C & F FINANCIAL CORP
Form 10-K
February 26, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2018

or

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

For the transition period from _________ to _________

Commission file number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	54-1680165
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

802 Main Street

West Point, VA 23181

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (804) 843-2360

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

Common Stock, $1.00 par value per share	The NASDAQ Stock Market LLC
Title of each class	Name of each exchange on which registered

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

NONE

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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated Filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 common stock held by non-affiliates of the registrant as of June 30, 2018 was $205,720,132.

There were 3,486,861 shares of common stock, $1.00 par value per share, outstanding as of February 22, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held April 16, 2019 are incorporated by reference in Part III of this report.

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PART I

ITEM 1.BUSINESS

General

C&F Financial Corporation (the Corporation) is a bank holding company that was incorporated in March 1994 under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of Citizens and Farmers Bank (the Bank or C&F Bank), which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. C&F Bank originally opened for business under the name Farmers and Mechanics Bank on January 22, 1927. C&F Bank has the following five wholly-owned subsidiaries, all incorporated under the laws of the Commonwealth of Virginia:

- C&F Mortgage Corporation
- C&F Finance Company
- C&F Wealth Management Corporation
- C&F Insurance Services, Inc.
- CVB Title Services, Inc.

The Corporation operates in a decentralized manner in three principal business segments: (1) retail banking through C&F Bank, (2) mortgage banking through C&F Mortgage Corporation (C&F Mortgage) and (3) consumer finance through C&F Finance Company (C&F Finance). For detailed information about the financial condition and results of operations of these segments, see “Note 18: Business Segments” in Item 8. “Financial Statements and Supplementary Data” in this report. C&F Wealth Management Corporation, organized in April 1995, is a full-service brokerage firm offering a comprehensive range of wealth management services and insurance products through third-party service providers. C&F Insurance Services, Inc. was organized in July 1999 for the primary purpose of owning an equity interest in an independent insurance agency that operates in Virginia and North Carolina. CVB Title Services, Inc. was organized for the primary purpose of owning an equity interest in a full service title and settlement agency. The financial position and operating results of C&F Wealth Management Corporation, C&F Insurance Services, Inc. and CVB Title Services, Inc. are not significant to the Corporation as a whole.

The Corporation also owns three non-operating subsidiaries, C&F Financial Statutory Trust II (Trust II) formed in December 2007, C&F Financial Statutory Trust I (Trust I) formed in July 2005, and Central Virginia Bankshares Statutory Trust I (CVBK Trust I) formed in December 2003. These trusts were formed for the purpose of issuing $10.0 million each for Trust II and Trust I of the Corporation's junior subordinated debt securities and $5.0 million for CVBK Trust I of junior subordinated debt securities originally issued by Central Virginia Bankshares, Inc. (CVBK), and assumed by the Corporation when CVBK was merged into the Corporation on March 22, 2014, with all such issuances occurring in private placements to institutional investors. All three trusts are unconsolidated subsidiaries of the Corporation. The principal assets of these trusts are $10.3 million each for Trust II and Trust I and $5.2 million for CVBK Trust I of the Corporation's junior subordinated debt securities (such securities of the Corporation referred to herein as "trust preferred capital notes") that are reported as liabilities of the consolidated Corporation.

Retail Banking

We provide retail banking services through C&F Bank. C&F Bank provides retail banking services at its main office in West Point, Virginia, and 25 Virginia branches located one each in Cartersville, Charlottesville, Chester, Cumberland, Hampton, Mechanicsville, Newport News, Norge, Powhatan, Providence Forge, Quinton, Saluda, Sandston, West Point and Yorktown, two in Williamsburg, four in Richmond and four in Midlothian. These branches provide a wide range of banking services to individuals and businesses. These services include various types of checking and savings deposit accounts, as well as business, real estate, development, mortgage, home equity and installment loans. The Bank also offers ATMs, internet and mobile banking and debit and credit cards, as well as safe deposit box rentals, notary public,

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electronic transfer and other customary bank services to its customers. Revenues from retail banking operations consist primarily of interest earned on loans and investment securities and fees related to deposit services. Retail banking revenues and operations are not materially affected by seasonal factors; however, public deposits tend to increase with tax collections primarily in the fourth quarter of each year and decline with spending thereafter. At December 31, 2018, assets of the retail banking segment totaled $1.4 billion. For the year ended December 31, 2018, net income for this segment totaled $10.6 million.

Mortgage Banking

We conduct mortgage banking activities through C&F Mortgage, which was organized in September 1995. C&F Mortgage provides mortgage loan origination services through 11 locations in Virginia, two in Maryland, two in North Carolina, one in South Carolina, and one in West Virginia. The Virginia offices are located one each in Charlottesville, Chesapeake, Fishersville, Fredericksburg, Glen Allen, Harrisonburg, Lynchburg, Newport News and Williamsburg and two in Midlothian. The Maryland offices are located in Annapolis and Waldorf. The North Carolina offices are located in Gastonia and Moyock. The South Carolina office is located in Fort Mill. The West Virginia office is located in Keyser. C&F Mortgage offers a wide variety of residential mortgage loans, which are originated for sale generally to the following investors: Penny Mac Corporation; Wells Fargo Home Mortgage; AmeriHome Mortgage Company, LLC; the Virginia Housing Development Authority (VHDA); and Freedom Mortgage Corporation. C&F Mortgage does not securitize loans. C&F Bank may also purchase mortgage loans from C&F Mortgage. C&F Mortgage originates conventional mortgage loans, mortgage loans insured by the Federal Housing Administration (the FHA), and mortgage loans guaranteed by the United States Department of Agriculture (the USDA) and the Veterans Administration (the VA). A majority of the conventional loans are conforming loans that qualify for purchase by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). The remainder of the conventional loans are non-conforming in that they do not meet Fannie Mae or Freddie Mac guidelines, but are eligible for sale to various other investors. C&F Mortgage also has a division, Lender Solutions, that provides certain mortgage loan origination functions to third parties and a subsidiary, Certified Appraisals LLC, which provides ancillary mortgage loan origination services to third parties for residential appraisals. Revenues from mortgage banking operations consist principally of gains on sales of loans to investors in the secondary mortgage market, loan origination fee income and interest earned on mortgage loans held for sale. Revenues and income from mortgage banking, which are driven primarily by the origination and sale of mortage loans, are subject to seasonal factors, including the volume of home sales in the residential real estate market, which typically rises during spring and summer months and declines during fall and winter months. However, seasonal trends may be disrupted by cyclical and other economic factors that affect the residential real estate market. At December 31, 2018, assets of the mortgage banking segment totaled $56.1 million. For the year ended December 31, 2018, net income for this segment totaled $1.9 million.

Consumer Finance

We conduct consumer finance activities through C&F Finance. C&F Finance is a regional finance company purchasing automobile, marine and recreational vehicle (RV) loans throughout Virginia and in portions of Alabama, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Maryland, Minnesota, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Texas and West Virginia through its offices in Richmond and Hampton, Virginia, and in Nashville, Tennessee. C&F Finance is an indirect lender that primarily provides automobile financing through lending programs that are designed to serve customers in the “non-prime” market who have limited access to traditional automobile financing. C&F Finance generally purchases automobile retail installment sales contracts from manufacturer-franchised dealerships with used-car operations and through selected independent dealerships. C&F Finance selects these dealers based on the types of vehicles sold. Specifically, C&F Finance prefers to finance later model, low mileage used vehicles because the initial depreciation on new vehicles is extremely high. The typical borrowers on the automobile retail installment sales contracts purchased have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, C&F Finance typically charges interest at higher rates than those charged by traditional financing sources. In addition, because C&F Finance provides financing in a relatively high-risk market, it expects to experience a higher level of credit losses than traditional automobile financing sources. Beginning in 2016 with C&F Finance’s implementation of a scorecard model for purchasing loan contracts, the credit worthiness of borrowers at origination has improved for automobile loans purchased by C&F Finance and both the interest rates charged and level of credit losses experienced have decreased. In addition to non-prime automobile financing, beginning in the first quarter of 2018, C&F Finance expanded its lending

portfolio to include marine and RV loan contracts in the prime sector. These contracts are also purchased on an indirect basis through a referral program administered by a third party. Because these contracts are for prime loans made to individuals with higher credit scores, they are priced at rates substantially lower than the non-prime automobile portfolio. Revenues from consumer finance operations consist principally of interest earned on automobile, marine and RV loans. While the consumer finance segment's loans outstanding and interest income are not materially affected by seasonal factors, delinquencies on automobile loans are generally highest in the period from November through January, related in part to seasonal trends affecting borrowers, including consumer spending. At December 31, 2018, assets of the consumer finance segment totaled $297.6 million. For the year ended December 31, 2018, net income for this segment totaled $6.7 million.

Employees

At December 31, 2018, we employed 634 full-time equivalent employees. We consider relations with our employees to be excellent.

