

NEW PEOPLES BANKSHARES INC
Form 10-Q
November 14, 2016

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, 2016

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)

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 11, 2016
Common Stock, \$2.00 par value	23,354,257

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, 2016 AND 2015**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

INTEREST AND DIVIDEND INCOME	2016	2015
Loans including fees	\$16,910	\$17,595
Federal funds sold	—	2
Interest-earning deposits with banks	67	73
Investments	1,161	1,306
Dividends on equity securities (restricted)	99	98
Total Interest and Dividend Income	18,237	19,074
INTEREST EXPENSE		
Deposits		
Demand	37	28
Savings	122	129
Time deposits below \$100,000	808	1,062
Time deposits above \$100,000	480	735
FHLB advances	109	113
Federal funds purchased	2	—
Trust preferred securities	373	328
Total Interest Expense	1,931	2,395
NET INTEREST INCOME	16,306	16,679
PROVISION FOR LOAN LOSSES	(500)	(1,200)
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	16,806	17,879
NONINTEREST INCOME		
Service charges	1,926	1,667
Fees, commissions and other income	2,694	2,333
Insurance and investment fees	404	411
Net realized gains on sale of investment securities	240	35
Life insurance investment income	118	316
Total Noninterest Income	5,382	4,762

NONINTEREST EXPENSES

Salaries and employee benefits	9,954	8,816
Occupancy and equipment expense	3,042	2,767
Advertising and public relations	332	240
Data processing and telecommunications	1,726	1,552
FDIC insurance premiums	407	652
Other real estate owned and repossessed vehicles, net	599	1,398
Other operating expenses	4,208	3,822
Total Noninterest Expenses	20,268	19,247

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INCOME BEFORE INCOME TAXES	1,920	3,394
INCOME TAX EXPENSE (BENEFIT)	(6) 17
NET INCOME	\$1,926	\$3,377
Income Per Share		
Basic	\$0.08	\$0.15
Fully Diluted	\$0.08	\$0.15
Average Weighted Shares of Common Stock		
Basic	23,354,092	22,878,654
Fully Diluted	23,354,092	22,878,654

The accompanying notes are an integral part of this statement.

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

(UNAUDITED)

INTEREST AND DIVIDEND INCOME	2016	2015
Loans including fees	\$5,732	\$5,889
Federal funds sold	—	—
Interest-earning deposits with banks	23	18
Investments	334	457
Dividends on equity securities (restricted)	35	32
Total Interest and Dividend Income	6,124	6,396
INTEREST EXPENSE		
Deposits		
Demand	13	10
Savings	44	44
Time deposits below \$100,000	273	315
Time deposits above \$100,000	168	213
FHLB Advances	45	35
Federal funds purchased	—	—
Trust Preferred Securities	128	111
Total Interest Expense	671	728
NET INTEREST INCOME	5,453	5,668
PROVISION FOR LOAN LOSSES	—	(1,200)
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,453	6,868
NONINTEREST INCOME		
Service charges	854	579
Fees, commissions and other income	1,031	796
Insurance and investment fees	103	155
Net realized gains on sale of investment securities	—	—
Life insurance investment income	55	247
Total Noninterest Income	2,043	1,777
NONINTEREST EXPENSES		

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Salaries and employee benefits	3,405	2,992
Occupancy and equipment expense	1,121	905
Advertising and public relations	99	111
Data processing and telecommunications	569	550
FDIC insurance premiums	137	213
Other real estate owned and repossessed vehicles, net	347	332
Other operating expenses	1,477	1,235
Total Noninterest Expenses	7,155	6,338

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INCOME BEFORE INCOME TAXES	341	2,307
INCOME TAX EXPENSE (BENEFIT)	(5) 14
NET INCOME	\$346	\$2,293
Income Per Share		
Basic	\$0.01	\$0.10
Fully Diluted	\$0.01	\$0.10
Weighted Average Shares of Common Stock		
Basic	23,354,111	22,878,654
Fully Diluted	23,354,111	22,878,654

The accompanying notes are an integral part of this statement.

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015**

(IN THOUSANDS)

(UNAUDITED)

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
NET INCOME	\$346	\$2,293	\$1,926	\$3,377
Other comprehensive income (loss):				
Investment Securities Activity				
Unrealized gains (losses) arising during the period	(70)	576	1,409	309
Tax related to unrealized gains (losses)	24	(196)	(479)	(105)
Reclassification of realized gains during the period	—	—	(240)	(35)
Tax related to realized gains	—	—	82	12
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	(46)	380	772	181
TOTAL COMPREHENSIVE INCOME	\$300	\$2,673	\$2,698	\$3,558

The accompanying notes are an integral part of this statement.

