



| (Dollars are in thousands)          | Carrying Amount | Fair Value | Fair Value Measurements                         |   |   |
|-------------------------------------|-----------------|------------|---|---|---|
|                                     |                 |            | Quoted market price in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| September 30, 2017                  |                 |            |   |   |   |
| Financial Instruments – Assets      |                 |            |   |   |   |
| Net Loans                           | \$495,304       | \$497,359  | \$—   | \$484,866                                     | \$ 12,493                                 |
| Financial Instruments – Liabilities |                 |            |   |   |   |
| Time Deposits                       | 267,283         | 266,990    | —   | 266,990                                       | —   |
| FHLB Advances                       | 7,858           | 8,053      | —   | 8,053   | —   |
| December 31, 2016                   |                 |            |   |   |   |
| Financial Instruments – Assets      |                 |            |   |   |   |
| Net Loans                           | \$462,557       | \$467,707  | \$—   | \$453,858                                     | \$ 13,849                                 |
| Financial Instruments – Liabilities |                 |            |   |   |   |
| Time Deposits                       | 247,819         | 247,258    | —   | 247,258                                       | —   |
| FHLB Advances                       | 13,758          | 13,993     | —   | 13,993  | —   |

**NOTE 11 SALE AND LEASEBACK TRANSACTIONS:**

On May 31, 2017 the Bank, the wholly-owned subsidiary of the Company, sold four (4) of its properties, one each located in Abingdon, Bristol, Gate City and Castlewood, Virginia to NPB Good Steward Properties, LLC (“Good Steward”) for a total purchase price of \$6.2 million. Good Steward is not an affiliate of the Company or the Bank. After selling expenses of \$192 thousand, the net proceeds on the transactions were \$6.0 million. The sales prices for the properties were based on outside appraisals obtained by the Bank. The Bank provided \$4.9 million of financing to Good Steward for a term of 10 years for this transaction.

In connection with the sale of the four properties, the Bank on May 31, 2017 entered into commercial lease agreements with Good Steward for the properties (the “Leases”), which will allow the Bank to continue to service customers from these locations. The Leases, which commenced on June 1, 2017, provide the Bank with use of the properties for an initial term of fifteen (15) years. Base rent payments for years 1 through 5 of the Leases are approximately \$417 thousand a year. The base rent payments will increase by 8% for years 6 through 10 of the Leases and then by another 8% for years 11 through 15 of the Leases. The Bank has the option to renew the Leases five (5) times and each renewal would be for a term of five (5) years. The base rent for the renewals would be

negotiated at the time the renewal option is exercised by the Bank. While the cash lease payments are currently \$417 thousand a year, the Company is required to straight-line the expense over the initial term of fifteen (15) years. As a result, the annual lease expense will be approximately \$451 thousand. The weighted average remaining life of the leases is 14.68 years.

In anticipation of this transaction the Company adopted ASU No. 2016-02 Leases (Topic 842) early. This ASU revised certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. As a result of this transaction the Company recognized right-to-use assets – operating leases of approximately \$5.3 million, along with corresponding lease liabilities of approximately \$5.3 million. The \$5.3 million was determined by calculating the present value of the annual cash lease payments using a discount rate of 3.25%. The 3.25% discount rate was determined to be our fifteen (15) year incremental borrowing rate as of May 31, 2017.

As a result of the sale and the determination that the corresponding leases were operating leases, the Company recognized a gain of \$2.6 million on the sale and leaseback transactions. The Bank and its parent, New Peoples Bankshares, Inc. and affiliates have no relationship with Good Steward other than those discussed above.

The Company's operating lease cost for the three and nine months ended September 30, 2017 as a result of the transactions discussed above was \$112 thousand and \$150 thousand, respectively. All other operating leases the Company has were evaluated and determined that they are immaterial to the financial statements.

**NOTE 12 SUBSEQUENT EVENTS:**

During the month of October 2017, a principal shareholder of the Company exercised 506,666 common stock warrants at a price of \$1.75 per share. As a result of this exercise an additional \$887 thousand of capital was raised by the Company. The additional liquidity provided by the funds will be used by the Company to pay its operating expenses and trust preferred interest payments.

On October 23, 2017, the Board of Directors approved for the Bank to pay the Company a dividend of \$111 thousand using 68,735 shares of the Company's common stock that had been repossessed by the Bank as a result of collection activities on loans. By law the 68,735 shares of the Company's common stock became part of the Company's authorized and unissued shares and would be available for reissuance in the future.

**NOTE 13 RECENT ACCOUNTING DEVELOPMENTS:**

The following is a summary of recent authoritative announcements:

In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2017.

The Company will apply the guidance using a modified retrospective approach. The Company's revenue is comprised of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of our revenues will not be affected. The Company is currently assessing our revenue contracts related to revenue streams that are within the scope of the standard. Our accounting policies will not change materially since the principles of revenue recognition from the ASU are largely consistent with existing guidance and current practices applied by our businesses. We have not identified material changes to the timing or amount of revenue recognition. Based on the updated guidance, we do anticipate changes in our disclosures associated with our revenues. We will provide qualitative disclosures of our performance obligations related to our revenue recognition and we continue to evaluate disaggregation for significant categories of revenue in the scope of the guidance.

