

UNITED STATES  
OFFICE OF THE COMPTROLLER OF THE CURRENCY  
WASHINGTON, D.C. 20219

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2009

or

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

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

OCC Charter Number: 23616

**VIRGINIA NATIONAL BANK**

(Exact name of registrant as specified in its charter)

**Virginia**

(State or other jurisdiction of  
incorporation or organization)

**54-1902129**

(I.R.S. Employer  
Identification Number)

**222 East Main Street, Charlottesville, Virginia**

(Address of principal executive offices)

**22902**

(Zip Code)

Registrant's telephone number, including area code:

**(434) 817-8621**

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

**None**

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

**Common Stock, par value \$2.50**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

Yes  No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of June 30, 2009, the last business day of the registrant’s most recently completed second fiscal quarter.

**\$31,973,694**

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

**2,338,422 shares as of March 24, 2010**

***Documents Incorporated by Reference***

Portions of the following documents are hereby incorporated into Part I and Part III of this Form 10-K by reference: the Proxy Statement for the Annual Meeting of Shareholders to be held on May 17, 2010.

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## **Part I**

In addition to historical information, the following Report contains forward looking statements that are subject to risks and uncertainties that could cause the Bank's actual results to differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of the Report.

### **Item 1. BUSINESS.**

#### **General**

Virginia National Bank (the "Bank") was organized under federal law as a national banking association to engage in general commercial and retail banking business. The Bank received its charter from the Comptroller of the Currency and commenced operations on July 29, 1998. The Bank's deposits are insured to the maximum amount provided by the Federal Deposit Insurance Act by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to the supervision, examination and regulation of the Office of the Comptroller of the Currency ("OCC").

The Bank emphasizes serving the needs of owner-operated businesses, professional concerns and individuals in the Charlottesville/Albemarle County area, the Orange County area, the Buckingham County area and the Winchester area. The Bank offers a full range of banking and related financial services, including checking accounts, NOW accounts, money market deposit accounts, certificates of deposit, individual retirement accounts and other depository services. The Bank actively solicits such accounts from individuals, businesses, associations and other organizations within its trade area. The Bank also offers short-to-medium term commercial, real estate and consumer loans. The Bank is committed to providing its customers with banking services comparable to those that larger regional and nation-wide banks generally reserve for their larger clients. Such services include being a reliable and consistent source of credit, with loans that are priced based upon an overall banking relationship, easy access to the Bank's local decision makers who possess strong local market knowledge, local delivery, fast response, and continuity in the banking relationship.

Other services offered by Virginia National Bank include automated teller machines ("ATMs"), Internet banking, safe deposit boxes, travelers' checks, cash management services and direct deposit of payroll and federal recurring payments. In addition, the Bank is associated with the STAR and Cirrus networks, giving customers access to cash at ATMs all across America and internationally.

In January, 2000, the Bank received regulatory approval from the OCC to open a Trust Department which began operations in the first quarter of 2000. On May 1, 2007, the Office of the Comptroller of the Currency ("OCC") granted approval to the Bank's application to establish a new national trust bank with the title VNBTrust, National Association ("VNBTrust"), which is now operating as a wholly owned subsidiary of the Bank. Additionally, the OCC approved the Bank's application for VNBTrust to create a wholly owned operating subsidiary, VNB Investment Management Company, LLC, a Delaware limited liability corporation, which has approval to organize and manage two private investment funds. One fund, known as Swift Run Capital, is in operation.

Since July 29, 1998, the Bank has conducted business from its full-service main banking office located at 222 East Main Street in Charlottesville. On March 15, 1999, a second full-service banking office was opened at 1580 Seminole Trail in Charlottesville. On December 21, 1999, a third full-service banking office was opened at 1900 Arlington Boulevard in Charlottesville. On

November 8, 2000, a fourth full-service banking office was opened at 102 East Main Street in Orange, Virginia. On January 28, 2002, a fifth full-service banking office was opened at 186 North Loudoun Street, Winchester, Virginia. On December 29, 2003, a sixth full-service banking office was opened at 3119 Valley Avenue, #102, Winchester, Virginia. On November 28, 2006, a seventh full-service banking office was opened at 28904 North James Madison Highway, in Arvon, Virginia. On April 28, 2008, an eighth full-service banking office was opened at 404 People Place, Charlottesville. Additionally, the multi-story office building houses the Bank's Operations Center and several administrative functions.

During 2006, the Trust Department relocated into leased space at 310 4<sup>th</sup> Street, NE, Suite 102, Charlottesville, Virginia where VNBTrust now conducts business.

## **Market Area**

The market area served by Virginia National Bank is growing. The combined populations of the City of Charlottesville and Albemarle County increased approximately 14.4 percent between 1990 and 2000, ending the period at 124,000 persons. The population is expected to grow to 131,400, or 15.1 percent, between 1997 and 2010. The Charlottesville metropolitan statistical area ("MSA"), which includes Charlottesville, Albemarle County, Fluvanna County and Greene County, was the fastest growing MSA in Virginia from 1990 to mid-1997 according to the U.S. Census Bureau. Charlottesville and Albemarle County support a diverse, well-rounded economy. Stability in the local economy stems from the significant number of persons employed by the University of Virginia, as well as several large manufacturers and service companies.

Orange County had a population of approximately 26,000 persons according to the 2000 Census. From 1990 to 2000, its population grew 20.8 percent, compared to a 14.4 percent growth rate for Commonwealth of Virginia as a whole.

Buckingham County had a population of approximately 16,000 persons according to the 2000 Census. The Bank's Arvon Office, located in northern Buckingham County, is able to serve customers in Cumberland County and Fluvanna County, as well as customers in Buckingham County.

The combined populations of the City of Winchester and Frederick County increased approximately 23.2 percent between 1990 and 2000, ending the period at 83,000 persons.

## **Competition**

The Bank engages in highly competitive activities. Each activity involves competition with other banks, as well as with non-banking enterprises that offer financial products and services that compete directly with the Bank's product and service offerings. The Bank actively competes with other banks in its efforts to obtain deposits and make loans, in the scope and types of services offered, in interest rates paid on time deposits and charged on loans, and in other aspects of banking.

In addition to competing with other commercial banks within and outside its primary service areas, the Bank competes with other financial institutions engaged in the business of making loans or accepting deposits, such as savings and loan associations, credit unions, insurance companies, small loan companies, finance companies, mortgage companies, certain governmental agencies and other enterprises. In recent years, competition for funds from securities brokers and mutual funds for money market accounts has also intensified. Additional competition for deposits comes from

government and private issues of debt obligations and other investment alternatives for depositors such as money market funds.

The market areas served by Virginia National Bank are highly competitive with respect to banking. Competition for loans to small businesses and professionals is intense, and pricing is important. Many of the Bank's competitors have substantially greater resources and lending limits than the Bank and offer certain services such as extensive and established branch networks that the Bank does not expect to match immediately. Deposit competition is also very strong. The Bank believes, however, that a market exists for the personal and customized financial services an independent, locally owned bank can offer.

## **Employees**

At December 31, 2009, the Bank had 124 full time equivalent employees. None of its employees is represented by any collective bargaining unit. The Bank considers relations with its employees to be good.

In 2008, the Bank purchased Bank Owned Life Insurance ("BOLI") policies on fifteen bank officers. BOLI is a bank-eligible asset designed to recover costs of providing pre- and post-retirement benefits and/or to finance general employee benefit expenses. Under BOLI policies, executives and other key personnel are the insured, and the Bank is the owner and beneficiary of the policies. The insured has no claim to the insurance policy or to the policy's cash value. Under separate split dollar agreements, a portion of any death benefit may be paid to the beneficiaries of the insured employees.

## **Supervision and Regulation**

The Bank is subject to supervision by the OCC, and is affected by the various applicable federal and Virginia laws, and regulations of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the FDIC. The various laws and regulations administered by these regulatory agencies affect corporate practices, expansion of business and provision of services. Also, monetary and fiscal policies of the United States directly affect bank loans and deposits and, thus, may affect the Bank's earnings. The OCC conducts regular examinations of the Bank, reviewing such matters as the quality of loans and investments, the adequacy of loan loss reserves, compliance with laws and regulations, management practices and other aspects of the Bank's operations. In addition to these regular examinations, the Bank must furnish periodic reports to regulatory agencies that contain a full and accurate statement of its affairs.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 temporarily increased the FDIC deposit insurance from \$100,000 to \$250,000 per insured depositor, as defined by law and regulation. The standard coverage limit is presently scheduled to return to \$100,000 per insured depositor on January 1, 2014.

VNB has opted to participate in the FDIC's Temporary Liquidity Guarantee Program ("TLGP"). All funds in noninterest-bearing transaction deposit accounts are fully guaranteed under the transaction account guarantee component of the TLGP through June 30, 2010. A "noninterest-bearing transaction account" is defined as a transaction account with respect to which interest is neither accrued nor paid and on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal. This definition encompasses traditional demand deposit checking accounts that allow for an unlimited number of deposits and withdrawals

at any time. This definition does not encompass interest-bearing money market deposit accounts (MMDAs). For purposes of the transaction account guarantee program, however, the FDIC included in the definition of a noninterest-bearing transaction account:

- Accounts commonly known as Interest on Lawyers Trust Accounts (IOLTAs) and functionally equivalent accounts; and
- Negotiable order of withdrawal accounts (NOW accounts) with interest rates no higher than 0.50 percent for which the insured depository institution at which the account is held has committed to maintain the interest rate at or below 0.50 percent.

A quarterly surcharge is applied to noninterest-bearing transaction deposit amounts over \$250,000. The FDIC collects the additional premium as part of its normal assessment cycle.

VNB opted not to participate in the Troubled Asset Relief Program (“TARP”). TARP was a program of the United States government to purchase assets and equity from financial institutions, and was the largest component of the federal government’s measures in 2008 to promote financial market stability. Any publicly traded financial institution that accepted TARP funds must have provided the U.S. Treasury with warrants for the right to receive nonvoting common stock or preferred stock in such financial institution, or voting stock, with respect to which the Secretary of the Treasury agreed not to exercise voting power, as the Secretary determined appropriate. The terms and conditions of such warrant must have provided for reasonable participation by the Secretary in equity appreciation of such financial institution. The warrant must also have contained anti-dilution provisions to protect the value of the securities from market transactions such as stock splits, stock distributions, dividends, and mergers. Other conditions for TARP recipients, such as executive compensation limits, have been imposed. VNB determined that its capital position and its strong credit quality made the acceptance of TARP funds unnecessary and not in the best interest of its shareholders.

The FDIC assesses deposit insurance premiums on all banks in order to adequately fund the Deposit Insurance Fund (“DIF”) so as to resolve any insured institution that is declared insolvent by its primary regulator. The FDIC has established a risk-based deposit insurance premium system to calculate a depository institution’s quarterly deposit insurance assessment. The FDIC’s quarterly assessment is based upon Federal Deposit Insurance Reform Act of 2005, passed by Congress in 2006 to create a stronger and more stable insurance system. A prepayment of the FDIC premium through the fourth quarter of 2012 was collected on December 30, 2009.

Banks are divided into four risk categories based on their confidential composite CAMELS regulatory rating and level of capital. A Risk Category I bank represents lower risk to the insurance system, while a Risk Category IV bank represents higher risk. Because of its confidential composite CAMELS rating and capital levels, Virginia National Bank is designated as a Risk Category I bank. Small banks (those with less than \$10 billion in assets) in Risk Category I are evaluated, and their premiums are set, based on a combination of financial ratios and supervisory ratings. The financial ratios are as follows:

- Tier I leverage ratio;
- Loans past due 30 – 89 days, as a percentage of gross assets;
- Nonperforming loans, as a percentage of gross assets;
- Net loan charge-offs, as a percentage of gross assets; and
- Net income before taxes, as a percentage of risk-weighted assets.

Supervisory ratings will also be taken into account using a weighted average of an institution's confidential CAMELS component ratings.

### **Safety and Soundness Standards**

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") expanded the OCC's authority to prohibit activities of banks which represent unsafe and unsound banking practices or which constitute violations of laws or regulations. Notably, FIRREA increased the amount of civil money penalties that the OCC can assess for certain activities conducted on a knowing and reckless basis, if those activities cause a substantial loss to a depository institution. The penalties can be as high as \$1 million per day. FIRREA also expanded the scope of individuals and entities against which such penalties may be assessed.

On July 10, 1995, the four federal agencies that regulate banks and savings associations (FDIC, Federal Reserve Board, OCC and the Office of Thrift Supervision) jointly issued guidelines for safe and sound banking operations ("Interagency Guidelines Establishing Standards for Safety and Soundness") as required by Section 132 of the Federal Deposit Insurance Corporation Improvement Act ("FDICIA"). The guidelines identify the fundamental standards that the four agencies follow when evaluating the operational and managerial controls at insured institutions. An institution's performance will be evaluated against these standards during the regulators' periodic on-site examinations.

### **Lending Activities**

The Bank offers credit facilities, both secured and occasionally unsecured, to business customers. These facilities include term loans, single payment loans, revolving credit facilities and other lines of credit. These loans may be for temporary or seasonal working capital needs, or to provide funding for the acquisition of fixed assets or real estate. In addition, the Bank offers commercial real estate construction and development loans to small businesses, including residential builders and owner-occupants of business facilities. In addition, the Bank offers commercial real estate construction loans for both investment properties and owner-occupants of business facilities.