Competition

Retail Banking

In the Bank's market area, we compete with large national and regional financial institutions, savings associations and other independent community banks, as well as credit unions, mutual funds, brokerage firms, insurance companies and other lending and deposit platforms offered by non-bank financial technology firms. Increased competition has come from out-of-state banks through their acquisition of Virginia-based banks and interstate branching, and expansion of community and regional banks into our service areas.

The banking business in Virginia, and specifically in the Bank's primary service area in the Hampton to Charlottesville corridor, is highly competitive for both loans and deposits, and is dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have are their ability to finance wide-ranging advertising campaigns, to maximize efficiencies through economies of scale and, by virtue of their greater total capitalization, to have substantially higher lending limits than the Bank.

Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution, affect competition for deposits and loans. We compete by emphasizing customer

service, establishing long-term customer relationships, building customer loyalty and providing traditional and digital products and services to address the specific needs of our customers. We target individual customers, small-to-medium size business customers and acquisition, development and construction loan customers in our markets.

No material part of the Bank's business is dependent upon a single or a few customers, and the loss of any single customer would not have a materially adverse effect upon the Bank's business.

Mortgage Banking

C&F Mortgage competes with large national and regional banks, credit unions, smaller regional mortgage lenders, small local broker operations and internet lending platforms. Due to the increased regulatory and compliance burden, the industry has seen a consolidation in the number of competitors in the marketplace. The agency guidelines for sales of mortgages in the secondary market business continue to be stringent.

The competitive factors faced by C&F Mortgage continue to evolve because of regulatory reforms and initiatives, including but not limited to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). While C&F Mortgage has kept pace with all aspects of the regulations issued pursuant to the Dodd-Frank Act and by the Consumer Financial Protection Bureau (CFPB), other such legislative and regulatory initiatives in the future have the potential to affect the operations of C&F Mortgage. Given the far-reaching effect of the Dodd-Frank Act and CFPB regulations on mortgage finance, compliance with the requirements of the Dodd-Frank Act and CFPB regulations has required and may continue to require substantial changes to mortgage lending systems and processes and other implementation efforts.

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To operate profitably in this competitive and regulatory environment, mortgage companies must have a high level of operational and risk management skills and be able to attract and retain top mortgage origination talent. C&F Mortgage competes by attracting the top people in sales and operations in the industry, expanding into new markets that offer strategic growth opportunities, providing an infrastructure that manages regulatory changes efficiently and effectively, utilizing technology to improve efficiency and consistency in its operations and to mitigate compliance risk, offering products that are competitive in both loan parameters and pricing, and providing consistently high quality customer service.

No material part of C&F Mortgage's business is dependent upon a single customer and the loss of any single customer would not have a materially adverse effect upon C&F Mortgage's business. C&F Mortgage, like all residential mortgage lenders, would be affected by the inability of Fannie Mae, Freddie Mac, the FHA or the VA to purchase or guarantee loans. Although C&F Mortgage sells loans to various third-party counterparties (i.e., investors), the ability of these aggregators to purchase or guarantee loans would be limited if these government-sponsored entities cease to exist or materially limit their purchases or guarantees of mortgage loans or suffer deteriorations in their financial condition.

Consumer Finance

The non-prime automobile finance business is highly competitive. The automobile finance market is highly fragmented and is served by a variety of financial entities, including the captive finance affiliates of major automotive manufacturers, banks, savings associations, credit unions and independent finance companies. Many of these competitors have substantially greater financial resources and lower costs of funds than our finance subsidiary. In addition, competitors often provide financing on terms that are more favorable to automobile purchasers or dealers than the terms C&F Finance offers. Many of these competitors also have long-standing relationships with automobile dealerships and may offer dealerships or their customers other forms of financing, including dealer floor plan financing and leasing, which we do not.

Over the past several years, a number of financial institutions and other lenders have increased focus on operations in the non-prime automobile finance markets resulting in intensified competition for loans and qualified personnel. In addition, certain competitors in the industry have (i) relaxed underwriting standards resulting in higher delinquencies and charge-offs for the industry and (ii) used loan pricing strategies resulting in lower loan yields. To continue to operate profitably, lenders must have a high level of operational and risk management skills and access to competitive costs of funds.

Providers of automobile financing traditionally have competed on the basis of interest rates charged, the quality of credit accepted, the flexibility of loan terms offered and the quality of service provided to dealers and customers. To establish C&F Finance as one of the principal financing sources for the dealers it serves, we compete predominately by providing a high level of dealer service, building strong dealer relationships, offering flexible loan terms and quickly funding loans purchased from dealers.

No material part of C&F Finance's business is dependent upon any single dealer relationship, and the loss of any single dealer relationship would not have a materially adverse effect upon C&F Finance's business.

Regulation and Supervision

General

Bank holding companies, banks and their affiliates are extensively regulated under both federal and state law. The following summary briefly describes significant provisions of currently applicable federal and state laws and certain regulations and the potential impact of such provisions. This summary is not complete, and we refer you to the particular statutory or regulatory provisions or proposals for more information. Because regulation of financial institutions changes regularly and is the subject of constant legislative and regulatory debate, we cannot forecast how federal and state regulation and supervision of financial institutions may change in the future and affect the Corporation's and the Bank's operations.

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Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other events led to the adoption of numerous laws and regulations that apply to, and focus on, financial institutions. The most significant of these laws is the Dodd-Frank Act, which was enacted on July 21, 2010 and, in part, was intended to implement significant structural reforms to the financial services industry.

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the EGRRCPA) was enacted to reduce the regulatory burden on certain banking organizations, including community banks, by modifying or eliminating certain federal regulatory requirements. While the EGRRCPA maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than $10 billion as well as for larger banks with assets above $50 billion. In addition, the EGRRCPA included regulatory relief for community banks regarding regulatory examination cycles, call reports, application of the Volcker Rule (proprietary trading prohibitions), mortgage disclosures, qualified mortgages, and risk weights for certain high-risk commercial real estate loans. However, federal banking regulators retain broad discretion to impose additional regulatory requirements on banking organizations based on safety and soundness and U.S. financial system stability considerations.

The Corporation continues to experience ongoing regulatory reform. These regulatory changes could have a significant effect on how the Corporation conducts its business. The specific implications of the Dodd-Frank Act, the EGRRCPA, and other potential regulatory reforms cannot yet be fully predicted and will depend to a large extent on the specific regulations that are to be adopted in the future. Certain aspects of the Dodd-Frank Act and the EGRRCPA are discussed in more detail below.

Regulation of the Corporation

As a bank holding company, the Corporation is subject to the Bank Holding Company Act of 1956 (the BHCA) and regulation and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Pursuant to the BHCA the Federal Reserve Board has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve Board has reasonable grounds to believe that continuation of such activity or ownership constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company. The Federal Reserve Board and the Federal Deposit Insurance Corporation (the FDIC) have adopted guidelines and released interpretative materials that establish operational and managerial standards to promote the safe and sound operation of banks and bank holding companies. These standards relate to the institution’s key operating functions, including but not limited to capital management, internal controls, internal audit systems, information systems, data and cybersecurity, loan

documentation, credit underwriting, interest rate exposure and risk management, vendor management, executive management and its compensation, corporate governance, asset growth, asset quality, earnings, liquidity and risk management.

The BHCA generally limits the activities of a bank holding company and its subsidiaries to that of banking, managing or controlling banks, or any other activity that is closely related to banking or to managing or controlling banks, and permits interstate banking acquisitions subject to certain conditions, including national and state concentration limits. The Federal Reserve Board has jurisdiction under the BHCA to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. A bank holding company must be “well capitalized” and “well managed” to engage in an interstate bank acquisition or merger, and banks may branch across state lines provided that the law of the state in which the branch is to be located would permit establishment of the branch if the bank were a state bank chartered by such state. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates, as further discussed below.

Each of the Bank’s depository accounts is insured by the FDIC against loss to the depositor to the maximum extent permitted by applicable law, and federal law and regulatory policy impose a number of obligations and restrictions on the Corporation and the Bank to reduce potential loss exposure to depositors and to the FDIC Deposit Insurance Fund (DIF). For example, pursuant to the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company must commit resources to support its subsidiary depository institutions, which is referred to as serving as a “source of strength.” In addition, insured depository institutions under common control must reimburse the FDIC for any loss suffered or reasonably anticipated by the DIF as a result of the default of a commonly controlled insured depository institution. The

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FDIC may decline to enforce the provisions if it determines that a waiver is in the best interest of the DIF. An FDIC claim for damages is superior to claims of stockholders of an insured depository institution or its holding company but is subordinate to claims of depositors, secured creditors and holders of subordinated debt, other than affiliates, of the commonly controlled insured depository institution.

The Federal Deposit Insurance Act (the FDIA) provides that amounts received from the liquidation or other resolution of any insured depository institution must be distributed, after payment of secured claims, to pay the deposit liabilities of the institution before payment of any other general creditor or stockholder of that institution – including that institution's parent holding company. This provision would give depositors a preference over general and subordinated creditors and stockholders if a receiver is appointed to distribute the assets of a bank.

The Corporation also is subject to regulation and supervision by the State Corporation Commission of Virginia. The Corporation also must file annual, quarterly and other periodic reports with, and comply with other regulations of, the Securities and Exchange Commission (the SEC).