In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral the guidance in ASU 2014-09 will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification ("ASC"), to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

In February 2016, the FASB amended the Leases topic of the ASC to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. As discussed in Note 11, the Company early adopted ASU No. 2016-02 Leases (Topic 842).

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018.

The Company will apply the amendments to the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in first quarter 2019, we do not expect to elect that option. We are evaluating the impact of the ASU on our consolidated financial position, results of operations, and cash flows. In addition to our allowance for loan losses, we will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In December 2016, the FASB issued technical corrections and improvements to the Revenue from Contracts with Customers Topic. These corrections make a limited number of revisions to several pieces of the revenue recognition standard issued in 2014. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2017. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2017, the FASB updated the Accounting Changes and Error Corrections and the Investments—Equity Method and Joint Ventures Topics of the Accounting Standards Codification. The ASU incorporates into the Accounting Standards Codification recent SEC guidance about disclosing, under SEC SAB Topic 11.M, the effect on financial statements of adopting the revenue, leases, and credit losses standards. The ASU was effective upon issuance. The Company is currently evaluating the impact on additional disclosure requirements as each of the standards is adopted, however it does not expect these amendments to have a material effect on its financial position, results of operations or cash flows.

In February 2017, the FASB amended the Other Income Topic of the ASC to clarify the scope of the guidance on nonfinancial asset derecognition as well as the accounting for partial sales of nonfinancial assets. The amendments conform the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Caution About Forward Looking Statements**

We make forward looking statements in this quarterly report that are subject to risks and uncertainties. These forward looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, business strategy, and financial and other goals. The words "believes," "expects," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends," or other similar words or terms are intended to identify forward looking statements.

Certain information contained in this discussion may include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements contain the Company's expectations, plans, future financial performance, and other statements that are not historical facts. These forward-looking statements are generally identified by phrases such as "the Company expects," "the Company believes" or words of similar importance. Such forward-looking statements involve known and unknown risks including, but not limited to, changes in general economic and business conditions, interest rate fluctuations, competition within and from outside the banking industry, new products and services in the banking industry, risk inherent in making loans such as repayment risks and fluctuating collateral values, problems with technology utilized by the Company, changing trends in customer profiles and changes in laws and regulations applicable to the Company. Although the Company believes that its expectations with respect to the forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

Because of these uncertainties, our actual future results may be materially different from the results indicated by these forward looking statements. In addition, our past results of operations do not necessarily indicate our future results.

### **Critical Accounting Policies**

For discussion of our significant accounting policies see our Annual Report on Form 10-K for the year ended December 31, 2016. Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements. Our most critical accounting policies relate to our provision for loan losses and the calculation of our deferred tax asset and related valuation allowance.

The provision for loan losses reflects the estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our borrowers were to further deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additional provisions could be required.

Our deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. If all or a portion of the net deferred tax asset is determined to be unlikely to be realized in the foreseeable future, a valuation allowance is established to reduce the net deferred tax asset to the amount that is more likely than not to be realized. For further discussion of the deferred tax asset and valuation allowance, we refer you to the section on “Deferred Tax Asset and Income Taxes” below.



## Overview

During 2017, management's focus has been on reducing nonperforming assets and growing the core business of the Bank. We believe significant progress is being made on both fronts. Although both initiatives result in higher expenses in the short term, over the longer-term we anticipate the resulting net income from these initiatives to be comparable to peer banks our size. Expenses to resolve problem assets remain high but our nonperforming assets have decreased to the lowest levels that they have been for many years. In the past couple of years, we have begun growing the Bank's loans and deposits again, our core earnings base. We currently are fine tuning our processes to substantially improve efficiency in the core operations of the Bank and we are preparing the Company for the future trends of the financial industry as we see them. We anticipate both a reduction in expenses and an increase in revenues in the upcoming years.

The Company had net income for the quarter ended September 30, 2017 of \$484 thousand, or basic net income per share of \$0.02, as compared to a net income of \$346 thousand, or basic net income per share of \$0.01, for the quarter ended September 30, 2016. This is an improvement of \$138 thousand, or 39.88%. The improvement was mainly driven by the \$326 thousand improvement in net interest income offset by the \$235 thousand decrease in noninterest income in the quarter to quarter comparison. The Company had net income for the nine months ended September 30, 2017 of \$3.2 million, or basic net income per share of \$0.14, as compared to the nine months ending September 30, 2016 in which the Company had net income of \$1.9 million, or \$0.08 basic net income per share. This is an improvement of \$1.3 million, or \$0.06 per share. The improvement was mainly driven by the \$2.6 million gain recognized on the sale and leaseback transactions the Company completed during the second quarter of 2017 and a \$629 thousand increase in net interest income, which was offset by a \$1.4 million increase in noninterest expenses.