Installment loans, consumer purpose loans, revolving lines of credit and home equity lines of credit are also offered by the Bank.

The Bank's lending activities are subject to a variety of lending limits imposed by federal law and internal policy. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower, the Bank is generally subject to a loan-to-one-borrower limit in an amount equal to fifteen percent of the Bank's capital and surplus. Loans, which are fully secured by readily marketable or other permissible types of collateral, may exceed the fifteen percent limitation. Although the Bank's capitalization has enabled it to have a lending limit that satisfies the credit needs of a large portion of its target market, the Bank has also established relationships with correspondent banks to participate in loans when the amounts exceed the Bank's legal lending limit or the more stringent limits imposed by internal lending policies.

### **Credit Policies**

The Bank employs a written credit policy to enhance its management of credit risk. The policy includes underwriting guidelines, principles of loan analysis, documentation requirements, maintenance guidelines for credit files, risk assessment rules and definitions, and procedures for

ongoing identification and management of loans of less than acceptable risk. The policy also fixes the lending limits of all lending personnel for both secured and unsecured lending. Loans in excess of this amount require consideration by and approval of the Bank's Loan Committee, which includes two members of the Bank's Board of Directors and meets at least once per week. The Bank places an extremely high value on the confidentiality of any customer information. The credit policy also addresses items such as aggregate loan diversification, conflicts of interest, loan pricing, concentrations of credit and the impact of business cycles on loan philosophy.

### **Community Reinvestment Act**

The Community Reinvestment Act of 1977 ("CRA"), and the regulations promulgated by the OCC to implement CRA, are intended to ensure that banks meet the credit needs of their service area, including low and moderate income communities and individuals, consistent with safe and sound banking practices. In 1995, the bank regulatory agencies adopted final regulations for implementing CRA. The CRA regulations require the banking regulatory authorities to evaluate a bank's record in meeting the needs of its service area when considering applications to establish new offices or consummate any merger or acquisition transaction. Under FIRREA, the federal banking agencies are required to rate each insured institution's performance under CRA and to make such information publicly available. In the case of an acquisition by a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed as part of the processing of the acquisition application. A CRA rating other than 'outstanding' or 'satisfactory' can substantially delay or block the transaction. The Bank was last examined under the Community Reinvestment Act during 2009.

### **Consumer Laws and Regulations**

Banks are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. Among the more prominent of such laws and regulations are the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, and the Fair Housing Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

### **The Financial Services Modernization Act of 1999**

The Financial Services Modernization Act of 1999, more commonly known as The Gramm-Leach-Bliley Act ("Act"), was signed into law on November 12, 1999. The 1933 Glass-Steagall Act's prohibitions on affiliations between banks and securities companies were repealed, as were the 1956 Bank Holding Company Act's prohibitions on affiliations between banks and insurance companies. Bank holding companies and foreign banks that meet certain eligibility criteria may become 'financial holding companies,' allowed to engage in any non-financial activity that the Federal Reserve Board determines is complementary to a financial activity and that does not pose a substantial risk to the safety or soundness of depository institutions or the financial system.

In addition, the Act requires all financial institutions, regardless of whether they form a financial holding company, to disclose to customers their policies and practices for protecting the privacy of non-public personal information. The Act prohibits a financial institution from disclosing to non-affiliated third parties any non-public information about a customer, unless the institution both

informs the customer that such information may be shared with third parties and allows the customer to opt out of such sharing arrangements.

### **Dividend Restrictions**

The amount of dividends payable by the Bank will depend on its earnings and capital position, and is limited by federal law, regulations and policy. No dividend may be declared or paid that would impair a bank's paid-in capital. Additionally, the OCC has the general authority to limit dividends paid by the Bank if such payments are deemed to constitute an unsafe and unsound practice.

Under current supervisory practice, prior approval of the OCC is required if cash dividends declared in any year exceed the total of a bank's net profits for such year, plus its retained net profits for the preceding two years. Also, the Bank may not pay a dividend greater than its undivided profits then on hand after deducting current losses and bad debts. Federal law further provides that no insured depository institution may make any capital distribution, including a cash dividend, if the institution would not satisfy one or more of its minimum capital requirements after making such distribution. At December 31, 2009, the maximum amount available to the Bank for dividends was \$3,535,000.

### **Code of Ethics**

VNB has adopted a Code of Ethics that applies to all of its employees, including its principal executive officer and its principal financial officer. The Code of Ethics is designed to deter wrongdoing and to promote the following:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships.
2. Full, fair, accurate, timely and understandable disclosure in reports and documents that are filed with regulatory agencies and in other public communications.
3. Compliance with applicable governmental laws, rules and regulations.
4. The prompt internal reporting of violations of the code to an appropriate person identified in the code.
5. Accountability for adherence to the code.

### **Availability of Information**

The Bank files its periodic and annual reports with the Office of the Comptroller of the Currency. Our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, plus any amendments to these reports, are available, free of charge, on the Bank's Internet website at [www.vnb.com](http://www.vnb.com). These reports are available as soon as reasonably practical after they are filed with the OCC.

### **Item 1A. RISK FACTORS.**

Not required

## **Item 2. PROPERTIES.**

The Bank currently occupies eight sites in Charlottesville, Winchester and Albemarle, Buckingham and Orange Counties. The executive offices and a full-service banking facility are located at 222 East Main Street, Charlottesville, Virginia. A second full-service banking facility is located at 1580 Seminole Trail, Charlottesville, Virginia. A third full-service banking facility is located at 1900 Arlington Boulevard, Charlottesville, Virginia. A fourth full-service banking facility is located at 102 East Main Street, Orange, Virginia. A fifth full-service banking facility is located at 186 North Loudoun Street, Winchester, Virginia. A sixth full-service banking office is located at 3119 Valley Avenue, #102, Winchester, Virginia. A seventh full-service banking office is located at 28904 North James Madison Highway, in Arvon, Virginia. An eighth full-service banking facility is located at 404 People Place, Charlottesville, Virginia. With the exception of the banking office in Arvon, all locations are leased as described further below.

VNBTrust leases space at 310 4<sup>th</sup> Street, NE, Suite 102, Charlottesville, Virginia.

Lease terms for the above-mentioned properties are as follows:

### **222 East Main Street, Charlottesville, VA (Downtown Mall Office):**

This property was originally leased from Williams Pentagram Corporation in 1998, and is currently in the second year of a five-year renewal term. The lease provides for three more five-year renewal options.

### **1900 Arlington Boulevard, Charlottesville, VA (Barracks Road Office):**

This property was leased in 1998 from Paul and Jean Holdren for a term of twenty years with seven five-year renewal options. The Arlington Boulevard site has additional space not occupied by the banking facility. All but one unit of this space has been leased, and the Bank is actively seeking a new tenant.

### **1580 Seminole Trail, Charlottesville, VA (29 North Office):**

This property was leased in 1998 from Sunny Hill Land Trust (an entity 50 percent owned by an entity controlled by Hunter Craig, vice chairman of the Bank) for a term of five years with six five-year renewal options. The Bank has exercised the second five-year renewal option. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal.

### **102 East Main Street, Orange, VA (Orange Office):**

This property was leased in 2000 from The Bryant Foundation for a term of three years with three five-year renewal options. The Bank has exercised the second five-year renewal option.

### **186 North Loudoun Street, Winchester, VA (Winchester Office):**

This property, consisting of approximately 4,913 square feet within the Bowman Building, was leased in 2001 from Shenandoah University for a term of ten years with two five-year renewal options. The Bank has the irrevocable and exclusive option to purchase the entire Bowman Building. In addition, the Bank has provided a sale put option to Shenandoah University that provides that, at any time during the term of the lease, the University will have the unilateral right to sell the Bowman Building to the Bank for \$1,350,000.

**3119 Valley Avenue, #102, Winchester, VA (Creekside Office):**

This property, consisting of approximately 3,875 square feet, is located in the Creekside Station Shopping Center. It was leased in 2003 from Joleen, L.C. for a term of ten years expiring January 31, 2014, with two five-year renewal options.

**404 People Place, Charlottesville, VA (Pantops Park Office):**

This property, consisting of approximately 8,167 square feet, is located just east of the Charlottesville city limits on Pantops Mountain, and fronts on Route 250 East. The building was constructed by the Bank on a pad site leased in 2005 from Pantops Park, LLC for a term of twenty years, with seven five-year renewal options. William D. Dittmar, Jr., a director of the Bank, is a Member of Pantops Park, LLC. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal. A five-story building, consisting of approximately 43,000 square feet was completed in early 2008, and the Bank's eighth full-service office opened in April, 2008. Additionally, the building houses the Bank's Operations Center and several administrative functions. It also contains space for lease to third parties. A portion of the space has been rented, and the Bank is actively seeking other tenants.

**310 4<sup>th</sup> Street, N.E., Suite 102, Charlottesville, VA (VNBTrust, N.A.):**

This property is located approximately two blocks from the downtown Charlottesville banking office. It was leased in 2006 from Court Square, L.L.C. for a term of five years, with two five-year renewal options.

**Item 3. LEGAL PROCEEDINGS.**

There are no legal proceedings against the Bank that would have a material adverse effect on the Bank or its financial condition.

**Item 4. (REMOVED AND RESERVED.)**

**Part II**

**Item 5. MARKET PRICE OF, AND DIVIDENDS ON, THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.**

Virginia National Bank's Common Stock is listed on the National Association of Securities Dealers Over-the-Counter Bulletin Board (OTCBB), an inter-dealer quotation system for equity securities not listed on the NASDAQ Stock Market, under the symbol VABK. As of December 31, 2009, the Bank had issued and outstanding 2,338,422 shares of Common Stock. These shares were held by approximately 590 shareholders of record and others who held shares at brokerage firms. The Bank's Common Stock was issued on June 26, 1998, at a price of \$10.00 per share.

For the years ended December 31, 2009 and December 31, 2008, the performance of the Common Stock was as follows:

	2009		2008	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First Quarter	\$26.85	\$19.00	\$31.05	\$29.00
Second Quarter	\$23.50	\$17.25	\$31.00	\$25.35
Third Quarter	\$19.75	\$15.40	\$28.50	\$24.60
Fourth Quarter	\$19.00	\$14.75	\$26.90	\$20.00

The Bank has not declared any cash dividends. Payments of dividends is at the discretion of the Bank's Board of Directors, is subject to various federal and state regulatory limitations, and is dependent upon the overall performance and capital requirements of the Bank.

American Stock Transfer and Trust Company is the Bank's stock transfer agent and registrar.

#### **Item 6. SELECTED FINANCIAL DATA.**

Not required

#### **Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion provides information about the major components of the results of consolidated operations and financial condition, liquidity and capital resources of Virginia National Bank. This discussion and analysis should be read in conjunction with the *Consolidated Financial Statements and Notes to the Consolidated Financial Statements*.

#### **Critical Accounting Policies**

##### General

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

As more fully described in the section labeled Recent Accounting Pronouncements, the Bank adopted Accounting Standards Codification ("ASC") 105, "The FASB Accounting Standards Codification and Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement 162" (ASC 105) during the third quarter of 2009. This guidance established ASC as the single source of authoritative U.S. GAAP recognized by the Financial Accounting Standards Board

("FASB") to be applied by nongovernmental entities, except for rules and interpretive releases of the Securities and Exchange Commission ("SEC").

### Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) ASC 450 (formerly SFAS 5), "Contingencies," which requires that losses be accrued when they are probable of occurring and estimatable, and (ii) ASC 310 (formerly SFAS 114), "Receivables," which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

In general, banks determine the adequacy of their allowance for credit losses by considering the risk classification and delinquency status of loans and other factors. A bank's management may also establish specific allowances for credits which management believes require allowances greater than those allocated according to their risk classification. The purpose of the allowance is to provide for potential losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate.

### Non-GAAP Presentations

The Bank, in referring to its net income, is referring to income under accounting principles generally accepted in the United States of America, or "GAAP". This management's discussion and analysis also refers to the efficiency ratio which is computed by dividing non-interest expense by the sum of net interest income and non-interest income. This is a non-GAAP financial measure which may provide important information concerning the Bank's operational efficiency. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently.

### Net Income

The net income for the period ended December 31, 2009 was \$1,948,000, compared to \$112,000 for the period ended December 31, 2008. VNBTrust, N.A. earned net income of \$1,648,000 for 2009, compared to a loss in 2008 of \$374,000. The commercial bank earned net income of \$300,000 in 2009, compared to \$486,000 in 2008. In 2009, the commercial bank incurred a one-time pre-tax expense of approximately \$643,000. This one-time expense represented the cost to dedicate People Place, the roadway built in conjunction with the Bank's Pantops Park Office, to the Virginia Department of Transportation ("VDOT"). The roadway was dedicated to VDOT on December 30, 2009.

At December 31, 2009, retained earnings for the Bank had grown to \$12,536,000. For the first quarter of 2009, the Bank had a net loss of \$110,000. During the second and third quarters of 2009, the Bank achieved net incomes of \$61,000 and \$241,000, and for the last quarter of 2009, realized \$1,756,000 in net income.