Capital Requirements

Basel III Capital Framework. The Federal Reserve Board and the FDIC have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the Basel III Final Rules) that apply to banking institutions they supervise. For the purposes of these capital rules, (i) common equity tier 1 capital (CET1) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stocks and trust preferred securities; and (iii) Tier 2 capital consists of other capital instruments, principally qualifying subordinated debt and preferred stock, and limited amounts of an institution's allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, importantly including applying higher risk weightings to certain commercial real estate loans.

The Basel III Final Rules and minimum capital ratios required to be maintained by banks were effective January 1, 2015. The Basel III Final Rules also include a requirement that banks maintain additional capital (the "capital conservation buffer"), which was phased in beginning January 1, 2016 and was fully phased in effective January 1, 2019. The Basel III Final Rules and fully phased in capital conservation buffer require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5 percent, plus a 2.5 percent capital conservation buffer (which is added to the minimum CET1 ratio, effectively resulting in a required ratio of CET1 to risk-weighted assets of at least 7 percent), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0 percent, plus the capital conservation buffer (effectively resulting in a required Tier 1 capital ratio of 8.5 percent), (iii) a minimum ratio

of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0 percent, plus the capital conservation buffer (effectively resulting in a required total capital ratio of 10.5 percent) and (iv) a minimum leverage ratio of 4 percent, calculated as the ratio of Tier 1 capital to average total assets, subject to certain adjustments and limitations.

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income, and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10 percent of CET1 or all such categories in the aggregate exceed 15 percent of CET1.

The Basel III Final Rules permanently include in Tier 1 capital trust preferred securities issued prior to May 19, 2010 by bank holding companies with less than $15 billion in total assets, subject to a limit of 25 percent of Tier 1 capital. The Corporation expects that its trust preferred securities will be included in the Corporation’s Tier 1 capital until their maturity.

Community Bank Leverage Ratio. As a result of the EGRRCPA, the federal banking agencies were required to develop a Community Bank Leverage Ratio (the ratio of a bank’s tangible equity capital to average total consolidated assets) for banking organizations with assets of less than $10 billion, such as the Bank. On November 21, 2018, the federal

banking agencies invited public comment on their proposal to establish the Community Bank Leverage Ratio framework. Under the proposal, a community banking organization would be eligible to elect the Community Bank Leverage Ratio framework if it has less than $10 billion in total consolidated assets, limited amounts of certain assets and off-balance sheet exposures, and a Community Bank Leverage Ratio greater than 9 percent. A qualifying community banking organization that has chosen the proposed framework would be automatically considered in compliance with the Basel III capital requirements and would be exempt from the complex Basel III risk-based capital calculations. Such a community banking organization would be considered to have met the capital ratio requirements to be "well capitalized" for the federal banking agencies' Prompt Corrective Action rules provided it has a Community Bank Leverage Ratio greater than 9 percent. Because the proposal has not been finalized and a final rule has not been issued, it is difficult at this time to predict when or how this new capital ratio will ultimately be applied to community banking organizations or to predict the specific effects of the final rule.

Small Bank Holding Company. The EGRRCPA also expanded the category of bank holding companies that may rely on the Federal Reserve Board's Small Bank Holding Company Policy Statement by raising the maximum amount of assets a qualifying bank holding company may have from $1 billion to $3 billion. In addition to meeting the asset threshold, a bank holding company must not engage in significant nonbanking activities, not conduct significant off-balance sheet activities, and not have a material amount of debt or equity securities outstanding and registered with the SEC (subject to certain exceptions). The Federal Reserve Board may, in its discretion, exclude any bank holding company from the application of the Small Bank Holding Company Policy Statement if such action is warranted for supervisory purposes.

In August 2018, the Federal Reserve Board issued an interim final rule to apply the Small Bank Holding Company Policy Statement to bank holding companies with consolidated total assets of less than $3 billion. The policy statement, which, among other things, exempts certain bank holding companies from minimum consolidated regulatory capital ratios that apply to other bank holding companies. As a result of the interim final rule, which was effective August 30, 2018, the Corporation expects that it will be treated as a small bank holding company and will no longer be subject to regulatory capital requirements. The comment period on the interim final rule closed on October 29, 2018. The Bank remains subject to the regulatory capital requirements described above.

Limits on Dividends

The Corporation is a legal entity that is separate and distinct from the Bank. A significant portion of the revenues of the Corporation result from dividends paid to it by the Bank. Both the Corporation and C&F Bank are subject to laws and regulations that limit the payment of dividends, including limits on the sources of dividends and requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, Federal Reserve Board supervisory guidance indicates that the Federal Reserve Board may have safety and soundness

concerns if a bank holding company pays dividends that exceed earnings for the period in which the dividend is being paid. Further, the FDIA prohibits insured depository institutions such as C&F Bank from making capital distributions, including paying dividends, if, after making such distribution, the institution would become undercapitalized as defined in the statute. We do not expect that any of these laws, regulations or policies will materially affect the ability of the Corporation or C&F Bank to pay dividends.

The Dodd-Frank Act

The Dodd-Frank Act implemented far-reaching changes across the financial regulatory landscape, including changes that have affected all bank holding companies and banks, including the Corporation and the Bank. Provisions that significantly affect the business of the Corporation and the Bank include the following:

- Insurance of Deposit Accounts. The Dodd-Frank Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000.

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- Payment of Interest on Demand Deposits. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

- Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the CFPB, which is discussed in more detail below.

- Debit Card Interchange Fees. The Dodd-Frank Act imposed limits for debit card interchange fees for issuers that have over $10 billion in assets, which could affect the amount of interchange fees collected by financial institutions with less than $10 billion in assets.

In addition, the Dodd-Frank Act implements other changes to financial regulations, including provisions that:

- Restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption.

- Impose comprehensive regulation of the over-the-counter derivatives market, subject to significant rulemaking processes, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself.

- Require loan originators to retain 5 percent of any loan sold or securitized, unless it is a “qualified residential mortgage,” subject to certain exceptions.

- Prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule), as subsequently amended by the EGRRCPA which provides an exemption from the Volcker Rule for many community banking organizations.

- Implement corporate governance revisions that apply to all public companies not just financial institutions.

Some of the rules that have been proposed and, in some cases, adopted to comply with the Dodd-Frank Act's mandates are discussed further below.

Insurance of Accounts, Assessments and Regulation by the FDIC

The Bank’s deposits are insured by the DIF of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. The basic limit on FDIC deposit insurance coverage is $250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations as an insured institution, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

Deposit Insurance Assessments. The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target “designated reserve ratio” (described in more detail below) of 2 percent for the DIF and, in lieu of dividends, provides for a lower assessment rate schedule when the reserve ratio reaches 2 percent and 2.5 percent. An institution's assessment rate is based on a statistical analysis of financial ratios that estimates the likelihood of failure over a three-year period, which considers the institution’s weighted average CAMELS component rating, and is subject to further adjustments including those related to levels of unsecured debt and brokered deposits (not applicable to banks with less than $10 billion in assets). At December 31, 2018, total base assessment rates for institutions that have been insured for at least five years range from 1.5 to 30 basis points applying to banks with less than $10 billion in assets.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the “designated reserve ratio.” Among other changes, the Dodd-Frank Act (i) raised the minimum

designated reserve ratio to 1.35 percent and removed the upper limit on the designated reserve ratio, (ii) requires that the reserve ratio reach 1.35 percent by September 2020, and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than $10 billion of raising the reserve ratio from 1.15 percent to 1.35 percent – which requirement was met by rules adopted by the FDIC during 2016. The FDIC adopted a DIF restoration plan, which resulted in the fund reserve ratio exceeding 1.35 percent by September 30, 2018, as discussed below. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis.

On June 30, 2016, the reserve ratio rose to 1.17 percent, which triggered three major changes to deposit insurance assessments beginning for the third quarter of 2016: (i) the range of initial assessment rates for all institutions declined from 5 to 35 basis points to 3 to 30 basis points (which are included in the total base assessment rates in the above paragraph); (ii) surcharges equal to an annual rate of 4.5 basis points began for insured depository institutions with total consolidated assets of $10 billion or more; and (iii) the revised assessment method described above was implemented.

At September 30, 2018, the reserve ratio was 1.36 percent. Banks with less than $10 billion in total consolidated assets will receive credits to offset the portion of their assessments that help to raise the reserve ratio to 1.35 percent. Beginning when the reserve ratio is at or above 1.38 percent, the FDIC will automatically apply such a bank’s credits to reduce its regular DIF assessment up to the entire amount of the assessment.