### Quarter-to-Date Results

Highlights from the second quarter of 2017 include:

- A \$12.6 million, or 2.58%, increase in loans, during the quarter;
- No provision for loan losses taken in the third quarter;
- An increase of \$5.3 million, or 0.91%, in total deposits during the quarter;
- A decrease of \$2.4 million, or 23.70%, in total past due loans during the quarter; and,
- Strong net interest margin of 3.93% for the quarter.

In the third quarter of 2017, our net interest margin was 3.93%, as compared to 3.92% for the same period in 2016, an improvement of 1 basis point. The Company's primary source of income, net interest income, increased \$326 thousand, or 5.98%, to \$5.8 million for the third quarter of 2017 from \$5.5 million for the same period in 2016. Loan

interest income increased \$391 thousand, or 6.82%, from \$5.7 million for the third quarter of 2016 to \$6.1 million for the third quarter of 2017. Investment interest income increased \$57 thousand to \$391 thousand for the third quarter of 2017 as compared to \$334 thousand for the third quarter of 2016. Interest expense increased \$162 thousand, or 24.14%, from \$671 thousand for the quarter ended September 30, 2016 to \$833 thousand for the same quarter of 2017 as a result of increases in our interest rates on time deposits.

No provision for loan losses was recorded during the third quarters of 2017 and 2016, respectively.

Noninterest income for the third quarter of 2017 was \$1.8 million, which is a decrease of \$235 thousand when compared to the \$2.0 million for the same period in 2016, or 11.50%. This decrease was primarily result of the \$156 thousand of income we recognized in the third quarter of 2016 for the sale of our existing insurance book of business that was a one-time event. We also experienced an \$80 thousand increase in nonsufficient funds / overdraft fee income during the third quarter of 2017 when compared to the same period in 2016. The increase in nonsufficient funds / overdraft fee income was the result of the Optional Overdraft Protection Services we began offering to our deposit customers in June 2016. The increase in nonsufficient funds / overdraft fee income helps to offset the \$63 thousand decrease in insurance and investment fees.

Noninterest expense decreased \$57 thousand, or 0.80%, to \$7.1 million for the third quarter 2017 as compared to \$7.2 million for the third quarter of 2016. Salaries and employee benefits were \$3.4 million for the third quarter of 2017 and 2016, respectively.

Occupancy and equipment expenses remained comparable at \$1.1 million for the third quarter of 2017 and 2016, respectively. Advertising expense decreased \$16 thousand in the quarter-to-quarter comparison. Other real estate owned and repossessed asset expenses decreased \$120 thousand, or 34.58%, to \$227 thousand for the third quarter of 2017 as compared to \$347 thousand for the same period in 2016. Writedowns on other real estate owned were \$78 thousand during the third quarter of 2017 as compared to \$241 thousand for the same period in 2016. During the third quarter of 2017 we had net losses on the sale of other real estate owned of \$25 thousand as compared to net gains on the sale of other real estate owned of \$104 thousand for the same period in 2016.

Our efficiency ratio, a non-GAAP measure which is defined as noninterest expense divided by the sum of net interest income plus noninterest income, was 93.55% for the third quarter of 2017 as compared to 95.45% for the same period in 2016. Included in this calculation are the other real estate owned write-downs which significantly impacts the ratio.

#### Year-to-Date Results

Highlights from the first nine months of 2017 include:

- \$2.6 million gain recognized on the sale and leaseback transactions;
- A reduction in nonaccrual loans of \$3.2 million, or 23.74% during the first nine months of 2017;
- Net recoveries of \$14 thousand for the nine-months ended September 30, 2017, which is an improvement of \$649 thousand, or 102.20%, versus net charges offs of \$635 thousand reported for the nine-months ended September 30, 2016;
- \$32.8 million, or 6.99% increase in loans during the first nine months of 2017;
- A decrease of \$3.2 million, or 29.55%, in other real estate owned during the first nine months of 2017;
- An increase of \$27.2 million, or 4.90% in total deposits during the first nine months of 2017;
- The Bank is considered well-capitalized under regulatory standards, and,  
· Book value per share of \$2.16 as of September 30, 2017.

Net interest income year-to-date for September 30, 2017 was \$16.9 million, which was an increase of \$629 thousand, or 3.86% when compared to the same period in 2016. Loan interest income for the first nine months of 2017 increased \$992 thousand, or 5.87%, from \$16.9 million for the nine months ended September 30, 2016 to \$17.9 million for the nine months ended September 30, 2017. Interest expense increased \$414 thousand, or 21.44%, from \$1.9 million for the first nine months of 2016 to \$2.3 million for the same period in 2017 as a result of increases in our interest rates on time deposits.

No provision for loan losses was recorded during the first nine months of 2017 as compared to the negative provision of \$500 thousand that was recorded in the first nine months of 2016.

Year-to-date September 30, 2017, noninterest income increased to \$7.9 million from \$5.4 million in 2016. This was an increase of \$2.5 million, or 47.36%. This increase was primarily due to the \$2.6 million gain recognized on the sale and leaseback transactions completed during the second quarter of 2017. We also experienced a \$741 thousand increase in nonsufficient funds / overdraft fee income during the first nine months of 2017 when compared to the same period in 2016. The increase in nonsufficient funds / overdraft fee income was the result of the Optional Overdraft Protection Services we began offering to our deposit customers in June 2016. The increase in nonsufficient funds / overdraft fee income offsets the \$240 thousand decrease in gains on the sale of investment securities and \$258 thousand decrease in insurance and investment fees.