### Net Interest Income

Net interest income is the major component of a bank's earnings, and represents the amount by which interest income exceeds interest expense. Variables that may have an impact on net interest income are the mix and volume of earning assets and interest-bearing liabilities, and market interest

rates. The management of the Bank strives to maximize net interest income through prudent balance sheet administration, while maintaining appropriate risk levels as determined by the Bank's Board of Directors. During 2009, net interest income was \$15,591,000 compared to \$13,731,000 for 2008. The \$1,860,000 variance in net interest income year to year is mainly attributed to significant increases in both loan and deposits. Average deposits grew 19.5% from \$293 million in average deposits for 2008 to \$350 million for 2009. Likewise average loans grew from \$247 million in 2008 to \$295 million for 2009, a 19.4% increase.

The net interest margin, defined as net interest income expressed as a percentage of average earning assets, was 4.30% during 2009, compared to 4.41% in 2008. The decrease in the net interest margin from year to year is the result of interest rate compression which has occurred during this period of historically low interest rates. The Bank's Prime Rate, representing the interest rate paid by the Bank's most creditworthy customers, was lowered to 3.25% in December, 2008, and remained unchanged throughout 2009. The Bank's margin remains relatively high among banks in general. A continuing primary driver of the Bank's above average net interest margin is the Bank's level of non-interest bearing demand deposits, which averaged 26.3% of total deposits for the year.

### **Allowance for Loan Losses**

The allowance for loan losses at December 31, 2009, was \$3,732,000, and represented 1.18% of outstanding loans. At December 31, 2008, the allowance was \$3,084,000, and represented 1.11% of outstanding loans. The purpose of the allowance is to provide for potential losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate.

The Bank is committed to determining, on an ongoing basis, the adequacy of its allowance for loan losses. The Bank applies historical loss rates to various pools of loans. Thereafter, the adequacy of the allowance is evaluated through reference to the following qualitative factors:

- National and local economic trends;
- Underlying collateral values;
- Loan delinquency status and trends;
- Loan risk classifications;
- Industry concentrations;
- Lending policies;
- Experience, ability and depth of lending staff; and
- Levels of policy exceptions.

### **Non-Interest Income**

Total non-interest income for the year ended December 31, 2009 was \$7,138,000. For the year ended December 31, 2008, non-interest income was \$2,420,000.

For 2009, income from trust services was \$5,351,000 compared to \$1,256,000 in 2008. \$3,951,000 of this increase was earned on fees associated with performance-based asset management accounts. No performance-based fees were earned in 2008. Fixed fee income and other trust fees increased from \$1,256,000 in 2008 to \$1,400,000 in 2009, an 11% increase.

For the 2009 period, deposit account fees were \$899,000 compared to \$754,000 in the 2008 period, reflective of an increase in certain fees in the Bank's fee schedule in September, 2009. This same fee schedule change, as well as the introduction of new products such as enhanced cash management services and business online banking, resulted in an increase of other income from \$410,000 in 2008 to \$888,000 in 2009. The increase in gross fees from these new products was somewhat offset by non-interest expenses associated with the same products.

### **Non-Interest Expense**

Total non-interest expense for the year ended December 31, 2009 was \$18,690,000. For the year ended December 31, 2008, non-interest expense was \$15,182,000. The primary components of 2009 non-interest expense were salaries and employee benefits of \$9,943,000, net occupancy expenses of \$3,099,000, equipment expenses of \$1,128,000, FDIC assessments of \$751,000, marketing, advertising, and promotional expenses of \$699,000 and an assortment of other expenses totaling \$3,070,000.

Personnel expenses for 2009 of \$9,943,000 were up from \$8,131,000 in 2008, and included approximately \$1.2 million in incentive compensation for VNBTrust, booked in accordance with pre-established formulas.

Over the past few years, the Bank planned and budgeted for strategic initiatives to expand the Bank's product and service offerings, and to add staff that is critical for managing these initiatives. The Bank now offers a full complement of treasury management and private banking offerings, allowing the Bank to better serve its niche of owner-operated businesses, professional concerns and individuals that were increasingly underserved within our marketplace. VNB now offers services to its customer base that larger regional and nation-wide banks typically reserve for their largest clients. In mid-2009, the Bank converted to a new core processing system for its deposits and loans, including ancillary systems such as check processing, ACH processing, and online banking for consumers and businesses. Much of the remaining increase in non-interest expense is attributable to these aforementioned strategic and budgeted initiatives, setting the stage for future growth.

FDIC assessments increased from \$202,000 in 2008 to \$751,000 in 2009. As of January 1, 2009, the FDIC increased the rates used to compute the amount collected from banks based on risk ratings and quarter-end deposits. Additionally, a special five basis point assessment was imposed on all financial institutions based on deposits as of June 30, 2009 and collected on September 30, 2009. For VNB, this special assessment amounted to \$184,000.

Net occupancy expenses of \$3,099,000 in 2009 have increased from expenses of \$2,240,000 in 2008. Equipment expenses of \$1,128,000 in 2009 also increased slightly over the \$1,043,000 incurred during 2008. The increase in the net occupancy expenses is primarily due to the Bank dedicating to the Virginia Department of Transportation the road built beside the Pantops Park office, People Place, which connects Spotnap Road to Richmond Road (Route 250). The remaining increases in the net occupancy and equipment expenses are mainly due to a full year of depreciation of the capitalized expenditures for the new Pantops Park office which opened on April 28, 2008.

## **Income Taxes**

For 2009, income tax expense for the Bank was \$1,072,000, compared to \$202,000 for 2008. Please see Note 7 in the *Notes to Consolidated Financial Statements* for a discussion regarding net deferred tax and valuation allowance.

## **Interest Sensitivity**

Prudent balance sheet management requires processes that monitor and protect the Bank against unanticipated or significant changes in the level of market interest rates. Net interest income stability should be maintained in changing rate environments by ensuring that interest rate risk is kept to an acceptable level.

The ability to reprice its interest-sensitive assets and liabilities over various time intervals is of critical importance. An asset-sensitive balance sheet structure implies that assets, such as loans and securities, will reprice faster than liabilities; consequently, net interest income should be positively affected in an increasing interest rate environment. Conversely, a liability-sensitive balance sheet structure implies that liabilities, such as deposits, will reprice faster than assets; consequently, net interest income should be positively affected in a decreasing interest rate environment.

The Bank uses a variety of traditional and on-balance sheet tools to manage its interest rate risk. Gap analysis, which monitors the “gap” between interest-sensitive assets and liabilities, is one such tool. In addition, the Bank uses simulation modeling to forecast future balance sheet and income statement behavior. By studying the effects on net interest income of rising, stable and falling interest rate scenarios, the Bank can position itself to take advantage of anticipated interest rate movements, and protect itself from unanticipated rate movements, by understanding the dynamic nature of its balance sheet components.

## **Asset Quality**

Since the Bank opened for business on July 29, 1998, it has accumulated data on which to base a realistic reserve against any problem loans that might arise in its portfolio. At present, the Bank has determined that an allowance for loan losses at 1.18% of outstanding loans is adequate. As any future problem loan data is accumulated and analyzed, the Bank may set aside more or less than 1.18%, and reallocate the allowance by category, such that it reflects a more accurate indication of management’s estimate of future potential losses.

In 2009, the Bank had a provision expense of \$1,019,000. In 2008, the Bank had a provision expense of \$655,000. Loan portfolio growth was the primary reason for the increased provision expense. There were \$412,000 in charged off loans for year 2009, with recoveries of \$41,000. There were \$284,000 in charged off loans for year 2008, with recoveries of \$67,000.

The ratio of the allowance to total loans outstanding at year-end 2009 was 1.18%, while it was 1.11% at year-end 2008.

At the end of 2009, the Bank had sixteen loans with balances of \$8,134,000 classified as non-accrual. The largest nonperforming asset is a single relationship totaling \$4,336,000. Loans to this relationship are secured by real estate and are fully collateralized. Another borrowing of \$1,781,000, which was classified as non-accrual at year end 2009, has subsequently been paid in full. Of the remaining non-accrual loans, eleven loans totaling \$1,906,000 are fully collateralized.

At the end of 2008, the Bank had one loan with a remaining balance of \$489,000 classified as non-accrual. There were no other potential problem loans identified as of either December 31, 2009 or December 31, 2008.

### **Securities**

The Bank's investment portfolio as of December 31, 2009, totaled \$35.3 million, a \$12.5 million increase from the December 31, 2008 portfolio total of \$22.8 million. In accordance with ASC320 (formerly FASB 115), "Investments-Debt and Equity Securities," the Bank has designated its unrestricted securities portfolio into (a) Held to maturity ("HTM") and (b) Available for sale ("AFS"). As of December 31, 2009, the HTM portfolio totaled \$3.5 million, and consisted of a corporate bond and tax exempt municipal securities. As of December 31, 2008, the HTM portfolio totaled \$4.0 million, and consisted of U.S. Government-sponsored agency securities. At December 31, 2009, the AFS portfolio totaled \$30.3 million and consisted of U.S. Government-sponsored agency securities. At December 31, 2008, the AFS portfolio totaled \$17.3 million and consisted of U.S. Government-sponsored agency securities. The Bank's holdings of restricted securities totaled \$1.5 million at December 31, 2009 and consisted of Federal Reserve Bank and Federal Home Loan Bank stocks. The Bank's holdings of Federal Reserve Bank and Federal Home Loan Bank stocks totaled \$1.4 million at December 31, 2008.

### **Loan Portfolio**

The Bank's loan portfolio as of December 31, 2009, totaled \$311.8 million, net of the allowance for loan losses. As of December 31, 2008, the Bank's loan portfolio totaled \$275.0 million, net of the allowance for loan losses. The 13.4% net variance from year to year was mainly attributed to non-residential mortgages increasing by \$15.2 million and residential mortgages increasing by \$12.7 million, with the remaining increase spread among the other major real estate and commercial loan categories.

In a commercial bank modeled such as the Bank, lending activities normally represent the primary source of income. By deploying its capital and deposit funds into earning assets, the Bank continued to meet this profile during 2009. The Bank offers three major types of loans: mortgage loans, commercial loans and consumer loans. The predominant market area for these loans is Charlottesville, Albemarle County, Orange County, Winchester, Frederick County, Buckingham County and all adjacent counties.

### **Deposits**

Depository accounts represent the Bank's primary source of funds and are comprised of demand deposits, interest-bearing checking accounts, money market deposit accounts and time deposits. Depository accounts held by the Bank as of December 31, 2009, totaled \$394.2 million, as compared to the December 31, 2008 total of \$357.9 million. These deposits have been provided by individuals, professionals and small businesses in the Charlottesville/Albemarle area, the Orange County area, the Winchester area and the Buckingham County area. At December 31, 2009, non-interest bearing demand deposits accounted for 25.4% of total deposits, as compared to 24.2% at December 31, 2008.

In early 2008, the Bank contracted to enter the Certificate of Deposit Account Registry Service (CDARS)<sup>TM</sup>. Through this network of financial institutions, the Bank is able to offer depositors CD rates and FDIC insurance on deposits up to \$50 million. With the recent economic turmoil,

especially in the financial industry, the Bank was able to attract \$47.2 million in CDARS deposits by year-end 2009. Because of the reciprocal relationship of these funds with other financial institutions, these CDARS deposits are classified as brokered deposits.

### **Liquidity**

Liquidity represents the Bank's ability to provide funds to meet customer demand for loan and deposit withdrawals without impairing profitability. Effective management of balance sheet liquidity is necessary to fund growth in earning assets and to pay liability maturities and depository customers' withdrawal requirements. The Bank has instituted Asset/Liability Management policies, including but not limited to a computer simulation model, to support liquidity controls and to enhance its management of interest rate risk and financial condition. Continuing forward, the Bank intends to maintain sufficient liquidity at all times to meet its funding commitments.

Since its opening, the Bank's customer base has provided a reliable and steadily increasing source of funds and liquidity. In addition, maturities within the securities portfolio, repayment of loan proceeds and a significant portfolio of overnight investments are additional primary sources of liquidity. The Bank has numerous secondary sources of liquidity including access to borrowing arrangements. Available borrowing arrangements maintained by the Bank include formal federal funds lines with three other commercial banks and access to the discount window at the Federal Reserve Bank of Richmond. On December 3, 2001, the Federal Home Loan Bank of Atlanta approved the Bank's application for membership, providing yet another source of secondary liquidity.

The Bank maintained an average of \$35.0 million outstanding in federal funds sold during 2009. Any excess funds are sold on a daily basis in the federal funds market. As opportunities have arisen for prudently investing this excess cash in either loans or securities, the Bank has done so. On December 31, 2009, the Bank sold \$53.1 million in the overnight federal funds market. Increased loan demand, coupled with turmoil in the capital markets, dictated that these funds remain highly liquid and available for future investment.

### **Capital Resources**

Federal banking law sets forth certain regulatory capital requirements that apply to the Bank. Within the framework established by the law, the Bank qualifies for the classification "well-capitalized", which is the highest regulatory classification. Additional information concerning the Bank's capital resources is contained in Note 11 of the *Notes to Consolidated Financial Statements*.