Regulation of the Bank and Other Subsidiaries

The Bank is subject to supervision, regulation and examination by the Virginia State Corporation Commission Bureau of Financial Institutions (VBFI) and its primary federal regulator, the FDIC. The various laws and regulations issued and administered by the regulatory agencies (including the CFPB) affect corporate practices, such as the payment of dividends, the incurrence of debt and the acquisition of financial institutions and other companies, and affect business practices and operations, such as the payment of interest on deposits, the charging of interest on loans, the types of business conducted, the products and terms offered to customers and the location of offices. Prior approval of the applicable primary federal regulator and the VBFI is required for a Virginia chartered bank or bank holding company to merge with another bank or bank holding company, or purchase the assets or assume the deposits of another bank or bank holding company, or acquire control of another bank or bank holding company. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the financial condition, managerial resources, capital position and any asset concentrations (including commercial real estate loan concentrations) of the constituent organizations and the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act (CRA) and fair housing initiatives, the data security and cybersecurity infrastructure of the constituent organizations and the combined organization, the applicant’s risk management programs and processes, and the applicant’s compliance with and the effectiveness of the subject organizations in combating money laundering activities and complying with Bank Secrecy Act requirements.

Certain Transactions by Insured Banks with their Affiliates. There are statutory restrictions related to the extent bank holding companies and their non-bank subsidiaries may borrow, obtain credit from or otherwise engage in “covered transactions” with their insured depository institution (i.e., banking) subsidiaries. In general, an “affiliate” of a bank includes the bank’s parent holding company and any subsidiary thereof. However, an “affiliate” does not generally include the bank’s operating subsidiaries. The Dodd-Frank Act amended the definition of affiliate to include any investment fund for which the bank or one of its affiliates is an investment adviser. A bank (and its subsidiaries) may not lend money to, or engage in other covered transactions with, its non-bank affiliates if the aggregate amount of covered transactions outstanding involving the bank, plus the proposed transaction, exceeds the following limits: (a) in the case of any one such affiliate, the aggregate amount of covered transactions of the bank and its subsidiaries cannot exceed 10 percent of the bank’s capital stock and surplus; and (b) in the case of all affiliates, the aggregate amount of covered transactions of the bank and its subsidiaries cannot exceed 20 percent of the bank’s capital stock and surplus. “Covered transactions” are defined to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliate that creates a credit exposure to such affiliate, or a derivatives

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transaction with an affiliate that creates a credit exposure to such affiliate. Certain covered transactions are also subject to collateral security requirements.

Covered transactions as well as other types of transactions between a bank and a bank holding company must be on market terms, which means that the transaction must be conducted on terms and under circumstances that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with or involving nonaffiliates or, in the absence of comparable transactions, that in good faith would be offered to or would apply to nonaffiliates. Moreover, certain amendments to the BHCA provide that, to further competition, a bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

Community Reinvestment Act. The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution’s efforts in meeting community credit needs are assessed based on specified factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility. In 2017, the Bank received a “Satisfactory” CRA rating.

Federal Home Loan Bank of Atlanta. The Bank is a member of the Federal Home Loan Bank (FHLB) of Atlanta, which is one of 12 regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each FHLB makes loans to members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, the Bank must purchase and maintain stock in the FHLB. At December 31, 2018, the Bank owned $3.2 million of FHLB stock.

Consumer Protection. The CFPB is the federal regulatory agency that is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. The CFPB supervises and regulates providers of consumer financial products and services, and has rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth-in-Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA)).

Because the Corporation and the Bank are smaller institutions (i.e., with assets of $10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Corporation by the Federal Reserve Board and to the Bank by the FDIC. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution’s principal regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and

banks, could influence how the Federal Reserve Board and FDIC apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise effect of the CFPB's consumer protection activities on the Corporation and the Bank cannot be determined with certainty.

Mortgage Banking Regulation. In connection with making mortgage loans, the Bank and C&F Mortgage are subject to rules and regulations that, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers, in some cases restrict certain loan features and fix maximum interest rates and fees, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level. The Bank's mortgage origination activities are subject to the Equal Credit Opportunity Act (ECOA), TILA, Home Mortgage Disclosure Act, RESPA, and Home Ownership Equity Protection Act, and the regulations promulgated under these acts, among other additional state and federal laws, regulations and rules.

The Bank's mortgage origination activities are also subject to Regulation Z, which implements TILA. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined

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as mortgage loans without negative amortization, interest-only payments, balloon payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3 percent of the total loan amount. Under the EGRRCPA, most residential mortgage loans originated and held in portfolio by a bank with less than $10 billion in assets will be designated as “qualified mortgages.” Higher-priced qualified mortgages (e.g., sub-prime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Corporation’s mortgage banking segment predominately originates mortgage loans that comply with Regulation Z’s “qualified mortgage” rules.

In addition to certain regulations applicable to the Bank’s mortgage origination activities, C&F Mortgage is subject to the rules and regulations of, and examination by, the Department of Housing and Urban Development (HUD), the FHA, the USDA, the VA and state regulatory authorities with respect to originating, processing and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers and, in some cases, restrict certain loan features and fix maximum interest rates and fees.

Consumer Financing Regulation. C&F Finance also is regulated by the VBFI and the states and jurisdictions in which it operates, and its lending operations are subject to numerous federal regulations over which the CFPB has rulemaking authority and regarding which enforcement authority is shared by the Federal Reserve Board, the FDIC, the Department of Justice and the Federal Trade Commission. The VBFI regulates and enforces laws relating to consumer lenders and sales finance agencies such as C&F Finance. Such rules and regulations generally provide for licensing of sales finance agencies; limitations on amounts, duration and charges, including interest rates, for various categories of loans; requirements as to the form and content of finance contracts and other documentation; and restrictions on collection practices and creditors’ rights.

Certain federal regulatory agencies, and in particular, the CFPB, the Federal Trade Commission, and the Federal Reserve Board, have recently become more active in investigating the products, services and operations of banks and other finance companies engaged in auto finance activities. These investigations have extended to banks that engage in indirect automobile lending, and the CFPB has released regulatory guidance that deems automobile lenders within the CFPB’s jurisdiction responsible for ECOA noncompliance even if such noncompliance is a result of dealer lending practices. As of January 1, 2019, the Corporation and C&F Finance were not subject to supervision by the CFPB.

Brokered Deposits. Section 29 of the FDIA and FDIC regulations generally limit the ability of any bank to accept, renew or roll over any brokered deposit unless it is “well capitalized” or, with the FDIC’s approval, “adequately capitalized.” However, as a result of the EGRRCPA, the FDIC is undertaking a comprehensive review of its regulatory approach to brokered deposits, including reciprocal deposits, and interest rate caps applicable to banks that are less than “well capitalized.” At this time, it is difficult to predict the impact, if any, of the FDIC’s review of brokered deposit regulations.

Other Regulations

Prompt Corrective Action. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” These terms are defined under uniform regulations issued by each of the federal banking agencies regulating these institutions. An insured depository institution which is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities. As of December 31, 2018, the Bank was considered “well capitalized.”

Incentive Compensation. The Federal Reserve Board, the Office of the Comptroller of the Currency (OCC) and the FDIC have issued regulatory guidance (the Incentive Compensation Guidance) intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Corporation, that are not “large, complex banking organizations.” The findings will be included in reports of examination, and deficiencies will be incorporated into the organization’s supervisory ratings. Enforcement actions may be taken against a banking organization

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if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In 2016, the SEC and the federal banking agencies proposed rules that prohibit covered financial institutions (including bank holding companies and banks) from establishing or maintaining incentive-based compensation arrangements that encourage inappropriate risk taking by providing covered persons (consisting of senior executive officers and significant risk takers, as defined in the rules) with excessive compensation, fees or benefits that could lead to material financial loss to the financial institution. The proposed rules outline factors to be considered when analyzing whether compensation is excessive and whether an incentive-based compensation arrangement encourages inappropriate risks that could lead to material loss to the covered financial institution, and establishes minimum requirements that incentive-based compensation arrangements must meet to be considered to not encourage inappropriate risks and to appropriately balance risk and reward. The proposed rules also impose additional corporate governance requirements on the boards of directors of covered financial institutions and impose additional record-keeping requirements. The comment period for these proposed rules has closed and a final rule has not yet been published.

Confidentiality and Required Disclosures of Customer Information. The Corporation is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution’s policies and procedures regarding the handling of customers’ nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer’s personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure. In August 2018, the CFPB published a final rule that provides an exception to the requirement to deliver an annual privacy notice if a financial institution only provides nonpublic personal information to unaffiliated third parties under limited exceptions under the Gramm-Leach-Bliley Act and related regulations, and has not changed its policies and practices regarding disclosure of nonpublic personal financial information from those disclosed in the most recent privacy notice provided to the customer. The final rule was effective September 17, 2018.

In August 2018, the CFPB published its final rule to update Regulation P pursuant to the amended Gramm-Leach-Bliley Act. Under this rule, certain qualifying financial institutions are not required to provide annual privacy notices to customers. To qualify, a financial institution must not share nonpublic personal information about customers except as described in certain statutory exceptions which do not trigger a customer’s statutory opt-out right. In addition, the financial institution must not have changed its disclosure policies and practices from those disclosed in its most recent privacy notice. The rule sets forth timing requirements for delivery of annual privacy notices in the event that a financial institution that qualified for the annual notice exemption later changes its policies or practices in such a way that it no longer qualifies for the exemption.

