

NEW PEOPLES BANKSHARES INC
Form 10-K
March 13, 2017

United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-K

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

For fiscal year ended December 31, 2016

Commission File Number 000-33411

New Peoples Bankshares, Inc.

(Exact name of registrant as specified in its charter)

Virginia 31-1804543
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

67 Commerce Drive 24260
Honaker, VA
(Address of principal executive offices) (Zip Code)

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

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

None

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

Common Stock - \$2 Par Value

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 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K Section 229.405 is not contained herein, and will not be contained, to the best of 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. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if 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 Act). Yes No

The aggregate market value of the common stock held by non-affiliates, based on the last reported sales prices of \$1.50 per share on the last business day of the second quarter of 2016 was \$15,017,102.

The number of shares outstanding of the registrant’s common stock was 23,355,457 as of March 10, 2017.

DOCUMENTS INCORPORATED BY REFERENCE:

The Proxy Statement for New Peoples Bankshares, Inc’s 2017 Annual Meeting to Shareholders, is incorporated into Items 10 through 14 of this form 10-K.

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PART I

Item 1. Business

General

New Peoples Bankshares, Inc. (New Peoples) is a Virginia financial holding company headquartered in Honaker, Virginia. From January 1, 2009 to March 3, 2016, New Peoples was a bank holding company. On March 4, 2016 the Federal Reserve Bank of Richmond approved New Peoples's election to become a financial holding company. Our business is conducted primarily through New Peoples Bank, Inc., a Virginia banking corporation (the Bank). The Bank has a division doing business as New Peoples Financial Services which offers investment services through its broker-dealer relationship with LPL Financial Services, Inc. NPB Insurance Services, Inc. (NPB Insurance) is a subsidiary of the Bank and offers insurance services only.

The Bank offers a range of banking and related financial services focused primarily on serving individuals, small to medium size businesses, and the professional community. We strive to serve the banking needs of our customers while developing personal, hometown relationships with them. Our board of directors believes that marketing customized banking services enables us to establish a niche in the financial services marketplace where we do business.

The Bank is headquartered in Honaker, Virginia and operates 19 full service offices in southwestern Virginia, southern West Virginia and eastern Tennessee. The Bank also operates a loan production office in the eastern Tennessee county of Washington.

We provide professionals and small and medium size businesses in our market area with responsive and technologically enabled banking services. These services include loans that are priced on a deposit relationship basis, easy access to our decision makers, and quick and innovative action necessary to meet a customer's banking needs. Our capitalization and lending limit enable us to satisfy the credit needs of a large portion of the targeted market segment. When a customer needs a loan that exceeds our lending limit, we try to find other financial institutions to participate in the loan with us.

Our History

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The Bank was incorporated under the laws of the Commonwealth of Virginia on December 9, 1997 and began operations on October 28, 1998. On September 27, 2001, the shareholders of the Bank approved a plan of reorganization under which they exchanged their shares of Bank common stock for shares of New Peoples common stock. On November 30, 2001, the reorganization was completed and the Bank became New Peoples' wholly-owned subsidiary.

In June 2003, New Peoples formed two new wholly-owned subsidiaries, NPB Financial Services, Inc. (currently named NPB Insurance Services, Inc.) and NPB Web Services, Inc. (NPB Web), a web design and hosting company.

The Bank, through its division New Peoples Financial services, offers fixed and variable annuities, fee based asset management and other investment products through a broker/dealer relationship with LPL Financial Services, Inc.

NPB Web is inactive.

In July 2004, NPB Capital Trust I was formed to issue \$11.3 million in trust preferred securities.

In September 2006, NPB Capital Trust 2 was formed to issue \$5.2 million in trust preferred securities.

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In July 2016, the Bank and its wholly-owned subsidiary NPB Insurance Services, Inc. commenced a business relationship with The Hilb Group of Virginia dba CSE Insurance Services, a division of the Hilb Group, LLC (“CSE”), located in Abingdon, Virginia, to provide insurance services for the Bank’s current and future customers. Effective July 1, 2016, NPB Insurance Services, Inc. sold its existing book of business to CSE. These customers are now serviced by CSE and the Bank refers future insurance needs of its bank customers to CSE.

Branch Locations

After a period of significant branch expansion between 2000 and 2008, we have consolidated some of our branch operations to improve efficiency. Currently, in addition to our headquarters in Honaker, Virginia we have 18 branches located in Abingdon, Virginia; Big Stone Gap, Virginia; Bluefield, Virginia; Bristol, Virginia; Castlewood, Virginia; Chilhowie, Virginia; Clintwood, Virginia; Gate City, Virginia; Grundy, Virginia; Haysi, Virginia; Lebanon, Virginia; Pound, Virginia; Pounding Mill, Virginia; Tazewell, Virginia; Weber City, Virginia; Wise, Virginia; Princeton, West Virginia; and Kingsport, Tennessee. In July 2016, a loan production office was opened in Jonesborough, Tennessee.

Our Market Areas

Our primary market area consists of southwestern Virginia, southern West Virginia and northeastern Tennessee. Specifically, we operate in the southwestern Virginia counties of Russell, Scott, Washington, Tazewell, Buchanan, Dickenson, Wise, and Smyth; Mercer county in southern West Virginia and the northeastern Tennessee county of Sullivan and Washington (collectively, the “Tri-State Area”). The close proximity and mobile nature of individuals and businesses in adjoining counties and nearby cities in Virginia, West Virginia and Tennessee place these markets within our Bank’s targeted trade area, as well.

Accessibility to Interstates I-77, I-81, I-26, I-64 and I-75, as well as major state and U.S. highways including US 19, US 23, US 58, US 460 and US 421, make the area an ideal location for businesses to serve markets in the Mid-Atlantic, Southeast and Midwest. The area is strategically located midway between Atlanta-Pittsburgh, Charlotte-Cincinnati, and Richmond-Louisville, and is within a day’s drive of more than half of the U.S. population. A regional airport located in Bristol, Tennessee serves the area with commercial flights to and from major cities in the United States. Commercial rail service providers include CSX Transportation and Norfolk Southern Railways.

The Tri-State Area has a diversified economy supported by natural resources, which include coal, natural gas, limestone, and timber; agriculture; healthcare; education; technology; manufacturing and services industries. Predominantly, the market is comprised of locally-owned and operated small businesses. Considerable investments in high-technology communications, high-speed broadband network and infrastructure have been made which has opened the area to large technology companies and future business development potential for new and existing businesses. Industries are taking advantage of the low cost of doing business, training opportunities, available

workforce and an exceptional quality of life experience for employers and employees alike.

Internet Site

We have our internet banking site at www.newpeoplesbank.com. The site includes a customer service area that contains branch and ATM locations, product descriptions and current interest rates offered on deposit accounts. Customers with internet access can access account balances, make transfers between accounts, enter stop payment orders, order checks, and use an optional bill paying service.

Available Information

We file annual, quarterly, and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). Our SEC filings are filed electronically and are available to the public online at the SEC's web site at www.sec.gov. In addition, any document we file with the SEC can be read and copied at the SEC's public reference facilities at 100 F Street, N.E., Washington, D.C. 20549. Copies of documents can be obtained at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We also provide a link to our filings on the SEC website, free of charge, through our internet website www.npbankshares.com under "Investor Relations."

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Banking Services

General. We accept deposits, make consumer and commercial loans, issue drafts, and provide other services customarily offered by a commercial bank, such as business and personal checking and savings accounts, walk-up tellers, drive-in windows, and 24-hour automated teller machines. The Bank is a member of the Federal Reserve System and its deposits are insured under the Federal Deposit Insurance Act (the FDIA) to the maximum limit.

Loans. Generally, we offer a full range of short-to-medium term commercial, 1-4 family residential mortgages and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements) and purchase of equipment and machinery. Consumer loans may include secured and unsecured loans for financing automobiles, home improvements, education, personal investments and other purposes.

Our lending activities are subject to a variety of lending limits imposed by state law. While differing limits may apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the Bank), the Bank generally is subject to a loan-to-one-borrower limit of an amount equal to 15% of its capital and surplus plus the allowance for loan losses. The Bank voluntarily may choose to impose a policy limit on loans to a single borrower that is less than the legal lending limit.

We obtain short-to-medium term commercial and personal loans through direct solicitation of business owners and continued business from existing customers. Completed loan applications are reviewed by our loan officers. As part of the application process, information is obtained concerning the income, financial condition, employment and credit history of the applicant. If commercial real estate is involved, information is also obtained concerning cash flow after debt service. Loan quality is analyzed based on the Bank's experience and its credit underwriting guidelines.

Loans by type as a percentage of total loans are as follows:

	December 31,				
	2016	2015	2014	2013	2012
Commercial, financial and agricultural	11.75%	10.76%	10.99%	11.70%	12.61%
Real estate – construction	5.50%	3.33%	3.37%	4.55%	4.66%
Real estate – commercial	22.05%	22.34%	23.62%	25.59%	28.70%
Real estate – residential	55.97%	58.00%	56.37%	52.87%	48.39%
Installment loans to individuals	4.73%	5.57%	5.65%	5.29%	5.64%
Total	100.00%	100.00%	100.00%	100.00%	100.00%

Commercial Loans. We make commercial loans to qualified businesses in our market area. Our commercial lending consists primarily of commercial and industrial loans to finance accounts receivable, inventory, property, plant and equipment. Commercial business loans generally have a higher degree of risk than residential mortgage loans, but have commensurately higher yields. Residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from employment and other income and are secured by real estate whose value tends to be easily ascertainable. In contrast, commercial business loans typically are made on the basis of the borrower's ability to make repayment from cash flow from its business and are secured by business assets, such as commercial real estate, accounts receivable, equipment and inventory. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself.

Further, the collateral for commercial business loans may depreciate over time and cannot be appraised with as much precision as residential real estate. To manage these risks, our underwriting guidelines require us to secure commercial loans with both the assets of the borrowing business and other additional collateral and guarantees that may be available. In addition, we actively monitor certain measures of the borrower, including advance rate, cash flow, collateral value and other appropriate credit factors.

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Residential Mortgage Loans. Our residential mortgage loans consist of residential first and second mortgage loans, residential construction loans, home equity lines of credit and term loans secured by first and second mortgages on the residences of borrowers for home improvements, education and other personal expenditures. We make mortgage loans with a variety of terms, including fixed and floating or variable rates and a variety of maturities.

Under our underwriting guidelines, residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from employment and other income and are secured by real estate whose value tends to be easily ascertainable. These loans are made consistent with our appraisal policies and real estate lending policies, which detail maximum loan-to-value ratios and maturities. New requirements arising out of the response to the recent financial crisis for extending residential mortgage loans may impact our ability to make these types of loans in the same volume as in the past.

Construction Loans. Construction lending entails significant additional risks, compared to residential mortgage lending. Construction loans often involve larger loan balances concentrated with single borrowers or groups of related borrowers. Construction loans also involve additional risks attributable to the fact that loan funds are advanced upon the security of property under construction, which is of uncertain value prior to the completion of construction. Thus, it is more difficult to evaluate the total loan funds required to complete a project and related loan-to-value ratios accurately. To minimize the risks associated with construction lending, loan-to-value limitations for residential, multi-family and non-residential construction loans are in place. These are in addition to the usual credit analysis of borrowers. Management feels that the loan-to-value ratios help to minimize the risk of loss and to compensate for normal fluctuations in the real estate market. Maturities for construction loans generally range from 4 to 12 months for residential property and from 6 to 18 months for non-residential and multi-family properties.

Consumer Loans. Our consumer loans consist primarily of installment loans to individuals for personal, family and household purposes. The specific types of consumer loans that we make include home improvement loans, debt consolidation loans and general consumer lending. Consumer loans entail greater risk than residential mortgage loans do, particularly in the case of consumer loans that are unsecured, such as lines of credit, or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. A borrower may also be able to assert against the Bank as an assignee any claims and defenses that it has against the seller of the underlying collateral.

Our underwriting policy for consumer loans seeks to limit risk and minimize losses, primarily through a careful analysis of the borrower. In evaluating consumer loans, we require our lending officers to review the borrower's level and stability of income, past credit history and the impact of these factors on the ability of the borrower to repay the loan in a timely manner. In addition, we maintain an appropriate margin between the loan amount and collateral value.

Deposits. We offer a variety of deposit products for both individual and business customers. These include demand deposit, interest-bearing demand deposit, savings deposit, and money market deposit accounts. In addition, we offer certificates of deposit with terms ranging from 7 days to 60 months and individual retirement accounts with terms ranging from 12 months to 60 months.

Investment Services. We offer a variety of investment services for both individual and business customers. These services include fixed income products, variable annuities, mutual funds, indexed certificates of deposit, individual retirement accounts, long term care insurance, employee group benefit plans, college savings plans, financial planning, managed money accounts, and estate planning. We offer these services through our broker-dealer relationship with LPL Financial Services, Inc.

Other Bank Services. Other bank services include safe deposit boxes, cashier's checks, certain cash management services, direct deposit of payroll and social security checks and automatic drafts for various accounts. We offer ATM card services that can be used by our customers throughout Virginia and other regions. We also offer consumer and commercial VISA credit card services. Electronic banking services include debit cards, internet banking, telephone banking, mobile banking, remote deposit capture, and wire transfers.

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We do not presently anticipate obtaining trust powers, but we are able to provide similar services through our affiliation with LPL Financial Services, Inc.

Competition

The banking business is highly competitive. We compete as a financial intermediary with other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions operating in the southwestern Virginia, southern West Virginia, and eastern Tennessee market area and elsewhere. Our market area is a highly competitive, highly branched banking market.

Competition in the market area for loans to small businesses and professionals, the Bank's target market, is intense, and pricing is important. Many of our larger competitors have substantially greater resources and lending limits than we have. They offer certain services, such as extensive and established branch networks and trust services that we do not expect to provide or will not provide in the near future. Moreover, larger institutions operating in the market area have access to borrowed funds at lower costs than are available to us. Deposit competition among institutions in the market area also is strong. As a result, it is possible that we may have to pay above-market rates to attract deposits.

While pricing is important, our principal method of competition is service. As a community banking organization, we strive to serve the banking needs of our customers while developing personal, hometown relationships with them. As a result, we provide a significant amount of service and a range of products without the fees that customers can expect from larger banking institutions.

According to a market share report prepared by the Federal Deposit Insurance Corporation (the FDIC), as of June 30, 2016, the most recent date for which market share information is available, the Bank's deposits as a percentage of total deposits in its major market areas were as follows: Russell County, VA – 23.28%, Scott County, VA – 34.16%, Dickenson County, VA – 27.92%, Tazewell County, VA – 9.24%, Smyth County, VA – 2.27%, Buchanan County, VA – 9.08%, Wise County, VA – 11.40%, Washington County, VA – 2.74%, and the City of Bristol, VA – 1.81%, Mercer County, WV – 5.53%, and City of Kingsport, TN – 1.26%.

Employees

As of December 31, 2016, we had 255 total employees, of which 243 were full-time employees. None of our employees are covered by a collective bargaining agreement, and we consider relations with employees to be excellent.

Supervision and Regulation

General. As a financial holding company, we are subject to regulation under the Bank Holding Company Act of 1956, as amended (“BHCA”), and the examination and reporting requirements of the Board of Governors of the Federal Reserve System (the “Federal Reserve”). We are also subject to Chapter 13 of the Virginia Banking Act, as amended (“Virginia Act”). As a state-chartered commercial bank, the Bank is subject to regulation, supervision and examination by the Virginia State Corporation Commission’s Bureau of Financial Institutions (“BFI”). As a member of the Federal Reserve system, the Bank is also subject to regulation, supervision and examination by the Federal Reserve. Other federal and state laws, including various consumer protection and compliance laws, govern the activities of the Bank, such as the investments that it makes and the aggregate amount of loans that it may grant to one borrower.

The following description summarizes the most significant federal and state laws applicable to New Peoples and its subsidiaries. To the extent that statutory or regulatory provisions are described, the description is qualified in its entirety by reference to that particular statutory or regulatory provision.

The Bank Holding Company Act. Under the BHCA, the Federal Reserve examines New Peoples periodically. New Peoples is also required to file periodic reports and provide any additional information that the Federal Reserve may require. Activities at the bank holding company level are generally limited to:

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- banking, managing or controlling banks;
- furnishing services to or performing services for its subsidiaries; and
- engaging in other activities that the Federal Reserve has determined by regulation or order to be so closely related to banking as to be a proper incident to these activities.

Thus, the activities we can engage in are restricted as a matter of law.

With some limited exceptions, the BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before:

- acquiring substantially all the assets of any bank;
- acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares); or
- merging or consolidating with another bank holding company.

As a result, our ability to engage in certain strategic activities is conditioned on regulatory approval.

In addition, and subject to some exceptions, the BHCA and the Change in Bank Control Act require Federal Reserve approval prior to any person or company acquiring “control” of a bank holding company as defined in the statutes and regulations. These requirements make it more difficult for control of our company to change or for us to acquire substantial investments.

Financial Holding Company. As of March 4, 2016 the Company qualified as a financial holding company (“FHC”). The Gramm-Leach-Bliley Act created this category of bank holding companies. FHC’s may directly or indirectly through

subsidiaries engage in financial activities and activities “incidental” or “complimentary” to financial activities. Generally, a FHC need not give prior notice of acquisitions or activities, but must notify the Federal Reserve within 30 days after the event.

The BHCA provides a long list of “financial” activities such as underwriting, brokering or selling insurance; providing financial or investment advice; underwriting; dealing in or making a market in securities.

There are other potential “financial” activities in which the Federal Reserve is permitted to designate as permitted financial or incidental to financial activities.

We do not currently undertake activities specifically permitted to us as a FHC.

The Virginia Act. As a bank holding company registered with the BFI, we must provide the BFI with information concerning our financial condition, operations and management, among other reports required by the BFI. New Peoples is also examined by the BFI in addition to its Federal Reserve examinations. Similar to the BHCA, the Virginia Act requires that the BFI approve the acquisition of direct or indirect ownership or control of more than 5% of the voting shares of any Virginia bank or bank holding company like us.

Payment of Dividends. New Peoples is a separate legal entity that derives the majority of its revenues from dividends paid to it by its subsidiaries. The Bank is subject to laws and regulations that limit the amount of dividends it can pay. In addition, both New Peoples and the Bank are subject to various regulatory restrictions relating to the payment of dividends, including requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that banking organizations should generally pay dividends only if the organization’s net income available to common shareholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with the organization’s capital needs, asset quality and overall financial condition. The FDIC has the general authority to limit the dividends paid by FDIC insured banks if the FDIC deems the payment to be an unsafe and unsound practice. The FDIC has indicated that paying dividends that deplete a bank’s capital base to an inadequate level would be an unsound and unsafe banking practice. In October 2009, the Federal Reserve Bank of Richmond (“Richmond FRB”) restricted the Company from paying dividends without prior approval. This restriction was lifted when the Written Agreement was terminated effective January 20, 2016. For additional discussion concerning the Written Agreement, see Note 3, “Formal Written Agreement”.