### **Impact of Inflation and Changing Prices**

The consolidated financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles. These principles dictate that financial position and operating results be measured in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

A financial institution's assets and liabilities primarily are monetary in nature. As a result, general levels of inflation typically have a less significant effect on financial performance than do changes in interest rates; however, non-interest expenses tend to rise in periods of general inflation.

### **Off-Balance Sheet Arrangements**

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. Additional information concerning the Bank's off-balance sheet arrangements is contained in Note 9 of the *Notes to the Consolidated Financial Statements*.

### **Statistical Information**

The following statistical information is provided pursuant to the requirements of Guide 3, promulgated by the Securities Act of 1933:

**TABLE 1**  
Average Balances, Interest Income and Expense, and Average Yields and Costs

	Year Ended December 31, 2009			Year Ended December 31, 2008			Year Ended December 31, 2007		
	Average Balance	Interest Income / Expense	Average Yield/Cost	Average Balance	Interest Income / Expense	Average Yield/Cost	Average Balance	Interest Income / Expense	Average Yield/Cost
	(in Thousands)			(in Thousands)			(in Thousands)		
<b>Assets:</b>									
Securities	\$30,956	\$1,033	3.34%	\$29,555	\$1,174	3.97%	\$25,707	\$965	3.75%
Loans:									
Real estate	242,283	14,270	5.89%	196,324	12,834	6.54%	181,499	13,511	7.44%
Commercial	38,885	1,881	4.84%	36,710	2,086	5.68%	32,272	2,422	7.50%
Consumer	13,642	562	4.12%	13,786	840	6.09%	13,220	1,038	7.85%
Total Loans	294,810	16,713	5.67%	246,820	15,760	6.39%	226,991	16,971	7.48%
Fed Funds Sold	35,032	55	0.16%	30,055	548	1.82%	29,271	1,393	4.76%
Other Interest Bearing Deposits	1,368	40	2.92%	4,667	136	2.91%	-	-	0.00%
Total Earning Assets	362,166	17,841	4.92%	311,097	17,618	5.66%	281,969	19,329	6.85%
Less: Allowance for Loan Losses	3,427			2,737			2,571		
Total Non-Earning Assets	34,683			34,894			24,964		
<b>Total Assets</b>	<b>\$393,422</b>			<b>\$343,254</b>			<b>\$304,362</b>		
<b>Liabilities and Shareholders' Equity:</b>									
Interest Checking	\$52,931	\$26	0.05%	\$44,131	\$58	0.13%	\$41,184	\$121	0.29%
Money Market Deposits	88,102	183	0.21%	86,377	1,027	1.19%	81,855	2,094	2.56%
Certificates of Deposit:									
\$100,000 and over	76,202	1,194	1.57%	41,170	1,184	2.88%	31,947	1,455	4.55%
Under \$100,000	40,597	839	2.07%	41,665	1,482	3.56%	22,691	962	4.24%
Total Interest-Bearing Deposits	257,832	2,242	0.87%	213,343	3,751	1.76%	177,677	4,632	2.61%
Federal Funds Purchased and Securities Sold									
Under Agreements to Repurchase	3,713	8	0.22%	10,114	97	0.96%	15,354	647	4.21%
Other Short Term Borrowings	-	-	N/A	1,530	39	2.55%	-	-	0.00%
Total Interest-Bearing Liabilities	261,545	2,250	0.86%	224,987	3,887	1.73%	193,031	5,279	2.73%
Non-Interest-Bearing Liabilities:									
Demand deposits	91,907			79,951			76,412		
Other liabilities	995			914			945		
Total Liabilities	354,447			305,852			270,388		
Shareholders' Equity	38,975			37,402			33,974		
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$393,422</b>			<b>\$343,254</b>			<b>\$304,362</b>		
Net Interest Income		\$15,591			\$13,731			\$14,050	
Interest Rate Spread (1)			4.06%			3.93%			4.12%
Interest Expense as a Percentage of Average Earning Assets			0.62%			1.25%			1.87%
Net Interest Margin (2)			4.30%			4.41%			4.98%

- (1) Interest spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.
- (2) Net interest margin is net interest income expressed as a percentage of average earning assets.

**TABLE 2**  
**Volume and Rate Analysis**

The following table describes the impact on the net interest income of the Bank resulting from changes in average balances and average rates for the periods indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

<b>2009 compared to 2008</b>			
<i>(in Thousands)</i>			
<b>Change due to:</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Increase / Decrease</b>
Assets:			
Securities	\$ 54	\$ (195)	\$ (141)
Loans:			
Real estate	2,795	(1,359)	1,436
Commercial	118	(323)	(205)
Consumer	(9)	(269)	(278)
Total loans	<u>2,904</u>	<u>(1,951)</u>	<u>953</u>
Other interest bearing deposits	(96)	-	(96)
Federal funds sold	78	(571)	(493)
Total earning assets	<u>\$ 2,940</u>	<u>\$ (2,717)</u>	<u>\$ 223</u>
Liabilities and Shareholders' Equity:			
Interest-bearing deposits:			
Interest checking	\$ 10	\$ (42)	\$ (32)
Money market	20	(864)	(844)
Certificates of deposit:			
\$100,000 and over	709	(699)	10
Under \$100,000	(37)	(606)	(643)
Total interest-bearing deposits	<u>702</u>	<u>(2,211)</u>	<u>(1,509)</u>
Short-term borrowings	(59)	(69)	(128)
Total interest-bearing liabilities	<u>643</u>	<u>(2,280)</u>	<u>(1,637)</u>
Change in net interest income	<u>\$ 2,297</u>	<u>\$ (437)</u>	<u>\$ 1,860</u>

<b>2008 compared to 2007</b>			
<i>(in Thousands)</i>			
<b>Change due to:</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Increase / Decrease</b>
Assets:			
Securities	\$ 150	\$ 59	\$ 209
Loans:			
Real estate	1,050	(1,727)	(677)
Commercial	304	(640)	(336)
Consumer	43	(241)	(198)
Total loans	<u>1,397</u>	<u>(2,608)</u>	<u>(1,211)</u>
Total interest-bearing deposits	136	-	136
Federal funds sold	36	(881)	(845)
Total earning assets	<u>\$ 1,719</u>	<u>\$ (3,430)</u>	<u>\$ 1,711</u>
Liabilities and Shareholders' Equity:			
Interest-bearing deposits:			
Interest checking	\$ 8	\$ (71)	\$ (63)
Money market	110	(1,177)	(1,067)
Certificates of deposit:			
\$100,000 and over	352	(623)	(271)
Under \$100,000	696	(176)	520
Total interest-bearing deposits	<u>1,166</u>	<u>(2,047)</u>	<u>(881)</u>
Short-term borrowings	(128)	(383)	(511)
Total interest-bearing liabilities	<u>1,038</u>	<u>(2,430)</u>	<u>(1,392)</u>
Change in net interest income	<u>\$ 681</u>	<u>\$ (1,000)</u>	<u>\$ (319)</u>

**TABLE 3**  
**Securities Held to Maturity and Available for Sale**  
**Maturity Distribution and Average Yields**

**Carrying Value of Securities**

	December 31, 2009	December 31, 2008	December 31, 2007
	(in Thousands)	(in Thousands)	(in Thousands)
<b>Securities Held to Maturity</b>			
Amortized Cost:			
U.S. Government-Sponsored Agencies	\$ -	\$4,005	\$9,052
Corporate Bonds and Notes	1,518	-	-
Tax Exempt Municipal Securities	1,994	-	-
Taxable Municipal Securities	-	-	1,455
	<u>\$3,512</u>	<u>\$4,005</u>	<u>\$10,507</u>

**Securities Available for Sale**

Fair Value:			
U.S. Treasury Securities	\$ -	\$ -	\$1,499
U.S. Government-Sponsored Agencies	30,273	17,343	23,064
	<u>\$30,273</u>	<u>\$17,343</u>	<u>\$24,563</u>

**Restricted Securities**

Cost:			
Federal Reserve Bank Stock	\$820	\$798	\$696
Federal Home Loan Bank Stock	722	627	545
	<u>\$1,542</u>	<u>\$1,425</u>	<u>\$1,241</u>

The Bank does not hold any derivative instruments. The Bank held no issues that exceeded ten percent of Shareholders' Equity at December 31, 2009.

**Maturities of Securities at December 31, 2009**

	Amortized Cost	Fair Value	Weighted
	(in Thousands)	(in Thousands)	Average Yield
<b>U.S. Government-Sponsored Agencies:</b>			
One year or less	\$1,993	\$2,030	5.26%
After one year to five years	27,161	28,243	3.27%
	<u>\$29,154</u>	<u>\$30,273</u>	<u>3.41%</u>
<b>Corporate Bonds and Notes</b>			
One year or less	\$ -	\$ -	0.00%
After one year to five years	1,518	1,567	2.87%
	<u>\$1,518</u>	<u>\$1,567</u>	<u>2.87%</u>
<b>Tax Exempt Municipal Securities</b>			
One year or less	\$ -	\$ -	0.00%
After one year to five years	1,994	2,036	1.52%
	<u>\$1,994</u>	<u>\$2,036</u>	<u>1.52%</u>
<b>Total Securities (1)</b>	<b>\$32,666</b>	<b>\$33,876</b>	

(1) Excludes Federal Reserve Bank and Federal Home Loan Bank stocks which have no stated maturity dates.

**TABLE 4**  
**Loan Portfolio and Maturity Schedule of Selected Loans**

	<u>Dec. 31,</u> <u>2009</u>	<u>Dec. 31,</u> <u>2008</u>	<u>Dec. 31,</u> <u>2007</u>	<u>Dec. 31,</u> <u>2006</u>	<u>Dec. 31,</u> <u>2005</u>
	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Commercial	\$38,955	\$41,915	\$34,351	\$28,950	\$26,119
Real estate construction	38,462	32,761	23,752	34,373	21,129
Real estate mortgage:					
Residential	87,298	74,637	51,600	37,553	37,235
Non-residential	109,919	94,686	88,171	92,120	86,389
Home equity loans	26,921	21,294	15,878	15,980	15,521
Total real estate mortgage	<u>224,138</u>	<u>190,617</u>	<u>155,649</u>	<u>145,653</u>	<u>139,145</u>
Consumer	<u>14,014</u>	<u>12,781</u>	<u>13,585</u>	<u>12,616</u>	<u>8,253</u>
Total loans	<u>315,569</u>	<u>278,074</u>	<u>227,337</u>	<u>221,592</u>	<u>194,646</u>
Less: Allowance for loan losses	<u>(3,732)</u>	<u>(3,084)</u>	<u>(2,646)</u>	<u>(2,577)</u>	<u>(2,262)</u>
Net loans	<u><u>\$311,837</u></u>	<u><u>\$274,990</u></u>	<u><u>\$224,691</u></u>	<u><u>\$219,015</u></u>	<u><u>\$192,384</u></u>

**Maturities and Sensitivities of Loans to Changes in Interest Rates**

(in Thousands)

	<u>1 Year or Less</u>		<u>1 - 5 Years</u>		<u>After 5 Years</u>		
	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Total</u>
Commercial loans	\$8,623	\$11,883	\$8,262	\$3,543	\$118	\$6,526	\$38,955
Real estate construction loans	\$8,493	\$9,794	\$5,206	\$1,072	\$ -	\$13,897	\$38,462

**TABLE 5**  
**Risk Elements**

The Bank places a loan on non-accrual status when management believes, after considering economic and business conditions and collections efforts, that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, or when the loan is past due for 90 days or more, unless the debt is both well-secured and in the process of collection.

**Non-Accrual Loans**

*(Dollar Amounts in Thousands)*

	<b><u>December 31, 2009</u></b>	<b><u>December 31, 2008</u></b>	<b><u>December 31, 2007</u></b>
<b>Total</b>	\$ 8,134	\$ 489	\$ 960
<b>Number of Loans</b>	16	1	1

**Loans Past Due 90 Days or More**

*(Dollar Amounts in Thousands)*

	<b><u>December 31, 2009</u></b>	<b><u>December 31, 2008</u></b>	<b><u>December 31, 2007</u></b>
<b>Total</b>	\$ -	\$ 231	\$ -
<b>Number of Loans</b>	0	4	0

**TABLE 6**  
**Summary of the Allowance for Loan Losses**  
**(in Thousands)**

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>Balance, beginning of period</b>	\$ 3,084	\$ 2,646	\$ 2,577	\$ 2,262	2,075
<b>Loans charged off</b>					
<b>Real estate</b>	232	39	261	-	4
<b>Commercial</b>	146	233	-	61	9
<b>Consumer</b>	34	12	268	7	9
<b>Total</b>	412	284	529	68	22
<b>Recoveries</b>					
<b>Real estate</b>	-	62	-	-	4
<b>Commercial</b>	40	-	31	4	3
<b>Consumer</b>	1	5	5	9	4
<b>Total</b>	41	67	36	13	11
<b>Provision for loan losses</b>	1,019	655	562	370	198
<b>Balance, December 31</b>	\$ <u>3,732</u>	\$ <u>3,084</u>	\$ <u>2,646</u>	\$ <u>2,577</u>	<u>2,262</u>
<b>Net charge-offs to average loans</b>	0.13%	0.09%	0.22%	0.03%	0.01%
<b>Allowance for loan losses as a percentage of period-end total loans</b>	1.18%	1.11%	1.16%	1.16%	1.16%

**TABLE 7**  
**Allocation of the Allowance for Loan Losses**

A breakdown of the allowance for loan losses is provided in the following table. The percentage of loans in each major category is also provided. The Bank does not believe that a further fragmentation of loan categories would be useful to investors.