Noninterest expense increased \$1.4 million, or 7.06%, for the first nine months of 2017 from \$20.3 million for the nine months ended September 30, 2016 to \$21.7 million for the nine months ended September 30, 2017. The increase was largely due to expenses associated with other real estate owned and repossessed assets as well as expenses related to investments in technology, lending staff, and new products and services in which we have not yet realized all of the benefits of these new additions. For the nine months ended September 30, 2017, salaries and employee benefits increased \$181 thousand, or 1.82%, to \$10.1 million as compared to \$10.0 million for the same period in 2016. This increase was primarily the result of seasoned commercial bankers hired throughout 2016 and 2017 as a part of our strategy to grow the loan portfolio, the opening of a loan production office in Jonesborough, Tennessee to expand our market presence in the Tri-Cities, Tennessee area, staff added to operate the Interactive Teller Machines (“ITMs”) and provide digital banking services, and staffing for new products and services, such as secondary market mortgage staff.

Occupancy and equipment expenses increased \$334 thousand from \$3.0 million for the first nine months of 2016 to \$3.4 million for the first nine months of 2017. The increase in occupancy and equipment expenses was mainly due to the rollout of the ITMs during 2016 in our 19 offices and 4 other locations. The ITMs, a new, state-of-the-art technology which replaced the Bank's ATMs, help provide additional convenience by providing teller services from 7 AM to 7 PM Monday through Saturday. We anticipate the addition of the ITMs will create efficiencies going forward as usage continues to increase. In addition, we have been transitioning our bank branches to the universal banker model. This model utilizes staff in multiple job functions versus staffing specialized in one area. To help accommodate this model, investments in video conferencing, cash recyclers, and other technological tools have been implemented. Although costs have increased, as we continue to grow, these costs should maintain and staffing costs in this area should decline in the future.

Other real estate owned and repossessed asset expenses increased \$681 thousand, or 113.69%, to \$1.3 million for the first nine months of 2017 as compared to \$599 thousand for the same period in 2016. During the first nine months of 2017 we had net losses on the sale of other real estate owned of \$29 thousand as compared to a net gains on the sale of other real estate owned of \$290 thousand for the same period in 2016. Writedowns on other real estate owned were \$668 thousand for the first nine months of 2017 as compared to writedowns of \$265 thousand for the same period in 2016. These writedowns were primarily the result of price reductions and auctions that helped us in being successful in reducing our other real estate owned by \$3.2 million during the first nine months of 2017. We believe that future expenses should be less as we anticipate a lower level of foreclosed properties to manage and liquidate.

### Balance Sheet

Total assets increased \$30.9 million, or 4.87%, to \$665.2 million at September 30, 2017 from \$634.3 million at December 31, 2016. The main driver in the increase was an increase of \$32.8 million in loans as a result of our efforts to conservatively grow the loan portfolio. \$4.9 million of the \$32.8 million increase was related to the loan provided in the financing of the sale and lease back transactions previously discussed in Note 11. Going forward, we anticipate total assets increasing due to our plan to prudently grow the loan portfolio, as we believe we accomplished in the first nine months of 2017.

Total investments decreased \$1.8 million, or 2.54%, to \$68.2 million at September 30, 2017 from \$70.0 million at December 31, 2016. Interest bearing deposits with banks increased \$4.0 million, or 23.74%, in the first nine months of 2017 to \$20.8 million from \$16.8 million at December 31, 2016.

Total loans increased \$32.8 million, or 6.99%, to \$501.4 million at September 30, 2017 as compared to \$468.6 million at December 31, 2016. We believe the focus on developing new and existing lending relationships should continue the pace of increasing total loans as experienced in the first nine months of 2017, subject to the economy and heightened competition in our markets.

As discussed in Note 11, “Sale and Leaseback Transactions,” the Company recognized right-to-use assets – operating leases of approximately \$5.3 million, along with corresponding lease liabilities of approximately \$5.3 million.

Total deposits increased \$27.2 million, or 4.90%, from \$554.4 million at December 31, 2016 to \$581.6 million at September 30, 2017 largely from an increase in time deposits. Noninterest-bearing demand deposits increased 4.98%, or \$7.6 million, from \$151.9 million at December 31, 2016 to \$159.5 million at September 30, 2017. We experienced a decrease of \$6.4 million, or 16.02%, in interest-bearing demand deposits during the first nine months of 2017. The main reason for the decrease was due to one relationship that moved its funding out of its interest-bearing demand deposit product into certificate of deposit time deposits. We have experienced a \$6.6 million, or 5.76%, increase in savings deposits. Time deposits increased by \$19.5 million during the first nine months of 2017, or 7.85%. As previously discussed part of this increase was due to one relationship moving its funding from an interest-bearing demand deposit product into certificate of deposit time deposits. Also we obtained an additional \$11.6 million of certificate of deposits funding with one relationship during the first nine months of 2017. Due to competitive pressures, rising interest rates, and our need for funding, we expect to see an uptick on the interest we pay on time deposits in 2017. Overall, we continue to maintain core deposits through attractive consumer and commercial deposit products and strong ties with our customer base and communities.