Capital Requirements. The Federal Reserve has issued risk-based and leverage capital guidelines applicable to banking organizations that it supervises. Under the risk-based capital requirements, the Bank and the Company are each generally required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) of 8%. At least half of the total capital must be composed of “Tier 1 Capital”, which is defined as common equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles. The remainder may consist of “Tier 2 Capital”, which is defined as specific subordinated debt, some hybrid capital instruments and other qualifying preferred stock and a limited amount of the loan loss allowance. These risk-based capital standards attempt to measure capital adequacy relative to the institution’s risk profiles. In addition, each of the federal banking regulatory agencies has established minimum leverage capital requirements for banking organizations. Under these requirements, banking organizations must maintain a minimum ratio of Tier 1 capital to adjusted average quarterly assets of between 3% and 5%, subject to federal bank regulatory evaluation of an organization’s overall safety and soundness. The principal objective of the leverage ratio is to constrain the degree to which an institution may leverage its equity capital base. In sum, the capital measures used by the federal banking regulators are:

- the Total Capital ratio, which is the total of Tier 1 Capital and Tier 2 Capital;
- the Tier 1 Capital ratio;
- the Leverage ratio; and,
- the Common Equity Tier 1 Capital ratio.

Under these regulations, a bank will be:

- “well capitalized” if it has a Total Capital ratio of 10% or greater, a Tier 1 Capital ratio of 6% or greater, a leverage ratio of 5% or greater, and is not subject to any written agreement, order, capital directive, or prompt corrective action directive by a federal bank regulatory agency to meet and maintain a specific capital level for any capital measure;
- “adequately capitalized” if it has a Total Capital ratio of 8% or greater, a Tier 1 Capital ratio of 4% or greater, and a leverage ratio of 4% or greater – or 3% in certain circumstances – and is not well capitalized;

- “undercapitalized” if it has a Total Capital ratio of less than 8%, a Tier 1 Capital ratio of less than 4% - or 3% in certain circumstances;
- “significantly undercapitalized” if it has a Total Capital ratio of less than 6%, a Tier 1 Capital ratio of less than 3%, or a leverage ratio of less than 3%; or
- “critically undercapitalized” if its tangible equity is equal to or less than 2% of average quarterly tangible assets,

The risk-based capital standards of the Federal Reserve explicitly identify concentrations of credit risk and the risk arising from non-traditional activities, as well as an institution’s ability to manage these risks, as important factors to be taken into account by the agency in assessing an institution’s overall capital adequacy. The capital guidelines also provide that an institution’s exposure to a decline in the economic value of its capital due to changes in interest rates be considered as a factor in evaluating a banking organization’s capital adequacy. Thus, the capital level of a bank can be of regulatory concern even if it is “well-capitalized” under the regulatory formula and a “well-capitalized” bank can be required to maintain even higher capital levels based on its asset quality or other regulatory concerns.

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The regulators may take various corrective actions with respect to a financial institution considered to be capital deficient. These powers include, but are not limited to, requiring the institution to be recapitalized, prohibiting asset growth, restricting interest rates paid or dividends, requiring prior approval of capital distributions by any bank holding company that controls the institution, requiring divestiture by the institution of its subsidiaries or by the holding company of the institution itself, requiring new election of directors, and requiring the dismissal of directors and officers. Bank holding companies can be called upon to boost their subsidiary bank's capital and to partially guarantee the institution's performance under its capital restoration plan. If this occurs, capital which otherwise would be available for holding company purposes, including possible distributions to shareholders, would be required to be downstreamed to the subsidiary bank. As of December 31, 2016, the Bank was "well capitalized," with a Total Capital ratio of 16.64%; a Tier 1 Capital ratio of 15.39%; a leverage ratio of 9.93%, and a Common Equity Tier 1 Capital ratio of 15.39%.

New Capital Requirements. On July 2, 2013, the Federal Reserve adopted final Basel III capital rules for U.S. banking organizations. Effective January 1, 2015, the final rules require the Company and the Bank to comply with the following new minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets (increased from the current requirement of 4.0%); (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from current requirement); and (iv) a leverage ratio of 4.0% of total assets. These are the initial capital requirements and the remainder will be phased in over a five-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% common equity Tier 1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

With respect to the Bank, the rules also revised the "prompt corrective action" regulations pursuant to Section 38 of the FDIA by (i) introducing a common equity Tier 1 capital ratio requirement at each level (other than critically undercapitalized), with the required ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum ratio for well-capitalized status being 8.0% (as compared to the current 6.0%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized.

The new capital requirements also include changes in the risk weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and nonresidential mortgage loans that are 90 days past due or otherwise on nonaccrual status, a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital, and increased risk-weights (from 0% to up to 600%) for equity exposures.

As a result of the new capital requirements effective January 1, 2015, the Bank experienced increases in its capital levels. Part of this increase was due to the regulatory changes concerning deferred tax assets being excluded in the capital calculations. As a result of the deferred tax valuation allowance of \$5.7 million as of December 31, 2015, which had been expensed in prior years, we did not have to deduct any of our deferred tax assets in the calculation of our capital ratios for 2015. For our 2016 capital ratios, we only had to deduct \$151 thousand of our deferred tax asset due to the deferred tax valuation allowance of \$5.4 million as of December 31, 2016. In prior years we would have had to deduct the portion of our deferred tax asset that would only be recognizable in a one year time period. See Note 22 of the Notes to the Consolidated Financial Statements for further discussion of our capital requirements and ratios.

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Other Safety and Soundness Regulations. There are a number of obligations and restrictions imposed on bank holding companies and their bank subsidiaries by federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event that the depository institution is insolvent or is in danger of becoming insolvent. For example, the Federal Reserve requires a bank holding company to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so otherwise. These requirements can restrict the ability of bank holding companies to deploy their capital as they otherwise might.

Interstate Banking and Branching. Banks in Virginia may branch without geographic restriction. Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation. Bank holding companies may acquire banks in any state without regard to state law except for state laws requiring a minimum time a bank must be in existence to be acquired. The Virginia Act generally permits out of state bank holding companies or banks to acquire Virginia banks or bank holding companies subject to regulatory approval. These laws have the effect of increasing competition in banking markets.

Monetary Policy. The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. The Federal Reserve's monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of unsettled conditions in the national and international political environment, economy and money markets, as well as governmental fiscal and monetary policies their impact on interest rates, deposit levels, loan demand or the business and earnings of the Bank is unpredictable.

Federal Reserve System. Depository institutions that maintain transaction accounts or nonpersonal time deposits are subject to reserve requirements. These reserve requirements are subject to adjustment by the Federal Reserve. Because required reserves must be maintained in the form of vault cash or in a non-interest-bearing account at, or on behalf of, a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets.

Transactions with Affiliates. Transactions between banks and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. These provisions restrict the amount and provide conditions with respect to loans, investments, transfers of assets and other transactions between New Peoples and the Bank.

Loans to Insiders. The Bank is subject to rules on the amount, terms and risks associated with loans to executive officers, directors, principal shareholders and their related interests.

Community Reinvestment Act. Under the Community Reinvestment Act, depository institutions have an affirmative obligation to assist in meeting the credit needs of their market areas, including low and moderate-income areas,

consistent with safe and sound banking practice. The Community Reinvestment Act emphasizes the delivery of bank products and services through branch locations in its market areas and requires banks to keep data reflecting their efforts to assist in its community's credit needs. Depository institutions are periodically examined for compliance with the Community Reinvestment Act and are periodically assigned ratings in this regard. Banking regulators consider a depository institution's Community Reinvestment Act rating when reviewing applications to establish new branches, undertake new lines of business, and/or acquire part or all of another depository institution. An unsatisfactory rating can significantly delay or even prohibit regulatory approval of a proposed transaction by a bank holding company or its depository institution subsidiaries. A bank holding company will not be permitted to become a financial holding company and no new activities authorized under the GLBA (see below) may be commenced by a holding company or by a bank financial subsidiary if any of its bank subsidiaries received less than a "satisfactory" rating in its latest Community Reinvestment Act examination. The Bank received a rating of "Satisfactory" at its last Community Reinvestment Act performance evaluation, as of June 13, 2016.

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Other Laws. Banks and other depository institutions also are subject to numerous consumer-oriented laws and regulations. These laws, which include the Truth in Lending Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, the Electronic Funds Transfer Act, the Equal Credit Opportunity Act, the Fair and Accurate Credit Transactions Act of 2003 and the Fair Housing Act, require compliance by depository institutions with various disclosure and consumer information handling requirements. These and other similar laws result in significant costs to financial institutions and create potential liability for financial institutions, including the imposition of regulatory penalties for inadequate compliance.

Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Act of 1999 (“GLBA”) covers a broad range of issues, including a repeal of most of the restrictions on affiliations among depository institutions, securities firms and insurance companies.

For example, the GLBA permits unrestricted affiliations between banks and securities firms. It also permits bank holding companies to elect to become financial holding companies, which can engage in a broad range of financial services including securities activities such as underwriting, dealing, investment, merchant banking, insurance underwriting, sales and brokerage activities. In order to become a financial holding company, a bank holding company and all of its affiliated depository institutions must be well-capitalized, well-managed and have at least a satisfactory Community Reinvestment Act rating. We converted from a financial holding company to a bank holding company on January 1, 2009 and remained a bank holding company until March 3, 2016. On March 4, 2016 the Federal Reserve Bank of Richmond approved New Peoples’s election to convert back to a financial holding company.

Essentially as discussed above, GLBA removed many of the limitations on affiliations between commercial banks and their holding companies and other financially related business that had been in place since the Depression. Recently, this effect of GLBA has been the subject of controversy and cited as one of the causes of the financial services crisis. As a result, The Dodd-Frank Act (as discussed later) addressed some of the criticized aspects of GLBA.

The GLBA also provides that the states continue to have the authority to regulate insurance activities, but prohibits the states in most instances from preventing or significantly interfering with the ability of a bank, directly or through an affiliate, to engage in insurance sales, solicitations or cross-marketing activities.

USA Patriot Act. The USA Patriot Act provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Regulatory authorities must consider the effectiveness of a financial institution’s anti-money laundering activities, for example, its procedures for effective customer identification, when reviewing bank mergers and acquisitions. Various other laws and regulations require the Bank to cooperate with governmental authorities in respect to counter-terrorism activities. Although it does create a reporting obligation and cost of compliance for the Bank, the USA Patriot Act has not materially affected New Peoples’ products, services or other business activities.

Privacy and Fair Credit Reporting. Financial institutions, such as the Bank, are required to disclose their privacy policies to customers and consumers and require that such customers or consumers be given a choice (through an opt-out notice) to forbid the sharing of nonpublic personal information about them with nonaffiliated third persons. The Bank also requires business partners with whom it shares such information to assure the Bank that they have adequate security safeguards and to abide by the redisclosure and reuse provisions of applicable law. In addition to adopting federal requirements regarding privacy, individual states are authorized to enact more stringent laws relating to the use of customer information. To date, Virginia has not done so. These privacy laws create compliance obligations and potential liability for the Bank.

Sarbanes-Oxley Act. The Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”) is intended to increase corporate responsibility, provide enhanced penalties for accounting and auditing improprieties by publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities law. The changes required by the Sarbanes-Oxley Act and its implementing regulations are intended to allow shareholders to monitor the performance of companies and their directors more easily and effectively.

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The Sarbanes-Oxley Act generally applies to all domestic companies, such as New Peoples, that file periodic reports with the Securities and Exchange Commission (“SEC”) under the Securities Exchange Act of 1934, as amended. The Sarbanes-Oxley Act includes significant additional disclosure requirements and expanded corporate governance rules and the SEC has adopted extensive additional disclosures, corporate governance provisions and other related rules pursuant to it. New Peoples has expended, and will continue to expend, considerable time and money in complying with the Sarbanes-Oxley Act.

Federal Deposit Insurance Corporation. The Bank’s deposits are insured by the Deposit insurance Fund, as administered by the FDIC, to the maximum amount permitted by law, now \$250,000 per depositor.

Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act was signed into law on July 21, 2010. Its wide ranging provisions affect all federal financial regulatory agencies and nearly every aspect of the American financial services industry. Among the provisions of the Dodd-Frank Act that directly impact the Company is the creation of an independent Consumer Financial Protection Bureau (CFPB), which has the ability to write rules for consumer protections governing all financial institutions. All consumer protection responsibility formerly handled by other banking regulators is consolidated in the CFPB. It also oversees the enforcement of all federal laws intended to ensure fair access to credit. For smaller financial institutions such as the Company and the Bank, the CFPB will coordinate its examination activities through their primary regulators.

The Dodd-Frank Act contains provisions designed to reform mortgage lending, which includes the requirement of additional disclosures for consumer mortgages. The CFPB has implemented mortgage lending regulations to carry out its mandate. In addition, the Federal Reserve has issued new rules, effective October 1, 2011, which had the effect of limiting the fees charged to merchants by credit card companies for debit card transactions. The result of these rules is to limit the amount of interchange fee income available explicitly to larger banks and indirectly to us. The Dodd-Frank Act also contains provisions that affect corporate governance and executive compensation.

The Dodd-Frank Act provisions themselves are extensive; however, there is much uncertainty concerning the ultimate impact of this legislation. The process of adopting and implementing the regulations is not complete and the Trump Administration has indicated its intent to pare back regulations under Dodd-Frank substantially. Whether and to what extent this will happen and its effect on the financial services industry and the economy as a whole are unknown.

Future Regulatory Uncertainty. Because federal and state regulation of financial institutions changes regularly and is the subject of constant legislative debate, New Peoples cannot forecast how regulation of financial institutions may change in the future and impact its operations. New Peoples fully expects that the financial institution industry will remain heavily regulated notwithstanding any regulatory relief that is adopted.

Subsequent Events

We have considered subsequent events through the date of the financial statements in this Form 10-K.

Item 1A. Risk Factors

Not applicable.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

At December 31, 2016, the Company's net investment in premises and equipment in service was \$30.0 million. Our main office and operations center is located in Honaker, Virginia. This location contains a full service branch, and our administration and operations center.

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The Bank owns all of its 19 full service branches, including its headquarter office, as well as its loan production office in Tennessee. The locations of these branches are described in Item 1.

The Bank owns a location in Dungannon, Virginia that is now currently being leased, but was formerly used as a branch until its closure during 2010. The Bank owns additional property in Princeton, West Virginia that has potential for a future full service branch location, and currently serves as an administration office. During 2012, the Bank closed offices in Bristol, Pennington Gap, and Richlands, Virginia and Jonesborough, Tennessee. The Bristol office was subsequently leased to the Bank's subsidiary NPB Insurance Services, Inc. in 2014 and this lease was canceled during 2016. The Pennington Gap property was sold in January 2013. The Richlands property was sold in April 2015. During 2014, the Bank closed offices in Bland, Jonesville, and Norton, Virginia and Bluewell, West Virginia. The Norton office now serves as an administrative office. In November 2015, we purchased a building in Bristol, which began use as an operations office for our Interactive Teller Machine network starting in April 2016. In July 2016, the Jonesborough office was reopened as a loan production office of the Bank. The other four offices (Bland, Bluewell, Bristol, and Jonesville) are vacant and may be used for future banking offices again.

We believe that all of our properties are maintained in good operating condition and are suitable and adequate for our operational needs.

Item 3. Legal Proceedings

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

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

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

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Market Information

Computershare Investor Services is the stock transfer agent for New Peoples Bankshares, Inc. The common stock of New Peoples is quoted on the Over The Counter Bulletin Board (OTCBB) under the symbol “NWPP”. The volume of trading of shares of common stock is very limited. Trades in our common stock occur sporadically on a local basis and typically small volumes of stock are traded.

The high and low prices at which our common stock has traded known to us for each quarter in the past two years are set forth in the table below. These prices are obtained through our listing on the OTCBB. Other transactions may have occurred at prices about which we are not aware.

	2016		2015	
	High	Low	High	Low
1 st quarter	\$ 1.55	\$ 1.36	\$ 1.60	\$ 1.26
2 nd quarter	1.60	1.41	1.60	1.45
3 rd quarter	1.55	1.45	1.60	1.30
4 th quarter	1.75	1.55	1.69	1.30

The most recent sales price of which management is aware was \$1.75 per share on March 9, 2017.

(b) Holders

On March 9, 2017, there were approximately 4,426 shareholders of record.

(c) Dividends

In order to preserve capital we have not paid cash dividends to our shareholders. Any declaration of dividends in the future will depend on our earnings, capital requirements, growth strategies, and compliance with regulatory mandates. We are subject to certain dividend restrictions and capital requirements imposed by the Federal Reserve Bank as well as Virginia banking statutes and regulations. As a result, we do not anticipate paying a dividend on our common stock in the foreseeable future. See Note 3, Note 16 and Note 22 of the Notes to the Consolidated Financial Statements for further discussion of dividend limitations and capital requirements.

Item 6. Selected Financial Data

Not applicable.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Caution About Forward Looking Statements

We make forward looking statements in this annual report that are subject to risks and uncertainties. These forward looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals. The words “believes,” “expects,” “may,” “will,” “should,” “projects,” “contemplates,” “anticipates,” “forecasts,” “intends,” or other similar words or terms are intended to identify forward looking statements. The forward-looking information is based on various factors and was derived using numerous assumptions. Important factors that may cause actual results to differ from projections include:

- the success or failure of our efforts to implement our business plan;
- any required increase in our regulatory capital ratios;
- satisfying other regulatory requirements that may arise from examinations, changes in the law and other similar factors;
- deterioration of asset quality;
- fluctuations of real estate values in our markets;
- our ability to attract and retain talent;
- demographical changes in our markets which negatively impact the local economy;
- the uncertain outcome of enacted legislation to stabilize the U.S. financial system such as Dodd-Frank;
- the successful management of interest rate risk;
- the successful management of liquidity;
- changes in general economic and business conditions in our market area;
- credit risks inherent in making loans such as borrower ability to repay;
- competition with other banks and financial institutions, and companies outside of the banking industry, including online lenders and those companies that have substantially greater access to capital and other resources;
- demand, development and acceptance of new products and services we have offered or may offer;
- technology utilized by us;
- our ability to successfully manage cyber security;
- our reliance on third-party vendors and correspondent banks;
- changes in general accepted accounting principles;
- changes in governmental regulations, tax rates and similar matters; and,
- other risks which may be described in our future filings with the SEC.

Because of these uncertainties, our actual future results may be materially different from the results indicated by these forward looking statements. In addition, our past results of operations do not necessarily indicate our future results. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

General

The following commentary discusses major components of our business and presents an overview of our consolidated financial position at December 31, 2016 and 2015 as well as results of operations for the years ended December 31, 2016 and 2015. This discussion should be reviewed in conjunction with the consolidated financial statements and accompanying notes and other statistical information presented elsewhere in this Form 10-K.

New Peoples generates a significant amount of its income from the net interest income earned by the Bank. Net interest income is the difference between interest income and interest expense. Interest income depends on the volume of interest-earning assets outstanding during the period and the interest rates earned thereon. The Bank's interest expense is a function of the average amount of interest-bearing deposits and borrowed money outstanding during the period and the interest rates paid thereon. The quality of the assets further influences the amount of interest income lost on nonaccrual loans and the amount of additions to the allowance for loan losses. The Bank also generates noninterest income from service charges on deposit accounts and commissions on insurance and investment products sold.

Written Agreement

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

Overview

At December 31, 2016, total assets were \$634.3 million, total loans were \$468.6 million, and total deposits were \$554.4 million. The Company's consolidated net income for the year ended December 31, 2016 was \$958 thousand, or basic net income per share of \$0.04 as compared to a net income of \$2.7 million, or basic net income per share of \$0.12, for the year ended December 31, 2015. This is a decrease of \$1.7 million, or \$0.08 per share. This decrease was mainly driven by a negative provision for loan losses of \$500 thousand for 2016 as compared to a negative provision for loan losses of \$2.2 million for 2015. We also had an increase of noninterest income of \$888 thousand, which offset our decrease in net interest income of \$875 thousand. The annualized return on average assets for the fiscal year 2016 was 0.15% as compared to 0.41% for the same period in 2015. The annualized return on average equity was 2.00% for the fiscal year 2016 and 5.95% for the same period in 2015.