**December 31, 2009**

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$545	12.34%
Real estate construction	604	12.19
Real estate mortgage	2,488	71.03
Consumer	95	4.44
<b>Totals</b>	<b>\$3,732</b>	<b>100.00%</b>

**December 31, 2008**

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$465	15.08%
Real estate construction	363	11.77
Real estate mortgage	2,114	68.55
Consumer	142	4.60
<b>Totals</b>	<b>\$3,084</b>	<b>100.00%</b>

**December 31, 2007**

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$400	15.12%
Real estate construction	276	10.43
Real estate mortgage	1,812	68.48
Consumer	158	5.97
<b>Totals</b>	<b>\$2,646</b>	<b>100.00%</b>

**December 31, 2006**

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$336	13.04%
Real estate construction	400	15.52
Real estate mortgage	1,694	65.74
Consumer	147	5.70
<b>Totals</b>	<b>\$2,577</b>	<b>100.00%</b>

**December 31, 2005**

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$304	13.44%
Real estate construction	245	10.83
Real estate mortgage	1,617	71.49
Consumer	96	4.24
<b>Totals</b>	<b>\$2,262</b>	<b>100.00%</b>

**TABLE 8**  
**Deposits**

	<u>Average Deposits and Rates Paid</u>					
	<u>Year Ended December 31, 2009</u>		<u>Year Ended December 31, 2008</u>		<u>Year Ended December 31, 2007</u>	
	<u>Average</u> <u>Balance</u> <u>(in Thousands)</u>	<u>Average</u> <u>Rate</u>	<u>Average</u> <u>Balance</u> <u>(in Thousands)</u>	<u>Average</u> <u>Rate</u>	<u>Average</u> <u>Balance</u> <u>(in Thousands)</u>	<u>Average</u> <u>Rate</u>
<b>Non-Interest-Bearing Demand Deposits</b>	\$91,907		\$79,951		\$76,412	
<b>Interest Checking</b>	52,931	0.05 %	44,131	0.13 %	41,184	0.29 %
<b>Money Market Deposits</b>	88,102	0.21	86,377	1.19	81,855	2.56
<b>Certificates of Deposit:</b>						
<b>\$100,000 and over</b>	76,202	1.57	41,170	2.88	31,947	4.55
<b>Under \$100,000</b>	40,597	2.07	41,665	3.56	22,691	4.24
<b>Total Interest-Bearing Deposits</b>	257,832	0.87 %	213,343	1.76 %	177,677	2.61 %
<b>Total Deposits</b>	\$349,739		\$293,294		\$254,089	

**Maturities of CD's of \$100,000 and Over**

	<u>December 31, 2009</u>	
	<u>Amount</u> <u>(in Thousands)</u>	<u>Percentage</u>
<b>Three months or less</b>	\$55,284	60.22 %
<b>Over three months to six months</b>	26,622	29.00
<b>Over six months to one year</b>	8,184	8.91
<b>Over one year</b>	1,718	1.87
<b>Totals</b>	\$91,808	100.00 %

**TABLE 9**  
**Consolidated Return on Equity and Assets**

The annualized ratio of net income to average total assets and average shareholders' equity and certain other ratios for the periods indicated are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Return on average assets</b>	0.50%	0.03%	0.48%
<b>Return on average equity</b>	5.00%	0.30%	4.34%
<b>Average equity to average assets</b>	9.91%	10.90%	11.16%
<b>Dividend payout ratio</b>	0.00%	0.00%	0.00%

**Short-Term Borrowings**

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(dollar amounts in thousands)		
<b>Federal funds purchases and securities sold under agreements to repurchase:</b>			
<b>Period-end balance</b>	\$ 3,610	\$ 2,842	\$ 11,110
<b>Weighted average interest rate</b>	0.24%	0.05%	2.98%
<b>Maximum amount at any month-end</b>	\$ 4,981	\$ 14,856	\$ 26,182
<b>Average balance outstanding</b>	\$ 3,713	\$ 10,114	\$ 15,354
<b>Weighted average interest rate</b>	0.22%	0.96%	4.21%

**TABLE 10**  
**Interest Sensitivity Analysis**  
(in Thousands)

	<u>Within 90 days</u>	<u>90-365 days</u>	<u>1 to 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
<b><u>Earning Assets</u></b>					
Loans	\$120,439	\$34,312	\$129,952	\$30,866	\$315,569
Investment securities	-	2,030	31,755	1,542	35,327
Federal funds sold	53,103	-	-	-	53,103
Total earning assets	<u>\$173,542</u>	<u>\$36,342</u>	<u>\$161,707</u>	<u>\$32,408</u>	<u>\$403,999</u>
<b><u>Interest-Bearing Liabilities</u></b>					
Interest checking	\$2,856	\$8,569	\$69,504	-	\$80,929
Money market deposits	10,437	31,309	45,224	-	86,970
Time deposits	75,300	46,311	4,501	-	126,112
Repurchase agreements	3,610	-	-	-	3,610
Total interest-bearing liabilities	<u>\$92,203</u>	<u>\$86,189</u>	<u>\$119,229</u>	-	<u>\$297,621</u>
Period gap	\$81,339	-\$49,847	\$42,478	\$32,408	\$106,378
Cumulative gap	\$81,339	\$31,492	\$73,970	\$106,378	
Ratio of cumulative gap to total earning assets	20.13%	7.80%	18.31%	26.33%	

**Item 8 - CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.****VIRGINIA NATIONAL BANK AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)**

	December 31, 2009	December 31, 2008
<b>ASSETS</b>		
Cash and due from banks	\$ 12,857	\$ 22,819
Federal funds sold	53,103	51,602
Other interest-bearing deposits	-	6,000
Securities:		
Available for sale, at fair value	30,273	17,343
Held to maturity, at amortized cost (Fair value - \$3,603 in 2009, \$4,017 in 2008)	3,512	4,005
Restricted securities, at cost	1,542	1,425
Total securities	<u>35,327</u>	<u>22,773</u>
Total loans	315,569	278,074
Allowance for loan losses	(3,732)	(3,084)
Total loans, net	<u>311,837</u>	<u>274,990</u>
Premises and equipment, net	13,215	14,249
Other real estate owned	605	605
Accrued interest receivable and other assets	14,350	8,137
Total assets	<u>\$ 441,294</u>	<u>\$ 401,175</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Demand deposits:		
Noninterest-bearing	\$ 100,146	\$ 86,453
Interest-bearing	80,929	54,827
Money market deposit accounts	86,970	96,635
Certificates of deposit and other time deposits	126,112	119,966
Total deposits	<u>394,157</u>	<u>357,881</u>
Securities sold under agreements to repurchase	3,610	2,842
Accrued interest payable and other liabilities	2,624	2,164
Total liabilities	<u>400,391</u>	<u>362,887</u>
Shareholders' equity:		
Preferred stock, \$2.50 par value, 2,000,000 shares authorized, no shares outstanding	-	-
Common stock, \$2.50 par value, 5,000,000 shares authorized; 2,338,422 shares issued and outstanding in 2009 (including 3,500 non-vested shares); 2,334,922 shares issued and outstanding in 2008 (including 5,000 non-vested shares)	5,837	5,823
Capital surplus	21,792	21,208
Retained earnings	12,536	10,588
Accumulated other comprehensive income, net	738	669
Total shareholders' equity	<u>40,903</u>	<u>38,288</u>
Total liabilities and shareholders' equity	<u>\$ 441,294</u>	<u>\$ 401,175</u>

See Notes to Consolidated Financial Statements

**VIRGINIA NATIONAL BANK AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**For the Years Ended December 31, 2009 and 2008**  
(in thousands, except per share data)

	<u>2009</u>	<u>2008</u>
Interest and dividend income:		
Loans, including fees	\$ 16,713	\$ 15,760
Federal funds sold	55	548
Held to maturity securities:		
Taxable	44	304
Tax exempt	18	-
Available for sale securities:		
Taxable	921	793
Dividends	50	77
Other	40	136
Total interest and dividend income	<u>17,841</u>	<u>17,618</u>
Interest expense:		
Demand and savings deposits	209	1,085
Certificates and other time deposits	2,033	2,666
Federal funds purchased and securities sold under agreements to repurchase	8	97
Other short term borrowings	-	39
Total interest expense	<u>2,250</u>	<u>3,887</u>
NET INTEREST INCOME	15,591	13,731
Provision for loan losses	<u>1,019</u>	<u>655</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	14,572	13,076
Noninterest income:		
Trust income	5,351	1,256
Customer service fees	899	754
Other	888	410
Total noninterest income	<u>7,138</u>	<u>2,420</u>
Noninterest expenses:		
Salaries and employee benefits	9,943	8,131
Net occupancy expense	3,099	2,241
Equipment expense	1,128	1,043
Other	4,520	3,767
Total noninterest expenses	<u>18,690</u>	<u>15,182</u>
INCOME BEFORE INCOME TAXES	3,020	314
Provision for income taxes	<u>1,072</u>	<u>202</u>
NET INCOME	<u>\$ 1,948</u>	<u>\$ 112</u>
Net Income Per Share, Basic	\$ 0.83	\$ 0.05
Net Income Per Share, Diluted	\$ 0.83	\$ 0.05

See Notes to Consolidated Financial Statements

**VIRGINIA NATIONAL BANK AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**For the Years Ended December 31, 2009 and 2008**  
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Comprehensive Income	Total
<b>Balance, December 31, 2007</b>	\$5,678	\$19,947	\$10,476	\$2		\$36,103
Equity adjustment for stock options exercised	140	656	-	-		796
Equity adjustment for vested stock grants	5	(5)	-	-		-
Stock option/grant expense	-	610	-	-		610
Comprehensive income:						
Net income	-	-	112	-	\$112	112
Unrealized holding gains arising during the period, (net of tax, \$343)	-	-	-	667	667	667
Total comprehensive income	-	-	-	-	\$779	-
<b>Balance, December 31, 2008</b>	<u>\$5,823</u>	<u>\$21,208</u>	<u>\$10,588</u>	<u>\$669</u>		<u>\$38,288</u>
<b>Balance, December 31, 2008</b>	\$5,823	\$21,208	\$10,588	\$669		\$38,288
Equity adjustment for stock options exercised	9	26	-	-		35
Equity adjustment for vested stock grants	5	(15)	-	-		(10)
Stock option/grant expense	-	573	-	-		573
Comprehensive income:						
Net income	-	-	1,948	-	\$1,948	1,948
Unrealized holding gains arising during the period, (net of tax, \$36)	-	-	-	69	69	69
Total comprehensive income	-	-	-	-	\$2,017	-
<b>Balance, December 31, 2009</b>	<u>\$5,837</u>	<u>\$21,792</u>	<u>\$12,536</u>	<u>\$738</u>		<u>\$40,903</u>

See Notes to Consolidated Financial Statements

**VIRGINIA NATIONAL BANK AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOW**  
**For the Years Ended December 31, 2009 and 2008**  
**(in Thousands)**

	<b>2009</b>		<b>2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 1,948	\$	112
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan losses	1,019		655
Net amortization and accretion of securities	242		128
Depreciation and amortization	1,657		1,384
Dedication of roadway	643		-
Deferred tax benefit	(478)		(200)
Stock option/stock grant expense	573		610
Increase in accrued interest receivable and other assets	(5,771)		(5,830)
Increase in accrued interest payable and other liabilities	460		1,299
Net cash provided by (used in) operating activities	293		(1,842)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of held to maturity securities	\$ (3,522)	\$	-
Purchases of available for sale securities	(14,052)		-
Purchases of restricted investments	(117)		(634)
Proceeds from maturities, calls and principal payments of held to maturity securities	4,000		6,455
Proceeds from maturities, calls and principal payments of available for sale securities	1,000		8,150
Redemption of restricted investments	-		450
Maturity (purchase) of interest-bearing deposits	6,000		(6,000)
Net increase in loans	(37,866)		(50,349)
Purchase of premises and equipment	(1,266)		(5,042)
Net cash used in investing activities	(45,823)		(46,970)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net increase in demand deposits, NOW accounts and money market accounts	\$ 30,130	\$	4,184
Net increase in certificates of deposit and other time deposits	6,146		53,177
Net increase (decrease) in securities sold under agreements to repurchase	768		(8,268)
Issuance of common stock	25		796
Net cash provided by financing activities	37,069		49,889
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>\$ (8,461)</b>	<b>\$</b>	<b>1,077</b>
<b>CASH AND CASH EQUIVALENTS:</b>			
Beginning of period	\$ 74,421	\$	73,344
End of period	65,960	\$	74,421
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>			
Cash payments for:			
Interest	\$ 2,478	\$	3,937
Taxes	419	\$	369
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>			
Unrealized gain on available for sale securities	\$ 105	\$	1,010
Transfer of loans to foreclosed assets	-	\$	605

See Notes to Consolidated Financial Statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Organization and Summary of Significant Accounting Policies:

The accounting and reporting policies of Virginia National Bank conform to accounting principles generally accepted in the United States of America and to the reporting guidelines prescribed by regulatory authorities. The following is a description of the more significant of those policies and practices.