The Corporation is also subject to various laws and regulations that attempt to combat money laundering and terrorist financing. The Bank Secrecy Act requires all financial institutions to, among other things, create a system of controls designed to prevent money laundering and the financing of terrorism, and imposes recordkeeping and reporting requirements. The USA Patriot Act added regulations to facilitate information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering, and requires financial institutions to establish anti-money laundering programs. The Office of Foreign Assets Control (OFAC), which is a division of the Treasury, is responsible for helping to ensure that United States entities do not engage in transactions with “enemies” of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name of an “enemy” of the United States on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds into a blocked account, and report it to OFAC.

Although these laws and programs impose compliance costs and create privacy obligations and, in some cases, reporting obligations, and compliance with all of the laws, programs, and privacy and reporting obligations may require significant resources of the Corporation and the Bank, these laws and programs do not materially affect the Bank’s products, services or other business activities.

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Cybersecurity. The federal banking agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution's board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking agencies expect financial institutions to establish lines of defense and ensure that their risk management processes also address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack. If the Corporation or the Bank fails to meet the expectations set forth in this regulatory guidance, the Corporation or the Bank could be subject to various regulatory actions and any remediation efforts may require significant resources of the Corporation or the Bank.

In October 2016, the federal banking agencies issued proposed rules on enhanced cybersecurity risk-management and resilience standards that would apply to very large financial institutions and to services provided by third parties to these institutions. The comment period for these proposed rules has closed and a final rule has not been published. Although the proposed rules would apply only to bank holding companies and banks with $50 billion or more in total consolidated assets, these rules could influence the federal banking agencies' expectations and supervisory requirements for information security standards and cybersecurity programs of smaller financial institutions, such as the Corporation and the Bank.

Stress Testing. As required by the Dodd-Frank Act, the federal banking agencies implemented stress testing requirements for certain financial institutions, including bank holding companies and state-chartered banks, with more than $10 billion in total consolidated assets. The EGRRCPA subsequently raised the asset thresholds for company-run stress testing and mandatory stress testing conducted by the Federal Reserve Board to $50 billion and $100 billion, respectively. Although these requirements do not apply to the Company and the Bank, the federal banking agencies emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential effect of adverse market conditions or outcomes on the organization's financial condition. Based on existing regulatory guidance, the Corporation and the Bank will be expected to consider the institution's interest rate risk management, commercial real estate loan concentrations and other credit-related information, and funding and liquidity management during this analysis of adverse market conditions or outcomes.

Volcker Rule. The Dodd-Frank Act prohibits bank holding companies and their subsidiary banks from engaging in proprietary trading except in limited circumstances, and places limits on ownership of equity investments in private equity and hedge funds (the Volcker Rule). The EGRRCPA exempted all banks with less than $10 billion in assets (including their holding companies and affiliates) from the Volcker Rule, provided that the institution has total trading assets and liabilities of five percent or less of total assets, subject to certain limited exceptions. In December 2018, the federal banking agencies invited public comment on a proposal to exclude community banks from the application of the Volcker Rule. The Corporation believes that its financial condition and its operations are not and will not be significantly affected by the Volcker Rule, amendments thereto, or its implementing regulations.

Call Reports and Examination Cycle. All institutions, regardless of size, submit a quarterly call report that includes data used by federal banking agencies to monitor the condition, performance, and risk profile of individual institutions and the industry as a whole. The EGRRCPA contained provisions expanding the number of regulated institutions eligible to use streamline call report forms. In November 2018, the federal banking agencies issued a proposal to permit insured depository institutions with total assets of less than $5 billion that do not engage in certain complex or international activities to file the most streamlined version of the quarterly call report, and to reduce data reportable on certain streamlined call report submissions.

In December 2018, consistent with the provisions of the EGRRCPA, the federal banking agencies jointly adopted final rules that permit banks with up to $3 billion in total assets, that received a composite CAMELS rating of “1” or “2,” and that meet certain other criteria (including not having undergone any change in control during the previous 12-month period, and not being subject to a formal enforcement proceeding or order), to qualify for an 18-month on-site examination cycle.

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Future Regulation

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Corporation in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Corporation cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Corporation. A change in statutes, regulations or regulatory policies applicable to the Corporation or any of its subsidiaries could have a material effect on the business of the Corporation.

Available Information

The Corporation's SEC filings are filed electronically and are available to the public over the Internet at the SEC's web site at http://www.sec.gov. The Corporation's SEC filings also are available through our web site at http://www.cffc.com under "Investor Relations/SEC Filings" as of the day they are filed with the SEC. Copies of documents also can be obtained free of charge by writing to the Corporation's secretary at P.O. Box 391, West Point, VA 23181 or by calling 804-843-2360.

ITEM 1A.RISK FACTORS

Risks Related to the Corporation's Operations

We are subject to interest rate risk and fluctuations in interest rates may negatively affect our financial performance.

Our profitability depends in substantial part on our net interest margin, which is the difference between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits and borrowings divided by total interest-earning assets. Changes in interest rates will affect our net interest margin in diverse ways, including the pricing of loans and deposits, the levels of prepayments and asset quality. We are unable to predict actual fluctuations of market interest rates because many factors influencing interest rates are beyond our control. We believe that our current interest rate exposure is manageable and does not indicate any significant exposure to interest rate changes. On December 19, 2018, the Federal Open Market Committee (FOMC) announced its fourth increase during 2018 for the federal funds rate, which is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight, to 2.25 to 2.50 percent. The FOMC's monetary policy remains accommodative after this increase, thereby supporting strong labor market conditions and a sustained return to two percent inflation. Financial markets expect two more quarter-point rate increases to the federal funds rate during 2019. As short-term market interest rates have risen, however, longer-term market interest rates, including yields on U.S. treasury bonds, remain low. Therefore, we are expecting continued pressure on our net interest margin due to intense competition for loans and deposits from both local and national financial institutions. In addition, a significant portion of C&F Finance's funding is indexed to short-term interest rates and reprices as short-term interest rates change. An upward movement in interest rates may result in an unfavorable pricing disparity between C&F Finance's fixed rate loan portfolio and its adjustable-rate borrowings. Continued pressure on our net interest margin could adversely affect our results of operations.

Our business is subject to various lending and other economic risks that could adversely affect our results of operations and financial condition.

Deterioration in economic conditions could adversely affect our business. Our business is directly affected by general economic and market conditions; broad trends in industry and finance; legislative and regulatory changes; changes in governmental monetary and fiscal policies; and inflation, all of which are beyond our control. A deterioration in economic conditions, in particular a prolonged economic slowdown within our geographic region, could result in the

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following consequences, any of which could hurt our business materially: an increase in loan delinquencies; an increase in problem assets and foreclosures; a decline in demand for our products and services; and a deterioration in the value of collateral for loans made by our various business segments.

Adverse changes in economic conditions in our market areas or adverse conditions in an industry on which a local market in which we do business is dependent could adversely affect our results of operations and financial condition.

We provide full service banking and other financial services in the Hampton to Charlottesville corridor in Virginia. Our loan and deposit activities are directly affected by, and our financial success depends on, economic conditions within these markets, as well as conditions in the industries on which those markets are economically dependent. A deterioration in local economic conditions or in the condition of an industry on which a local market depends, such as the U.S. military and related defense contractors and industries, could adversely affect such factors as unemployment rates, business formations and expansions and housing market conditions. Adverse developments in any of these factors could result in among other things, a decline in loan demand, a reduction in the number of creditworthy borrowers seeking loans, an increase in delinquencies, defaults and foreclosures, an increase in classified and nonaccrual loans, a decrease in the value of loan collateral, and a decline in the financial condition of borrowers and guarantors, any of which could adversely affect our financial condition or business.

Our risk management framework may not be effective in mitigating risk and loss.

We maintain an enterprise risk management program that is designed to identify, quantify, monitor, report and control the risks we face. These risks include, but are not limited to, interest rate, credit, liquidity, operational, reputation, legal, compliance, economic and litigation risk. Although we assess our risk management program on an ongoing basis and make identified improvements to it, we can give no assurance that this approach and risk management framework (including related controls) will effectively mitigate the risks listed above or limit losses that we may incur. If our risk management program has flaws or gaps, or if our risk management controls do not function effectively, our results of operations, financial condition or business may be adversely affected.

Our level of credit risk is higher due to the concentration of our loan portfolio in commercial loans and in consumer finance loans.

At December 31, 2018, 43 percent of our loan portfolio consisted of commercial, financial and agricultural loans, which include loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity and residential loans. The

increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans and to borrowers in similar lines of business, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans.

At December 31, 2018, 27 percent of our loan portfolio consisted of consumer finance loans that provide automobile financing for customers in the non-prime market. During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses may increase in this portfolio. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed vehicles or delay the timing of these sales. Because we focus on non-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on these loans are higher than those experienced in the general automobile finance industry and could be dramatically affected by a general economic downturn. In addition, our servicing costs may increase without a corresponding increase in our finance charge income. While we manage the higher risk inherent in loans made to non-prime borrowers through our underwriting criteria for installment sales contracts we purchase and collection methods, we cannot guarantee that these criteria or methods will ultimately provide adequate protection against these risks.