Highlights from the year 2016 include:

- A \$27.4 million, or 6.22%, increase in loans, when compared to 2015;
- A negative provision for loan losses of \$500 thousand for 2016 as compared to a negative provision for loan losses of \$2.2 million for 2015;
- Writedowns of other real estate owned properties of \$1.4 million, a decrease of \$1.8 million, or 56.44% when compared to 2015;
- A reduction in other real estate owned of \$1.7 million, or 14.06%, when compared to 2015;
- A reduction of \$434 thousand, or 14.21%, in interest expenses when compared to 2015;
- A decrease of \$1.4 million, or 9.71% in nonaccrual loans during 2016;
- A decrease of \$1.4 million, or 6.98%, in substandard loans during 2016;
- A decrease of \$9.2 million, or 3.56%, in higher-costing time deposits during 2016;
- A strong net interest margin of 3.92% for 2016;
- The Bank is considered well capitalized as defined by regulatory guidelines;
- Rollout of Interactive Teller Machines (“ITMs”), a new, state-of-the-art technology;
- The Bank opened a loan production office in Jonesborough, Tennessee; and,
- Book value per share of \$2.01 as of December 31, 2016.

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Total assets increased \$8.4 million in 2016, or 1.35%, from \$625.9 million at December 31, 2015. Loans showed an increase of \$27.4 million as a result of our efforts to conservatively grow the loan portfolio, which was funded by selling investment securities of \$29.5 million during 2016. Going forward, we anticipate total assets increasing due to our plan to conservatively and prudently grow the loan portfolio, as we were able to accomplish in 2016.

During 2016, total deposits declined \$3.6 million, or 0.64% to \$554.4 million. However, lower-costing non-time deposits increased \$5.6 million, or 1.85%, while time deposits declined \$9.2 million, or 3.56%. We anticipate total deposits to increase as we focus on growth in the future.

The Bank improved its capital position and maintained a well-capitalized status during both 2016 and 2015. The following Bank ratios existed at December 31, 2016 as compared to December 31, 2015, respectively: Tier 1 leverage ratio of 9.93% versus 9.67%; Tier 1 risk based capital ratio of 15.39% versus 16.29%; total risk based capital ratio of 16.64% versus 17.55%; and common equity Tier 1 ratio of 15.39% versus 16.29%.

Expenses related to other real estate owned properties were \$2.2 million in 2016 compared to \$4.1 million in 2015. During 2016 we recorded writedowns on other real estate owned properties in the amount of \$1.4 million compared to \$3.2 million in 2015. During 2016 we had a net gain on the sale of other real estate owned of \$221 thousand compared to a net gain of \$99 thousand in 2015.

Total loans increased \$27.4 million in 2016, or 6.22%, to \$468.6 million at December 31, 2016 as compared to \$441.2 million at December 31, 2015. Loans rated substandard decreased \$1.4 million, or 6.98%, to \$18.3 million at December 31, 2016 from \$19.7 million at December 31, 2015. The main driver in this increase in total loans is our strategy is to conservatively grow assets, namely the loan portfolio. To assist in these efforts, we added several commercial lenders, during the latter part of 2015 and throughout 2016, mostly focused in the Tri-Cities market of Bristol, VA and TN, Kingsport, TN, and Johnson City, TN. We expect the trend in total loan growth we have experienced in 2016 to continue at least in the near term, subject to economic conditions, customer demand, and competition in our markets. During 2016, we introduced new lending products that we anticipate will help us further service our customers, generate loan growth and enhance earnings. These include secondary market mortgage loans, Small Business Administration loans and credit cards.

Regarding asset quality, we continue to make progress in reducing the levels of non-performing assets. However, as asset quality improves, the level of nonperforming assets remains high as a result of the prolonged, deteriorated residential and commercial real estate markets, as well as the sluggish economy. The ratio of nonperforming assets to total assets lowered to 3.79% at December 31, 2016 as compared to 4.35% at December 31, 2015. Nonperforming assets, which include nonaccrual loans, other real estate owned and past due loans greater than 90 days still accruing interest, decreased to \$24.1 million at December 31, 2016 from \$27.2 million at December 31, 2015, a reduction of \$3.1 million, or 11.69%. The makeup of these assets are primarily loans secured by commercial real estate, residential mortgages, and farmland as well as other real estate owned properties. We continue undertaking extensive and more aggressive measures to work out problem credits and liquidate foreclosed properties in an effort to accelerate a

reduction of nonperforming assets. Our goal is to reduce the nonperforming assets being mindful of the impact to earnings and capital; however, we may recognize some losses and reductions in the allowance for loan loss as we expedite the resolution of these problem assets.

Our allowance for loan losses at December 31, 2016 was \$6.1 million, or 1.30% of total loans, as compared to \$7.5 million, or 1.70% of total loans at December 31, 2015. Impaired loans decreased \$2.9 million, or 16.87%, to \$14.4 million with an estimated allowance of \$552 thousand for potential losses at December 31, 2016 as compared to \$17.3 million in impaired loans with an estimated allowance of \$983 thousand at the end of 2015. A negative provision for loan losses of \$500 thousand was recorded in 2016, while a negative provision of \$2.2 million was recorded in 2015. Net loans charged off increased in 2016 as they were \$921 thousand, or 0.20% of average loans, compared to \$229 thousand, or 0.05% of average loans, in 2015. Included in the net charge offs in 2015 is a recovery of \$1.2 million, which was due to the receipt in August 2015 of death benefits on a life insurance policy on which the Bank was the beneficiary. The policy was acquired in 2010 as part of a settlement with a former borrower on several defaulted loans. As a result of this \$1.2 million recovery a negative provision for loan losses of \$1.2 million was made in the third quarter of 2015. In the fourth quarter of 2015, an additional \$1.0 million negative provision was made bringing the total negative provision for 2015 to \$2.2 million. The allowance for loan losses is being maintained at a level that management deems appropriate to absorb any potential future losses and known impairments within the loan portfolio whether or not the losses are actually ever realized. We continue to adjust the allowance for loan loss model to best reflect the risks in the portfolio and the improvements made in our internal policies and procedures; however, future provisions may be deemed necessary.

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Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements. Our most critical accounting policies relate to our provision for loan losses and the calculation of our deferred tax asset and valuation allowance.

The provision for loan losses reflects the estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our borrowers were to further deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additional provisions could be required. For further discussion of the estimates used in determining the allowance for loan losses, we refer you to the section on “Provision for Loan Losses” in this discussion.

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

For further discussion of our other critical accounting policies, see Note 2, Summary of Significant Accounting Policies, to our Consolidated Financial Statements, found in Item 8 to this annual report on Form 10-K.

Net Interest Income and Net Interest Margin

The Company’s primary source of income, net interest income, decreased \$875 thousand, or 3.87% from 2015 to 2016. The decrease in net interest income is due primarily to the \$1.1 million decrease in interest income on loans during 2016. While we have been successful in our strategy to conservatively grow the loan portfolio, renewed loans are repricing at lower interest rates and new loans are being booked at lower interest rates due to competitive pressures and the continued low interest rate environment. With new commercial lenders added during 2016, we believe, going forward, new increased volume will outpace the monthly loan paydowns and maturities. The decrease in interest income was offset by a \$517 thousand decrease in interest expense on time deposits, as a result of our time deposits re-pricing at lower interest rates at maturity, decrease in volume of higher cost time deposits that left the bank, as well as a favorable shift in the deposit mix whereby our higher-cost time deposits were replaced with lower-cost deposit products.

Nonaccrual loans were \$13.4 million at December 31, 2016 compared to \$14.8 million at December 31, 2015. This represents a decrease of \$1.4 million, or 9.71%. Although nonaccrual loans decreased during 2016, the continued high volume of nonaccrual loans negatively affects interest income as these loans are nonearning assets. Interest income and cash receipts on impaired loans are handled differently depending on whether or not the loan is on nonaccrual status. If the impaired loan is not on nonaccrual status, the interest income on the loan is computed using the effective interest method. When doubt about the collectability of a loan exists, it is the Bank's policy to stop accruing interest on that loan under the following circumstances: (a) whenever we are advised by the borrower that scheduled payment or interest payments cannot be met, (b) when conditions indicate that payment of principal and interest can no longer be expected, or (c) when any such loan becomes delinquent for 90 days and is not both well secured and in the process of collection. All interest accrued but not collected on loans that are placed on nonaccrual or charged off are reversed against interest income in the current period. The interest on these loans is accounted for on the cash basis or cost-recovery method until qualifying for return to accrual. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, six consecutive timely payments are made, and prospects for future contractual payments are reasonably assured.

Investment interest income decreased \$279 thousand, or 15.86%, from \$1.8 million for the year ended 2015 to \$1.5 million in 2016. This decrease was due to the liquidation of a portion of the investment portfolio, which was used to fund loan growth.

Interest expense decreased \$434 thousand, or 14.21%, from \$3.1 million for the year ending 2015 to \$2.6 million in 2016 mainly due to a decline in volume and repricing of time deposits to lower interest rates, as well as a favorable shift in the overall deposit mix. We do not expect time deposits to decrease in 2017 at the same pace of 2016 as we have increased our interest rates paid on time deposits in an effort to fund anticipated loan growth.

Our net interest margin decreased one basis point to 3.92% for the year ended December 31, 2016 compared to 3.93% for the same period in 2015. Unless we are able to increase the volume of our interest-earning assets going forward, we may experience further compression on the net interest margin as new and renewed loans are often being repriced at lower interest rates while we anticipate a slight increase on interest rates paid on deposits.

The following table shows the rates paid on earning assets and deposit liabilities for the periods indicated.

Net Interest Margin Analysis
Average Balances, Income and Expense, and Yields and Rates
(Dollars in thousands)

	For the Year Ended December 31, 2016			For the Year Ended December 31, 2015			For the Year Ended December 31, 2014		
	Average Balance	Income/ Expense	Yields/ Rates	Average Balance	Income/ Expense	Yields/ Rates	Average Balance	Income/ Expense	Yields/ Rates
ASSETS									
Loans (1), (2), (3)	\$ 457,266	\$ 22,644	4.95%	\$ 445,839	\$ 23,671	5.31%	\$ 473,610	\$ 24,875	5.25%
Federal funds sold	14	-	0.00%	777	2	0.26%	1,408	3	0.21%
Interest bearing deposits	12,835	84	0.65%	23,258	91	0.39%	43,652	155	0.36%
Other investments (3)	84,080	1,618	1.92%	104,727	1,891	1.81%	90,878	1,611	1.77%
Total Earning Assets	554,195	24,346	4.39%	574,601	25,655	4.46%	609,548	26,644	4.37%
Less: Allowance for loans losses	(6,849)			(9,063)			(11,587)		
Non-earning assets	83,030			80,609			81,824		
Total Assets	\$ 630,376			\$ 646,147			\$ 679,785		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Deposits									
Demand – Interest bearing	\$ 39,834	\$ 50	0.13%	\$ 31,334	\$ 37	0.12%	\$ 29,854	\$ 37	0.12%
Savings	115,213	166	0.14%	119,606	173	0.14%	111,744	180	0.16%
Time deposits	250,296	1,742	0.70%	277,747	2,259	0.81%	327,328	3,099	0.95%
Other Borrowings	8,508	154	1.81%	3,577	145	4.05%	4,767	195	4.09%
Trust Preferred Securities	16,496	508	3.08%	16,496	440	2.67%	16,496	545	3.30%
Total interest bearing liabilities	430,347	2,620	0.61%	448,760	3,054	0.68%	490,189	4,056	0.83%
	149,350			150,061			143,916		

Non-interest bearing deposits			
Other liabilities	2,849	2,574	4,889
Total Liabilities	582,546	601,395	638,994
Stockholders' Equity	47,830	44,752	40,791
Total Liabilities and Stockholders' Equity	\$ 630,376	\$ 646,147	\$ 679,785
Net Interest Income	\$ 21,726	\$ 22,601	\$ 22,588
Net Interest Margin	3.92%	3.93%	3.71%
Net Interest Spread	3.78%	3.78%	3.54%

(1) Non-accrual loans have been included in the average balance of loans outstanding.

(2) Loan fees have been included in interest income on loans.

(3) Tax exempt income is not significant and has been treated as fully taxable.

Net interest income is affected by changes in both average interest rates and average volumes of interest-earning assets and interest-bearing liabilities. The following table sets forth the amounts of the total changes in interest income and expense which can be attributed to rate (change in rate multiplied by old volume) and volume (change in volume multiplied by old rate) for the periods indicated.

Volume and Rate Analysis

(Dollars in thousands)

	2016 Compared to 2015		2015 Compared to 2014			
	Increase (Decrease)		Increase (Decrease)			
	Volume Effect	Rate Effect	Change in Interest Income/ Expense	Volume Effect	Rate Effect	Change in Interest Income/ Expense
Interest Income:						
Loans	\$607	\$(1,634)	\$(1,027)	\$(1,459)	\$255	\$(1,204)
Federal funds sold	(2)	-	(2)	(1)	-	(1)
Interest bearing deposits	(41)	34	(7)	(72)	8	(64)
Other investments	(373)	100	(273)	246	34	280
Total Earning Assets	191	(1,500)	(1,309)	(1,286)	297	(989)
Interest Bearing Liabilities:						
Demand	10	3	13	2	(2)	-
Savings	(6)	(1)	(7)	13	(20)	(7)
All other time deposits	(223)	(294)	(517)	(469)	(371)	(840)
Other borrowings	200	(191)	9	(49)	(1)	(50)
Trust Preferred Securities	-	68	68	-	(105)	(105)
Total Interest Bearing Liabilities	(19)	(415)	(434)	(503)	(499)	(1,002)
Change in Net Interest Income	\$210	\$(1,085)	\$(875)	\$(783)	\$796	\$13

Loans

Our primary source of income comes from interest earned on loans. Total loans increased \$27.4 million in 2016, or 6.22%, to \$468.6 million at December 31, 2016 as compared to \$441.2 million at December 31, 2015. Loans rated substandard decreased \$1.4 million, or 6.98%, to \$18.3 million at December 31, 2016 from \$19.7 million at December 31, 2015. The main driver in this increase in total loans is our strategy to conservatively grow assets, namely the loan portfolio. To assist in these efforts, we added several commercial lenders, during the latter part of 2015 and throughout 2016, mostly focused in the Tri-Cities markets of Bristol, VA and TN, Kingsport, TN, and Johnson City,

TN. We expect the trend in total loan growth we have experienced in 2016 to continue at least in the near term, subject to economic conditions, customer demand, and competition in our markets. During 2016, we introduced new lending products that we anticipate will help us further service our customers, generate loan growth and enhance earnings. These include secondary market mortgage loans, Small Business Administration loans and credit cards.

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Loans receivable outstanding are summarized as follows:

Loan Portfolio

December 31,

(Dollars in thousands)	2016	2015	2014	2013	2012
Commercial, financial and agricultural	\$55,073	\$47,490	\$50,273	\$57,704	\$65,888
Real estate – construction	25,755	14,672	15,439	22,421	24,327
Real estate – commercial	103,331	98,569	108,062	126,174	149,935
Real estate – residential	262,282	255,870	257,947	260,669	252,768
Installment loans to individuals	22,188	24,568	25,828	26,055	29,445
Total	\$468,629	\$441,169	\$457,549	\$493,023	\$522,363

Our loan maturities as of December 31, 2016 are shown in the following table:

Maturities of Loans

(Dollars in thousands)	Less than One Year	One to Five Years	After Five Years	Total
Commercial, financial and agricultural	\$23,592	\$22,924	\$8,557	\$55,073
Real estate – construction	3,408	4,930	17,417	25,755
Real estate – commercial	26,487	56,275	20,569	103,331
Real estate – residential	31,305	109,162	121,815	262,282
Installment loans to individuals	4,707	16,625	856	22,188
Total	\$89,499	\$209,916	\$169,214	\$468,629
Loans with fixed rates	\$31,695	\$111,010	\$167,211	\$309,916
Loans with variable rates	57,804	98,906	2,003	158,713
Total	\$89,499	\$209,916	\$169,214	\$468,629

The above table reflects the earlier of the maturity or re-pricing dates for loans at December 31, 2016. In preparing this table, no assumptions are made with respect to loan prepayments. Loan principal payments are included in the earliest period in which the loan matures or can be re-priced. Principal payments on installment loans scheduled prior to maturity are included in the period of maturity or re-pricing.

Provision for Loan Losses

The methodology we use to calculate the allowance for loan losses is considered a critical accounting policy. The adequacy of the allowance for loan losses is based upon management's judgment and analysis. The following factors are included in our evaluation of determining the adequacy of the allowance: risk characteristics of the loan portfolio, current and historical loss experience, concentrations and internal and external factors such as general economic conditions.

The allowance for loan losses decreased to \$6.1 million at December 31, 2016 as compared to \$7.5 million at December 31, 2015. The allowance for loan losses at the end of 2016 was approximately 1.30% of total loans as compared to 1.70% at the end of 2015. Negative provisions for loan losses of \$2.2 million were record during 2015, while a negative provision of \$500 thousand was recorded in 2016. Loans charged off, net of recoveries, increased during 2016 as they were \$921 thousand, or 0.20% of average loans, compared to \$229 thousand, or 0.05% of average loans, in 2015. Included in the net charge offs in 2015 is a recovery of \$1.2 million, which was due to the receipt of a death benefit on a life insurance policy on which the Bank was the beneficiary. The policy was acquired in 2010 as part of a settlement with a former borrower on several defaulted loans. As a result of this \$1.2 million recovery, a negative provision for loan losses of \$1.2 million was made in the third quarter of 2015. In the fourth quarter of 2015, an additional \$1.0 million negative provision was made bringing the total negative provision for 2015 to \$2.2 million. The allowance for loan losses is being maintained at a level that management deems appropriate to absorb any potential future losses and known impairments within the loan portfolio whether or not the losses are actually ever realized. We continue to adjust the allowance for loan loss model to best reflect the risks in the portfolio and the improvements made in our internal policies and procedures; however, future provisions may be deemed necessary.

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We have experienced a decrease in loans delinquent 90 days or more and nonaccrual loans in 2016. Total past due loans 90 days or more were \$3.5 million as of December 31, 2016, a decrease of \$2.6 million, or 43.09%, from the \$6.1 million as of December 31, 2015. Loans delinquent greater than 90 days and loans in non-accrual status present higher risks of default. At December 31, 2016, there were 184 loans in non-accrual status totaling \$13.4 million, or 2.86% of total loans. At December 31, 2015, there were 161 loans in non-accrual status totaling \$14.8 million, or 3.37% of total loans. The amounts of interest that would have been recognized on these loans were \$639 thousand and \$697 thousand in the years 2016 and 2015, respectively. There were no loans past due 90 days or greater and still accruing interest at December 31, 2016 and 2015, respectively. There were \$9.6 million in loans classified as troubled debt restructurings as of December 31, 2016, as compared to \$9.5 million in loans classified as troubled debt restructurings as of December 31, 2015. Of the loans classified as troubled debt restructurings \$2.3 million were in non-accrual status as of December 31, 2016 and 2015, respectively. We do not have any commitments to lend additional funds to non-performing debtors.