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

(IN THOUSANDS EXCEPT PER SHARE AND SHARE DATA)

ASSETS	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
Cash and due from banks	\$ 16,625	\$ 15,087
Interest-bearing deposits with banks	15,776	11,251
Federal funds sold	36	—
Total Cash and Cash Equivalents	32,437	26,338
Investment securities available-for-sale	74,561	101,642
Loans receivable	464,721	441,169
Allowance for loan losses	(6,358)	(7,493)
Net Loans	458,363	433,676
Bank premises and equipment, net	30,259	28,148
Equity securities (restricted)	2,613	2,441
Other real estate owned	13,194	12,398
Accrued interest receivable	1,924	1,816
Life insurance investments	12,223	12,105
Deferred taxes, net	4,819	5,121
Other assets	3,474	2,213
Total Assets	\$ 633,867	\$ 625,898
LIABILITIES		
Deposits:		
Demand deposits:		
Noninterest bearing	\$ 152,930	\$ 149,714
Interest-bearing	40,623	30,251
Savings deposits	115,007	121,076
Time deposits	247,956	256,978
Total Deposits	556,516	558,019
Federal Home Loan Bank advances	9,058	2,958
Accrued interest payable	294	288
Accrued expenses and other liabilities	2,718	2,050
Trust preferred securities	16,496	16,496
Total Liabilities	585,082	579,811

Commitments and contingencies — —

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STOCKHOLDERS' EQUITY

Common stock - \$2.00 par value; 50,000,000 shares authorized; 23,354,257 and 23,354,082 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	46,708	46,708
Common stock warrants	764	764
Additional paid-in-capital	13,965	13,965
Retained deficit	(13,097)	(15,023)
Accumulated other comprehensive income (loss)	445	(327)
Total Stockholders' Equity	48,785	46,087
Total Liabilities and Stockholders' Equity	\$633,867	\$625,898

The accompanying notes are an integral part of this statement.

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015**

(IN THOUSANDS INCLUDING SHARE DATA)

(UNAUDITED)

	Shares of Common Stock	Common Stock	Common Stock Warrants	Additional Paid-in- Capital	Retained Deficit	Accum-ulated Other Compre-hensive Income (Loss)	Total Stockholders' Equity
Balance, December 31, 2014	22,878	\$45,757	\$ 1,176	\$ 13,672	\$ (17,685)	\$ (69)	\$ 42,851
Net income	—	—	—	—	3,377	—	3,377
Other comprehensive loss, net of tax	—	—	—	—	—	181	181
Balance, September 30, 2015	22,878	\$45,757	\$ 1,176	\$ 13,672	\$ (14,308)	\$ 112	\$ 46,409
Balance, December 31, 2015	23,354	\$46,708	\$ 764	\$ 13,965	\$ (15,023)	\$ (327)	\$ 46,087
Net income	—	—	—	—	1,926	—	1,926
Other comprehensive income, net of tax	—	—	—	—	—	772	772
Balance, September 30, 2016*	23,354	\$46,708	\$ 764	\$ 13,965	\$ (13,097)	\$ 445	\$ 48,785

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

NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015**

(IN THOUSANDS)

(UNAUDITED)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,926	\$ 3,377
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,815	1,571
Provision for loan losses	(500)	(1,200)
Income on life insurance	(118)	(316)
Gain on sale of securities available-for-sale	(240)	(35)
Gain on sale of premises and equipment	(67)	(67)
Gain on sale of foreclosed assets	(290)	(10)
Net write-down of carrying value of foreclosed real estate	165	784
Accretion of bond premiums/discounts	711	867
Deferred tax benefit	(95)	—
Net change in:		
Interest receivable	(108)	140
Other assets	(1,261)	110
Accrued interest payable	6	35
Accrued expenses and other liabilities	668	550
Net Cash Provided by Operating Activities	2,612	5,806
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase) decrease in loans	(27,362)	15,686
Purchase of securities available-for-sale	(9,708)	(25,202)
Proceeds from sales and maturities of securities available-for-sale	37,487	22,330
Net Purchase of equity securities (restricted)	(172)	(72)
Payments for the purchase of premises and equipment	(4,469)	(1,325)
Payments for the purchase of other real estate owned	—	(5)
Payments for premiums on life insurance investments	—	(65)
Proceeds from life insurance investment	—	1,793
Proceeds from sales of premises and equipment	735	181
Proceeds from insurance on other real estate owned	—	57
Proceeds from sales of other real estate owned	2,379	1,084
Net Cash Provided by (Used in) Investing Activities	(1,110)	14,462