Total borrowings decreased to \$7.9 million at September 30, 2017, a decrease of \$5.9 million from the \$13.8 million outstanding balance at December 31, 2016. The decrease in advances from the Federal Home Loan Bank was due to a \$5.0 million borrowing that matured in March 2017 and \$900 thousand in regularly scheduled principal payments on the other borrowings.

Total equity at September 30, 2017 was \$50.4 million. That represents an increase of \$3.5 million, or 7.33%, when compared to the December 31, 2016 balance of \$46.9 million. Net income of \$3.2 million and the \$258 thousand decrease in other comprehensive loss as a result of a decrease in net unrealized loss in the investment portfolio during the nine months ended September 30, 2017 were the drivers of the increase in equity.

### Asset Quality

We continue to make significant progress in reducing the levels of non-performing assets. Though asset quality is improving, the level of nonperforming assets remains elevated as we continue to work through foreclosed properties that are held over from the Great Recession and address nonaccrual loans. The ratio of nonperforming assets to total assets decreased to 2.67% at September 30, 2017 as compared to 3.79% at December 31, 2016. Nonperforming assets, which include nonaccrual loans, other real estate owned and past due loans greater than 90 days still accruing interest, were \$17.7 million at September 30, 2017 compared to \$24.1 million at December 31, 2016. This is a decrease of \$6.4 million, or 26.31%. The makeup of these assets is primarily loans secured by commercial real estate, residential mortgages and other real estate owned properties. We continue undertaking extensive and more aggressive measures to work through problem credits and liquidate foreclosed properties in an effort to accelerate a reduction of nonperforming assets. Our goal is to reduce the nonperforming assets while being mindful of the impact to earnings and capital; however, we may recognize some losses and reductions in the allowance for loan loss as we expedite the resolution of these problem assets. Loans rated substandard decreased \$2.7 million, or 14.95%, to \$15.6 million at September 30, 2017 from \$18.3 million at December 31, 2016 and delinquencies decreased in the first nine months of 2017 as total past due loans decreased to \$7.6 million at September 30, 2017 from \$15.9 million at December 31, 2016, a decrease of \$8.3 million, or 52.13%.

Other real estate owned (“OREO”) decreased \$3.2 million, or 29.55%, to \$7.5 million at September 30, 2017 from \$10.7 million at December 31, 2016. All properties are available for sale by commercial and residential realtors under the direction of our Special Assets division. During the first nine months of 2017, we acquired \$2.8 million in other real estate owned as a result of settlement of foreclosed loans, which was offset by sales of \$5.4 million of our properties with losses of \$29 thousand realized as a result of the sales. During the first nine months of 2017, we were successful in liquidating several of our older properties and \$323 thousand of OREO is under contract to sell as of early November 2017. In an effort to reduce our level of foreclosed properties, we have taken an aggressive approach toward liquidating properties by making pricing adjustments and holding auctions on several of our older properties. We expect to continue these efforts during the remainder of 2017 which could result in additional losses, while reducing future carrying costs. We do have lease agreements on certain OREO properties which are generating rental income at market rates pending disposition. Rental income on OREO properties was \$177 thousand for the first nine

months of 2017, a decrease of \$5 thousand, or 2.75%, when compared to the \$182 thousand recognized in the first nine months of 2016.

Our allowance for loan losses at September 30, 2017 was \$6.1 million, or 1.21% of total loans as compared to \$6.1 million, or 1.30% of total loans at December 31, 2016. Impaired loans decreased \$776 thousand, or 5.39%, to \$13.6 million with an estimated related allowance of \$1.1 million for potential losses at September 30, 2017 as compared to \$14.4 million in impaired loans with an estimated related allowance of \$552 thousand at the end of 2016. No provision for loan losses was recorded during first nine months of 2017 and a negative provision of \$500 thousand was recorded during the first nine months of 2016. In the first nine months of 2017, net recoveries were \$14 thousand, or 0.00% of average loans, as compared to \$635 thousand, or 0.19% of average loans, in net charge offs for the same period of 2016. The allowance for loan losses is being maintained at a level that management deems appropriate to absorb any potential future losses and known impairments within the loan portfolio whether or not the losses are actually ever realized. We continue to adjust the allowance for loan loss model to best reflect the risks in the portfolio and the improvements made in our internal policies and procedures; however, future provisions may be deemed necessary.



### Capital Ratios

The Company meets the eligibility criteria for a small bank holding company in the Federal Reserve Board's Small Bank Holding Company Policy Statement issued in February 2015, and therefore, is no longer obligated to report consolidated regulatory capital. The Bank continues to be subject to various capital requirements administered by banking agencies.