A majority of our loans are collateralized by real estate located in our market area. It is our policy to sufficiently collateralize loans to help minimize loss exposures in case of default. However, during the last economic downturn, the real estate values in the Bank's market materially declined which negatively impacted the Bank. Since that economic downturn, real estate values have stabilized. Our market area is somewhat diverse, but certain areas are more reliant upon agriculture, coal mining and natural gas. As a result, increased risk of loan impairments is possible as the coal mining and natural gas industry have been negatively affected in the past couple of years due to the increase in natural gas supplies from "fracking", layoffs and environmental legislation. We do not foresee a major impact upon the Bank unless an additional severe downturn occurs which we believe is not highly likely. We are monitoring these industries. We consider these factors to be the primary higher risk characteristics of the loan portfolio.

Commercial and commercial real estate loans are initially risk rated by the originating loan officer. If deterioration in the financial condition of the borrower and/or his or her capacity to repay the debt occur, the loan may be downgraded by the loan officer. Guidance for the risk rate grading is established by the regulatory authorities who periodically review the Bank's loan portfolio for compliance. Classifications used by the Bank are Exceptional, Very Good, Standard, Acceptable, Transitory Risk, Other Assets Especially Mentioned, Substandard, Doubtful and Loss.

In regard to our consumer and consumer real estate loan portfolio, the Company uses the guidance found in the Uniform Retail Credit Classification and Account Management Policy which affects our estimate of the allowance for loan losses. Under this approach, a consumer or consumer real estate loan must initially have a credit risk grade of Pass or better. Subsequently, if the loan becomes contractually 90 days past due or the borrower files for bankruptcy protection, the loan is downgraded to Substandard and placed in nonaccrual status. If the loan is unsecured upon being deemed Substandard, the entire loan amount is charged-off.

For non 1-4 family residential loans that are 90 days past due or greater or in bankruptcy, the collateral value less estimated liquidation costs is compared to the loan balance to calculate any potential deficiency. If the collateral is sufficient, then no charge-off is necessary. If a deficiency exists, then upon the loan becoming contractually 120 days past due, the deficiency is charged-off against the allowance for loan loss. In the case of 1-4 family residential or

home equity loans, upon the loan becoming 120 days past due, a current value is obtained and after application of an estimated liquidation discount, a comparison is made to the loan balance to calculate any deficiency. Subsequently, any noted deficiency is then charged-off against the allowance for loan loss when the loan becomes contractually 180 days past due. If the customer has filed bankruptcy, then within 60 days of the bankruptcy notice, any calculated deficiency is charged-off against the allowance for loan loss. Collection efforts continue by means of repossessions or foreclosures, and upon bank ownership, liquidation ensues.

All loans classified as substandard, doubtful or loss are individually reviewed for impairment in accordance with ASC 310-10-35. In evaluating impairment, a current appraisal is generally used to determine if the collateral is sufficient. Appraisals are typically less than a year old and have to be independently reviewed to be relied upon. If the appraisal is not current, we perform a useful life review of the appraisal to determine if it is reasonable. If this review determines that the appraisal is not reasonable, then a new appraisal is ordered. Impaired loans decreased to \$14.4 million with \$2.7 million requiring a valuation allowance of \$552 thousand at December 31, 2016 as compared to \$17.3 million with \$5.6 million requiring a valuation allowance of \$983 thousand at December 31, 2015. Of the \$14.4 million recorded as impaired loans, \$5.4 million were nonperforming loans, which includes nonaccrual loans and past due 90 days or more. Management is aggressively working to reduce the impaired credits at minimal loss.

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In determining the component of our allowance in accordance with the Contingencies topic of the Accounting Standards Codification (“ASC 450”), we do not directly consider the potential for outdated appraisals since that portion of our allowance is based on the analysis of the performance of loans with similar characteristics, external and internal risk factors. We consider the overall quality of our underwriting process in our internal risk factors, but the need to update appraisals is associated with loans identified as impaired under the Receivables topic of the Accounting Standards Codification (“ASC 310”). If an appraisal is older than one year, a new external certified appraisal may be obtained and used to determine impairment. If an exposure exists, a specific allowance is directly made for the amount of the potential loss in addition to estimated liquidation and disposal costs. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Following is a summary of non-accrual, past due loans greater than 90 days still accruing interest, and restructured loans:

Non-Accrual, Past Due, and Restructured Loans

(Dollars in thousands)

December 31,

	2016	2015	2014	2013	2012
Non-accruing loans					
Commercial, financial and agricultural	\$1,086	\$1,244	\$6,554	\$6,307	\$10,962
Real estate – construction	319	436	332	775	2,412
Real estate – commercial	3,403	4,358	6,222	16,098	16,308
Real estate – residential	8,521	8,768	8,707	5,023	3,845
Installment loans to individuals	76	41	46	104	9
Total Non-accruing loans	13,405	14,847	21,861	28,307	33,536
Loans past due 90 days or more and still accruing	-	-	-	1	551
Troubled debt restructurings (accruing)	7,310	7,198	4,249	5,563	14,567
Total	\$20,715	\$22,045	\$26,110	\$33,871	\$48,654
Percent of total loans	4.42%	5.00%	5.71%	6.87%	9.31%

The above table includes \$2.3 million in nonaccrual loans as of December 31, 2016 and 2015, respectively, that have been classified as troubled debt restructurings. No troubled debt restructurings were past due 90 days or more and still accruing as of December 31, 2016 and 2015. There were \$9.6 million in loans classified as troubled debt restructurings as of December 31, 2016, as compared to \$9.5 million in loans classified as troubled debt restructurings as of December 31, 2015.

In addition to impaired loans, the remaining loan portfolio is evaluated based on net charge-off history, economic conditions, and internal processes. To calculate the net charge-off history factor, we perform a 12-quarter look-back and use the average net charge offs as a percentage of the loan balances. To calculate the economic conditions factor,

we use current economic data which includes national and local regional unemployment information, local housing price changes, gross domestic product growth, and interest rates. Lastly, we also evaluate our internal processes of underwriting and consider the inherent risks present in the portfolio due to past and present lending practices. As economic conditions, performance of our loans, and internal processes change, it is possible that future increases or decreases may be needed to the allowance for loan losses. The following table provides a summary of the activity in the allowance for loan losses.

Analysis of the Allowance for Loan Losses

(Dollars in thousands)

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For the Years Ended December 31,

Activity	2016	2015	2014	2013	2012
Beginning Balance	\$7,493	\$9,922	\$13,080	\$16,810	\$18,380
Provision charged to expense	(500)	(2,200)	-	550	4,800
Advances made on loans with					
off balance sheet provision	-	-	-	-	-
Loan Losses:					
Commercial, financial and agricultural	(67)	(182)	(894)	(1,625)	(1,523)
Real estate – construction	(5)	(226)	(292)	(312)	(357)
Real estate – commercial	(557)	(724)	(2,190)	(2,811)	(2,845)
Real estate – residential	(738)	(1,127)	(1,104)	(1,143)	(1,690)
Installment loans to individuals	(83)	(101)	(79)	(153)	(336)
Total loan losses	(1,450)	(2,360)	(4,559)	(6,044)	(6,751)
Recoveries:					
Commercial, financial and agricultural	172	1,629	550	169	97
Real estate – construction	26	215	236	452	73
Real estate – commercial	220	147	427	439	61
Real estate – residential	87	99	148	576	87
Installment loans to individuals	24	41	40	128	63
Total recoveries	529	2,131	1,401	1,764	381
Net charge offs	(921)	(229)	(3,158)	(4,280)	(6,370)
Balance at End of Period	\$6,072	\$7,493	\$9,922	\$13,080	\$16,810
Net charge offs as a % of average loans	0.20%	0.05%	0.67%	0.84%	1.14%

We have allocated the allowance according to the amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within each of the categories of loans. The allocation of the allowance as shown in the following table should not be interpreted as an indication that loan losses in future years will occur in the same proportions or that the allocation indicates future loan loss trends. Furthermore, the portion allocated to each loan category is not the total amount available for future losses that might occur within such categories since the total allowance is a general allowance applicable to the entire portfolio.

The allocation of the allowance for loan losses is based on our judgment of the relative risk associated with each type of loan. We have allocated 27% of the allowance to commercial real estate loans, which constituted 22.05% of our loan portfolio at December 31, 2016. This allocation decreased when compared to the 36% in 2015 due to the \$337 thousand in net charge offs during 2016 that impacts our historical loss rate. We have allocated 43% of the allowance to residential real estate loans, which constituted 55.97% of our loan portfolio at December 31, 2016. This allocation increased when compared to the 32% in 2015 due to the \$6.4 million increase in residential real estate loans during 2016.

Both residential and commercial real estate loans are secured by real estate whose value tends to be easily ascertainable. These loans are made consistent with appraisal policies and real estate lending policies, which detail

maximum loan-to-value ratios and maturities.

We have allocated 6% of the allowance to real estate construction loans, which constituted 5.50% of our loan portfolio at December 31, 2016. Construction loans are secured by real estate with values that are dependent upon market and economic conditions. Values may not always be easily ascertainable as evidenced by the current market conditions. These loans are made consistent with appraisal policies and real estate lending policies which detail maximum loan-to-value ratios and maturities.

We have allocated 10% of the allowance to commercial loans, which constituted 11.75% of our loan portfolio at December 31, 2016. Our allocation decreased as a percentage of the allowance for loan losses due to the \$105 thousand in net recoveries in commercial loans during 2016, which affects our historical loss rate.

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We have allocated 2% of the allowance to consumer installment loans, which constituted 4.73% of our loan portfolio at December 31, 2016, which was comparable to the 2% allocation we had in 2015.

The following table shows the balance and percentage of our allowance for loan losses (or “ALLL”) allocated to each major category of loans.

Allocation of the Allowance for Loan Losses

December 31, 2012 through December 31, 2016

(Dollars in thousands)

	December 31, 2016			December 31, 2015			December 31, 2014		
	Amount	% of ALLL	% of Loans	Amount	% of ALLL	% of Loans	Amount	% of ALLL	% of Loans
Commercial	\$622	10%	11.75%	\$1,066	14%	10.76%	\$1,496	15%	10.99%
R/E-const.	346	6%	5.50%	332	4%	3.33%	199	2%	3.37%
R/E-comm.	1,625	27%	22.05%	2,384	36%	22.34%	4,418	45%	23.62%
R/E-resid.	2,617	43%	55.97%	2,669	32%	58.00%	2,726	27%	56.37%
Installment	123	2%	4.73%	128	2%	5.57%	171	2%	5.65%
Unallocated	739	12%		914	12%		912	9%	
Total	\$6,072	100%	100.00%	\$7,493	100%	100.00%	\$9,922	100%	100.00%

	December 31, 2013			December 31, 2012		
	Amount	% of ALLL	% of Loans	Amount	% of ALLL	% of Loans
Commercial	\$2,710	21%	11.70%	\$3,383	20%	12.61%
R/E-const.	1,184	9%	4.55%	2,166	13%	4.66%
R/E-comm.	5,203	40%	25.59%	6,720	40%	28.70%
R/E-resid.	3,449	26%	52.87%	3,602	22%	48.39%
Installment	153	1%	5.29%	388	2%	5.64%
Unallocated	381	3%		551	3%	
Total	\$13,080	100%	100.00%	\$16,810	100%	100.00%

Other Real Estate Owned

Other real estate owned (“OREO”) decreased \$1.7 million or 14.06%, to \$10.7 million at December 31, 2016 from \$12.4 million at December 31, 2015. All properties are available for sale by commercial and residential realtors under the direction of our Special Assets division. Our aim is to reduce the level of OREO in order to reduce the level of nonperforming assets at the Bank, while keeping in mind the impact to earnings and capital. In both 2016 and 2015, pricing adjustments were made to make certain properties more marketable, which, in some cases, reduced the price below the fair value of the property (which is based on an appraisal less estimated disposition costs). During 2016, we recorded OREO writedowns of \$1.4 million as compared to \$3.2 million in 2015. Of the \$1.4 million in OREO writedowns during 2016, \$625 thousand of the writedowns were due to auctions we held on some of our OREO properties during the second half of 2016.

During 2016 we added \$4.5 million in OREO properties as a result of settlement of foreclosed loans, offset by sales of \$5.0 million with net gains totaling \$221 thousand. During 2015, we acquired \$3.3 million in OREO properties as a result of settlement of foreclosed loans, which was offset by sales of \$2.7 million with net gains totaling \$99 thousand. We have taken an aggressive approach toward liquidating properties to reduce our level of foreclosed properties by making pricing adjustments and holding auctions on some of our older properties. We expect to continue these efforts in 2017, which could result in additional losses, while reducing future carrying costs.

We do have lease agreements on certain other real estate owned properties which are generating rental income at market rates. Rental income on OREO properties was \$247 thousand in 2016, a decrease of \$18 thousand, or 6.79%, when compared to the \$265 thousand recognized in 2015.

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Investment Securities

Total investment securities decreased \$31.6 million, or 31.12%, to \$70.0 million at December 31, 2016 from \$101.6 million at December 31, 2015. All securities are classified as available-for-sale for liquidity purposes. We sold \$29.5 million in investments securities during 2016 resulting in net realized gains of \$303 thousand. These sales were executed to provide liquidity to fund our loan growth during 2016 and to take advantage of gains in the investment portfolio as deemed appropriate. In 2015 we sold \$7.1 million in investment securities resulting in net realized gains of \$35 thousand. Investment securities with a carrying value of \$11.3 million and \$15.4 million at December 31, 2016 and 2015, were pledged to secure public deposits and for other purposes required by law.

Our strategy is to invest excess funds in investment securities to increase interest income while providing for liquidity. We anticipate maintaining or slightly decreasing the size of the portfolio during 2017. The portfolio is comprised of short to mid-term investments. The carrying values of investment securities and the different types of investments are shown in the following table:

Investment Securities Portfolio

(Dollars in thousands)

December 31,	2016		2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<u>Available for Sale</u>				
U.S. Government Agencies	\$24,821	\$24,632	\$41,488	\$41,523
Taxable municipals	2,340	2,292	3,337	3,281
Corporate bonds	3,600	3,749	1,944	1,939
Mortgage backed securities	39,941	39,338	55,369	54,899
Total Securities AFS	\$70,702	\$70,011	\$102,138	\$101,642

At December 31, 2016 we had an unrealized loss in our investment portfolio totaling \$691 thousand as compared to a \$496 thousand unrealized loss at December 31, 2015. The \$195 thousand decrease in fair value is mainly due to changes in interest rates during 2016. We have reviewed our investment portfolio and no investment security is deemed to have an other than temporary impairment. We monitor our portfolio regularly and use it to maintain liquidity, manage interest rate risk and enhance earnings.

The amortized cost, fair value and weighted average yield of investment securities at December 31, 2016 are shown by contractual maturity and do not reflect principal paydowns for amortizing securities, in the following schedule. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Maturities of Securities

(Dollars are in thousands)	Amortized	Fair	Weighted
<u>Securities Available for Sale</u>	Cost	Value	Average
			Yield
Due in one year or less	\$1,210	\$1,210	0.91%
Due after one year through five years	1,599	1,593	1.85%
Due after five years through ten years	11,971	12,083	2.69%
Due after ten years	55,922	55,125	1.91%
Total	\$70,702	\$70,011	2.02%

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Deposits

Total deposits were \$554.4 million at December 31, 2016, a decrease of \$3.6 million, or 0.64%, from \$558.0 million at December 31, 2015. Most of the decrease has been in time deposits which are our highest cost deposit funding source. During 2016, we experienced a decrease in time deposits of \$9.2 million, while our lower-costing non-time deposits increased \$5.6 million. The shift from higher-costing time deposits to lower-costing non-maturity deposits represents a favorable repositioning of the Company's deposit mix. Due to competitive pressures, rising interest rates, and our need for funding, we expect to see an uptick on the interest we pay on time deposits in 2017.

Core deposits, which are mainly transaction accounts, commercial relationships and savings products, increased as noninterest bearing deposits grew 1.47%, or \$2.2 million, from \$149.7 million at December 31, 2015 to \$151.9 million at December 31, 2016. We experienced an increase of \$9.9 million, or 32.93%, in interest-bearing demand deposits during 2016. Savings deposits decreased \$6.6 million, or 5.44%, to \$114.5 million at December 31, 2016 as compared to \$121.1 million at December 31, 2015. Overall, we continue to maintain core deposits through attractive consumer and commercial deposit products and strong ties with our customer base and communities.

Time deposits of \$100,000 or more equaled approximately 17.20% of deposits at the end of 2016 and 16.59% of deposits at the end of 2015.

We have brokered deposits totaling \$2.7 million that mature in 2019. These deposits were used to fund a particular 10 year balloon mortgage product. Internet accounts are limited to customers located in the surrounding geographical area. The average balance of and the average rate paid on deposits is shown in the net interest margin analysis above. Total CDARs time deposits were \$10.2 million and \$6.3 million in 2016 and 2015, respectively.

Maturities of time deposits of \$100,000 or more outstanding are summarized as follows:

Maturities of Time Deposits of \$100 Thousand and More

(Dollars in thousands)

December 31, 2016

Three months or less	\$ 17,696
Over three months through six months	16,958

Over six months through twelve months	23,242
Over one year	37,485
Total	\$ 95,381

Noninterest Income

For 2016, noninterest income increased to \$7.3 million from \$6.4 million for the same period in 2015. This is an increase of \$888 thousand, or 13.87%. This increase was due to the \$303 thousand gain on the sale of investment securities during 2016, as compared to the \$35 thousand gain on the sale of investment securities for the same period in 2015. In addition our nonsufficient funds / overdraft fee income increased by \$690 thousand during 2016 as a result of the new optional overdraft protection services we began offering to our deposit customers in June 2016. In 2016, we introduced offering secondary market mortgage loans and credit cards that we anticipate being an additional source of noninterest income in the future. The ratio of noninterest income as a percentage of average assets increased to 1.16% in 2016 as compared to 0.99% in 2015. We anticipate this percentage to slightly increase during 2017 as we continue to seek opportunities to improve noninterest income through new products and services.

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Noninterest Expense

Noninterest expenses increased \$45 thousand, or 0.16%, to \$28.6 million in 2016 from \$28.5 million in 2015. The following are explanations of the increase in non-interest expenses during 2016.

Salaries and employee benefits increased from \$11.8 million in 2015 to \$13.1 million in 2016, an increase of \$1.3 million, or 11.02%. This increase was primarily the result of seasoned commercial bankers hired during the fourth quarter of 2015 and throughout 2016 as a part of our strategy to grow the loan portfolio, the opening of a loan production office in Jonesborough, Tennessee to expand our market presence in the Tri-Cities, Tennessee area, as well as staff added to operate the Interactive Teller Machines (“ITMs”) and provide digital banking services, additions to credit administration and business development personnel. Total full time equivalent employees have increased to 249 at December 31, 2016 from 242 at December 31, 2015, an increase of 7, or 2.89%.

Occupancy and equipment expenses increased \$292 thousand, or 7.55%, from 2015 to 2016. The increase in occupancy and equipment expenses was mainly due to the rollout of the ITMs during 2016. The ITMs, a new, state-of-the-art technology which replaced the Bank’s ATMs, help provide additional convenience by providing teller services from 7 AM to 7 PM Monday thru Saturday. We anticipate the addition of the ITMs will create efficiencies going forward. Advertising expense increased \$42 thousand from 2015 to 2016. Data processing and telecommunication expenses increased \$254 thousand from 2015 to 2016 as a result of updating our systems.

In 2016, FDIC assessment expense decreased \$372 thousand, or 44.18%, from \$842 thousand in 2015 to \$470 thousand in 2016. This is partly due to the reduction of average assets, which is caused by the reduction of total deposits during 2015, and the Bank’s overall improvements.