CASH FLOWS FROM FINANCING ACTIVITIES

Net increase (decrease) in Federal Home Loan Bank advances	6,100	(900)
Net change in:		
Demand deposits	13,588	2,064
Savings deposits	(6,069)	11,129
Time deposits	(9,022)	(33,762)
Net Cash Provided by (Used in) Financing Activities	4,597	(21,469)

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Net increase (decrease) in cash and cash equivalents	6,099	(1,201)
Cash and Cash Equivalents, Beginning of Period	26,338	35,560
Cash and Cash Equivalents, End of Period	\$32,437	\$34,359

Supplemental Disclosure of Cash Paid During the Period for:

Interest	\$1,925	\$2,360
Taxes	\$95	\$—

Supplemental Disclosure of Non Cash Transactions:

Other real estate acquired in settlement of foreclosed loans	\$3,851	\$2,249
Loans made to finance sale of foreclosed real estate	\$676	\$193
Transfer of other real estate to premises and equipment	\$125	\$—
Change in unrealized gains on securities available-for-sale	\$1,169	\$274

The accompanying notes are an integral part of this statement.

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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 by press release it is teaming up 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 will be serviced by CSE and the Bank will refer future insurance needs of its bank customers to CSE.

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, 2016 and December 31, 2015, and the results of operations for the three and nine month periods ended September 30, 2016 and 2015. 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, 2015. The results of operations for the three and nine month periods ended September 30, 2016 and 2015 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 FORMAL WRITTEN AGREEMENT:

The Company and the Bank had previously entered into the Written Agreement with the Federal Reserve Bank of Richmond and the Virginia State Corporation Commission Bureau of Financial Institutions under which the Company and the Bank were required to take certain actions and implement certain plans. On February 2, 2016, the Company and the Bank announced that they had successfully complied with all of the requirements of the Written Agreement and accordingly, effective January 20, 2016, the agreement had been terminated.

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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, 2016, 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 continues to be subject to various capital requirements administered by banking agencies. The Bank's actual capital amounts and ratios are presented in the following table as of September 30, 2016 and December 31, 2015, 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, 2016:						
Total Capital to Risk Weighted Assets:						
New Peoples Bank, Inc.	68,259	16.98 %	\$32,168	8.0 %	40,209	10.0 %
Tier 1 Capital to Risk Weighted Assets:						
New Peoples Bank, Inc.	63,216	15.72 %	24,126	6.0 %	32,168	8.0 %
Tier 1 Capital to Average Assets:						

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New Peoples Bank, Inc. Common Equity Tier 1 Capital to Risk Weighted Assets:	63,216	10.00 %	25,287	4.0 %	31,609	5.0 %
New Peoples Bank, Inc.	63,216	15.72 %	18,094	4.5 %	26,136	6.5 %
December 31, 2015:						
Total Capital to Risk Weighted Assets:						
New Peoples Bank, Inc.	65,713	17.55 %	\$29,954	8.0 %	37,443	10.0 %
Tier 1 Capital to Risk Weighted Assets:						
New Peoples Bank, Inc.	60,998	16.29 %	22,466	6.0 %	29,954	8.0 %
Tier 1 Capital to Average Assets:						
New Peoples Bank, Inc.	60,998	9.67 %	25,239	4.0 %	31,549	5.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets:						
New Peoples Bank, Inc.	60,998	16.29 %	16,849	4.5 %	24,338	6.5 %

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As of September 30, 2016, 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.

Beginning January 1, 2016, a capital conservation buffer of 0.625% became effective. The capital conservation buffer will be gradually increased through January 1, 2019 to 2.5%. 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
September 30, 2016				
U.S. Government Agencies	\$26,995	\$314	\$51	\$27,258
Taxable municipals	2,401	73	-	2,474
Corporate bonds	3,100	186	-	3,286
Mortgage backed securities	41,392	239	88	41,543
Total Securities AFS	\$73,888	\$812	\$139	\$74,561
December 31, 2015				
U.S. Government Agencies	\$41,488	\$244	\$209	\$41,523
Taxable municipals	3,337	5	61	3,281
Corporate bonds	1,944	15	20	1,939
Mortgage backed securities	55,369	41	511	54,899
Total Securities AFS	\$102,138	\$305	\$801	\$101,642

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, 2016 and December 31, 2015.