At September 30, 2017, the Bank is considered well capitalized under the regulatory capital framework for prompt corrective action. The following ratios existed at September 30, 2017 for the Bank: Tier 1 leverage ratio of 9.84%, Tier 1 risk based capital ratio of 14.71%, Total risk based capital ratio of 15.96%, and Common Equity Tier 1 ratio of 14.71%. The ratios were as follows at December 31, 2016: Tier 1 leverage ratio of 9.93%, Tier 1 risk based capital ratio of 15.39%, Total risk based capital ratio of 16.64%, and Common Equity Tier 1 ratio of 15.39%.

The ratios mentioned above comply with the Federal Reserve rules to align with the Basel III Capital requirements effective January 1, 2015. As a result of these new rules the Company and Bank are now subject to a Common Equity Tier 1 ratio set out above.

### Deferred Tax Asset and Income Taxes

Due to timing differences between book and tax treatment of several income and expense items, a net deferred tax asset of \$5.2 million existed at September 30, 2017 as compared to a net deferred tax asset of \$5.3 million at December 31, 2016. At September 30, 2017 we had a valuation allowance of \$4.4 million as compared to a valuation allowance of \$5.3 million at December 31, 2016. As of September 30, 2017, the Company had \$18.3 million of net operating loss carryforwards which will expire in 2031 thru 2037. Management expects to utilize all of these carryforwards prior to expiration. Direct charge-offs contributed to a reduction of the tax asset and are permitted as tax deductions. In addition, writedowns on other real estate owned property are expensed for book purposes but are not deductible for tax purposes until disposition of the property. Goodwill expense also was realized for book purposes in 2011 but continues to only be tax deductible based on the statutory requirements; thus, creating a deferred tax asset. When, and if, taxable income increases in the future and during the net operating loss carryforward period, this valuation allowance may be reversed and used to decrease tax obligations in the future. Our income tax expense was computed at the normal corporate income tax rate of 34% of taxable income included in net income. We do not have significant nontaxable income or nondeductible expenses.

### Capital Resources

Our total capital at the end of the third quarter 2017 was \$50.4 million compared to \$46.9 million at December 31, 2016. The increase was \$3.5 million, or 7.33%. The Bank was considered well capitalized as of September 30, 2017, under the regulatory capital framework for prompt corrective action. New Peoples equity as a percentage of total assets was 7.57% at September 30, 2017 compared to 7.40% at December 31, 2016. The tangible book value per common share was \$2.16 at September 30, 2017 compared to \$2.01 at December 31, 2016.

Total assets increased during the first nine months of 2017 and we anticipate asset levels to increase in the future due to an emphasis on growing the loan portfolio and the core deposit base of the Bank. Under current economic conditions, we believe it is prudent to continue to increase capital to support planned asset growth while being able to absorb potential losses that may occur if asset quality deteriorates further. Based upon projections, we believe our current capital levels will be sufficient to support the Bank's planned asset growth.

No cash dividends have been paid historically and we do not anticipate paying a cash dividend in the foreseeable future as the Company continues to have a retained deficit. Earnings will continue to be retained to build capital and position the Company to pay a dividend to its shareholders as soon as practicable.

Liquidity

We closely monitor our liquidity and our liquid assets in the form of cash, due from banks, federal funds sold, and unpledged available for sale investments. Collectively, those balances were \$95.0 million at September 30, 2017, an increase from \$94.2 million at December 31, 2016. A surplus of short-term assets are maintained at levels management deems adequate to meet potential liquidity needs during 2017.

At September 30, 2017, all of our investments are classified as available-for-sale. These investments provide an additional source of liquidity in the amount of \$57.6 million, which is net of the \$10.6 million of securities pledged as collateral. Investment securities available for sale serve as a source of liquidity while yielding a higher return versus other short-term investment options, such as federal funds sold and overnight deposits with the Federal Reserve Bank. Total investments decreased \$1.8 million, or 2.54%, to \$68.2 million at September 30, 2017 from \$70.0 million at December 31, 2016. A \$391 thousand increase in the fair market value of the investment portfolio during the first nine months of 2017 resulted in a net unrealized loss of \$300 thousand at September 30, 2017 compared to the net unrealized loss of \$691 thousand at December 31, 2016.

Our loan to deposit ratio was 86.21% at September 30, 2017 and 84.52% at December 31, 2016. We anticipate this ratio to drop below 85% in the near future.

Available third-party sources of liquidity at September 30, 2017 include the following: a line of credit with the Federal Home Loan Bank of Atlanta, access to brokered certificates of deposit markets and internet certificates of deposit, and the discount window at the Federal Reserve Bank of Richmond. We also had the ability to borrow \$10.0 million in unsecured federal funds as of September 30, 2017, which gives us an additional source of liquidity.

At September 30, 2017, we had borrowings from the Federal Home Loan Bank ("FHLB") totaling \$7.9 million as compared to \$13.8 million at December 31, 2016. The decrease of \$5.9 million was due to a \$5.0 million borrowing that matured in March 2017 and \$900 thousand in regularly scheduled principal payments on the other borrowings. None of the FHLB advances are overnight borrowings and therefore none of the advances is subject to daily interest rate changes. At September 30, 2017, \$900 thousand of these borrowings had fixed interest rates with an average rate of 4.07%, and a maturity date in 2018. In June 2016 the Bank borrowed \$2.0 million with a maturity date in the year 2019 and \$5.0 million with a maturity date in the year 2021. Both borrowings have fixed interest rates and interest is payable monthly, with an interest rate of 0.99% on the \$2.0 million borrowing and an interest rate of 1.38% on the \$5.0 million borrowing.