Competition from other financial institutions and financial intermediaries may adversely affect our profitability.

We face substantial competition in originating loans and in attracting deposits. Our competition in originating loans and attracting deposits comes principally from other banks, mortgage banking companies, consumer finance companies, savings associations, credit unions, brokerage firms, insurance companies and other institutional lenders and purchasers

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of loans. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger clients. These institutions may be able to offer the same loan products and services that we offer at more competitive rates and prices. Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could adversely affect our profitability.

Weakness in the secondary residential mortgage loan markets will adversely affect income from our mortgage company.

One of the components of our strategic plan is to generate significant noninterest income from C&F Mortgage, which originates a variety of residential loan products for sale into the secondary market. Interest rates, low housing inventory, cash buyers, new mortgage lending regulations and other market conditions have a direct effect on loan originations across the industry.

In addition, deterioration in economic conditions may also cause borrowers to default on their mortgages. This may result in potential repurchase or indemnification liability for C&F Mortgage on residential mortgage loans originated and sold into the secondary market in the event of claims by investors of borrower misrepresentation, fraud, early-payment default, or underwriting error, as investors attempt to minimize their losses. We cannot be assured that a prolonged period of payment defaults and foreclosures will not result in an increase in requests for repurchases or indemnifications. We attempt to maintain an appropriate allowance for indemnification losses. Although we believe our allowance for indemnification losses is adequate, this estimate is inherently subjective and indemnification losses depend on future events that are often not within our control. Therefore, we can give no assurance that established reserves will be adequate in the future. Additional provision for indemnification losses would have an adverse effect on the Corporation’s net income.

Our home lending profitability could be significantly reduced if we are not able to originate and sell a high volume of mortgage loans.

The existence of an active secondary market is a critical component of C&F Mortgage’s ability to generate income from the sale of loans to investors. Active secondary markets for residential mortgages depend upon the continuation of programs currently offered by government-sponsored enterprises (GSEs) (such as Fannie Mae and Freddie Mac), the FHA, the VA, the USDA, and state bond programs, which account for a substantial portion of the secondary market in residential mortgage loans. Because the largest participants in the secondary market are GSEs whose activities are governed by federal law, any future changes in laws that significantly affect the activity of the GSEs could adversely affect our mortgage company’s operations. Further, in September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the U.S. government. Although to date, the conservatorship has not had a significant or adverse effect on our operations, it is unclear whether further changes or reforms would adversely affect

our operations. Although we sell loans to various third-party counterparties (i.e., investors), the ability of these aggregators to purchase loans would be limited if the GSEs cease to exist or materially limit their purchases of mortgage loans.

An increase in interest rates may reduce our mortgage revenues, which would negatively affect our noninterest income.

Our mortgage banking segment provides a significant portion of our noninterest income. We generate gains on sales of mortgage loans primarily from sales of mortgage loans that we originate. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors. This would result in a decrease in noninterest income. In addition, our results of operations are affected by the amount of noninterest expenses (including for personnel and systems infrastructure) associated with mortgage banking activities. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in mortgage loan origination activity.

If our allowance for loan losses becomes inadequate, our results of operations may be adversely affected.

Making loans is an essential element of our business. The risk of nonpayment is affected by a number of factors, including but not limited to: the duration of the credit; credit risks of a particular customer; changes in economic and industry conditions; and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans

may not be repaid. We attempt to maintain an appropriate allowance for loan losses to provide for losses in our loan portfolio. Because any estimate of loan losses is necessarily subjective and the accuracy of any estimate depends on the outcome of future events that are not within our control, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional provision for loan losses will be required, which would have an adverse effect on the Corporation's net income. Although we believe our allowance for loan losses is adequate to absorb losses that are inherent in our loan portfolio, we cannot predict the timing or severity of such losses nor give any assurance that our allowance will be adequate in the future.

The Financial Accounting Standards Board (FASB) has issued a new accounting standard that will be effective for the Corporation for the fiscal year beginning January 1, 2020. This standard, Accounting Standards Codification (ASC) Topic 326, "Financial Instruments—Credit Losses" (ASC 326) will require the Corporation to record an allowance for credit losses that represents expected credit losses over the lifetime of all loans in its portfolio. This represents a change from the current method of providing for an allowance for loan losses that have been incurred. We have not yet determined the impact that ASC 326 will have on our consolidated financial statements and regulatory capital. While the adoption of ASC 326 will not affect ultimate loan performance or cash flows of the Corporation from making loans, the period in which expected credit losses affect net income of the Corporation may not be similar to the recognition of loan losses under current accounting guidance. If recognition of the allowance for credit losses results in a reduction of the regulatory capital of C&F Bank, the initial reduction in regulatory capital will be phased in over three years under regulatory guidance. If the reduction in regulatory capital of C&F Bank is significant, it may adversely impact the future ability of the Corporation to pay dividends to shareholders.

Our real estate lending business can result in increased costs associated with Other Real Estate Owned (OREO).

Because we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we are exposed to the risks inherent in the ownership of real estate. The amount that we may realize after a default is dependent upon factors outside of our control, including, but not limited to, general or local economic conditions, environmental cleanup liability, neighborhood values, interest rates, real estate tax rates, operating expenses of the mortgaged properties, and supply of and demand for properties. Certain expenditures associated with the ownership of income-producing real estate, principally real estate taxes and maintenance costs, may adversely affect the net cash flows generated by the real estate. Therefore, the cost of operating income-producing real property may exceed the rental income earned from such property, and we may have to advance funds in order to protect our investment or we may be required to dispose of the real property at a loss.

Acquisition of assets and assumption of liabilities may expose us to intangible asset risk, which could affect our result of operations and financial condition.

In connection with accounting for the acquisitions of C&F Finance Company in 2002 and CVBK in 2013, we recorded assets acquired and liabilities assumed at their fair value, which resulted in the recognition of certain

intangible assets, including goodwill. Adverse conditions in our business climate, including a significant decline in future operating cash flows, a significant change in our stock price or market capitalization, or a deviation from our expected growth rate and performance, may significantly affect the fair value of any goodwill and may trigger impairment losses, which could be materially adverse to our results of operations and financial condition.

We rely substantially on deposits obtained from customers in our target markets to provide liquidity and support growth.

Our business strategies are based on access to funding from local customer deposits. Deposit levels may be affected by a number of factors, including interest rates paid by competitors, general interest rate levels, returns available to customers on alternative investments and general economic conditions. If our deposit levels fall, we could lose a relatively low cost source of funding and our interest expense would likely increase as we obtain alternative funding to replace lost deposits. If local customer deposits are not sufficient to fund our normal operations and growth, we will look to outside sources, such as borrowings from the FHLB, which is a secured funding source. Our ability to access borrowings from the FHLB will be dependent upon whether and the extent to which we can provide collateral to secure FHLB borrowings. We may also look to federal funds purchased and brokered deposits, although the use of brokered deposits may be limited or discouraged by our banking regulators. We may also seek to raise funds through the issuance of shares of our common stock, or other equity or equity-related securities, or debt securities including subordinated notes as additional sources of

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liquidity. If we are unable to access funding sufficient to support our business operations and growth strategies or are only able to access such funding on unattractive terms, we may not be able to implement our business strategies which may negatively affect our financial performance.

We are subject to security and operational risks, including cybersecurity risks and cyber attacks, relating to our use of technology that could damage our reputation and our business.

In the ordinary course of business, the Corporation collects and stores sensitive data, including proprietary business information and personally identifiable information of our customers and employees, in systems and on networks. The secure processing, maintenance and use of this information is critical to operations and the Corporation's business strategy. The Corporation has invested in information security technologies and continually reviews processes and practices that are designed to protect its networks, computers and data from damage or unauthorized access. Despite these security measures, the Corporation's computer systems and infrastructure may be vulnerable to attacks by hackers or may be breached due to employee error, malfeasance or other disruptions. Security breaches, including cyber incidents, identity theft and hacking events, have been experienced by several of the world's largest financial institutions that utilize sophisticated security tools to prevent such breaches, incidents and events. Any security breach that we experience could result in legal claims, regulatory penalties, disruption in operation, remediation expenses, costs associated with customer notification and credit monitoring services, increased insurance premiums, loss of customers and business partners and damage to the Corporation's reputation. We rely on customary security systems and procedures to provide the security and authentication necessary to effect secure collection, transmission and storage of sensitive data. These systems and procedures include but are not limited to (i) regular penetration testing of our network, (ii) regular employee training programs on sound security practices and awareness of security threats, (iii) deployment of tools to monitor our network including intrusion prevention and detection systems, electronic mail spam filters, anti-virus, anti-malware, anti-ransomware, resource logging and patch management, (iv) multifactor authentication for customers using treasury management tools and employees who access our network from outside of our premises, and (v) enforcement of security policies and procedures for the additions and maintenance of user access and rights to resources. However, because the techniques used to obtain unauthorized access, or to disable or degrade systems change frequently and are often not recognized until launched against a target, the Corporation may be unable to anticipate these techniques or to implement adequate protective measures.