Less than 12 Months 12 Months or More Total

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(Dollars are in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2016						
U.S. Government Agencies	\$3,724	\$ 42	\$1,794	\$ 9	\$5,518	\$ 51
Mtg. backed securities	7,915	45	4,938	43	12,853	88
Total Securities AFS	\$11,639	\$ 87	\$6,732	\$ 52	\$18,371	\$ 139
December 31, 2015						
U.S. Government Agencies	\$14,995	\$ 81	\$7,708	\$ 128	\$22,073	\$ 209
Taxable municipals	2,136	57	278	4	2,414	61
Corporate bonds	923	20	—	—	923	20
Mtg. backed securities	38,945	354	8,719	157	47,664	511
Total Securities AFS	\$56,999	\$ 512	\$16,705	\$ 289	\$73,074	\$ 801

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At September 30, 2016, the available-for-sale portfolio included forty two investments for which the fair market value was less than amortized cost. At December 31, 2015, the available-for-sale portfolio included one hundred and thirty four 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, or 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 \$11.8 million and \$15.4 million at September 30, 2016 and December 31, 2015, 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 \$24.8 million and \$7.1 million, respectively, for the nine months ended September 30, 2016 and 2015. Gross realized gains and losses pertaining to the sale of investment securities available for sale are detailed as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
(Dollars are in thousands)	2016	2015	2016	2015
Gross gains realized	\$ —	\$ —	\$275	\$62
Gross losses realized	—	—	(35)	(27)
Net realized gains	\$ —	\$ —	\$240	\$35

The amortized cost and fair value of investment securities at September 30, 2016, 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
Due in one year or less	\$1,221	\$1,225	0.91%
Due after one year through five years	656	657	1.84%
Due after five years through ten years	12,836	13,107	2.50%
Due after ten years	59,175	59,572	1.80%
Total	\$73,888	\$74,561	1.91%

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 \$2.4 million as of September 30, 2016 and December 31, 2015, respectively.

NOTE 6 LOANS:

Loans receivable outstanding are summarized as follows:

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(Dollars are in thousands)	September 30, 2016	December 31, 2015
Real estate secured:		
Commercial	\$ 102,997	\$ 98,569
Construction and land development	22,749	14,672
Residential 1-4 family	248,042	242,916
Multifamily	13,205	12,954
Farmland	23,828	22,174
Total real estate loans	410,821	391,285
Commercial	26,246	21,469
Agriculture	4,459	3,793
Consumer installment loans	23,177	24,568
All other loans	18	54
Total loans	\$ 464,721	\$ 441,169

Loans receivable on nonaccrual status are summarized as follows:

(Dollars are in thousands)	September 30, 2016	December 31, 2015
Real estate secured:		
Commercial	\$ 3,671	\$ 4,358
Construction and land development	354	436
Residential 1-4 family	8,145	8,338
Multifamily	169	430
Farmland	930	1,170
Total real estate loans	13,269	14,732
Commercial	3	65
Agriculture	83	9
Consumer installment loans	93	41
All other loans	—	—
Total loans receivable on nonaccrual status	\$ 13,448	\$ 14,847

Total interest income not recognized on nonaccrual loans for the nine months ended September 30, 2016 and 2015 was \$397 thousand and \$486 thousand, respectively.

The following table presents information concerning the Company's investment in loans considered impaired as of September 30, 2016 and December 31, 2015:

As of September 30, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars are in thousands)			
With no related allowance recorded:			
Real estate secured:			
Commercial	3,533	\$3,959	\$—
Construction and land development	7	7	—
Residential 1-4 family	3,590	3,888	—
Multifamily	305	346	—
Farmland	4,358	5,050	—
Commercial	—	—	—
Agriculture	19	19	—
Consumer installment loans	—	—	—
All other loans	—	—	—
With an allowance recorded:			
Real estate secured:			
Commercial	1,589	1,680	172
Construction and land development	253	477	119
Residential 1-4 family	644	652	88
Multifamily	—	—	—
Farmland	502	512	293
Commercial	67	67	19
Agriculture	8	8	8
Consumer installment loans	53	53	20
All other loans	—	—	—
Total	14,928	\$16,718	\$719

As of December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars are in thousands)			
With no related allowance recorded:			
Real estate secured:			
Commercial	4,212	\$5,173	\$—
Construction and land development	10	10	—
Residential 1-4 family	3,037	3,150	—
Multifamily	430	471	—
Farmland	3,983	4,620	—
Commercial	—	—	—
Agriculture	36	36	—
Consumer installment loans	11	11	—
All other loans	—	—	—