We have used our line of credit with the FHLB to issue a letters of credit for \$17.0 million to the Treasury Board of Virginia as collateral on public deposits. An additional \$121.8 million was available on September 30, 2017 on the \$146.6 million line of credit, which is secured by a blanket lien on our residential real estate loans.

We have access to the brokered deposits market. Currently we have \$2.7 million in 10-year term time deposits comprised of \$3 thousand incremental deposits which yield an interest rate of 4.10%. With the exception of Certificate of Deposit Registry Service ("CDARS") time deposits, we have no other brokered deposits. As of September 30, 2017 we had no CDARS one way buys outstanding.

We are a member of an internet certificate of deposit network whereby we may purchase funds from other financial institutions at auction. We may invest funds through this network as well. Currently, we only intend to use this source of liquidity in a liquidity crisis event.

The Bank has access to additional liquidity through the Federal Reserve Bank discount window for overnight funding needs. We may collateralize this line with investment securities and loans at our discretion; however, we do not anticipate using this funding source except as a last resort.

With the on-balance sheet liquidity and other external sources of funding, we believe the Bank has adequate liquidity and capital resources to meet our requirements and needs for the foreseeable future. However, liquidity can be further affected by a number of factors such as counterparty willingness or ability to extend credit, regulatory actions and customer preferences, etc., some of which are beyond our control.

The bank holding company has \$291 thousand in cash on deposit at the Bank as of September 30, 2017. These funds will be used to pay operating expenses and trust preferred interest payments. The Company is making quarterly interest payments on the trust preferred securities.

During the capital raise in 2012, common stock warrants were issued to investors. The warrants are immediately exercisable through December 2017 at a price of \$1.75 per share. 2,175 warrants were exercised during the first nine months of 2017 and the number of warrants outstanding at September 30, 2017 was 879,803. During the month of October 2017, 528,102 warrants were exercised and the number of warrants outstanding at October 31, 2017 was 351,701. The exercised warrants in October 2017 increased cash at the holding company by \$924 thousand. If the remaining 351,701 warrants are exercised, additional funds will be received by the Company, which provides potentially up to an additional \$615 thousand in liquidity and capital to the holding company.

### **Off Balance Sheet Items and Contractual Obligations**

As discussed in Note 11, "Sale and Leaseback Transactions," in connection with the sale of the four properties referenced in the Note by the Bank to Good Steward, the Bank on May 31, 2017 entered into commercial lease agreements to lease back the properties (the "Leases") from Good Steward in order for the Bank to continue to service customers from these locations. The Leases, which commenced on June 1, 2017, provide the Bank with use of the properties for an initial term of fifteen (15) years. Base rent payments for years 1 through 5 of the Leases are approximately \$417 thousand a year. The base rent payments will increase by 8% for years 6 through 10 of the Leases and then by another 8% for years 11 through 15 of the Leases. The Bank has the option to renew the Leases five (5) times and each renewal would be for a term of five (5) years. The base rent for the renewals would be negotiated at the time the renewal option is exercised by the Bank. While the cash lease payments are currently \$417 thousand a year, the Company is required to straight-line the expense over the initial term of fifteen (15) years. As a result, the annual lease expense will be approximately \$451 thousand.

Other than the lease transactions discussed above, there have been no other material changes during the nine months ended September 30, 2017 to the off-balance sheet items and the contractual obligations disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2016.

Not Applicable.

Item 4.

Controls and Procedures

We have carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer (our “CEO”) and our Executive Vice President, Chief Operating Officer and Interim Chief Financial Officer (our “CFO”), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were operating effectively in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and (b) such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

There were no changes in the Company’s internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended September 30, 2017 that have materially affected or are reasonably likely to materially affect the Company’s internal control over financial reporting.

## Part II Other Information

### Item 1.

### Legal Proceedings

In the course of operations, we may become a party to legal proceedings.

There are no pending or threatened legal proceedings to which the Company or any of its subsidiaries is a party or to which the property of the Company or any of its subsidiaries is subject that, in the opinion of management, may materially impact the financial condition of the Company, except for the following:

On June 24, 2015 New Peoples Bank filed an Amended Complaint in the Circuit Court of Russell County, Virginia against Arthur Wayne Bostic, Michael W. Bostic, Sr. and Jeffrey C. Bostic to enforce guarantees of loans made to Bostic Ford Sales, Inc. and seeking judgment against the guarantors for \$1,427,709.76 with interest and legal fees. On July 24, 2015 Arthur Bostic filed a counterclaim against the Bank. On March 8, 2016 Michael Bostic, Sr., and Jeffrey Bostic filed their counterclaims against the Bank. The counterclaims assert lender liability theories of recovery and arise from the refusal of the Bank to continue to extend credit to Bostic Ford Sales, Inc. in 2008-2009. The defendants seek a judgment against the Bank of at least \$3 million. On December 16, 2016 the Court entered an Order sustaining New Peoples' demurrers to the counterclaims filed by all three defendants and providing the defendants an opportunity to amend their counterclaims. On December 23, 2016, the defendants filed amended counterclaims seeking a judgment against the Bank of at least \$3 million. Following the entry of the Court's Order on December 16, 2016, the parties began certain discussions to narrow the issues in dispute and facilitate settlement. Settlement discussions are still ongoing at the time of this filing.