**Organization** – Virginia National Bank (“Bank”) was organized in 1998 under federal law as a national banking association to engage in a general banking business serving the community in and around Charlottesville and Albemarle County, Virginia.

On May 1, 2007, the Office of the Comptroller of the Currency (“OCC”) granted conditional approval to the Bank’s application to establish a new national trust bank with the title VNBTrust, National Association (“VNBTrust”), which is now operating as a wholly owned subsidiary of the Bank. Additionally, the OCC approved the Bank’s application for VNBTrust to create a wholly owned operating subsidiary, VNB Investment Management Company, LLC, which has approval to organize and manage two private investment funds.

**Principles of Consolidation** – The consolidated financial statements include the accounts of Virginia National Bank (Bank) and its wholly-owned subsidiary, VNBTrust, N.A. All significant intercompany balances and transactions have been eliminated in consolidation.

**Securities** – Unrestricted investments are to be classified in three categories as described below.

**Securities Held to Maturity** – Securities classified as held to maturity are those debt and equity securities the Bank has both the positive intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions.

**Securities Available for Sale** – Securities classified as available for sale are those debt and equity securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Bank’s assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported as a separate component of other comprehensive income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings.

**Trading Securities** – Trading securities, which are generally held for the short term in anticipation of market gains, are carried at fair value. Realized and unrealized gains and losses on trading account assets are included in interest income on trading account securities. The Bank had no securities classified as trading securities at either December 31, 2009 or December 31, 2008.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Restricted Securities** – As members of the Federal Reserve Bank and the Federal Home Loan Bank (“FHLB”) of Atlanta, the Bank is required to maintain certain minimum investments in the common stock of the Federal Reserve Bank and the FHLB, which are carried at cost. Required levels of investments are based upon the Bank’s capital and a percentage of qualifying assets.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the Bank intends to sell the security or (2) it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis. If, however, the Bank does not intend to sell the security and it is not more-than-likely that the Bank will be required to sell the security before recovery, the Bank must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

**Loans** – Virginia National Bank makes commercial, financial, residential and consumer loans to customers in its market areas of Central Virginia and Winchester. The loan portfolio is well diversified and generally is collateralized by assets of the customers. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers.

Loans are shown on the balance sheet net of the allowance for loan losses. Interest is computed by methods which result in level rates of return on principal. Loans are charged off when in the opinion of management they are deemed to be uncollectible, after taking into consideration such factors as the current financial condition of the customer and the underlying collateral and guarantees.

Accounting guidance requires that the impairment of loans that have been separately identified for evaluation is to be measured based on the present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment of those loans is to be based on the fair value of the collateral. Additionally, accounting guidance requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Bank considers all consumer installment and residential mortgage loans to be homogeneous loans. These loans are not subject to impairment. A loan is considered impaired when it is probable that the Bank will be unable to collect all principal and interest amounts according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, expected future cash flows, financial condition of the borrower, and current economic conditions. A performing loan may be considered impaired, if the factors above indicate a need for impairment. A loan on non-accrual status may not be impaired if it is in the process of collection or there is an insignificant shortfall in payment. An insignificant delay of less than 30 days or a shortfall of less than 5% of the required principal and interest payment generally does not indicate an impairment situation, if in management's judgment the loan will be paid in full. Loans that meet the regulatory definitions of doubtful or loss generally qualify as impaired loans. Charge-offs for impaired loans occur when the loan, or a portion of the loan, is determined to be uncollectible, as is the case for all loans.

Loans are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other non-accrual loans is recognized only to the extent of interest payments received.

**Allowance for Loan Losses** – The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio and the related allowance may change in the near term.

**Foreclosed Assets** – Assets acquired through, or in lieu of, loan foreclosures are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses for foreclosed assets.

**Premises and Equipment** – Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method based on the estimated useful lives of assets, which range from 3 to 40 years. Expenditures for repairs and maintenance are charged to expense as incurred. The costs of

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, the asset and related accumulated depreciation are removed from the books and any resulting gain or loss is charged to income.

**Use of Estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred tax assets, and fair value measurements.

**Income Taxes** – Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences, operating loss carryforwards, and tax credit carryforwards. Deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

When tax returns are filed, it is highly probable that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statements of income.

**Earnings Per Common Share** – Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Potential common shares that may be issued by the Bank relate to outstanding stock options and are determined using the treasury stock method.

**Comprehensive Income** – Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

**Advertising Costs** – The Bank follows the policy of charging the costs of advertising to expense as they are incurred.

**Cash and Cash Equivalents** – For purposes of the statements of cash flows, the Bank considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents consist of cash on hand, funds due from banks, and federal funds sold.

**Other Interest-Bearing Deposits** – Other interest-bearing deposits mature within one year and are carried at cost.

**VNBTrust, N.A.** – Securities and other property held by the VNBTrust in a fiduciary or agency capacity are not assets of the Bank and are not included in the accompanying consolidated financial statements.

**Stock-Based Compensation** – The Bank accounts for all plans under recognition and measurement accounting principles which require that the compensation cost relating to share-based payment transactions be recognized in the financial statements. Share-based compensation arrangements include share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. Stock-based compensation is estimated at the date of grant, using the Black-Scholes option valuation model for determining fair value. The model employs the following assumptions:

- Dividend yield - calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant;
- Expected life (term of the option) - based on the average of the contractual life and vesting schedule for the respective option;
- Expected volatility - based on the monthly historical volatility of the Bank's stock price over the expected life of the options;
- Risk-free interest rate - based upon the U.S. Treasury bill yield curve, for periods within the contractual life of the option, in effect at the time of grant.

The Bank is required to estimate forfeitures when recognizing compensation expense and that this estimate of forfeitures be adjusted over the requisite service period or vesting schedule based on the extent to which actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

adjustment, which is recognized in the period of change, and also will impact the amount of estimated unamortized compensation expense to be recognized in future periods.

**Reclassifications** – Certain reclassifications have been made to prior periods to conform to current year presentation.

### **Recent Accounting Pronouncements**

#### *Adoption of New Accounting Standards*

In June 2009, FASB issued new accounting guidance related to U.S. GAAP (FASB ASC 105, “Generally Accepted Accounting Principles”). This guidance establishes FASB ASC as the source of authoritative U.S. GAAP recognized by FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. FASB ASC supersedes all existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in FASB ASC has become nonauthoritative. FASB will no longer issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates (“ASUs”), which will serve to update FASB ASC, provide background information about the guidance and provide the basis for conclusions on the changes to FASB ASC. FASB ASC is not intended to change U.S. GAAP or any requirements of the SEC.

The Bank adopted new guidance impacting Financial Accounting Standards Board Topic 805, “Business Combinations” (Topic 805) on January 1, 2009. This guidance requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. The adoption of the new guidance did not have a material impact on the Bank’s consolidated financial statements.

In April 2009, the FASB issued new guidance impacting Topic 805. This guidance addresses application issues raised by preparers, auditors, and members of the legal profession on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This guidance was effective for business combinations entered into on or after January 1, 2009. This guidance did not have a material impact on the Bank’s consolidated financial statements.

In April 2009, the FASB issued new guidance impacting FASB Topic 820, “Fair Value Measurements and Disclosures” (Topic 820). This interpretation provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This also includes guidance on identifying circumstances that indicate a transaction is not orderly and requires additional disclosures

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

of valuation inputs and techniques in interim periods and defines the major security types that are required to be disclosed. This guidance was effective for interim and annual periods ending after June 15, 2009, and should be applied prospectively. The adoption of the standard did not have a material impact on the Bank's consolidated financial statements.

In April 2009, the FASB issued new guidance impacting FASB Topic 320-10, "Investments – Debt and Equity Securities." This guidance amends GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance was effective for interim and annual periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. This guidance did not have a material impact on the Bank's consolidated financial statements.

In May 2009, the FASB issued new guidance impacting FASB Topic 855, "Subsequent Events." This update provides guidance on management's assessment of subsequent events that occur after the balance sheet date through the date that the financial statements are issued. This guidance is generally consistent with current accounting practice. In addition, it requires certain additional disclosures. This guidance was effective for periods ending after June 15, 2009 and had no impact on the Bank's consolidated financial statements.

In August 2009, the FASB issued new guidance impacting Topic 820. This guidance is intended to reduce ambiguity in financial reporting when measuring the fair value of liabilities. This guidance was effective for the first reporting period (including interim periods) after issuance and had no impact on the Bank's consolidated financial statements.

In September 2009, the FASB issued new guidance impacting Topic 820. This creates a practical expedient to measure the fair value of an alternative investment that does not have a readily determinable fair value. This guidance also requires certain additional disclosures. This guidance is effective for interim and annual periods ending after December 15, 2009 and had no impact on the Bank's consolidated financial statements.

In October 2009, the Securities and Exchange Commission issued Release No. 33-99072, "Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers." Release No. 33-99072 delays the requirement for non-accelerated filers to include an attestation report of their independent auditor on internal control over financial reporting with their annual report until the fiscal year ending on or after June 15, 2010.

In January 2010, the FASB issued ASU 2010-01, "Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash – a consensus of the FASB Emerging Issues Task Force." ASU 2010-01 clarifies that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

not a stock dividend. ASU 2010-01 is effective for interim and annual periods ending on or after December 15, 2009 and should be applied on a retrospective basis. The adoption of ASU 2010-01 did not have a material impact on the Bank's consolidated financial statements.

In January 2010, the FASB issued ASU 2010-02, "Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification." ASU 2010-02 amends Subtopic 810-10 to address implementation issues related to changes in ownership provisions including clarifying the scope of the decrease in ownership and additional disclosures. ASU 2010-02 is effective beginning in the period that an entity adopts Statement 160. If an entity has previously adopted Statement 160, ASU 2010-02 is effective beginning in the first interim or annual reporting period ending on or after December 15, 2009 and should be applied retrospectively to the first period Statement 160 was adopted. The adoption of ASU 2010-02 did not have a material impact on the Bank's consolidated financial statements.

### *Accounting Standards Not Yet Effective*

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as SFAS No. 166, "Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140," was adopted into Codification in December 2009 through the issuance of Accounting Standards Updated (ASU) 2009-16. The new standard provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. The Bank will adopt the new guidance in 2010 and is evaluating the impact it will have, if any, on its consolidated financial statements.

In June 2009, the FASB issued new guidance relating to the variable interest entities. The new guidance, which was issued as SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)," was adopted into Codification in December 2009. The objective of the guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 is effective as of January 1, 2010. The Bank does not expect the adoption of the new guidance to have a material impact on its consolidated financial statements.

In January 2010, the FASB issued ASU 2010-05, "Compensation – Stock Compensation (Topic 718): Escrowed Share Arrangements and the Presumption of Compensation." ASU 2010-05 updates existing guidance to address the SEC staff's views on overcoming the presumption that for certain shareholders escrowed share arrangements represent compensation. The Bank does not expect the adoption of ASU 2010-05 to have a material impact on its consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In January 2010, the FASB issued ASU No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Bank does not expect the adoption of ASU 2010-06 to have a material impact on its consolidated financial statements.

### 2. Securities

The amortized cost and fair values of securities held to maturity as of December 31, 2009 are as follows:

	<b><u>Amortized Cost</u></b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b><u>Fair Value</u></b>
	(in Thousands)			
Corporate securities	\$ 1,518	\$ 49	\$ -	\$ 1,567
Tax exempt municipals	1,994	42	-	2,036
	<u>\$ 3,512</u>	<u>\$ 91</u>	<u>\$ -</u>	<u>\$ 3,603</u>

The amortized cost and fair values of securities held to maturity as of December 31, 2008 were as follows:

	<b><u>Amortized Cost</u></b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b><u>Fair Value</u></b>
	(in Thousands)			
U.S. Government agencies	\$ 4,005	\$ 12	\$ -	\$ 4,017

The amortized cost and fair values of securities available for sale as of December 31, 2009 are as follows:

	<b><u>Amortized Cost</u></b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b><u>Fair Value</u></b>
	(in Thousands)			
U.S. Government agencies	\$ 29,154	\$ 1,119	\$ -	\$ 30,273

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The amortized cost and fair values of securities available for sale as of December 31, 2008 were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
	(in Thousands)			
U.S. Government agencies	\$ 16,329	\$ 1,014	\$ -	\$ 17,343

There were no sales of held to maturity or available for sale securities in 2009 or 2008.

In addition, the Bank held restricted securities of \$1,542,000 as of December 31, 2009 and \$1,425,000 as of December 31, 2008. These restricted securities are carried at cost and are comprised of Federal Reserve Bank stock and Federal Home Loan Bank of Atlanta stock.