With an allowance recorded:

Real estate secured:

Commercial	2,503	2,849	288
Construction and land development	289	499	155
Residential 1-4 family	1,920	2,121	168
Multifamily	—	—	—
Farmland	761	778	328
Commercial	69	69	24
Agriculture	18	18	18
Consumer installment loans	45	45	2
All other loans	—	—	—
Total	17,324	\$19,850	\$983

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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, 2015	
	Average Interest Recorded Income	InvestmenRecognized	Average Interest Recorded Income	InvestmenRecognized
(Dollars are in thousands)				
With no related allowance recorded:				
Real estate secured:				
Commercial	\$4,222	\$ 77	\$4,615	\$ 102
Construction and land development	89	—	13	1
Residential 1-4 family	3,716	140	3,623	140
Multifamily	288	14	543	5
Farmland	4,211	163	5,346	94
Commercial	—	—	333	—
Agriculture	29	2	44	3
Consumer installment loans	24	—	36	4
All other loans	—	—	—	—
With an allowance recorded:				
Real estate secured:				
Commercial	1,539	6	3,043	58
Construction and land development	271	—	394	—
Residential 1-4 family	939	18	2,294	84
Multifamily	100	—	28	—
Farmland	572	18	942	28
Commercial	71	2	83	3
Agriculture	107	1	26	1
Consumer installment loans	30	1	13	—
All other loans	—	—	—	—
Total	\$16,208	\$ 442	\$21,376	\$ 523

	Three Months Ended			
	September 30, 2016		September 30, 2015	
	Average	Interest	Average	Interest
	Recorded	Recognized	Recorded	Recognized
	Investmen	Investmen	Investmen	Investmen
(Dollars are in thousands)				
With no related allowance recorded:				
Real estate secured:				
Commercial	\$3,965	\$ 4	\$4,916	\$ 43
Construction and land development	7	—	12	1
Residential 1-4 family	3,833	37	3,674	47
Multifamily	307	3	434	3
Farmland	4,274	61	4,963	42
Commercial	—	—	105	(2)
Agriculture	23	—	36	—
Consumer installment loans	22	(2)	59	1
All other loans	—	—	—	—
With an allowance recorded:				
Real estate secured:				
Commercial	1,309	6	2,411	18
Construction and land development	259	—	407	—
Residential 1-4 family	606	7	2,162	31
Multifamily	83	(4)	—	—
Farmland	504	6	781	9
Commercial	68	—	82	1
Agriculture	97	3	23	—
Consumer installment loans	32	1	—	—
All other loans	—	—	—	—
Total	\$15,389	\$ 122	\$20,065	\$ 194

An age analysis of past due loans receivable was as follows:

Loans	Loans	Loans	Total	Current	Total	Accruing
30-59	60-89	90 or	Past	Loans	Loans	Loans
Days	Days	More	Due			90 or
Past	Past	Days	Loans			More
Due	Due	Past				Days
		Due				Past
						Due

As of September 30, 2016

(Dollars are in thousands)

Real estate secured:

Commercial	\$747	\$305	\$1,819	\$2,871	\$100,126	\$102,997	\$ —
Construction and land development	100	—	64	164	22,585	22,749	—
Residential 1-4 family	4,099	1,312	1,669	7,080	240,962	248,042	—
Multifamily	1,720	—	67	1,787	11,418	13,205	—
Farmland	82	—	—	82	23,746	23,828	—
Total real estate loans	6,748	1,617	3,619	11,984	398,837	410,821	—
Commercial	—	—	—	—	26,246	26,246	—
Agriculture	15	—	79	94	4,365	4,459	—
Consumer installment Loans	91	—	68	159	23,018	23,177	—
All other loans	—	—	—	—	18	18	—
Total loans	\$6,854	\$1,617	\$3,766	\$12,237	\$452,484	\$464,721	\$ —

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	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
As of December 31, 2015							
(Dollars are in thousands)							
Real estate secured:							
Commercial	\$311	\$105	\$2,534	\$2,950	\$95,619	\$98,569	\$ —
Construction and land development	144	—	17	161	14,511	14,672	—
Residential 1-4 family	4,694	1,487	2,891	9,072	233,844	242,916	—
Multifamily	47	—	320	367	12,587	12,954	—
Farmland	363	—	251	614	21,560	22,174	—
Total real estate loans	5,559	1,592	6,013	13,164	378,121	391,285	—
Commercial	18	1	64	83	21,386	21,469	—
Agriculture	—	—	—	—	3,793	3,793	—
Consumer installment Loans	113	1	27	141	24,427	24,568	—
All other loans	6	—	—	6	48	54	—
Total loans	\$5,696	\$1,594	\$6,104	\$13,394	\$427,775	\$441,169	\$ —

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.