Expenses related to OREO and repossessed assets decreased \$1.9 million, or 46.36%, from \$4.1 million in 2015 to \$2.2 million in 2016. During 2016 we recorded net OREO writedowns of \$1.4 million compared to \$3.2 million in 2015. During 2016, we had net gains on the sale of OREO of \$221 thousand compared to net gains of \$99 thousand in 2015. OREO decreased in 2016 to \$10.7 million at December 31, 2016 from \$12.4 million at December 31, 2015.

Our efficiency ratio, a non-GAAP measure, which is defined as noninterest expense divided by the sum of net interest income plus noninterest income, was 98.45% in 2016 as compared to 98.34% in 2015. Included in this calculation are the other real estate owned write-downs which significantly and negatively impact the ratio. We continue to seek opportunities to operate more efficiently through the use of technology, improving processes, reducing nonperforming assets and increasing productivity.

Bank-Owned Life Insurance

We have life insurance policies on one current key officer and three former key officers for which the Bank is the beneficiary. The aggregate total cash surrender value of the policies was \$12.3 million and \$12.1 million at December 31, 2016 and December 31, 2015, respectively. The policies are separate account life insurance policies and the income derived from the policies is based on a short term investment portfolio managed by the insurance provider.

Total income for the policies during 2016 was \$169 thousand as compared to \$346 thousand for the year ending 2015.

Deferred Tax Asset and Income Taxes

Due to timing differences between book and tax treatment of several income and expense items, a net deferred tax asset of \$5.3 million existed at December 31, 2016 as compared to a net deferred tax asset of \$5.1 million at December 31, 2015. At December 31, 2016 we had a valuation allowance of \$5.3 million as compared to a valuation allowance of \$5.7 million at December 31, 2015. During 2016 we recorded a reversal of \$338 thousand of our deferred tax asset valuation allowance as compared to reversing \$735 thousand in deferred tax asset valuation allowance in 2015. Management periodically reviews the deferred tax calculation to determine the need for a valuation allowance. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. In management's opinion, based on a three year taxable income projection and the effects of off-setting deferred tax liabilities, it is more likely than not that all the deferred tax assets, net of the \$5.3 million allowance, would be realizable. Management is required to consider all evidence, both positive and negative in making this determination. As of December 31, 2016, the Company had \$16.6 million of net operating loss carryforwards which will expire in 2031 thru 2036. Management expects to utilize all of these carryforwards prior to expiration. Direct charge-offs contributed to a reduction of the tax asset and are permitted as tax deductions. In addition, writedowns on other real estate owned property are expensed for book purposes but are not deductible for tax purposes until disposition of the property. Goodwill expense also was realized for book purposes in 2011 but continues to only be tax deductible based on the statutory requirements; thus, creating a deferred tax asset. When, and if, taxable income increases in the future and during the net operating loss carryforward period, this valuation allowance may be reversed and used to decrease tax obligations in the future. Our income tax expense was computed at the normal corporate income tax rate of 34% of taxable income included in net income. We do not have significant nontaxable income or nondeductible expenses.

The Company's tax filings for years ended 2013 through 2016 were at year end 2016 open to audit under statutes of limitations by the Internal Revenue Service ("IRS") and state taxing authorities. Our tax filings for the years ended 2010, 2011, and 2012 had been under examination by the IRS. In March 2015, we received notification from the IRS that as a result of the examination no changes were made to our reported tax.

After the common stock offering was concluded in December 2012, the Company evaluated whether a "change of control" as defined in Internal Revenue Code ("IRC") section 382 had occurred. A change of control for purposes of IRC section 382 would have occurred if 50% or more of the ownership of the Company had changed as a result of the offering and stock transactions occurring in the preceding 3 years. In that case IRC section 382 would impose certain limitations which would restrict the ability of the Company to utilize the current amount of tax loss carryforwards among other future tax deductions. We concluded that a change of control did not occur under the IRC section 382. The three year period concluded in December 2015. We are no longer required to monitor any increase in the ownership of any 5% owner in the Company, of any new investors participating in the common stock offering that were not investors before the offering, and of any new 5% owner acquiring common stock from existing shareholders excluding the two aforementioned groups.

Capital Resources

Our total capital at the end of 2016 was \$46.9 million compared to \$46.1 million in 2015. The increase was \$830 thousand, or 1.80%. New Peoples equity as a percentage of total assets was 7.40% at December 31, 2016 compared to 7.36% at December 31, 2015. The annualized return on average equity was 2.00% for the fiscal year 2016 and 5.95% for the same period in 2015. The book value per common share was \$2.01 at December 31, 2016 compared to \$1.97 at December 31, 2015.

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

At December 31, 2016, the Bank remains well capitalized under the regulatory framework for prompt corrective action. The following ratios existed at December 31, 2016 for the Bank: Tier 1 leverage ratio of 9.93%, Tier 1 risk based capital ratio of 15.39%, Total risk based capital ratio of 16.64%, and Common Equity Tier 1 ratio of 15.39%. The ratios were as follows at December 31, 2015: Tier 1 leverage ratio of 9.67%, Tier 1 risk based capital ratio of 16.29%, Total risk based capital ratio of 17.55%, and Common Equity Tier 1 ratio of 16.29%.

The ratios mentioned above for the Bank comply with the Federal Reserve rules to align with the Basel III Capital requirements effective January 1, 2015. As a result of these new rules the Bank is now subject to a Common Equity

Tier 1 ratio set out above.

Beginning January 1, 2016, a capital conservation buffer of 0.625% became effective. The capital conservation buffer will be gradually increased through January 1, 2019 to 2.5%. Banks will be required to maintain levels that meet the required minimum plus the capital conservation buffer in order to make distributions, such as dividends, or discretionary bonus payments.

Total assets increased in 2016 and we anticipate asset levels to increase in the future due to an emphasis on growing the loan portfolio and the core deposit base of the Bank. Under current economic conditions, we believe it is prudent to continue to increase capital to support planned asset growth while being able to absorb potential losses that may occur if asset quality deteriorates further. Based upon projections, we believe our earnings will be sufficient to support the Bank's planned asset growth.

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

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Liquidity

We closely monitor our liquidity and our liquid assets in the form of cash, due from banks, federal funds sold, and unpledged available-for-sale investments. Collectively, those balances were \$94.2 million at December 31, 2016, down from \$112.6 million at December 31, 2015. A surplus of short-term assets are maintained at levels management deems adequate to meet potential liquidity needs during 2017.

At December 31, 2016, all of our investments are classified as available-for-sale, providing an additional source of liquidity in the amount of \$58.7 million, which is net of the \$11.3 million of securities pledged as collateral. This will serve as a source of liquidity while yielding a higher return when compared to other short term investment options, such as federal funds sold and overnight deposits with the Federal Reserve Bank. Due to maturities, paydowns, and sales of securities to fund loan growth our investment portfolio has declined from \$101.6 million at December 31, 2015 to \$70.0 million at December 31, 2016.

A \$195 thousand decrease in fair market value resulted in a net unrealized loss of \$691 thousand at December 31, 2016 compared to the net unrealized loss at December 31, 2015, which was \$496 thousand. This unrealized loss of \$691 thousand could negatively impact earnings if the investment portfolio had to be quickly liquidated.

Our loan to deposit ratio was 84.52% at December 31, 2016 and 79.06% at year end 2015.

Available third party sources of liquidity remain intact at December 31, 2016 which includes the following: our line of credit with the Federal Home Loan Bank of Atlanta ("FHLB"), the brokered certificates of deposit markets, internet certificates of deposit, and the discount window at the Federal Reserve Bank of Richmond. In May 2015, we received notification that a \$3.0 million unsecured federal funds line of credit facility with a correspondent bank had been reinstated. In February 2016, we received notification that this facility had been increased to \$5.0 million. In March 2016, we received notification that another correspondent bank had reinstated an unsecured federal funds line of credit facility in the amount of \$5.0 million. As a result we had the ability to borrow \$10.0 million in unsecured federal funds as of December 31, 2016, which gives us an additional source of liquidity.

At December 31, 2016, we had borrowings from the FHLB totaling \$13.8 million as compared to \$3.0 million at December 31, 2015. At December 31, 2016, \$1.8 million of these borrowings had fixed interest rates with an average yield of 4.07%, and a maturity date in 2018. In June 2016 the Bank borrowed \$2.0 million with a maturity date in the year 2019 and \$5.0 million with a maturity date in the year 2021. Both borrowings have fixed interest rates and interest is payable monthly, with a interest rate of 0.99% on the \$2.0 million borrowing and an interest rate of 1.38% on the \$5.0 million borrowing. In December 2016, the Bank borrowed \$5.0 million with a maturity date in March 2017 and a fixed interest rate of 0.69%, with interest payable monthly.

We also used our line of credit with the FHLB to issue a letter of credit for \$7.0 million in 2013 and letters of credit totaling \$5.0 million in 2015 to the Treasury Board of Virginia for collateral on public funds. An additional \$120.9 million was available on December 31, 2016 on the \$146.6 million line of credit, which is secured by a blanket lien on our residential real estate loans.

We have access to the brokered deposits market. Currently we have \$2.7 million in 10 year term time deposits comprised of \$3 thousand incremental deposits which yield an interest rate of 4.10%. With the exception of Certificate of Deposit Registry Service (“CDARS”) time deposits, we have no other brokered deposits. In February 2016, our ability to participate in CDARS one way buys was reinstated. As of December 31, 2016 we had \$3.9 million in CDARS one way buys outstanding.

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

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

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

New Peoples has \$813 thousand in cash as of December 31, 2016, which is on deposit at the Bank. These funds will be used to pay operating expenses, trust preferred interest payments, and provide additional capital injections to the Bank, if needed.

During the month of October 2015, a member of the board of directors of the Company and his family exercised 233,886 common stock warrants at a price of \$1.75 per share. During the month of November 2015, another member of the board of directors of the Company exercised 225,000 common stock warrants at a price of \$1.75 per share. During the month of December 2015, another member of the board of directors of the Company and his family exercised 16,542 common stock warrants at a price of \$1.75 per share. As a result of these exercises an additional \$832 thousand of capital was raised at the Company.

The Company is making quarterly interest payments on the trust preferred securities. The restriction requiring regulatory approval before the payment of interest on the trust preferred securities was lifted when the Written Agreement was terminated effective January 20, 2016. See Note 21 of the Notes to the Consolidated Financial Statements for further discussion of our trust preferred securities.

During the capital raise in 2012, common stock warrants were issued to investors. The warrants are immediately exercisable through December 2017 at a price of \$1.75 per share. During 2015, 475,428 warrants were exercised, and in 2016 375 warrants were exercised which reduced the number of warrants outstanding at December 31, 2016 to 881,978. If these warrants are exercised, additional funds may be received by the Company, which provides potentially up to \$1.5 million in additional liquidity and capital.

Financial Instruments with Off-Balance-Sheet 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 include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate 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 and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2016 and 2015 is as follows:

(Dollars in thousands)	2016	2015
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$34,770	\$27,742
Standby letters of credit	2,019	2,435

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 commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

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Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. Those lines of credit may not actually be drawn upon to the total extent to which the Bank is committed.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, 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 certificates of deposit, deposit accounts, and real estate as collateral supporting those commitments for which collateral is deemed necessary.

Interest Sensitivity

At December 31, 2016, we had a negative cumulative gap rate sensitivity ratio of 35.19% for the one year re-pricing period, compared to 40.13% at December 31, 2015. A negative cumulative gap generally indicates that net interest income would improve in a declining interest rate environment as liabilities re-price more quickly than assets. Conversely, net interest income would likely decrease in periods during which interest rates are increasing. The below table is based on contractual maturities and does not take into consideration prepayment speeds of investment securities and loans nor does it factor decay rates for non maturity deposits. Based on these behavioral factors, we are in a position to increase interest income in a rising interest rate environment. Management reviews our interest rate risk profile quarterly and believes that the current position presents acceptable risk.

Interest Sensitivity Analysis

December 31, 2016

(Dollars in thousands)

	1- 90 Days	91-365 Days	1-3 Years	4-5 Years	6-15 Years	Over 15 Years	Total
Uses of funds:							
Loans	\$ 51,088	\$37,643	\$ 109,754	\$ 100,929	\$ 106,915	\$62,300	\$ 468,629
Federal funds sold	132	-	-	-	-	-	132
Deposits with banks	16,816	-	-	-	-	-	16,816
Investments	14,600	2,411	734	3,848	21,664	26,754	70,011
Bank owned life insurance	12,274	-	-	-	-	-	12,274
Total earning assets	\$ 94,910	40,054	\$ 110,488	\$ 104,777	\$ 128,579	\$89,054	\$ 567,862
Sources of funds:							
Interest Bearing DDA	\$ 40,213	\$-	\$-	\$-	\$-	\$-	40,213
Savings & MMDA	114,492	-	-	-	-	-	114,492
Time Deposits	54,552	104,069	41,211	47,987	-	-	247,819
Trust preferred securities	16,496	-	-	-	-	-	16,496

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Other borrowings	5,000	-	3,758	5,000	-	-	13,758
Total interest bearing liabilities	\$ 230,758	\$ 104,069	\$ 44,969	\$ 52,987	\$-	\$-	\$ 432,778
Discrete Gap	\$ (135,843)	\$ (64,015)	\$ 65,519	\$ 51,790	\$ 128,579	\$ 89,054	\$ 135,084
Cumulative Gap	\$ (135,843)	\$ (199,858)	\$ (134,339)	\$ (82,549)	\$ 46,030	\$ 135,084	
Cumulative Gap as % of Total Earning Assets	(23.92%)	(35.19%)	(23.66%)	(14.54%)	8.11%	23.79%	

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

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FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
New Peoples Bankshares, Inc. and Subsidiaries

Honaker, Virginia

We have audited the accompanying consolidated balance sheets of New Peoples Bankshares, Inc. and subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, 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 New Peoples Bankshares, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Elliott Davis Decosimo, LLC

Greenville, South Carolina

March 13, 2017

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED BALANCE SHEETS****DECEMBER 31, 2016 AND 2015**

(IN THOUSANDS EXCEPT SHARE DATA)

ASSETS	2016	2015
Cash and due from banks	\$18,500	\$15,087
Interest-bearing deposits with banks	16,816	11,251
Federal funds sold	132	-
Total Cash and Cash Equivalents	35,448	26,338
Investment securities available-for-sale	70,011	101,642
Loans receivable	468,629	441,169
Allowance for loan losses	(6,072)	(7,493)
Net Loans	462,557	433,676
Bank premises and equipment, net	29,985	28,148
Equity securities (restricted)	2,802	2,441
Other real estate owned	10,655	12,398
Accrued interest receivable	1,848	1,816
Life insurance investments	12,274	12,105
Deferred taxes, net	5,285	5,121
Other assets	3,470	2,213
Total Assets	\$634,335	\$625,898

LIABILITIES

Deposits		
Demand deposits		
Noninterest bearing	\$151,914	\$149,714
Interest-bearing	40,213	30,251
Savings deposits	114,492	121,076
Time deposits	247,819	256,978
Total Deposits	554,438	558,019
FHLB advances	13,758	2,958

Accrued interest payable	331	288
Accrued expenses and other liabilities	2,395	2,050
Trust preferred securities	16,496	16,496
Total Liabilities	587,418	579,811

STOCKHOLDERS' EQUITY

Common stock - \$2.00 par value; 50,000,000 shares authorized;
23,354,457 and 23,354,082 shares issued and outstanding at

December 31, 2016 and 2015, respectively	46,709	46,708
Common stock warrants	764	764
Additional paid-in capital	13,965	13,965
Retained deficit	(14,065)	(15,023)
Accumulated other comprehensive loss	(456)	(327)
Total Stockholders' Equity	46,917	46,087
Total Liabilities and Stockholders' Equity	\$ 634,335	\$ 625,898

The accompanying notes are an integral part of these financial statements.

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF INCOME****FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

(IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

INTEREST AND DIVIDEND INCOME	2016	2015
Loans including fees	\$22,644	\$23,671
Federal funds sold	-	2
Interest-earning deposits with banks	84	91
Investments	1,480	1,759
Dividends on equity securities (restricted)	138	132
Total Interest and Dividend Income	24,346	25,655
INTEREST EXPENSE		
Deposits		
Demand	50	37
Savings	166	173
Time deposits below \$100,000	1,087	1,343
Time deposits above \$100,000	655	916
FHLB advances	152	145
Federal funds purchased	2	-
Trust preferred securities	508	440
Total Interest Expense	2,620	3,054
NET INTEREST INCOME	21,726	22,601
PROVISION FOR LOAN LOSSES	(500)	(2,200)
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	22,226	24,801
NONINTEREST INCOME		
Service charges	2,850	2,216
Fees, commission and other income	3,507	3,247
Insurance and investment fees	462	559
Net realized gains on sale of investment securities	303	35
Life insurance investment income	169	346
Total Noninterest Income	7,291	6,403
NONINTEREST EXPENSES		
Salaries and employee benefits	13,126	11,823
Occupancy and equipment expenses	4,157	3,865
Advertising and public relations	449	407
Data processing and telecommunications	2,403	2,149

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FDIC insurance premiums	470	842
Other real estate owned and repossessed assets, net	2,193	4,088
Other operating expenses	5,770	5,349
Total Noninterest Expenses	28,568	28,523
INCOME BEFORE INCOME TAXES	949	2,681
INCOME TAX EXPENSE (BENEFIT)	(9)	19
NET INCOME	\$958	\$2,662
Income Per Share		
Basic and Diluted	\$0.04	\$0.12
Average Weighted Shares of Common Stock		
Basic and Diluted	23,354,155	22,955,391

The accompanying notes are an integral part of these financial statements.

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NEW PEOPLES BANKSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

(IN THOUSANDS)

	2016	2015
NET INCOME	\$958	\$2,662
Other comprehensive loss:		
Investment securities activity:		
Unrealized gains (losses) arising during the year	108	(356)
Tax related to unrealized gains (losses)	(37)	121
Reclassification of realized gains during the year	(303)	(35)
Tax related to realized gains	103	12
TOTAL OTHER COMPREHENSIVE LOSS	(129)	(258)
TOTAL COMPREHENSIVE INCOME	\$829	\$2,404

The accompanying notes are an integral part of these financial statements.

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

(IN THOUANDS INCLUDING SHARE DATA)

	Shares of	Common	Common	Additional	Accumu-lated	Other	Total
	Common	Common	Stock	Paid in	Income (Loss)	Compre-hensive	Stockholders'
	Stock	Stock	Warrants	Capital	Retained		Equity
					Deficit		
Balance,							
December 31, 2014	22,878	\$45,757	\$1,176	\$13,672	\$(17,685)	\$(69)	\$42,851
Net income	-	-	-	-	2,662	-	2,662
Exercise of common stock warrants	476	951	(412)	293	-	-	832
Other comprehensive loss, net of tax	-	-	-	-	-	(258)	(258)
Balance,							
December 31, 2015	23,354	46,708	764	13,965	(15,023)	(327)	46,087
Net income	-	-	-	-	958	-	958
Exercise of common stock warrants*	-	1	-	-	-	-	1

Other comprehensive	-	-	-	-	-	(129)	(129)
loss, net of tax							
Balance,	23,354	\$46,709	\$764	\$13,965	\$(14,065)	\$(456)	\$46,917
December 31, 2016							

*During 2016, 375 shares of common stock were issued in connection with common stock warrants being exercised.