The Bank's securities portfolio is made up of fixed rate bonds, whose prices move inversely with interest rates. At the end of any accounting period, the portfolio may have both unrealized gains and losses. Unrealized losses within the Bank's portfolio typically occur as market interest rates rise. Such unrealized losses are considered temporary in nature. In the event that a security would suffer an impairment for a reason that was "other-than-temporary," the Bank would be expected to write down the security's value to its new fair value, and the amount of the writedown would be included in earnings as a realized loss.

At December 31, 2009 and December 31, 2008, none of the securities in the portfolio had an unrealized loss.

Securities having carrying values of \$10,211,000 at December 31, 2009 were pledged to secure deposits and for other purposes required by law. At December 31, 2008, securities having carrying values of \$15,365,000 were similarly pledged.

The amortized cost and fair value of investment securities as of December 31, 2009, by contractual maturities, are shown in Table 3, *Securities*, in Management's Discussion and Analysis.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 3. Loans

The composition of the loan portfolio by loan classification at December 31, 2009 and 2008 appears below.

	December 31	
	2009	2008
	(in Thousands)	
Commercial	\$ 38,955	\$ 41,915
Real estate construction	38,462	32,761
Real estate mortgage:		
Residential	87,298	74,637
Non-residential	109,919	94,686
Home equity loans	26,921	21,294
Total real estate mortgage	224,138	190,617
Consumer	14,014	12,781
Total loans	315,569	278,074
Less: Allowance for loan losses	(3,732)	(3,084)
Net loans	\$ 311,837	\$ 274,990

The Bank had sixteen loans in the amount of \$8,134,000 in non-accrual loans and loans classified as impaired loans at December 31, 2009; however, there was no valuation allowance on any of these loans after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer. The Bank had one loan in the amount of \$489,000 in non-accrual loans, and no loans classified as impaired loans at December 31, 2008.

Following is a summary of information pertaining to impaired and non-accrual loans:

	2009	2008
	(in Thousands)	
Impaired loans without a valuation allowance	\$ 8,134	\$ -
Impaired loans with a valuation allowance	-	-
Total impaired loans	\$ 8,134	\$ -
Valuation allowance related to impaired loans	\$ -	\$ -
Total non-accrual loans	\$ 8,134	\$ 489
Total loans past-due ninety days or more and still accruing	\$ -	\$ 231
Average investment in impaired loans	\$ 2,433	\$ 313
Gross interest that would have been recorded if all loans had been accruing interest at their contractual rates	\$ 232	\$ 26
Interest income recognized on a cash basis on impaired loans, included in above amount	\$ 54	\$ -

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 4. Allowance for Loan Losses

A summary of the transactions in the allowance for loan losses for the years ended December 31, 2009 and 2008 appears below:

	2009	2008
	(in Thousands)	
Balance, beginning of period	\$ 3,084	\$ 2,646
Loans charged off	(412)	(284)
Recoveries	41	67
Provision for loan losses	1,019	655
Balance, December 31	\$ 3,732	\$ 3,084

### 5. Premises and Equipment

Bank premises and equipment are summarized as follows:

	December 31, 2009	December 31, 2008
	(in Thousands)	
Leasehold improvements	\$ 15,145	\$ 15,702
Buildings	207	207
Land	9	9
Construction in progress	129	-
Furniture and equipment	5,771	5,279
Computer software	1,713	1,238
	\$ 22,974	\$ 22,435
Less accumulated depreciation and amortization	9,759	8,186
	\$ 13,215	\$ 14,249

Depreciation and amortization expense included in the operating expenses amounted to \$1,657,000 in 2009 and \$1,384,000 in 2008.

### 6. Deposits

The aggregate amount of time deposits with a minimum balance of \$100,000 was \$91,808,000 at December 31, 2009 and \$55,427,000 at December 31, 2008.

Brokered deposits totaled \$47,175,000 and \$36,501,000 at December 31, 2009 and 2008, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2009, the scheduled maturities of time deposits are as follows:

		Scheduled Maturities at December 31, 2009
		(in thousands)
2010	\$	121,612
2011		1,424
2012		1,053
2013		853
2014		1,170
	\$	126,112

### 7. Income Taxes

The Bank files tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, the Bank is no longer subject to U.S. federal and state tax examinations by tax authorities for years prior to 2006.

Net deferred tax assets consist of the following components as of December 31, 2009 and December 31, 2008:

		2009		2008
		(in Thousands)		(in Thousands)
Deferred tax assets:				
Allowance for loan losses	\$	1,182	\$	958
Non-accrual loan interest		60		9
Stock option/grant expense		220		153
Start-up expenses		1		1
Home equity closing costs		92		103
Deferred loan costs		1		-
Deferred compensation expense		5		-
Depreciation		759		659
	\$	2,320	\$	1,883
Deferred tax liabilities:				
Securities available for sale	\$	380	\$	345
Deferred loan costs		-		49
Investment from subsidiary income		8		-
	\$	388	\$	394
	\$	1,932	\$	1,489

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The provision for income taxes charged to operations for years ended December 31, 2009 and 2008 consists of the following:

		2009		2008
	\$	(in Thousands)	\$	(in Thousands)
Current tax expense	\$	1,550	\$	402
Deferred tax (benefit)		(478)		(200)
	\$	1,072	\$	202

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income for the years ended December 31, 2009 and 2008 due to the following:

		2009		2008
	\$	(in Thousands)	\$	(in Thousands)
Computed "expected" tax expense	\$	1,027	\$	107
Increase (decrease) in income taxes resulting from:				
Tax-exempt interest income		(19)		(13)
Tax-exempt income from Bank				
Owned Life Insurance (BOLI)		(73)		(46)
Stock option expense		109		135
Social dues		17		7
Other		11		12
	\$	1,072	\$	202

### 8. Commitments and Contingent Liabilities

In the normal course of business, there are various outstanding commitments and contingent liabilities, which are not reflected in the accompanying financial statements. The Bank does not anticipate any material loss as a result of these transactions.

As a member of the Federal Reserve System, the Bank is required to maintain certain average clearing balances. Those balances include amounts on deposit with the Federal Reserve. For the final weekly reporting period in the years ended December 31, 2009 and December 31, 2008, the amounts of daily average required balances were \$497,000 and \$350,000, respectively.

At December 31, 2009, the Bank had leased certain of its banking and operations offices under operating lease agreements on terms ranging from 1 to 20 years with renewal options. Rent expense charged to operations under operating lease agreements totaled \$1,101,000 in 2009 and \$1,165,000 in 2008.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a schedule of future minimum rental payments required under non-cancelable operating leases that have initial or remaining terms in excess of one year as of December 31, 2009:

	(in Thousands)
2010	\$ 1,054
2011	995
2012	840
2013	742
2014	581
Thereafter	5,245
	\$ 9,457

### 9. Financial Instruments With Off-Balance Sheet Risk and Credit Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. In addition to the amounts shown below, the Bank has extended commitment letters at December 31, 2009 in the amount of \$19,683,000 to various borrowers. At December 31, 2008, commitment letters totaled \$18,844,000. Commitment letters are done in the normal course of business and, typically, expire after 120 days. All of these off-balance-sheet instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

	<u>Notional Amount</u>	
	<u>December 31, 2009</u>	<u>December 31, 2008</u>
	(in Thousands)	
Financial instruments whose contract amounts represent credit risk		
Unfunded lines-of-credit	\$82,912	\$64,606
Letters of credit	5,470	2,517
Total	\$88,382	\$67,123

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral normally consists of real property.

Standby letters of credit are conditional commitments by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds real estate and bank deposits as collateral supporting those commitments for which collateral is deemed necessary.

The Bank has approximately \$103,000 in deposits in other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) at December 31, 2009.

### **10. Related Party Transactions**

During 2009, the Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal shareholders (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Related parties were indebted to the Bank for loans totaling \$6,406,000 and \$6,405,000 at December 31, 2009 and 2008, respectively. During 2009, total principal additions were \$4,239,000 and total principal payments were \$4,238,000.

In 2009, the Bank had business dealings with companies owned by directors of the Bank. Expenditures made to these companies in 2009 include rental expenditures of \$435,000, paid to an entity for which a director of the Bank is an owner. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal.

### **11. Capital Requirements**

The Bank is subject to various regulatory capital requirements administered by the 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 the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2009 and 2008, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts and ratios as of December 31, 2009, are presented in the following table:

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(in Thousands)		(in Thousands)		(in Thousands)	
Total Capital						
(To Risk Weighted Assets)	\$43,897	12.54%	\$28,011	8.00%	\$35,014	10.00%
Tier 1 Capital						
(To Risk Weighted Assets)	\$40,165	11.47%	\$14,006	4.00%	\$21,009	6.00%
Tier 1 Capital						
(To Average Assets)	\$40,165	10.07%	\$15,957	4.00%	\$19,947	5.00%

The Bank's actual capital amounts and ratios as of December 31, 2008, are presented as follows:

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(in Thousands)		(in Thousands)		(in Thousands)	
Total Capital						
(To Risk Weighted Assets)	\$40,703	13.18%	\$24,699	8.00%	\$30,874	10.00%
Tier 1 Capital						
(To Risk Weighted Assets)	\$37,619	12.18%	\$12,350	4.00%	\$18,524	6.00%
Tier 1 Capital						
(To Average Assets)	\$37,619	10.03%	\$14,999	4.00%	\$18,749	5.00%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 12. Dividend Restrictions

Federal regulations limit the amount of dividends which the Bank can pay without obtaining prior approval. The amount of dividends that the Bank may pay is limited to current year earnings plus retained net profits for the two preceding years. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. The Bank paid no dividends during 2009 or 2008.

### 13. Fair Value Measurements

#### Determination of Fair Value

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the "Fair Value Measurements and Disclosures" topic of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgement. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

#### Fair Value Hierarchy

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Bank to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

### Securities Available For Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balances measured at fair value on a recurring basis as of December 31, 2009:

Description	<b><u>Fair Value Measurements at December 31, 2009 Using:</u></b>			
	<b>Balance as of December 31, 2009</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Available for sale securities	\$ <u>30,273</u>	\$ <u>—</u>	\$ <u>30,273</u>	\$ <u>—</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the balances measured at fair value on a recurring basis as of December 31, 2008:

<u>Description</u>	<u>Fair Value Measurements at December 31, 2008 Using:</u>			
	<u>Balance as of December 31, 2008</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Available for sale securities	\$ <u>17,343</u>	\$ <u>—</u>	\$ <u>17,343</u>	\$ <u>—</u>

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Bank to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

### **Other Real Estate Owned**

Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. Currently, the Bank has one OREO property carried at a balance of \$605,000.

### **Impaired Loans**

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value would be measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The value of real estate collateral would be determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value would be considered Level 3. The value of business equipment would be based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral would be based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses would be measured at

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

fair value on a nonrecurring basis. Any fair value adjustments would be recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. The Bank had \$8,134,000 in impaired loans as of December 31, 2009. None of these impaired loans required a valuation allowance after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

The following table presents the Bank's assets that were measured at fair value on a nonrecurring basis as of December 31, 2009:

<u>Description</u>	<u>Fair Value Measurements at December 31, 2009 Using:</u>			
	<u>Net Carrying Value as of December 31, 2009</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Other Real Estate Owned (OREO)	\$ <u>605</u>	\$ <u>—</u>	\$ <u>605</u>	\$ <u>—</u>

The following table presents the Bank's assets that were measured at fair value on a nonrecurring basis as of December 31, 2008:

<u>Description</u>	<u>Fair Value Measurements at December 31, 2008 Using:</u>			
	<u>Net Carrying Value as of December 31, 2008</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Other Real Estate Owned (OREO)	\$ <u>605</u>	\$ <u>—</u>	\$ <u>605</u>	\$ <u>—</u>

The following methods and assumptions were used by the Bank in estimating the fair value disclosures for financial instruments:

### **Cash and Short-Term Investments**

For those short-term instruments, including cash, due from banks and federal funds sold, the carrying amount is a reasonable estimate of fair value.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **Interest bearing deposits**

The carrying amounts of interest bearing deposits maturing within ninety days approximate their fair value.

### **Securities**

Fair values for securities, excluding restricted securities, are based on quoted market prices.

### **Loan Receivables**

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

### **Accrued Interest**

The carrying amounts of accrued interest approximate fair value.

### **Deposit Liabilities**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

### **Short-Term Borrowings**

The carrying amounts of securities sold under agreements to repurchase approximate fair value.