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

As of September 30, 2016	Pass	Special Mention	Substandard	Doubtful	Total
(Dollars are in thousands)					
Real estate secured:					
Commercial	\$91,708	\$7,165	\$4,124	\$—	\$102,997
Construction and land development	20,885	1,539	325	—	22,749
Residential 1-4 family	237,338	2,054	8,650	—	248,042
Multifamily	12,831	—	374	—	13,205
Farmland	17,847	3,531	2,450	—	23,828
Total real estate loans	380,609	14,289	15,923	—	410,821
Commercial	25,483	696	67	—	26,246
Agriculture	4,368	—	91	—	4,459
Consumer installment loans	23,016	—	161	—	23,177
All other loans	18	—	—	—	18
Total	\$433,494	\$14,985	\$16,242	\$—	\$464,721

As of December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
(Dollars are in thousands)					
Real estate secured:					
Commercial	\$85,255	\$7,543	\$5,771	\$—	\$98,569
Construction and land development	12,262	1,974	436	—	14,672
Residential 1-4 family	229,182	3,572	10,162	—	242,916
Multifamily	12,264	187	503	—	12,954
Farmland	16,663	2,923	2,588	—	22,174
Total real estate loans	355,626	16,199	19,460	—	391,285
Commercial	20,641	724	104	—	21,469
Agriculture	3,767	—	26	—	3,793
Consumer installment loans	24,478	—	90	—	24,568
All other loans	54	—	—	—	54
Total	\$404,566	\$16,923	19,680	\$—	\$441,169

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, 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 September 30, 2016	Beginning Balance	Charge Offs	Recoveries	Advances	Provisions	Ending Balance
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(Dollars are in thousands)

Real estate secured:

Commercial	\$ 2,384	\$(417)	\$ 217	\$ —	\$(238)	\$ 1,946
Construction and land development	332	(5)	24	—	(5)	346
Residential 1-4 family	2,437	(601)	78	—	329	2,243
Multifamily	232	(18)	—	—	19	233
Farmland	675	(2)	102	—	(144)	631
Total real estate loans	6,060	(1,043)	421	—	(39)	5,399
Commercial	266	(65)	52	—	(46)	207
Agriculture	124	—	6	—	(87)	43
Consumer installment loans	128	(22)	16	—	9	131
All other loans	1	—	—	—	(1)	—
Unallocated	914	—	—	—	(336)	578
Total	\$ 7,493	\$(1,130)	\$ 495	\$ —	\$(500)	\$ 6,358

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As of September 30, 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	\$172	\$1,774	\$1,946	\$5,122	\$97,875	\$102,997
Construction and land development	119	227	346	260	22,489	22,749
Residential 1-4 family	88	2,155	2,243	4,234	243,808	248,042
Multifamily	-	233	233	305	12,900	13,205
Farmland	293	338	631	4,860	18,968	23,828
Total real estate loans	672	4,727	5,399	14,781	396,040	410,821
Commercial	19	188	207	67	26,179	26,246
Agriculture	8	35	43	27	4,432	4,459
Consumer installment loans	20	111	131	53	23,124	23,177
All other loans	-	-	-	-	18	18
Unallocated	-	578	578	-	-	-
Total	\$719	\$5,639	\$6,358	\$14,928	\$449,793	\$464,721

The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2015. 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, 2015	Beginning Balance	Charge Offs	Recoveries	Advances	Provisions	Ending Balance
(Dollars are in thousands)						
Real estate secured:						
Commercial	\$ 4,418	\$(724)	\$ 147	\$ —	\$(1,457)	\$ 2,384
Construction and land development	199	(226)	215	—	144	332
Residential 1-4 family	2,572	(743)	93	—	515	2,437
Multifamily	154	(384)	6	—	456	232

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Farmland	913	(90)	214	—	(362)	675
Total real estate loans	8,256	(2,167)	675	—	(704)	6,060
Commercial	457	(92)	1,412	—	(1,511)	266
Agriculture	125	—	3	—	(4)	124
Consumer installment loans	171	(101)	41	—	17	128
All other loans	1	—	—	—	—	1
Unallocated	912	—	—	—	2	914
Total	\$ 9,922	\$(2,360)	\$ 2,131	\$ —	\$(2,200)	\$ 7,493