The accompanying notes are an integral part of these financial statements.

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NEW PEOPLES BANKSHARES, INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

(IN THOUSANDS)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$958	\$2,662
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,398	2,092
Provision for loan losses	(500)	(2,200)
Income on life insurance	(169)	(346)
Gain on sale of securities available-for-sale	(303)	(35)
Gain on sale of premises and equipment	(63)	(160)
Gain on sale of foreclosed real estate	(221)	(99)
Adjustment of carrying value of foreclosed real estate	1,414	3,246
Accretion of bond premiums/discounts	931	1,140
Deferred tax benefit	(97)	-
Net change in:		
Interest receivable	(32)	159
Other assets	(1,257)	200
Accrued interest payable	43	22
Accrued expenses and other liabilities	345	(121)
Net Cash Provided by Operating Activities	3,447	6,560
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase) decrease in loans	(32,140)	12,566
Purchase of securities available-for-sale	(14,990)	(29,312)
Proceeds from sale and maturities of securities available-for-sale	45,797	26,243
Net purchase of equity securities (restricted)	(361)	(72)
Payments for the purchase of premises and equipment	(4,790)	(2,423)
Payments for the purchase of/improvements to other real estate owned	(48)	(12)
Payments for premiums on life insurance investments	-	(65)
Proceeds from bank owned life insurance investment	-	1,793
Proceeds from sale of premises and equipment	743	1,109
Proceeds from insurance claims on other real estate owned	-	101
Proceeds from sales of other real estate owned	4,232	1,831
Net Cash Provided by (Used in) Investing Activities	(1,557)	11,759
CASH FLOWS FROM FINANCING ACTIVITIES		
Exercise of common stock warrants	1	832

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Net increase (decrease) in Federal Home Loan Bank advances	10,800	(1,200)
Net change in:		
Demand deposits	12,162	6,448
Savings deposits	(6,584)	9,375
Time deposits	(9,159)	(42,996)
Net Cash Provided by (Used in) Financing Activities	7,220	(27,541)
Net increase (decrease) in cash and cash equivalents	9,110	(9,222)
Cash and Cash Equivalents, Beginning of the Year	26,338	35,560
Cash and Cash Equivalents, End of the Year	\$35,448	\$26,338
Supplemental Disclosure of Cash Paid During the Year for:		
Interest	\$2,577	\$3,032
Taxes	\$95	\$-
Supplemental Disclosure of Non Cash Transactions:		
Other real estate acquired in settlement of foreclosed loans	\$4,577	\$3,277
Loans made to finance sale of foreclosed real estate	\$818	\$878
Transfer of other real estate to premises and equipment	\$125	\$-
Donation of other real estate owned	\$-	\$33
Change in unrealized losses on securities available-for-sale	\$195	\$391

The accompanying notes are an integral part of these financial statements.

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NEW PEOPLES BANKSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 NATURE OF OPERATIONS:

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

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Consolidation Policy - The consolidated financial statements include the Company, the Bank, NPB Insurance Services, Inc., and NPB Web Services, Inc. (Hereinafter, collectively referred to as “The Company.”) All significant intercompany balances and transactions have been eliminated. In accordance with Accounting Standards Codification (“ASC”) 942, Financial Services – Depository and Lending, NPB Capital Trust I and 2 are not included in the consolidated financial statements.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions.

Cash and Cash Equivalents – Cash and cash equivalents as used in the cash flow statements include cash and due from banks, interest-bearing deposits with banks, and federal funds sold.

Investment Securities – Management determines the appropriate classification of securities at the time of purchase. If management has the intent and the Company has the ability at the time of purchase to hold securities until maturity, they are classified as held to maturity and carried at amortized historical cost. Securities not intended to be held to maturity are classified as available for sale and carried at fair value. Securities available for sale are intended to be used as part of the Company’s asset and liability management strategy and may be sold in response to changes in interest rates, prepayment risk or other similar factors.

The amortization of premiums and accretion of discounts are recognized in interest income using the effective interest method over the period to maturity. Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Realized gains (losses) on securities available-for-sale are included in noninterest income and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Unrealized gains and losses on investment securities available for sale are based on the difference between book value and fair value of each security. These gains and losses are credited or charged to other comprehensive income, net of tax, whereas realized gains and losses flow through the statements of income.

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Loans – Loans are carried on the balance sheet at unpaid principal balance, net of any unearned interest and the allowance for loan losses. Interest income on loans is computed using the effective interest method, except where serious doubt exists as to the collectibility of the loan, in which case accrual of the income is discontinued.

It is the Company's policy to stop accruing interest on a loan, and classify that loan as non-accrual under the following circumstances: (a) whenever we are advised by the borrower that scheduled payment or interest payments cannot be met, (b) when our best judgment indicates that payment in full of principal and interest can no longer be expected, or (c) when any such loan or obligation becomes delinquent for 90 days unless it is both well secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method, until qualifying for return to accrual. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, six consecutive timely payments are made, and prospects for future contractual payments are reasonably assured.

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

Significant Group Concentrations of Credit Risk – The Company identifies a concentration as any obligation, direct or indirect, of the same or affiliated interests which represent 25% or more of the Company's capital structure, or \$11.7 million as of December 31, 2016. Most of the Company's activities are with customers located within the southwest Virginia, southern West Virginia, and northeastern Tennessee region. Certain concentrations may pose credit risk. The Company does not have any significant concentrations to any one industry or customer.

Allowance for Loan Losses – The allowance for loan losses is maintained at a level that, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The loan portfolio is analyzed periodically and loans are assigned a risk rating. Allowances for impaired loans are generally determined based on collateral values or the present value of expected cash flows. A general allowance is made for all other loans not considered impaired as deemed appropriate by management. In determining the adequacy of the allowance, management considers the following factors: the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, the estimated value of any underlying collateral, prevailing environmental factors and economic conditions, and other inherent risks. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in collateral values and

changes in estimates of cash flows on impaired loans. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Loans are charged against the allowance for loan losses when management believes that collectability of all or part of the principal is unlikely. Past due status is determined based on contractual terms.

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In regard to our consumer and consumer real estate loan portfolio, the Company uses the guidance found in the Uniform Retail Credit Classification and Account Management Policy which affects our estimate of the allowance for loan losses. Under this approach, a consumer or consumer real estate loan must initially have a credit risk grade of Pass or better. Subsequently, if the loan becomes contractually 90 days past due or the borrower files for bankruptcy protection, the loan is downgraded to Substandard and placed in nonaccrual status. If the loan is unsecured, upon being deemed Substandard, the entire loan amount is charged off. For non 1-4 family residential loans that are 90 days past due or greater, or in bankruptcy, the collateral value less estimated liquidation costs is compared to the loan balance to calculate any potential deficiency. If the collateral is sufficient then no charge-off is necessary. If a deficiency exists, then upon the loan becoming contractually 120 days past due, the deficiency is charged-off against the allowance for loan loss. In the case of 1-4 family residential or home equity loans, upon the loan becoming 120 days past due, a current value is obtained and after application of an estimated liquidation discount, a comparison is made to the loan balance to calculate any deficiency. Subsequently, any noted deficiency is then charged-off against the allowance for loan loss when the loan becomes contractually 180 days past due. If the customer has filed bankruptcy, then within 60 days of the bankruptcy notice, any calculated deficiency is charged-off against the allowance for loan loss. Collection efforts continue by means of repossessions or foreclosures, and upon bank ownership, liquidation ensues.

Other Real Estate Owned – Other real estate owned represents properties acquired through foreclosure or deed taken in lieu of foreclosure. At the time of acquisition, these properties are recorded at fair value less estimated costs to sell. Expenses incurred in connection with operating these properties and subsequent write-downs, if any, are charged to expense. Subsequent to foreclosure, management periodically considers the adequacy of the reserve for losses on the property. Gains and losses on the sales of these properties are credited or charged to income in the year of the sale.

Bank Premises and Equipment – Land, buildings and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the following estimated useful lives:

Type	Estimated useful life
Buildings	39 years
Paving and landscaping	15 years
Computer equipment and software	3 to 5 years
Vehicles	5 years
Furniture and other equipment	5 to 10 years

Stock Options - The Company records compensation related to stock options pursuant to ASC 718, Compensation – Stock Compensation, which requires the estimated fair market value of the expense to be reflected over the period the award is earned which is presumed to be the vesting period. For additional discussion concerning stock options see Note 15, “Stock Option Plan.”

Common Stock Warrants - The company issued common stock warrants as a result of its conversion of Director notes and the completion of its common stock offering in 2012. For additional discussion concerning these

transactions including the terms and value of the warrants, see Note 22, “Capital.”

Income Taxes – Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. If all or a portion of the net deferred tax asset is determined to be unlikely to be realized, a valuation allowance is established to reduce the net deferred tax asset to the amount that is more likely than not to be realized.

In the event the Company has unrecognized tax expense in future accounting periods, the Company will recognize interest in interest expense and penalties in operating expenses. There were no interest or penalties related to an unrecognized tax position for the years ended December 31, 2016 and 2015. Because of the impact of deferred tax accounting, other than interest and penalties, the reversal of the Company’s treatment by taxing authorities would not affect the annual effective tax rate but would defer or accelerate the payment of cash to the taxing authority. The Company’s tax filings for years ended 2014 through 2016 are currently open to audit under statutes of limitations by the Internal Revenue Service (“IRS”) and state taxing authorities.

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Income Per Share – Basic income per share computations are based on the weighted average number of shares outstanding during each year. Dilutive earnings per share reflects the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued relate to outstanding options and common stock warrants and are determined by the Treasury Method. For the years ended December 31, 2016 and 2015, potential common shares of 881,978 and 882,353, respectively, were anti-dilutive and were not included in the calculation. Basic and diluted net income per common share calculations follows:

(Amounts in Thousands, Except Share and Per Share Data)	For the years ended	
	December 31,	
	2016	2015
Net income	\$958	\$2,662
Weighted average shares outstanding	23,354,155	22,955,391
Weighted average dilutive shares outstanding	23,354,155	22,955,391
Basic and diluted income per share	\$0.04	\$0.12

Financial Instruments – Off-balance-sheet instruments - In the ordinary course of business, the Company has entered into commitments to extend credit. Such financial instruments are recorded in the financial statements when they are funded.

Comprehensive Income (Loss) – Generally accepted accounting principles 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. The change in unrealized gains and losses on available-for-sale securities is our only component of other comprehensive income.

Advertising Cost – Advertising costs are expensed in the period incurred.

Business Combinations - For purchase acquisitions accounted for as a business combination, the Company is required to record the assets acquired, including identified intangible assets and liabilities assumed at their fair value, which in many instances involves estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques. The determination of the useful lives of intangible assets is subjective, as is the appropriate amortization method for such intangible assets. In addition, purchase acquisitions may result in goodwill, which is subject to ongoing periodic impairment testing based on the fair value of net assets acquired compared to the carrying value of goodwill. Changes in acquisition multiples, the overall interest rate environment, or the continuing operations of the assets acquired could have a significant impact on the periodic impairment testing.

Reclassification – Certain reclassifications have been made to the prior years’ financial statements to place them on a comparable basis with the current year. Net income and stockholders’ equity previously reported were not affected by these reclassifications.

Subsequent Events – The Company has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

NOTE 3 FORMAL WRITTEN AGREEMENT:

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

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NOTE 4 DEPOSITS IN AND FEDERAL FUNDS SOLD TO BANKS:

The Bank had federal funds sold and cash on deposit with other commercial banks amounting to \$16.9 million and \$11.2 million at December 31, 2016 and 2015, respectively. Deposit amounts at other commercial banks may, at times, exceed federally insured limits.

The Bank is required to maintain average reserve balances, computed by applying prescribed percentages to its various types of deposits, either at the Bank or on deposit with the Federal Reserve Bank. At December 31, 2016 and 2015, all required reserves were met by the Bank's vault cash.

In May 2015, we received notification that a \$3.0 million unsecured fed funds line of credit facility with a correspondent bank had been reinstated. In February 2016, we received notification that this facility had been increased to \$5.0 million. A condition of this unsecured fed funds line of credit is that the Bank agreed to maintain a minimum deposit balance with the correspondent bank of \$200 thousand. As of December 31, 2016 and 2015, the Bank was in compliance with this requirement.

NOTE 5 INVESTMENT SECURITIES:

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

(Dollars are in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
December 31, 2016				
U.S. Government Agencies	\$ 24,821	\$80	\$269	\$24,632
Taxable municipals	2,340	2	50	2,292
Corporate bonds	3,600	149	-	3,749
Mortgage backed securities	39,941	25	628	39,338
Total Securities AFS	\$ 70,702	\$256	\$947	\$70,011
December 31, 2015				
U.S. Government Agencies	\$ 41,488	\$244	\$209	\$41,523
Taxable municipals	3,337	5	61	3,281
Corporate bonds	1,944	15	20	1,939
Mortgage backed securities	55,369	41	511	54,899
Total Securities AFS	\$ 102,138	\$305	\$801	\$101,642

The following table details unrealized losses and related fair values in the available-for-sale portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2016 and December 31, 2015.

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Dollars are in thousands)						
December 31, 2016						
U.S. Government Agencies	\$12,081	\$250	\$2,449	\$19	\$14,530	\$269
Taxable municipals	1,561	50	-	-	1,561	50
Corporate bonds	500	-	-	-	500	-
Mtg. backed securities	28,680	543	4,655	85	33,335	628
Total Securities AFS	\$42,822	\$843	\$7,104	\$104	\$49,926	\$947
December 31, 2015						
U.S. Government Agencies	\$14,995	\$81	\$7,708	\$128	\$22,073	\$209
Taxable municipals	2,136	57	278	4	2,414	61
Corporate bonds	923	20	-	-	923	20
Mtg. backed securities	38,945	354	8,719	157	47,664	511
Total Securities AFS	\$56,999	\$512	\$16,705	\$289	\$73,074	\$801

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At December 31, 2016, the available-for-sale portfolio included one hundred and seven investments for which the fair market value was less than amortized cost. At December 31, 2015, the available-for-sale portfolio included one hundred and thirty four investments for which the fair market value was less than amortized cost. Management evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial conditions and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Based on the Company's analysis, no securities had an other-than-temporary impairment at December 31, 2016 or December 31, 2015.

Investment securities with a carrying value of \$11.3 million and \$15.4 million at December 31, 2016 and 2015, respectively, were pledged to secure public deposits and for other purposes required by law.

Gross proceeds on the sale of investment securities were \$29.5 million and \$7.1 million, respectively, as of December 31, 2016 and 2015. Gross realized gains and losses pertaining to the sale of investment securities available for sale are detailed as follows:

	For the years ended	
	December 31,	
(Dollars are in thousands)	2016	2015
Gross gains realized	\$366	\$62
Gross losses realized	(63)	(27)
Net realized gains	\$303	\$35

The amortized cost and fair value of investment securities at December 31, 2016, by contractual maturity, are shown in the following schedule. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Also, actual maturities may differ from scheduled maturities on amortizing securities, such as mortgage-back securities and collateralized mortgage obligations, because the underlying collateral on these type of securities may be repaid prior to the scheduled maturity date.

(Dollars are in thousands)	Amortized	Fair	Weighted
<u>Securities Available for Sale</u>	Cost	Value	Average
			Yield
Due in one year or less	\$1,210	\$1,210	0.91%
Due after one year through five years	1,599	1,593	1.85%

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Due after five years through ten years	11,971	12,083	2.69%
Due after ten years	55,922	55,125	1.91%
Total	\$70,702	\$70,011	2.02%

The Bank, as a member of the Federal Reserve Bank and the Federal Home Loan Bank, is required to hold stock in each. The Bank also owns stock in CBB Financial Corp., which is a correspondent of the Bank. These equity securities are restricted from trading and are recorded at a cost of \$2.8 million and \$2.4 million as of December 31, 2016 and 2015, respectively. The stock has no quoted market value and no ready market exists.

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NOTE 6 LOANS:

Loans receivable outstanding at December 31, are summarized as follows:

(Dollars are in thousands)	2016	2015
Real estate secured:		
Commercial	\$103,331	\$98,569
Construction and land development	25,755	14,672
Residential 1-4 family	249,700	242,916
Multifamily	12,582	12,954
Farmland	24,948	22,174
Total real estate loans	416,316	391,285
Commercial	26,955	21,469
Agriculture	3,164	3,793
Consumer installment loans	22,188	24,568
All other loans	6	54
Total loans	\$468,629	\$441,169

Loans receivable on nonaccrual status at December 31, are summarized as follows:

(Dollars are in thousands)	2016	2015
Real estate secured:		
Commercial	\$3,403	\$4,358
Construction and land development	319	436
Residential 1-4 family	8,355	8,338
Multifamily	166	430
Farmland	1,003	1,170
Total real estate loans	13,246	14,732
Commercial	-	65
Agriculture	83	9
Consumer installment loans	76	41
Total loans receivable on nonaccrual status	\$13,405	\$14,847

Total interest income not recognized on nonaccrual loans for 2016 and 2015 was \$639 thousand and \$697 thousand, respectively.

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

As of December 31, 2016	Average	Interest	Recorded	Unpaid Principal Balance	Related
	Recorded	Income			
(Dollars are in thousands)	Investment	Recognized	Investment		Allowance
With no related allowance recorded:					
Real estate secured:					
Commercial	\$4,104	\$147	\$3,636	\$4,055	\$-
Construction and land development	72	1	5	5	-
Residential 1-4 family	3,745	192	3,861	4,182	-
Multifamily	290	21	301	342	-
Farmland	4,148	184	3,895	4,601	-
Commercial	-	-	-	-	-
Agriculture	27	2	19	19	-
Consumer installment loans	25	1	26	43	-
All other loans	-	-	-	-	-
With an allowance recorded:					
Real estate secured:					
Commercial	1,469	8	1,191	1,270	65
Construction and land development	265	-	240	469	106
Residential 1-4 family	862	22	555	565	56
Multifamily	80	-	-	-	-
Farmland	575	27	591	602	299
Commercial	70	3	67	67	18
Agriculture	86	1	5	5	5
Consumer installment loans	26	1	9	9	3
All other loans	-	-	-	-	-
Total	\$15,844	\$610	\$14,401	\$16,234	\$552

As of December 31, 2015	Average	Interest	Recorded	Unpaid Principal Balance	Related
	Recorded	Income			
(Dollars are in thousands)	Investment	Recognized	Investment		Allowance
With no related allowance recorded:					
Real estate secured:					
Commercial	\$4,534	\$163	\$4,212	\$5,173	\$-
Construction and land development	12	1	10	10	-

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Residential 1-4 family	3,506	161	3,037	3,150	-
Multifamily	520	9	430	471	-
Farmland	5,073	213	3,983	4,620	-
Commercial	267	-	-	-	-
Agriculture	42	4	36	36	-
Consumer installment loans	31	1	11	11	-
All other loans	-	-	-	-	-
With an allowance recorded:					
Real estate secured:					
Commercial	2,935	37	2,503	2,849	288
Construction and land development	373	-	289	499	155
Residential 1-4 family	2,219	99	1,920	2,121	168
Multifamily	23	-	-	-	-
Farmland	906	38	761	778	328
Commercial	80	3	69	69	24
Agriculture	24	2	18	18	18
Consumer installment loans	19	4	45	45	2
All other loans	-	-	-	-	-
Total	\$20,564	\$735	\$17,324	\$19,850	\$983

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An age analysis of past due loans receivable is below. At December 31, 2016 and 2015, there were no loans over 90 days past due that were accruing.