In conjunction with the departure of Mr. Kenneth Hart, New Peoples former Chief Executive Officer, New Peoples entered into a separation agreement with him. Mr. Hart originally filed suit alleging various breaches by New Peoples related to this and earlier agreements between the parties, which was nonsuited in April 2016 for failure to serve. He then refiled the suit on October 7, 2016 providing him another 12 months to have the New Peoples served. On October 3, 2017, New Peoples was served with the current complaint for breach of contract which is substantially the same as his original suit. Mr. Hart is asking the court for an award of \$1.5 million plus interest, alleging a breach by New Peoples of these various agreements with Mr. Hart.

New Peoples filed a "demurrer" to the complaint, asking that the suit be dismissed, on October 23, 2017. New Peoples believes that there is no merit to this suit or these claims, which are based on conduct that occurred in 2010, and that the suit is a reaction to a judgment of over a million dollars awarded in favor of New Peoples and against Mr. Hart in a separate matter. The Court has not yet ruled on this motion to dismiss. Should this suit not be dismissed New Peoples intends to defend the matter vigorously to its conclusion and does not believe Mr. Hart's claims will be successful.

### Item 1A.

### Risk Factors

Not Applicable.

### Item 2.

### Unregistered Sales of Equity Securities and Use of Proceeds

Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

Item 6. Exhibits

See Index of Exhibits.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**NEW PEOPLES BANKSHARES, INC.  
(Registrant)**

By: /s/ C. TODD ASBURY  
C. Todd Asbury  
President and Chief Executive Officer

Date: November 14, 2017

By: /s/ FRANK SEXTON, JR.  
Frank Sexton, Jr.  
Executive Vice President, Chief Operating Officer  
and Interim Chief Financial Officer

Date: November 14, 2017

Index of Exhibits

| <u>No.</u> | <u>Description</u>   |
|------------|--|
| 2.1        | Agreement and Plan of Share Exchange dated August 15, 2011 (incorporated by reference to Exhibit 2 to Form 8-K filed December 17, 2011).   |
| 3.1        | Amended Articles of Incorporation of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q for the quarterly period ended June 30, 2008 filed on August 11, 2008).   |
| 3.2        | Bylaws of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K filed on April 15, 2004).   |
| 4.1        | Specimen Common Stock Certificate of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 4.1 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).   |
| 4.2        | Form of Warrant to Purchase Shares of Common Stock (incorporated by reference to Exhibit 4.2 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).  |
| 4.3        | Form of Rights Certificate (incorporated by reference to Exhibit 4.3 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).  |
| 10.1*      | New Peoples Bank, Inc. 2001 Stock Option Plan (incorporated by reference to Exhibit 10.1 to Annual Report on Form 10-KSB for the fiscal year ended December 31, 2001).   |
| 10.2*      | Form of Non-Employee Director Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 8-K filed November 30, 2004).  |
| 10.3*      | Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Form 8-K filed November 30, 2004).  |
| 10.4*      | Salary Continuation Agreement dated December 18, 2002 between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.6 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).  |
| 10.5*      | First Amendment dated June 30, 2003 to Salary Continuation Agreement between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.7 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).   |
| 10.6*      | Letter Agreement, dated as of June 29, 2009, between the Company and Kenneth D. Hart (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2009).   |
| 10.7       | Written Agreement, effective August 4, 2010, by and among New Peoples Bankshares, Inc., New Peoples Bank, Inc., the Federal Reserve Bank of Richmond and the State Corporation Commission Bureau of Financial Institutions (incorporated by reference to Exhibit 10.1 to Form 8-K filed August 6, 2010). |
| 10.8       | Engagement Letters of Scott & Stringfellow, LLC (incorporated by reference to Exhibit 10.8 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).  |
| 10.9       | Convertible Note Payable, B. Scott White, dated June 27, 2012 (incorporated by reference to Exhibit 10.1 to Form 8-K filed June 29, 2012).   |
| 10.10      | Convertible Note Payable, Harold Lynn Keene, dated June 27, 2012 (incorporated by reference to Exhibit 10.2 to Form 8-K filed June 29, 2012).  |
| 10.11*     | Employment Agreement dated December 1, 2016 between New Peoples Bankshares, Inc., New Peoples Bank, Inc., and C. Todd Asbury (incorporated by reference to Exhibit 10.1 to Form 8-K filed December 2, 2016).   |

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- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.
- 31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.
- 32 Certification by Chief Executive Officer and Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.

The following materials for the Company's 10-Q Report for the quarterly period ended September 30, 2017, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the

- 101 Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to the Consolidated Financial Statements, tagged as blocks of text.

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\* Denotes management contract.