While most of our core data processing is conducted internally, certain key applications are outsourced to third party providers. If our third party providers encounter difficulties or if we have difficulty in communicating with such third parties, it will significantly affect our ability to adequately process and account for customer transactions, which would significantly affect our business operations and reputation. Additionally, in recent years banking regulators have focused on the responsibilities of financial institutions to supervise vendors and other third-party service providers. We may have to dedicate significant resources to manage risks and regulatory burdens presented by our relationship with vendors and third-party service providers, including our data processing and cybersecurity service providers.

Business counterparties, over which the Corporation may have limited or no control, may experience disruptions that could adversely affect the Corporation.

Multiple major U.S. retailers and a major consumer credit reporting agency have experienced data systems incursions in recent years reportedly resulting in the thefts of credit and debit card information, online account information, and other personal and financial data of hundreds of millions of individuals. Retailer incursions may affect debit cards issued and deposit accounts maintained by many banks, including C&F Bank. Although the Corporation is not aware of any instance in which the Corporation's or the Bank's systems have been breached in a retailer incursion, these events can cause the Bank to reissue a significant number of cards and take other costly steps to avoid significant theft loss to the Bank and its customers. In some cases, the Bank may be required to reimburse customers for the losses they incur. Credit reporting agency intrusions affect the Bank's customers and can require these customers and the Bank to increase account monitoring and take remedial action to prevent unauthorized account activity or access. Other possible points of intrusion or disruption outside the Corporation's and the Bank's control include internet service providers, electronic mail portal providers, social media portals, distant-server (or "cloud") service providers, electronic data security providers, telecommunications companies and smart phone manufacturers.

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Our business is technology dependent and an inability to invest in technological improvements may adversely affect results of operations and financial condition.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services, which may require substantial capital expenditures to modify or adapt existing products and services. In addition to enhancing customer service, the effective use of technology increases efficiency and results in reduced costs, although a financial institution's initial investment in a technology product or service may represent a significant incremental cost. Our future success will depend in part upon our ability to create synergies in our operations through the use of technology and to facilitate the ability of customers to engage in financial transactions in a manner that enhances the customer experience. We cannot assure that technological improvements will increase operational efficiency or that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers, which may cause the Corporation to lose market share or incur additional expense.

Changes in accounting standards and management's selection of accounting methods, including assumptions and estimates, could materially affect our financial statements.

From time to time, the SEC and FASB change the financial accounting and reporting standards that govern the preparation of the Corporation's financial statements. These changes can be hard to predict and can materially affect how the Corporation records and reports its financial condition and results of operations. In some cases, the Corporation could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings. In addition, management is required to use certain assumptions and estimates in preparing our financial statements, including determining the fair value of certain assets and liabilities, among other items. If the assumptions or estimates are incorrect, the Corporation may experience unexpected material consequences.

We rely heavily on our management team and the unexpected loss of key officers may adversely affect our operations.

We believe that our growth and future success will depend in large part on the skills of our executive officers. We also depend upon the experience of the officers of our subsidiaries and on their relationships with the communities they serve. The loss of the services of one or more of these officers could disrupt our operations and impair our ability to implement our business strategy, which could adversely affect our business, financial condition and results of operations.

The success of our business strategies depends on our ability to identify and recruit individuals with experience and relationships in our primary markets.

The successful implementation of our business strategy will require us to continue to attract, hire, motivate and retain skilled personnel to develop new customer relationships as well as new financial products and services. The market for qualified management personnel is competitive, which has contributed to salary and employee benefit costs that have risen and are expected to continue to rise, which may have an adverse effect on the Corporation's net income. In addition, the process of identifying and recruiting individuals with the combination of skills and attributes required to carry out our strategy is often lengthy, and we may not be able to effectively integrate these individuals into our operations. Our inability to identify, recruit and retain talented personnel to manage our operations effectively and in a timely manner could limit our growth, which could materially adversely affect our business.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the beneficial aspects fostered by our culture, which could harm our business.

We believe that a critical contributor to our success has been our corporate culture, which focuses on building personal relationships with our customers. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively affect our future success.

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Risks Related to the Regulation of the Corporation

Compliance with laws, regulations and supervisory guidance, both new and existing, may adversely affect our business, financial condition and results of operations.

We are subject to numerous laws, regulations and supervision from both federal and state agencies. Failure to comply with these laws and regulations could result in financial, structural and operational penalties, including receivership. In addition, establishing systems and processes to achieve compliance with these laws and regulations may increase our costs and/or limit our ability to pursue certain business opportunities.

Laws and regulations, and any interpretations and applications with respect thereto, generally are intended to benefit consumers, borrowers and depositors, but not stockholders. The legislative and regulatory environment is beyond our control, may change rapidly and unpredictably and may negatively influence our revenues, costs, earnings, and capital levels. Our success depends on our ability to maintain compliance with both existing and new laws and regulations.

Future legislation, regulation and government policy could affect the banking industry as a whole, including the Corporation’s business and results of operations, in ways that are difficult to predict. In addition, the Corporation’s results of operations could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

The Dodd-Frank Act could continue to increase our regulatory compliance burden and associated costs, place restrictions on certain products and services, and limit our future capital raising strategies.

A wide range of regulatory initiatives directed at the financial services industry have been proposed in recent years. One of those initiatives, the Dodd-Frank Act, represents a sweeping overhaul of the financial services industry regulatory environment within the United States and implements significant changes in the financial regulatory landscape, including through regulations issued pursuant to the Dodd-Frank Act, that will affect all financial institutions, including the Corporation. The Dodd-Frank Act and regulations adopted pursuant and related thereto have increased and will likely continue to increase our regulatory compliance burden and may have a material adverse effect on us, by increasing the costs associated with our regulatory examinations and compliance measures. The federal regulatory agencies, and particularly bank regulatory agencies, have been given significant discretion in drafting the Dodd-Frank Act’s implementing rules and regulations, some of which have not been finalized. Consequently, the complete effect of the Dodd-Frank Act will depend on the final implementing rules and regulations, and it remains too early to fully assess the complete effect of the Dodd-Frank Act and related regulatory rulemaking processes on our business, financial condition or results of operations.

The CFPB may increase our regulatory compliance burden and could affect the consumer financial products and services that we offer.

Among the Dodd-Frank Act's significant regulatory changes, it created a new financial consumer protection agency, the CFPB. The CFPB is reshaping the consumer financial laws through rulemaking and enforcement of the Dodd-Frank Act's prohibitions against unfair, deceptive and abusive consumer finance products or practices, which are directly affecting the business operations of financial institutions offering consumer financial products or services, including the Corporation. This agency's broad rulemaking authority includes identifying practices or acts that are unfair, deceptive or abusive in connection with any consumer financial transaction, financial product or service. Although the CFPB has jurisdiction over banks with $10 billion or greater in assets, rules, regulations and policies issued by the CFPB may also apply to the Corporation or its subsidiaries by virtue of the adoption of such policies and best practices by the Federal Reserve and the FDIC. Further, the CFPB may include its own examiners in regulatory examinations by the Corporation's primary regulators. The total costs and limitations related to this additional regulatory agency and the limitations and restrictions that will be placed upon the Corporation with respect to its consumer product and service offerings have yet to be determined in their entirety. However, these costs, limitations and restrictions are producing, and may continue to produce, significant, material effects on our business, financial condition and results of operations.

Our earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies.

The policies of the Federal Reserve affect us significantly. The Federal Reserve regulates the supply of money and credit in the United States. Its policies directly and indirectly influence the rate of interest earned on loans and paid on borrowings and interest-bearing deposits and can also affect the value of financial instruments we hold. Those policies determine to a significant extent our cost of funds for lending and investing. Changes in those policies are beyond our control and are difficult to predict. Federal Reserve policies can also affect our borrowers, potentially increasing the risk that they may fail to repay their loans. For example, a tightening of the money supply by the Federal Reserve could reduce the demand for a borrower's products and services. This could adversely affect the borrower’s earnings and ability to repay a loan, which could have a material adverse effect on our financial condition and results of operations.

Risks Related to the Corporation’s Common Stock

Our common stock price may be volatile, which could result in losses to our investors.

Our common stock price has been volatile in the past, and several factors could cause the price to fluctuate in the future. These factors include, but are not limited to, actual or anticipated variations in earnings, changes in analysts’ recommendations or projections with regard to our common stock or the markets and businesses in which we operate, operations and stock performance of other companies deemed to be our peers, and reports of trends and concerns and other issues related to the financial services industry. Fluctuations in our common stock price may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices.

Future sales of our common stock by shareholders or the perception that those sales could occur may cause our common stock price to decline.

Although our common stock is listed for trading on NASDAQ Global Select Market, the trading volume in our common stock may be lower than that of other larger financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the potential for lower relative trading volume in our common stock, significant sales of the common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might

be in the absence of these sales or perceptions.