	Loans					
	Loans	Loans	90 or			
	30-59	60-89	More	Total		
	Days	Days	Days	Past		
As of December 31, 2016	Past	Past	Past	Due	Current	Total
(Dollars are in thousands)	Due	Due	Due	Loans	Loans	Loans
Real estate secured:						
Commercial	\$1,676	\$307	\$1,083	\$3,066	\$100,265	\$103,331
Construction and land	103	17	44	164	25,591	25,755
development						
Residential 1-4 family	4,237	1,547	2,233	8,017	241,683	249,700
Multifamily	1,367	-	-	1,367	11,215	12,582
Farmland	2,987	-	-	2,987	21,961	24,948
Total real estate loans	10,370	1,871	3,360	15,601	400,715	416,316
Commercial	20	-	-	20	26,935	26,955
Agriculture	19	-	78	97	3,067	3,164
Consumer installment	110	15	36	161	22,027	22,188
Loans						
All other loans	-	-	-	-	6	6
Total loans	\$10,519	\$1,886	\$3,474	\$15,879	\$452,750	\$468,629

	Loans					
	Loans	Loans	90 or			
	30-59	60-89	More	Total		
	Days	Days	Days	Past		
As of December 31, 2015	Past	Past	Past	Due	Current	Total

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

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

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

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

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

Doubtful - Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. There were no loans categorized as doubtful at December 31, 2016 or 2015.

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

As of December 31, 2016	Special			
(Dollars are in thousands)	Pass	Mention	Substandard	Total
Real estate secured:				
Commercial	\$92,562	\$6,922	\$3,847	\$103,331
Construction and land development	23,905	1,531	319	25,755
Residential 1-4 family	238,400	2,117	9,183	249,700
Multifamily	10,848	1,367	367	12,582
Farmland	19,070	1,545	4,333	24,948
Total real estate loans	384,785	13,482	18,049	416,316
Commercial	26,197	691	67	26,955
Agriculture	3,076	-	88	3,164
Consumer installment loans	22,086	-	102	22,188
All other loans	6	-	-	6
Total	\$436,150	\$14,173	18,306	\$468,629

As of December 31, 2015**Special**

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

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NOTE 7 ALLOWANCE FOR LOAN LOSSES:

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

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

As of December 31, 2016	Allowance for Loan Losses		Recorded Investment in Loans		Total
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	
(Dollars are in thousands)					
Real estate secured:					
Commercial	\$65	\$1,560	\$1,625	\$4,827	\$98,504
Construction and land development	106	240	346	245	25,510
					\$103,331
					25,755

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Residential 1-4 family	56	2,320	2,376	4,416	245,284	249,700
Multifamily	-	241	241	301	12,281	12,582
Farmland	299	129	428	4,486	20,462	24,948
Total real estate loans	526	4,490	5,016	14,275	402,041	416,316
Commercial	18	145	163	67	26,888	26,955
Agriculture	5	26	31	24	3,140	3,164
Consumer installment loans	3	120	123	35	22,153	22,188
All other loans	-	-	-	-	6	6
Unallocated	-	739	739	-	-	-
Total	\$552	\$5,520	6,072	\$14,401	\$454,228	\$468,629

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The following table details activity in the allowance for loan losses by portfolio segment for the period ended December 31, 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

As of December 31, 2015	Beginning Charge			Ending Balance	
	Balance	Offs	Recoveries	Provisions	
(Dollars are in thousands)					
Real estate secured:					
Commercial	\$4,418	\$(724)	\$147	\$(1,457)	\$2,384
Construction and land development	199	(226)	215	144	332
Residential 1-4 family	2,572	(743)	93	515	2,437
Multifamily	154	(384)	6	456	232
Farmland	913	(90)	214	(362)	675
Total real estate loans	8,256	(2,167)	675	(704)	6,060
Commercial	457	(92)	1,412	(1,511)	266
Agriculture	125	-	3	(4)	124
Consumer installment loans	171	(101)	41	17	128
All other loans	1	-	-	-	1
Unallocated	912	-	-	2	914
Total	\$9,922	\$(2,360)	\$2,131	\$(2,200)	\$7,493

As of December 31, 2015	Allowance for Loan Losses		Recorded Investment in Loans			
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment		Collectively Evaluated for Impairment	
(Dollars are in thousands)			Total		Total	
Real estate secured:						
Commercial	\$288	\$2,096	\$2,384	\$6,715	\$91,854	\$98,569
Construction and land development	155	177	332	299	14,373	14,672
Residential 1-4 family	168	2,269	2,437	4,957	237,959	242,916
Multifamily	-	232	232	430	12,524	12,954
Farmland	328	347	675	4,744	17,430	22,174
Total real estate loans	939	5,121	6,060	17,145	374,140	391,285
Commercial	24	242	266	69	21,400	21,469

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Agriculture	18	106	124	54	3,739	3,793
Consumer installment loans	2	126	128	56	24,512	24,568
All other loans	-	1	1	-	54	54
Unallocated	-	914	914	-	-	-
Total	\$983	\$6,510	7,493	\$17,324	\$423,845	\$441,169

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

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NOTE 8 TROUBLED DEBT RESTRUCTURINGS:

At December 31, 2016 loans classified as troubled debt restructurings totaled \$9.6 million compared to \$9.5 million at December 31, 2015. The following table presents information related to loans modified as troubled debt restructurings during the years ended December 31, 2016 and 2015.

Troubled Debt Restructurings	December 31, 2016		December 31, 2015			
	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment	# of Loans	Pre-Mod. Recorded Investment	Post-Mod. Recorded Investment
(Dollars are in thousands)						
Real estate secured:						
Commercial	1	\$341	\$336	1	\$320	\$313
Construction and land	-	-	-	1	551	290
Development						
Residential 1-4 family	2	420	402	2	225	221
Multifamily	-	-	-	-	-	-
Farmland	1	291	268	-	-	-
Total real estate loans	4	1,052	1,006	4	1,096	824
Commercial	-	-	-	-	-	-
Agriculture	-	-	-	-	-	-
Consumer installment loans	-	-	-	-	-	-
All other loans	-	-	-	-	-	-
Total	4	\$1,052	\$1,006	4	\$1,096	\$824

During the year ended 2016, the Company modified four loans that were considered to be troubled debt restructurings. On one loan the interest rate and maturity date were not modified; however, the payment terms were changed. On one loan the interest rate was lowered and the payment terms were changed. On two loans the interest rate was lowered and the payment terms and maturity date were changed. During the year ended 2015, the Company modified four loans that were considered to be troubled debt restructurings. On two of the loans we modified the terms and lowered the interest rate. On two of the loans the interest rate was not modified; however, the maturity date was extended.

One commercial real estate loan with a recorded investment of \$211 thousand that had been modified as a troubled debt restructuring defaulted during the year ended December 31, 2016, which was within twelve months of the loan's modification date. No loans modified as troubled debt restructurings defaulted during the year end December 31,

2015. Generally, a troubled debt restructuring is considered to be in default once it becomes 90 days or more past due following a modification.

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

NOTE 9 BANK PREMISES AND EQUIPMENT:

Bank premises and equipment at December 31, are summarized as follows:

(Dollars are in thousands)	2016	2015
Land	\$9,097	\$8,972
Buildings and improvements	22,889	22,593
Furniture and equipment	19,760	17,713
Vehicles	609	590
Construction in progress	18	18
	52,373	49,886
Less accumulated depreciation	(22,388)	(21,738)
Bank Premises and Equipment	\$29,985	\$28,148

Depreciation expense for 2016 and 2015 was \$2.4 million and \$2.1 million, respectively.

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NOTE 10 OTHER TIME DEPOSITS:

The aggregate amount of time deposits that meet or exceed the FDIC Insurance limit of \$250,000 was \$13.0 million and \$13.9 million at December 31, 2016 and 2015, respectively. We have brokered deposits totaling \$2.7 million at December 31, 2016 and 2015, respectively. At December 31, 2016, the scheduled maturities of time deposits are as follows (dollars are in thousands):

2017	\$ 157,392
2018	27,278
2019	13,933
2020	20,100
2021	29,060
After five years	56
Total	\$ 247,819

NOTE 11 INCOME TAX EXPENSE (BENEFIT):

The components of income tax expense (benefit) for the years ended December 31, are as follows:

(Dollars are in thousands)	2016	2015
Current expense (benefit)	\$(7)	\$19
Deferred tax expense (benefit)	(2)	-
Net income tax expense (benefit)	\$(9)	\$19

The net deferred tax assets and liabilities resulting from temporary differences as of December 31 are summarized as follows:

(Dollars are in thousands)	2016	2015
Deferred Tax Assets		
Allowance for loan losses	\$2,064	\$2,548
Deferred compensation	147	148
Accrued employee benefits	15	82
Nonaccrual loan interest	896	737
Other real estate owned	1,911	2,214
Reposessed assets	12	-
Amortization of core deposits	101	119

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Amortization of goodwill	514	607
Capitalized interest and repair expense	41	43
Net operating loss carryforward	5,648	5,150
AMT carryforward	320	305
Unrealized loss on securities available for sale	235	169
Total Assets, gross	11,904	12,122
Valuation allowance	(5,317)	(5,655)
Total Assets, net	6,587	6,467
Deferred Tax Liabilities		
Accelerated depreciation	867	959
Prepaid expenses	38	44
Deferred loan costs	397	343
Total Liabilities, gross	1,302	1,346
Net Deferred Tax Asset	\$5,285	\$5,121

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The following table summarizes the differences between the actual income tax expense and the amounts computed using the federal statutory tax rate of 34%:

(Dollars are in thousands)	2016	2015
Income tax expense (benefit) at the applicable federal rate	\$323	\$912
Permanent differences resulting from:		
Nondeductible expenses	7	7
Tax exempt interest income	(44)	(44)
State income taxes less federal tax effect	5	(13)
Bank owned life insurance	(57)	(42)
Deferred tax valuation allowance change, net	(338)	(735)
Other adjustments	95	(66)
Income tax expense (benefit)	\$(9)	\$19

Management reviewed the December 31, 2016 deferred tax calculation to determine the need for a valuation allowance. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. In management's opinion, based on a three year taxable income projection and the effects of off-setting deferred tax liabilities, it is more likely than not that all the deferred tax assets, net of the \$5.3 million allowance, would be realizable. Management is required to consider all evidence, both positive and negative in making this determination. As of December 31, 2016, the Company had \$16.6 million of net operating loss carryforwards which will expire in 2031 thru 2036. Management expects to utilize all of these carryforwards prior to expiration. Direct charge-offs contributed to a reduction of the tax asset and are permitted as tax deductions. In addition, writedowns on other real estate owned property are expensed for book purposes but are not deductible for tax purposes until disposition of the property. Goodwill expense also was realized for book purposes in 2011 but continues to only be tax deductible based on the statutory requirements; thus, creating a deferred tax asset. When, and if, taxable income increases in the future and during the net operating loss carryforward period, this valuation allowance may be reversed and used to decrease tax obligations in the future. We do not have significant nontaxable income or nondeductible expenses.

The Company's tax filings for years ended 2013 through 2016 were at year end 2016 open to audit under statutes of limitations by the Internal Revenue Service ("IRS") and state taxing authorities. Our tax filings for the years ended 2010, 2011, and 2012 had been under examination by the IRS. In March 2015 we received notification from the IRS that as a result of the examination no changes were made to our reported tax.

NOTE 12 RELATED PARTY TRANSACTIONS:

During the year, officers, directors (and companies controlled by them), principal shareholders, and associates were customers of and had loan transactions with the Bank in the normal course of business which amounted to \$5.4 million at December 31, 2016 and \$4.1 million at December 31, 2015. During the year ended December 31, 2016, total principal additions were \$4.9 million and principal payments were \$3.6 million, including renewals and advances

on revolving lines of credit. During the year ended December 31, 2015, total principal additions were \$3.1 million and principal payments were \$3.6 million, including renewals and advances on revolving lines of credit. These transactions were made on substantially the same terms as those prevailing for other customers and did not involve any abnormal risk. Total related party deposits held at the Bank were \$11.1 million and \$12.2 million at the end of years 2016 and 2015, respectively.

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NOTE 13 RETIREMENT PLANS:

The Company has established a qualified defined contribution plan that covers all full time employees. Effective January 1, 2012 the qualified defined contribution plan was modified where the Company matched employee contributions up to a maximum of 3% of their salary. The Company contributed \$385 thousand and \$224 thousand to the defined contribution plan for 2016 and 2015, respectively.

In addition, in 2002, the Bank established a salary continuation plan for key executives, which is funded by single premium life insurance policies. Expenses related to the plan were \$5 thousand and \$6 thousand for 2016 and 2015, respectively.

NOTE 14 OTHER REAL ESTATE OWNED:

The following table summarizes the activity in other real estate owned for the years ended December 31, 2016 and 2015:

(Dollars are in thousands)	2016	2015
Balance, beginning of year	\$ 12,398	\$ 15,049
Additions	4,577	3,277
Purchases of/improvements to		
other real estate owned	48	12
Donation of other real estate owned	-	(33)
Transfers of other real estate owned		
to premises and equipment	(125)	-
Proceeds from sales	(5,050)	(2,709)
Proceeds from insurance claims	-	(101)
Adjustment of carrying value	(1,414)	(3,246)
Deferred gain from sales	-	50
Gain from sales	221	99
Balance, end of year	\$ 10,655	\$ 12,398

NOTE 15 STOCK OPTION PLAN:

New Peoples' Stock Option Plan (“the Plan”) was adopted on September 27, 2001. The purpose of the Plan is to reward employees and directors for services rendered and investment risks undertaken to date and to promote the success of the Company by providing incentives to employees and directors that will promote the identification of their personal interest with the long-term financial success of the Company and with growth in shareholder value. The Plan provides that options for up to 1,287,000 shares of the Company’s common stock may be issued to employees and directors. The exercise price may not be less than 100% of the fair market value of the shares on the award date. Each award becomes exercisable in the event of a change in control of the Company. All options are subject to exercise or forfeiture if the Company’s capital falls below minimum requirements, as determined by its primary state or federal regulator. The Plan expired on May 31, 2011. The Company did not grant any options in 2016 and 2015. No stock options were exercised in 2016 and 2015. There were no stock options outstanding at December 31, 2016.

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A summary of the status of the Company's stock option plan is presented below:

	2016		2015		2014	
	Number	Weighted Average	Number of	Weighted Average	Number of	Weighted Average
	of	Exercise Price	Shares	Exercise Price	Shares	Exercise Price
	Shares					
Outstanding and exercisable,						
Beginning of year	-	\$ -	198,183	\$ 11.54	284,729	\$ 11.02
Exercised	-	-	-	-	-	-
Forfeited	-	-	(32,175)	11.54	(20,930)	11.04
Expired	-	-	(166,008)	11.54	(65,616)	9.44
Outstanding and exercisable,						
End of year	-	\$ -	-	\$ -	198,183	\$ 11.54

NOTE 16 DIVIDEND LIMITATIONS ON SUBSIDIARY BANK:

A principal source of funds of the Company is dividends paid by the Bank. The Federal Reserve Act restricts the amount of dividends the Bank may pay. Approval by the Board of Governors of the Federal Reserve System is required if the dividends declared by a state member bank, in any year, exceed the sum of (1) net income of the current year and (2) income net of dividends for the preceding two years. In October 2009, a restriction prohibiting the payment of dividends from the Bank to the Company was imposed by the Federal Reserve Bank of Richmond. This restriction was lifted when the Written Agreement was terminated effective January 20, 2016. For additional discussion concerning the Written Agreement, see Note 3, "Formal Written Agreement."

NOTE 17 LEASING ACTIVITIES:

As of December 31, 2016 and 2015, respectively, the Bank had no significant operating leases. Rental commitments of less than one year are not included. There were no rentals charged to operations under operating leases in 2016 and 2015.

NOTE 18 AVAILABLE LINES OF CREDIT AND FEDERAL HOME LOAN BANK ADVANCES:

The Bank has the ability to borrow up to an additional \$120.9 million from the Federal Home Loan Bank under a line of credit which is secured by a blanket lien on residential real estate loans. The Bank had no overnight borrowings subject to daily rate changes from the Federal Home Loan Bank at December 31, 2016 or 2015.

At December 31, 2016, we had borrowings from the FHLB totaling \$13.8 million as compared to \$3.0 million at December 31, 2015. At December 31, 2016, \$1.8 million of these borrowings had fixed interest rates with an average yield of 4.07%, and a maturity date in 2018. In June 2016 the Bank borrowed \$2.0 million with a maturity date in the year 2019 and \$5.0 million with a maturity date in the year 2021. Both borrowings have fixed interest rates and interest is payable monthly, with a interest rate of 0.99% on the \$2.0 million borrowing and an interest rate of 1.38% on the \$5.0 million borrowing. In December 2016, the Bank borrowed \$5.0 million with a maturity date in March 2017 and a fixed interest rate of 0.69%, with interest payable monthly.

Letters of credit for \$3.0 million and \$2.0 million were issued in 2015 and a letter of credit for \$7.0 million was issued in 2013 to the Treasury Board of Virginia for collateral on public funds. No draws on the letters of credit have been issued. The letters of credit are considered draws on our Federal Home Loan Bank line of credit.

In May 2015, we received notification that a \$3.0 million unsecured fed funds line of credit facility with a correspondent bank had been reinstated. In February 2016, we received notification that this facility had been increased to \$5.0 million. In March 2016, we received notification that another correspondent bank had reinstated an unsecured federal funds line of credit facility in the amount of \$5.0 million. As of December 31, 2016 and 2015, no balances were outstanding on these fed funds lines of credit.

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NOTE 19 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK:

In the normal course of business, the Bank has outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying consolidated financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheet.

Financial instruments whose contract amount represents credit risk at December 31 were as follows:

(Dollars are in thousands)	2016	2015
Commitments to extend credit	\$34,770	\$27,742
Standby letters of credit	2,019	2,435

Commitments to extend credit are agreements to lend to a customer at either a fixed or variable interest rate 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 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 obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

NOTE 20 LEGAL CONTINGENCIES:

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

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

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

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NOTE 21 TRUST PREFERRED SECURITIES AND DEFERRAL OF INTEREST PAYMENTS:

On July 7, 2004, the Company completed the issuance of \$11.3 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust I. The proceeds of the funds were used for general corporate purposes which included capital management for affiliates, retirement of indebtedness and other investments. The securities have a floating rate of 3 month LIBOR plus 260 basis points, which resets quarterly, with a current rate at December 31, 2016 of 3.48%.

On September 27, 2006, the Company completed the issuance of \$5.2 million in floating rate trust preferred securities offered by its wholly owned subsidiary, NPB Capital Trust 2. The proceeds of the funds were used for general corporate purposes, which include capital management for affiliates and the acquisition of two branch banks. The securities have a floating rate of 3 month LIBOR plus 177 basis points, which resets quarterly, with a current rate at December 31, 2016 of 2.65%.

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

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

The Company is currently not deferring the quarterly interest payments on the trust preferred securities. However, as discussed above, regulatory approval was needed to pay the interest while the Company was under the formal Written Agreement. This approval was granted during each quarter of 2015 and all trust preferred interest payments were made.

The restriction requiring regulatory approval before the payment of interest on the trust preferred securities was lifted when the Written Agreement was terminated effective January 20, 2016 and all trust preferred interest payments due have been made on time since that date.