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As of December 31, 2015	Allowance for Loan Losses		Recorded Investment in Loans			
	Evaluated for Impairment	Collectively Evaluated for Impairment	Individually		Collectively	
			Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Total
(Dollars are in thousands)						
Real estate secured:						
Commercial	\$288	\$2,096	\$2,384	\$6,715	\$91,854	\$98,569
Construction and land	155	177	332	299	14,373	14,672
development						
Residential 1-4 family	168	2,269	2,437	4,957	237,959	242,916
Multifamily	-	232	232	430	12,524	12,954
Farmland	328	347	675	4,744	17,430	22,174
Total real estate loans	939	5,121	6,060	17,145	374,140	391,285
Commercial	24	242	266	69	21,400	21,469
Agriculture	18	106	124	54	3,739	3,793
Consumer installment loans	2	126	128	56	24,512	24,568
All other loans	-	1	1	-	54	54
Unallocated	-	914	914	-	-	-
Total	\$983	\$6,510	7,493	\$17,324	\$423,845	\$441,169

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, 2016 there were \$9.4 million in loans that are classified as troubled debt restructurings compared to \$9.5 million at December 31, 2015. The following table presents information related to loans modified as troubled debt restructurings during the nine and three months ended September 30, 2016 and 2015.

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Troubled Debt Restructurings (Dollars are in thousands)	For the nine months ended September 30, 2016			For the nine months ended September 30, 2015		
	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment
Real estate secured:						
Commercial	1	\$341	\$341	—	\$—	\$—
Construction and land Development	—	—	—	1	551	302
Residential 1-4 family	—	—	—	2	225	224
Multifamily	—	—	—	—	—	—
Farmland	1	291	280	—	—	—
Total real estate loans	2	632	621	3	776	526
Commercial Agriculture	—	—	—	—	—	—
Consumer installment loans	—	—	—	—	—	—
All other loans	—	—	—	—	—	—
Total	2	\$632	\$621	3	\$776	\$526

Troubled Debt Restructurings (Dollars are in thousands)	For the three months ended September 30, 2016			For the three months ended September 30, 2015		
	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment
Real estate secured:						
Commercial	—	\$—	\$—	—	\$—	\$—
Construction and land Development	—	—	—	—	—	—
Residential 1-4 family	—	—	—	2	225	224
Multifamily	—	—	—	—	—	—
Farmland	—	—	—	—	—	—
Total real estate loans	—	—	—	2	225	224

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Commercial	—	—	—	—	—	—
Agriculture	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
installment loans	—	—	—	—	—	—
All other loans	—	—	—	—	—	—
Total	—	\$—	\$—	2	\$225	\$224

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 nine months ended September 30, 2015, the Company modified the terms of three loans for which the modification was considered to be a troubled debt restructuring. On two of the loans we modified the terms and lowered the interest rate. On one loan the interest rate was not modified; however, the maturity date was extended.

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During the three months ended September 30, 2016, the Company modified no loans that were considered to be a troubled debt restructuring. During the three months ended September 30, 2015, the Company modified the terms of two loans for which the modification was considered to be a troubled debt restructuring. On the two loans we modified the terms and lowered the interest rate.

One commercial real estate loan with a recorded investment of \$302 thousand that had been modified as a troubled debt restructuring defaulted during the nine months ended September 30, 2016, which was within twelve months of the loan's modification date. No loans modified as troubled debt restructurings defaulted during the nine months ended September 30, 2015. No loans modified as troubled debt restructurings defaulted during the three months ended September 30, 2016 and 2015, 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, 2016 and the year ended December 31, 2015:

(Dollars are in thousands)	September 30, 2016	December 31, 2015
Balance, beginning of period	\$ 12,398	\$ 15,049
Additions	3,851	3,277
Purchases of other real estate owned	—	12
Transfers of other real estate owned	(125)	—
Donation of other real estate owned	—	(33)
Proceeds from sales	(2,379)	(1,831)
Loans made to finance sales	(676)	(878)
Proceeds from insurance claims	—	(101)
Adjustment of carrying value	(165)	(3,246)
Deferred gain from sales	—	50
Gain from sales	290	99
Balance, end of period	\$ 13,194	\$ 12,398

NOTE 10 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 relate to outstanding options and common stock warrants are determined by the Treasury method. For the three and nine months ended September 30, 2016 and 2015, potential common shares of 882,178 and 1,539,877, respectively, were anti-dilutive and were not included in the calculation. Basic and diluted net income per common share calculations follows:

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(Amounts in Thousands, Except Share and Per Share Data)	For the three months ended September 30,		For the nine months ended September 30,	
	2016	2015	2016	2015
Net income	\$346	\$2,293	\$1,926	\$3,377
Weighted average shares outstanding	23,354,111	22,878,654	23,354,092	22,878,654
Dilutive shares for stock options and warrants	—	—	—	—
Weighted average dilutive shares outstanding	23,354,111	22,878,654	23,354,092	22,878,654
Basic income per share	\$0.01	\$0.10	\$0.08	\$0.15
Diluted income per share	\$0.01	\$0.10	\$0.08	\$0.15

NOTE 11 TRUST PREFERRED SECURITIES AND DEFERRAL OF INTEREST PAYMENTS:

On July 7, 2004, the Company completed the issuance of \$11.3 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust I. The proceeds of the funds were used for general corporate purposes which included capital management for affiliates, retirement of indebtedness and other investments. The securities have a floating rate of 3 month LIBOR plus 260 basis points, which resets quarterly, with a current rate at September 30, 2016 of 3.28%.

On September 27, 2006, the Company completed the issuance of \$5.2 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust 2. The proceeds of the funds were used for general corporate purposes, which include capital management for affiliates and the acquisition of two branch banks. The securities have a floating rate of 3 month LIBOR plus 177 basis points, which resets quarterly, with a current rate at September 30, 2016 of 2.45%.

Under the terms of the subordinated debt transactions, the securities mature in 30 years from the date of issuance and are redeemable, in whole or in part, without penalty, at the option of the Company after five years. Due to the ability to defer interest and principal payments for 60 months without being considered in default, the regulatory agencies consider the trust preferred securities as Tier 1 capital up to certain limits.

In October 2009, a restriction to pay dividends from the Bank to the Company was issued by the Federal Reserve Bank of Richmond. In July 2010, the Company and the Bank entered into the Written Agreement discussed in Note 3. The Written Agreement prohibited the payment of interest on the trust preferred securities without prior regulatory approval. As a result, interest on trust preferred securities was deferred. This deferral was for a period of 60 months, and was set to expire on January 7, 2015. In the fourth quarter of 2014, the Company requested and received regulatory approval to pay the cumulative deferred interest on the trust preferred securities due on January 7, 2015 totaling \$2.5 million, which the Company paid on December 10, 2014. As a result of this payment there has been no interest in arrears on the trust preferred securities since that date.

The Company is currently not deferring the quarterly interest payments on the trust preferred securities. However, as discussed above, regulatory approval was needed to pay the interest while the Company was under the formal Written Agreement. In March 2015 the Company requested and received regulatory approval to pay the \$107 thousand in interest on the trust preferred securities due on April 7, 2015, which the Company paid on April 3, 2015. In June 2015 the Company requested and received regulatory approval to pay the \$109 thousand in interest on the trust preferred securities due on July 7, 2015, which the Company paid on July 2, 2015. In September 2015 the Company requested and received regulatory approval to pay the \$111 thousand in interest on the trust preferred securities due on October 7, 2015, which the Company paid on October 5, 2015. In December 2015 the Company requested and received regulatory approval to pay the \$112 thousand in interest on the trust preferred securities due on January 7, 2016, which the Company paid on January 5, 2016.

The restriction requiring regulatory approval before the payment of interest on the trust preferred securities was lifted when the Written Agreement was terminated effective January 20, 2016. On April 4, 2016, the Company paid \$124 thousand in interest on the trust preferred securities, which was due on April 7, 2016. On July 6, 2016 the Company paid \$124 thousand in interest on the trust preferred securities, which was due on July 7, 2016. On October 4, 2016 the Company paid \$127 thousand in interest on the trust preferred securities, which was due on October 7, 2016.

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NOTE 12 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 establish 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 \$74.6 million and \$101.6 million at September 30, 2016 and December 31, 2015, 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 \$14.2 million and \$16.3 million at September 30, 2016 and December 31, 2015, respectively.

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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 \$13.2 million and \$12.4 million at September 30, 2016 and December 31, 2015, respectively.

Assets and liabilities measured at fair value are as follows as of September 30, 2016 (for purpose of this table the impaired loans are shown net of the related allowance):

(Dollars are in thousands)	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(On a recurring basis)			
Available-for-sale investments			
U.S. Government Agencies	\$		