### **Off-Balance Sheet Financial Instruments**

At December 31, 2009 and 2008, the fair values of loan commitments and standby letters of credit are immaterial. Therefore, they have not been included in the following table.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in Thousands)		(in Thousands)	
<b>Financial Assets:</b>				
Cash and short-term investments	\$65,960	\$65,960	\$74,421	\$74,421
Other interest-bearing deposits	-	-	6,000	6,000
Securities	33,785	33,876	21,348	21,360
Loans, net	311,837	315,316	274,990	276,087
Accrued interest receivable	1,256	1,256	1,060	1,060
<b>Financial Liabilities:</b>				
Demand deposits and interest-bearing transaction accounts	\$268,045	\$268,045	\$237,915	\$237,915
Certificates of deposit	126,112	126,253	119,966	120,356
Securities sold under agreements to repurchase	3,610	3,610	2,842	2,842
Accrued interest payable	253	253	481	481

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk; however, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 14. Other Expenses

The Bank had the following other expenses as of the dates indicated:

	<u>December 31, 2009</u>	<u>December 31, 2008</u>
	(in Thousands)	
FDIC deposit insurance assessment	\$ 751	\$ 202
Marketing, advertising and promotion	699	760
Professional fees	513	760
Third party processing	362	126
Telecommunications	299	319
Virginia franchise tax	209	286
Office supplies	222	205
Other	1,465	1,109
	<u>\$ 4,520</u>	<u>\$ 3,767</u>

### Employee Benefit Plans

The Bank has a 401(k) plan available to all employees who are at least 18 years of age. Employees are able to elect the amount to contribute, not to exceed a maximum amount as determined by IRS regulation. The Bank has agreed to match 50% of every dollar contributed by employees up to a maximum of 6% of annual compensation.

“Vesting” refers to the rights of ownership to the assets in the 401(k) accounts. Bank contributions to the plan are vested by the employees according to the following schedule: 50% after two years of service, 75% after three years of service and 100% after four years of service. Employee contributions to the plan are always 100% vested. The Bank contributed \$183,000 to the plan in 2009 and \$121,000 in 2008.

### 15. Stock Incentive Plans

The Bank’s shareholders approved the Virginia National Bank 1998 Stock Incentive Plan at the 1999 Annual Meeting of Shareholders. The plan reserved 374,000 shares of Common Stock, an amount equal to 20% of the aggregate number of shares sold in the June, 1998 Common Stock offering. The plan covers both employee and director stock options. The 1998 Plan expired in June, 2008. No new grants will be issued under this Plan. At December 31, 2009, 360,285 stock options had been granted under this plan, net of forfeitures.

At the Annual Meeting of Shareholders of Virginia National Bank, held on May 21, 2003, shareholders approved the Virginia National Bank 2003 Stock Incentive Plan. An aggregate of 111,625 shares are presently issuable under the 2003 Plan. Forfeitures return to the plan as ungranted. At December 31, 2009, 105,645 stock options had been issued under this plan, net of forfeitures. There are 5,980 shares still available under this plan.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At the Annual Meeting of Shareholders of Virginia National Bank, held on May 16, 2005, shareholders approved the Virginia National Bank 2005 Stock Incentive Plan. An aggregate of 200,000 shares are presently issuable under the 2005 Plan. Forfeitures return to the plan as ungranted. At December 31, 2009, 177,984 stock options had been issued under this plan, net of forfeitures. There are 22,016 shares still available under this plan.

All three stock plans provide for granting of both incentive and nonqualified stock options. The option price of incentive options will not be less than the fair market value of the stock at the time an option is granted. Nonqualified options may be granted at a price established by the Board of Directors, including prices less than the fair market value on the date of grant. All options expire ten years from the grant date.

Changes in the stock options outstanding related to the 1998 Plan, the 2003 Plan and the 2005 Plan are summarized as follows:

	<u>2009</u>	<u>Weighted</u>
	<u>Number of</u>	<u>Average</u>
	<u>Shares</u>	<u>Exercise</u>
		<u>Price</u>
Outstanding at beginning of year	236,684	\$31.59
Granted	23,208	\$21.00
Exercised	(3,500)	\$10.00
Forfeited	(5,900)	\$38.03
Expired	--	--
Outstanding at end of year	250,492	\$30.76
Options exercisable at year-end	147,138	\$31.30
Weighted-average fair value of options granted during the year	\$7.76	

The fair value of each grant is estimated at the grant date using the Black-Scholes option-pricing model. The estimates were calculated using the following weighted-average assumptions: price volatility of 32.93%; risk-free interest rate of 2.31%; no dividend rate; and an expected option life of 6.25 years. Price volatility assumptions were based on the historical volatility of the price of Virginia National Bank's Common Stock. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grants. Expected lives are based on historical experience. The dividend rate is based on the Bank's history of not paying a dividend.

For the year ended December 31, 2009, the Bank recognized \$511,000 in compensation expense for stock options. As of December 31, 2009, there was \$719,000 in unamortized compensation expense remaining to be recognized in future reporting periods through 2014.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The aggregate intrinsic value of options outstanding at December 31, 2009 was \$0. The aggregate intrinsic value of options exercisable at December 31, 2009 was also \$0.

The total intrinsic value of options exercised during the year ended December 31, 2009 was \$28,000.

Summary information pertaining to options outstanding at December 31, 2009 is as follows:

Exercise Price	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$10.00 to 20.00	12,600	3.0 Years	\$18.88	12,600	\$18.88
20.01 to 30.00	95,037	6.9 Years	23.98	45,176	24.08
30.01 to 40.00	122,155	6.7 Years	35.40	72,712	35.57
40.01 to 42.25	20,700	6.6 Years	41.69	16,650	41.65
Total	<u>250,492</u>	6.5 Years	\$30.76	<u>147,138</u>	\$31.30

The Bank granted 7,500 restricted stock awards (non-vested shares) in years prior to 2009. For 1,500 stock awards, the requisite service period is three years. For 6,000 stock awards, the requisite service period is four years. The Bank recorded \$62,375 in compensation expense related to these grants in 2009. No restricted stock awards were granted in 2009.

The following table summarizes restricted stock activity at December 31, 2009:

	<u>Number of Shares</u>	<u>Average Grant-Date Fair Value</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at beginning of year	5,500	\$30.59	
Vested	<u>2,000</u>	\$31.19	
Non-vested at end of year	<u>3,500</u>	\$30.25	\$51,625

The weighted average remaining contractual term for non-vested grants at December 31, 2009 was 1.2 years. As of December 31, 2009, there was \$98,625 of total unrecognized compensation expense related to the non-vested awards.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 16. Earnings Per Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential dilutive common stock has no effect on income available to common shareholders.

	2009		2008	
	<u>Shares</u>	<u>Per Share Amount</u>	<u>Shares</u>	<u>Per Share Amount</u>
Basic EPS	2,335,622	\$0.83	2,304,801	\$0.05
Effect of dilutive securities, stock options	7,159		26,431	
Diluted EPS	<u>2,342,781</u>	<u>\$0.83</u>	<u>2,331,232</u>	<u>\$0.05</u>

In 2009, stock options representing 224,284 average shares were not included in the calculation of earnings per share, as their effect would have been antidilutive. Stock options representing 191,509 average shares were similarly not included in 2008.

### 17. Segment Reporting

The Bank has two reportable segments, the commercial bank and VNBTrust.

Commercial banking involves making loans and generating deposits from individuals and businesses. Loan fee income, service charges from deposit accounts and other non-interest-related fees such as automatic teller machine fees and safe deposit box fees generate additional income for the commercial bank.

VNBTrust services include investment management, trust account administration and estate planning. VNBTrust receives fees on both a fixed basis and a performance basis for the provision of these services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Each reportable segment is a strategic business unit that offers different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technology and marketing strategies.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Segment information as of, and for the years ended, December 31, 2009 and 2008, is shown in the following table:

<b><u>2009</u></b>	<u>Commercial</u>		<u>Consolidated</u>
(in Thousands)	<u>Bank</u>	<u>VNBTrust</u>	<u>Totals</u>
Net interest income	\$ 15,583	\$ 8	\$ 15,591
Provision for loan losses	1,019	-	1,019
Non-interest income	1,787	5,351	7,138
Non-interest expense	15,903	2,787	18,690
Income before income taxes	448	2,572	3,020
Provision for income taxes	148	924	1,072
Net income	300	1,648	1,948
Total assets	436,080	5,214	441,294

<b><u>2008</u></b>	<u>Commercial</u>		<u>Consolidated</u>
(in Thousands)	<u>Bank</u>	<u>VNBTrust</u>	<u>Totals</u>
Net interest income	\$ 13,693	\$ 38	\$ 13,731
Provision for loan losses	655	-	655
Non-interest income	1,164	1,256	2,420
Non-interest expense	13,398	1,784	15,182
Income (loss) before income taxes	804	(490)	314
Provision for income taxes	319	(117)	202
Net income (loss)	485	(373)	112
Total assets	398,837	2,338	401,175

### 19. Subsequent Events

In preparing these financial statements, the Bank has evaluated events and transactions for potential recognition or disclosure through the date the financial statements were issued.



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders  
Virginia National Bank and Subsidiary  
Charlottesville, Virginia

We have audited the accompanying consolidated balance sheets of Virginia National Bank and Subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Virginia National Bank and Subsidiary as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assessment of the effectiveness of Virginia National Bank and Subsidiary's internal control over financial reporting as of December 31, 2009, included in the accompanying *Item 9A(T) Controls and Procedures* and, accordingly, we do not express an opinion thereon.

*Yount, Hyde & Barbour, P.C.*

Winchester, Virginia  
March 26, 2010

**Item 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None

**Item 9A(T) – CONTROLS AND PROCEDURES.**

Bank management is responsible for establishing and maintaining adequate control over financial reporting, as defined in Rules 13a – 15(f) under the Exchange Act. The Bank’s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of performing their assigned functions.

Management assessed the effectiveness of the Bank’s internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in “Internal Control-Integrated Framework.” Based on this assessment, management believes that, as of December 31, 2009, the Bank’s internal control over financial reporting was effective.

This annual report does not include an attestation report of the Bank’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the Bank’s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Bank to provide only management’s report in this annual report.

**Item 9B – OTHER INFORMATION.**

None

**Part III**

**Item 10 – DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

Information is incorporated herein by reference from pages 4 through 16 of the Bank’s 2010 Definitive Proxy Statement (“Proxy Statement”) for all directors and executive officers.

**Item 11 – EXECUTIVE COMPENSATION.**

This information is incorporated herein by reference from pages 11 through 14 of the Bank’s Definitive Proxy Statement.

**Item 12 – SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

Other than as set forth below, this information is incorporated herein by reference from pages 15 and 16 of the Bank’s Definitive Proxy Statement and from Note 15, “Stock Incentive Plans,” contained in the *Notes to Consolidated Financial Statements* of this Form 10-K.

The following table summarizes information, as of December 31, 2009, relating to the Bank’s 1998 Stock Incentive Plan, 2003 Stock Incentive Plan and 2005 Stock Incentive Plan:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	250,492	\$30.76	27,996
Equity compensation plans not approved by security holders	--	--	--
Total	250,492	\$30.76	27,996

**Item 13 – CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

This information is incorporated herein by reference from pages 11 and 16 of the Bank’s Definitive Proxy Statement. For further information, see Note 10 of the *Notes to Consolidated Financial Statements*.

**Item 14 – PRINCIPAL ACCOUNTING FEES AND SERVICES.**

This information is incorporated herein by reference from page 17 of the Bank’s Definitive Proxy Statement.

## Part IV

### **Item 15 – EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

(a) Exhibit Index:

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
3.1	Articles of Association of Virginia National Bank, as amended
3.2	Bylaws of Virginia National Bank, as amended
4.0	Form of Common Stock Certificate of Virginia National Bank*
10.1	Employment Letter Agreement between the Organizers of Virginia National Bank (In Organization) and Mark T. Giles*
10.2	Employment Letter Agreement between Virginia National Bank (In Organization) and Hunter E. Craig*
10.3	Form of Virginia National Bank 1998 Stock Incentive Plan* Form of Virginia National Bank 2003 Stock Incentive Plan** Form of Virginia National Bank 2005 Stock Incentive Plan***
21.0	Subsidiaries of the Registrant****
22.0	Proxy Statement for Annual Meeting on May 17, 2010, filed herewith
31.1	302 Certification of Principal Executive Officer
31.2	302 Certification of Principal Financial Officer
32.1	906 Certification

\* Incorporated herein by reference from Virginia National Bank's Registration Statement on Form SB-2, filed with the Office of the Comptroller of the Currency's Southeastern District Office on May 21, 1998, as amended.

\*\* Incorporated herein by reference from Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 24, 2003.

\*\*\* Incorporated herein by reference from Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 22, 2005.

\*\*\*\* Refer to page 4 for a discussion of Virginia National Bank's direct and indirect subsidiaries.



**EXHIBIT 31.1**

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**

I, Glenn W. Rust, certify that:

1. I have reviewed this annual report on Form 10-K of Virginia National Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such disclosure over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 26, 2010

/s/ Glenn W. Rust  
Glenn W. Rust  
Chief Executive Officer

## EXHIBIT 31.2

### **CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER**

I, Stephen B. Perry, certify that:

1. I have reviewed this annual report on Form 10-K of Virginia National Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such disclosure over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 26, 2010

/s/ Stephen B. Perry  
Stephen B. Perry  
Chief Operations Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT  
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Virginia National Bank (the "Bank") on Form 10-K for the period ending December 31, 2009 as filed with the Office of the Comptroller of the Currency on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Bank hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that, based on their knowledge and belief: (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank as of and for the periods covered in the Report.

/s/ Glenn W. Rust

Glenn W. Rust, Principal Executive Officer

/s/ Stephen B. Perry

Stephen B. Perry, Principal Financial Officer

March 26, 2010