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NOTE 22 CAPITAL:**Capital Requirements and Ratios**

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined) to risk-weighted assets (as defined), Tier 1 capital (as defined) to average assets (as defined), and Common Equity Tier 1 capital (as defined) to risk-weighted assets (as defined). As of December 31, 2016, the Bank meets all capital adequacy requirements to which it is subject.

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

Actual	Minimum Capital Requirement	Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions		Amount	Ratio	Amount	Ratio
		Amount	Ratio				
(Dollars are in thousands)							
December 31, 2016:							
Total Capital to Risk Weighted Assets:							
New Peoples Bank, Inc.	67,549	16.64	%	\$32,476	8.0%	\$40,595	10.0%
Tier 1 Capital to Risk Weighted Assets:							
New Peoples Bank, Inc.	62,462	15.39	%	24,357	6.0%	32,476	8.0 %
Tier 1 Capital to Average Assets:							

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New Peoples Bank, Inc. Common Equity Tier 1 Capital	62,462	9.93	%	25,149	4.0%	31,436	5.0	%
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to Risk Weighted Assets:

New Peoples Bank, Inc.	62,462	15.39	%	18,268	4.5%	26,386	6.5	%
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December 31, 2015:

Total Capital to Risk Weighted Assets:

New Peoples Bank, Inc.	65,713	17.55	%	\$29,954	8.0%	\$37,443	10.0	%
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Tier 1 Capital to Risk Weighted Assets:

New Peoples Bank, Inc.	60,998	16.29	%	22,466	6.0%	29,954	8.0	%
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Tier 1 Capital to Average Assets:

New Peoples Bank, Inc.	60,998	9.67	%	25,239	4.0%	31,549	5.0	%
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Common Equity Tier 1 Capital

to Risk Weighted Assets:

New Peoples Bank, Inc.	60,998	16.29	%	16,849	4.5%	24,338	6.5	%
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As of December 31, 2016, the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage, and Common Equity Tier 1 ratios as set forth in the above tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

Under Basel III Capital requirements, beginning January 1, 2016, a capital conservation buffer of 0.625% became effective. The capital conservation buffer will be gradually increased through January 1, 2019 to 2.5%. Banks will be required to maintain levels that meet the required minimum plus the capital conservation buffer in order to make distributions, such as dividends, or discretionary bonus payments.

Board of Directors Exercise of Common Stock Warrants

During the month of October 2015, a member of the board of directors of the Company and his family exercised 233,886 common stock warrants at a price of \$1.75 per share. During the month of November 2015, another member of the board of directors of the Company exercised 225,000 common stock warrants at a price of \$1.75 per share. During the month of December 2015, another member of the board of directors of the Company and his family exercised 16,542 common stock warrants at a price of \$1.75 per share. As a result of these exercises an additional \$832 thousand of capital was raised by the Company. The additional liquidity provided by the funds will be used by the Company to pay its operating expenses and trust preferred interest payments.

Common Stock Warrants

As of December 31, 2016, 881,978 common stock warrants were outstanding as compared to 882,353 common stock warrants as of December 31, 2015. During 2016, 375 of the common stock warrants were exercised at a price of \$1.75. As noted above, during 2015, 475,428 of common stock warrants were exercised at a price of \$1.75. A summary of common stock warrants outstanding at December 31, 2016 follows:

Expiration Date	Exercise Price	Number Outstanding And Exercisable	Weighted Average Remaining Contractual Life
December 20, 2017	\$1.75	881,978	0.97 years

Totals 881,978 0.97 years

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NOTE 23 FAIR VALUES:

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

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

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

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

Investment Securities Available for Sale – Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices. The Company’s available for sale securities,

totaling \$70.0 million and \$101.6 million at December 31, 2016 and 2015, respectively, are the only assets whose fair values are measured on a recurring basis using Level 2 inputs from an independent pricing service.

Loans - The Company does not record loans at fair value on a recurring basis. Real estate serves as collateral on a substantial majority of the Company's loans. From time to time a loan is considered impaired and an allowance for loan losses is established. Loans which are deemed to be impaired and require a reserve are primarily valued on a non-recurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which management evaluates and determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or an appraised value does not include estimated costs of disposition and management must make an estimate, the Company records the impaired loan as nonrecurring Level 3. The aggregate carrying amount of impaired loans carried at fair value were \$13.8 million and \$16.3 million at December 31, 2016 and 2015, respectively.

Foreclosed Assets – Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Foreclosed assets are carried at the lower of the carrying value or fair value. Fair value is based upon independent observable market prices or appraised values of the collateral with a third party estimate of disposition costs, which the Company considers to be nonrecurring level 2 inputs. When the appraised value is not available, management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, or an appraised value does not include estimated costs of disposition and management must make an estimate, the Company records the foreclosed asset as nonrecurring Level 3. The aggregate carrying amounts of foreclosed assets were \$10.7 million and \$12.4 million at December 31, 2016 and 2015, respectively.

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

	Quoted market price in active markets	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(Dollars are in thousands)	(Level 1)	(Level 2)	(Level 3)
(On a recurring basis)			
Available for sale investments			
U.S. Government Agencies	\$ —	\$ 24,632	\$ —
Taxable municipals	—	2,292	—
Corporate bonds	—	3,749	—
Mortgage backed securities	—	39,338	—
(On a non-recurring basis)	—	—	10,655
Other real estate owned			
Impaired loans:			
Real estate secured:			
Commercial	—	—	4,762
Construction and land development	—	—	139
Residential 1-4 family	—	—	4,360
Multifamily	—	—	301
Farmland	—	—	4,187
Commercial	—	—	49
Agriculture	—	—	19
Consumer installment loans	—	—	32
All other loans	—	—	—
Total	\$ —	\$ 70,011	\$ 24,504

Assets and liabilities measured at fair value are as follows as of December 31, 2015 (for purpose of this table the impaired loans are shown net of the related allowance):

Quoted market price in active markets	Significant other observable inputs	Significant unobservable inputs (Level 3)
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(Dollars are in thousands)	(Level 1)	(Level 2)	
(On a recurring basis)			
Available for sale investments			
U.S. Government Agencies	\$ —	\$ 41,523	\$ —
Taxable municipals	—	3,281	—
Corporate bonds	—	1,939	—
Mortgage backed securities	—	54,899	—
(On a non-recurring basis)			
	—	—	12,398
Other real estate owned			
Impaired loans:			
Real estate secured:			
Commercial	—	—	6,427
Construction and land development	—	—	144
Residential 1-4 family	—	—	4,789
Multifamily	—	—	430
Farmland	—	—	4,416
Commercial	—	—	45
Agriculture	—	—	36
Consumer installment loans	—	—	54
All other loans	—	—	—
Total	\$ —	\$ 101,642	\$ 28,739

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

(Dollars in thousands)	Fair Value at December 31, 2016	Fair Value at December 31, 2015	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Impaired Loans	\$13,849	\$16,341	Appraised Value/Discounted Cash Flows/Market Value of Note	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0 – 18%
Other Real Estate Owned	\$10,655	\$12,398	Appraised Value/Comparable Sales/Other Estimates from Independent Sources	Discounts to reflect current market conditions and estimated costs to sell	0 – 18%

Fair Value of Financial Instruments

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

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

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2016 and 2015. This table excludes financial instruments for which the carrying amount approximates fair value. The carrying value of cash and due from banks, federal funds sold, interest-bearing deposits, deposits with no stated maturities, trust preferred securities and accrued interest approximates fair value. The remaining financial instruments were valued based on the present value of estimated future cash flows, discounted at various rates in effect for similar instruments during the months of December 2016 and 2015.

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	Carrying Amount	Fair Value	Fair Value Measurements		
			Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
(Dollars are in thousands)					
December 31, 2016					
Financial Instruments – Assets					
Net Loans	\$462,557	\$467,707	\$—	\$453,858	\$ 13,849
Financial Instruments – Liabilities					
Time Deposits	247,819	247,258	—	247,258	—
FHLB Advances	13,758	13,993	—	13,993	—
December 31, 2015					
Financial Instruments – Assets					
Net Loans	\$433,676	\$438,589	\$—	\$422,248	\$ 16,341
Financial Instruments – Liabilities					
Time Deposits	256,978	256,797	—	256,797	—
FHLB Advances	2,958	2,958	—	2,958	—

NOTE 24 RECENT ACCOUNTING DEVELOPMENTS:

The following is a summary of recent authoritative announcements:

In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2017. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral the guidance in ASU 2014-09 will be effective for the Company for reporting periods beginning

after December 15, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

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

In February 2016, the FASB amended the Leases topic of the ASC to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

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

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them to apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for the Company for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

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

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NOTE 25 PARENT CORPORATION ONLY FINANCIAL STATEMENTS:**CONDENSED BALANCE SHEETS****AS OF DECEMBER 31, 2016 AND 2015****(Dollars in Thousands)**

ASSETS	2016	2015
Due from banks	\$813	\$1,445
Investment in subsidiaries	62,158	60,672
Other assets	587	589
Total Assets	\$63,558	\$62,706
LIABILITIES		
Accrued interest payable	\$125	\$104
Accrued expenses and other liabilities	20	19
Trust preferred securities	16,496	16,496
Total Liabilities	16,641	16,619
STOCKHOLDERS' EQUITY		
Common stock - \$2.00 par value, 50,000,000 shares authorized; 23,354,457 and 23,354,082 shares issued and outstanding at December 31, 2016 and 2015, respectively	46,709	46,708
Common stock warrants	764	764
Additional paid capital	13,965	13,965
Retained deficit	(14,065)	(15,023)
Accumulated other comprehensive loss	(456)	(327)
Total Stockholders' Equity	46,917	46,087
Total Liabilities and Stockholders' Equity	\$63,558	\$62,706

CONDENSED STATEMENTS OF INCOME**FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

(Dollars in Thousands)	2016	2015
Income		
Miscellaneous income	\$15	\$13

Undistributed income of subsidiaries	1,615	3,295
Total income	1,630	3,308

Expenses

Trust preferred securities interest expense	508	440
Legal fees	17	23
Accounting fees	88	114
Other operating expenses	59	69
Total Expenses	672	646

Income before Income Taxes	958	2,662
Income Tax Expense (Benefit)	-	-
Net Income	\$958	\$2,662

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CONDENSED STATEMENTS OF CASH FLOWS**FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

(Dollars in Thousands)	2016	2015
Cash Flows From Operating Activities		
Net income	\$958	\$2,662
Adjustments to reconcile net income to net cash used in operating activities:		
Income of subsidiaries	(1,615)	(3,295)
Net change in:		
Other assets	2	98
Other liabilities	22	57
Net Cash Used in Operating Activities	(633)	(478)
Cash Flows From Financing Activities		
Exercise of common stock warrants	1	832
Net Cash Provided by Financing Activities	1	832
Net increase (decrease) in Cash and Cash Equivalents	(632)	354
Cash and Cash Equivalents, Beginning of year	1,445	1,091
Cash and Cash Equivalents, End of Year	\$813	\$1,445
Supplemental Disclosure of Cash Paid During the Year for:		
Interest	\$487	\$327
Taxes	\$-	\$-

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NOTE 26 SELECTED QUARTERLY INFORMATION (UNAUDITED)**2016 QUARTERS**

(Dollars in thousands except per share data)

Income statement

	Fourth	Third	Second	First
Net interest income	\$5,420	\$5,453	\$5,402	\$5,451
Noninterest income	1,909	2,043	1,753	1,586
Provision for loan losses	-	-	(500)	-
Noninterest expense	8,300	7,155	6,776	6,337
Net income (loss)	(968)	346	882	698
Earnings (loss) per share, basic	(0.04)	0.01	0.04	0.03
Earnings (loss) per share, diluted	(0.04)	0.01	0.04	0.03

Period end balance sheet

Total loans receivable	\$468,629	\$464,721	\$459,613	\$450,309
Total assets	634,335	633,867	632,311	636,459
Total deposits	554,438	556,516	555,084	555,216
Total stockholders' equity	46,917	48,785	48,485	47,234

2015 QUARTERS

(Dollars in thousands except per share data)

Income statement

	Fourth	Third	Second	First
Net interest income	\$5,922	\$5,668	\$5,601	\$5,410
Noninterest income	1,641	1,777	1,541	1,444
Provision for loan losses	(1,000)	(1,200)	—	—
Noninterest expense	9,276	6,338	6,680	6,229
Net income (loss)	(715)	2,293	462	622
Earnings (loss) per share, basic	(0.03)	0.10	0.02	0.03
Earnings (loss) per share, diluted	(0.03)	0.10	0.02	0.03

Period end balance sheet

Total loans receivable	\$441,169	\$438,538	\$443,775	\$449,929
Total assets	625,898	633,758	642,774	660,130
Total deposits	558,019	564,623	576,597	593,324
Total stockholders' equity	46,087	46,409	43,736	43,863

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting of New Peoples Bankshares, Inc. New Peoples' internal control system was designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting practices.

All internal control systems, no matter how well designed, have inherent limitations. Because of these inherent limitations, internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and presentation, and may not prevent or detect misstatements. 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.

Management assessed the effectiveness of New Peoples' internal control over financial reporting as of December 31, 2016. 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" issued in 1992. Based on this assessment management concluded that the internal control over financial reporting was effective as of December 31, 2016.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures that is designed to ensure that material information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were operating effectively as of December 31, 2016.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information contained under the captions "Election of Directors," "Executive Officers Who Are Not Directors," "Corporate Governance" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2017 Proxy Statement that is required to be disclosed in this Item 10 is incorporated herein by reference.

Item 11. Executive Compensation

The information contained under the captions "Director Compensation" and "Executive Compensation and Related Party Transactions" in the 2017 Proxy Statement that is required to be disclosed in this Item 11 is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information contained under the captions "Security Ownership of Management" and "Security Ownership of Certain Beneficial Owners" in the 2017 Proxy Statement that is required to be disclosed in this Item 12 is incorporated herein by reference.

Item 13. Certain Relationships, Related Transactions and Director Independence

The information contained under the caption "Executive Compensation and Related Party Transactions" and "Corporate Governance" in the 2017 Proxy Statement that is required to be disclosed in this Item 13 is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information contained under the caption "Audit Information" in the 2017 Proxy Statement that is required to be disclosed in this Item 14 is incorporated herein by reference.

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Item 15. Exhibits and Financial Statement Schedules

- (a)(1) The response to this portion of Item 15 is included in Item 8 above.
- (a)(2) The response to this portion of Item 15 is included in Item 8 above.
- (a)(3) The following exhibits are filed as part of this Form 10-K, and this list includes the exhibit index::

Exhibit	<u>Number</u>
3.1	Amended Articles of Incorporation of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q for the quarterly period ended June 30, 2008 filed on August 11, 2008).
3.2	Bylaws of Registrant (incorporated by reference to Exhibit 3.1 to Form 8-K filed April 15, 2004).
4.1	Specimen Common Stock Certificate of New Peoples Bankshares, Inc. (incorporated by reference to Exhibit 4.1 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
4.2	Form of Warrant to Purchase Shares of Common Stock (incorporated by reference to Exhibit 4.2 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
4.3	Form of Rights Certificate (incorporated by reference to Exhibit 4.3 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
10.1*	New Peoples Bank, Inc. 2001 Stock Option Plan (incorporated by reference to Exhibit 10.1 to Annual Report on Form 10-KSB for the fiscal year ended December 31, 2001).
10.2*	Form of Non-Employee Director Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 8-K filed November 30, 2004)
10.3*	Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Form 8-K filed November 30, 2004).
10.4*	Salary Continuation Agreement dated December 18, 2002 between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.6 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).
10.5*	First Amendment dated June 30, 2003 to Salary Continuation Agreement between New Peoples Bank, Inc. and Frank Sexton, Jr. (incorporated by reference to Exhibit 10.7 to Annual Report on Form 10-K for the fiscal year ended December 31, 2004).
10.6*	Letter Agreement, dated as of June 29, 2009, between the Company and Kenneth D. Hart (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2009).
10.7	Written Agreement, effective August 4, 2010, by and among New Peoples Bankshares, Inc., New Peoples Bank, Inc., the Federal Reserve Bank of Richmond and the State Corporation Commission Bureau of Financial Institutions (incorporated by reference to Exhibit 10.1 to Form 8-K filed August 6, 2010).
10.8	Engagement Letters of Scott & Stringfellow, LLC (incorporated by reference to Exhibit 10.8 to Form 10-Q for the quarterly period ended June 30, 2012 filed on August 14, 2012).
10.9	Convertible Note Payable, B. Scott White, dated June 27, 2012 (incorporated by reference to Exhibit 10.1 to Form 8-K filed June 29, 2012).
10.10	Convertible Note Payable, Harold Lynn Keene, dated June 27, 2012 (incorporated by reference to Exhibit 10.2 to Form 8-K filed June 29, 2012).
10.11*	Employment Agreement dated December 1, 2016 between New Peoples Bankshares, Inc., New Peoples Bank, Inc., and C. Todd Asbury (incorporated by reference to Exhibit 10.1 to Form 8-K filed December 2, 2016)

- 14 Code of Ethics (incorporated by reference to Exhibit 14 to Annual Report on Form 10-K for the fiscal year ended December 31, 2003).
- 21 Subsidiaries of the Registrant.
- 23 Consent of Elliott Davis Decosimo, LLC.
- 24 Powers of Attorney (contained on signature page).
- 31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a).
Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.
- 32
- 101 The following materials for the Company's 10-K Report for the year ended December 31, 2016, formatted in XBRL. (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to the Consolidated Financial Statements, tagged as blocks of text.)
-

* Denotes management contract.

- (b) See Item 15(a)(3) above.
- (c) See Items 15(a)(1) and (2) above.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEW PEOPLES BANKSHARES, INC.

By: /s/ C. TODD ASBURY

C. Todd Asbury

President and Chief Executive Officer

Date: March 13, 2017

By: /s/ JOSEPH D. PENNINGTON

Joseph D. Pennington

Senior Vice President and Chief Financial Officer

Date: March 13, 2017

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POWER OF ATTORNEY

Each of the undersigned hereby appoints C. Todd Asbury and Joseph D. Pennington, and each of them, as attorneys and agents for the undersigned, with full power of substitution, in his name and on his behalf as a director of New Peoples Bankshares, Inc. (the “Registrant”), to act and to execute any and all instruments as such attorneys or attorney deem necessary or advisable to enable the Registrant to comply with the Securities Exchange Act of 1934, and any rules, regulations, policies or requirements of the Securities and Exchange Commission (the “Commission”) in respect thereof, in connection with the preparation and filing with the Commission of the Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (the “Report”), and any and all amendments to such Report, together with such other supplements, statements, instruments and documents as such attorneys or attorney deem necessary or appropriate.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ C. TODD ASBURY C. Todd Asbury	President and Chief Executive Officer (Principal Executive Officer)	March 13, 2017
/s/ JOSEPH D. PENNINGTON Joseph D. Pennington	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 13, 2017
/s/ TIM BALL Tim Ball	Director	March 13, 2017
/s/ JOE CARTER Joe Carter	Director	March 13, 2017
/s/ JOHN D. COX John D. Cox	Director	March 13, 2017
/s/ CHARLES H. GENT Charles H. Gent	Director	March 13, 2017
/s/ EUGENE HEARL Eugene Hearl	Director	March 13, 2017

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/s/ HAROLD LYNN KEENE Chairman, Director March 13, 2017
Harold Lynn Keene

/s/ MICHAEL G. MCGLOTHLIN Director March 13, 2017
Michael G. McGlothlin

/s/ FRED MEADE Director March 13, 2017
Fred Meade

/s/ B. SCOTT WHITE Director March 13, 2017

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