Future issuances of our common stock could adversely affect the market price of our common stock and could be dilutive.

We may issue additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, shares of our common stock. Issuances of a substantial number of shares of our common stock, or the expectation that such issuances might occur, including in connection with acquisitions, could materially adversely affect the market price of the shares of our common stock and could be dilutive to shareholders. Any decision we make to issue common stock in the future will depend on market conditions and other factors, and we cannot predict or estimate the amount, timing, or nature of possible future issuances of our common stock. Accordingly, our shareholders bear the risk that future issuances of our securities will reduce the market price of the common stock and dilute their stock holdings in the Corporation.

The Corporation relies on dividends from its subsidiary for substantially all of its revenue.

The Corporation is a bank holding company that conducts substantially all of its operations through the Bank and the Bank’s subsidiaries. As a result, the Corporation relies on dividends from the Bank for substantially all of its revenues. There are various regulatory restrictions on the ability of the Bank to pay dividends or make other payments to the Corporation, and the Corporation’s right to participate in a distribution of assets upon the Bank’s liquidation or reorganization is subject to the prior claims of the Bank’s creditors. If the Bank is unable to pay dividends to the Corporation, the Corporation may not be able to service its outstanding borrowings and other debt, pay its other obligations

or pay a cash dividend to the holders of the Corporation’s common stock, and the Corporation’s business, financial condition and results of operations may be materially adversely affected. Further, although the Corporation has historically paid cash dividends to holders of its common stock, holders of common stock are not entitled to receive dividends and regulatory or economic factors may cause the Corporation’s Board of Directors to consider, among other actions, the reduction of dividends paid on the Corporation’s common stock even if the Bank continues to pay dividends to the Corporation.

ITEM 1B.UNRESOLVED STAFF COMMENTS

The Corporation has no unresolved comments from the SEC staff.

ITEM 2.PROPERTIES

The following describes the location and general character of the principal offices and other materially important physical properties of the Corporation.

C&F Bank owns a building located at Eighth and Main Streets in the business district of West Point, Virginia. The building, originally constructed in 1923, has three floors totaling 15,000 square feet and houses C&F Bank’s Main Office.

C&F Bank owns a building located at 3600 LaGrange Parkway in Toano, Virginia. The building was acquired in 2004 and has 85,000 square feet. Portions of the building have since been renovated in order to house C&F Bank’s operations center, which consists of C&F Bank’s loan, deposit and administrative functions and staff.

C&F Bank owns a building located at 1400 Alverser Drive in Midlothian, Virginia. The building provides space for a branch office of C&F Bank and for a C&F Mortgage branch office, as well as C&F Mortgage’s main administrative offices. This two-story building has 25,000 square feet and was constructed in 2001.

C&F Bank owns 22 other retail banking branch locations and leases two retail banking branch locations and three regional commercial lending offices in Virginia.

C&F Mortgage's Newport News and Williamsburg loan production offices are located on the second floor of C&F Bank's Newport News and Williamsburg branch buildings, respectively. In addition, C&F Mortgage has 14 loan production offices leased from nonaffiliates including 8 in Virginia, two in Maryland, two in North Carolina, one in South Carolina and one in West Virginia.

The Hampton office of C&F Finance is located on the second floor of C&F Bank's Hampton branch building. C&F Finance leases approximately 17,000 square feet of office space from an unrelated third party in Richmond, Virginia, which provides space for C&F Finance's headquarters and its loan and administrative functions and staff. C&F Finance has one leased office in Tennessee.

All of the Corporation's properties are in good operating condition and are adequate for the Corporation's present and anticipated future needs.

ITEM 3.LEGAL PROCEEDINGS

The Corporation and its subsidiaries may be involved in certain litigation matters arising in the ordinary course of business. Although the ultimate outcome of these matters cannot be ascertained at this time, and the results of legal proceedings cannot be predicted with certainty, we believe, based on current knowledge, that the resolution of any such matters arising in the ordinary course of business will not have a material adverse effect on the Corporation.

ITEM 4.MINE SAFETY DISCLOSURES

None.

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EXECUTIVE OFFICERS OF THE REGISTRANT

Name (Age) Present Position	Business Experience During Past Five Years
Larry G. Dillon (66) Executive Chairman	Chairman of the Board of Directors of the Corporation and C&F Bank since 1989; Chief Executive Officer of the Corporation and C&F Bank from 1989 to December 2018; President of the Corporation and C&F Bank from 1989 to 2014; Chairman, President and Chief Executive Officer of CVBK and Central Virginia Bank from September 2013 through March 2014
Thomas F. Cherry (50) President and Chief Executive Officer	Chief Executive Officer of the Corporation and C&F Bank since January 2019; President of the Corporation and C&F Bank since 2014; Director of the Corporation and C&F Bank since 2015; Secretary of the Corporation and C&F Bank from 2002 to 2018; Chief Financial Officer of the Corporation and C&F Bank from 2004 to 2016; Executive Vice President and Chief Financial Officer of CVBK and Central Virginia Bank from September 2013 through March 2014
Jason E. Long (39) Senior Vice President and Chief Financial Officer	Senior Vice President and Chief Financial Officer of the Corporation and C&F Bank since 2016; First Vice President of C&F Bank from 2014 to 2016; Various positions, most recently Principal from April 2013 through September 2014, at the accounting firm of Yount, Hyde & Barbour, P.C. since 2002 focusing on the financial services industry
Bryan E. McKernon (62) President and Chief Executive Officer, C&F Mortgage	President and Chief Executive Officer of C&F Mortgage since 1995; Director of C&F Bank since 1998
S. Dustin Crone (50) President, C&F Finance	President of C&F Finance since 2010
John A. Seaman, III (61)	Executive Vice President and Chief Credit Officer of C&F Bank since 2011 and of Central Virginia Bank from September 2013 through March 2014

Executive Vice
President and Chief
Credit Officer,

C&F Bank

PART II

ITEM 5.MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation's common stock is listed for trading on the NASDAQ Global Select Market of the NASDAQ Stock Market under the symbol "CFFI." As of February 22, 2019, there were approximately 2,000 shareholders of record. As of that date, the closing price of our common stock on the NASDAQ Global Select Stock Market was $51.73.

Payment of dividends is at the discretion of the Corporation's Board of Directors and is subject to various federal and state regulatory limitations. For further information regarding payment of dividends refer to Item 1. "Business," under the heading "Limits on Dividends."

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Issuer Purchases of Equity Securities

The Corporation's Board of Directors authorized a share repurchase program for the Corporation's common stock (the Repurchase Program) in May 2014 and subsequently reauthorized the Repurchase Program annually, most recently in April 2018 for up to $5.0 million of the Corporation's common stock and expiring on May 31, 2019. Repurchases under the Repurchase Program may be made through privately-negotiated transactions, or open-market transactions, including pursuant to a trading plan in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the Exchange Act) and/or Rule 10b-18 of the Exchange Act. As of December 31, 2018, $3.9 million of the Corporation's common stock may be purchased under the Repurchase Program.

The following table summarizes repurchases of the Corporation's common stock that occurred during the three months ended December 31, 2018.

(Dollars in thousands, except for per share amounts)	Total Number of Shares Purchased1	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximu (or Appr Dollar V Shares t Be Purc Under th Program
October 1, 2018 - October 31, 2018	—	$ —	—	$ 5,000
November 1, 2018 - November 30, 2018	14,283	52.22	14,283	4,254
December 1, 2018 - December 31, 2018	10,984	50.87	6,949	3,895
Total	25,267	51.63	21,232	

[1] During the three months ended December 31, 2018, 4,035 shares were withheld upon the vesting of restricted shares granted to employees of the Corporation and its subsidiaries in order to satisfy tax withholding obligations.

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ITEM 6.SELECTED FINANCIAL DATA

Five Year Financial Summary

(Dollars in thousands, except per share amounts)	2018	2017	2016	2015	2014
Financial Condition:					
Total assets	$ 1,521,411	$ 1,509,056	$ 1,451,992	$ 1,405,076	$ 1,338,187
Securities, available for sale	214,910	218,976	210,026	219,476	221,897
Loans held for sale	41,895	55,384	52,027	44,000	28,279
Loans (net of allowance for loan losses)	1,028,097	992,062	962,674	865,892	800,198
Total deposits	1,181,661	1,171,429	1,119,921	1,073,633	1,026,101
Total shareholders' equity	151,958	141,702	139,214	131,059	123,610
Results of Operations:					
Interest income	$ 92,548	$ 89,593	$ 89,439	$ 87,049	$ 86,495
Interest expense	11,027	9,601	8,968	8,694	8,525
Net interest income	81,521	79,992	80,471	78,355	77,970
Provision for loan losses	11,006	16,435	18,040	15,512	16,330
Net interest income after provision for loan losses	70,515	63,557	62,431	62,843	61,640

Noninterest income	25,758		27,232		26,047		21,220		19,821	
Noninterest expenses	73,732		72,823		70,560		66,680		63,973	
Income before taxes	22,541		17,966		17,918		17,383		17,488	
Income tax expense1	4,521		11,394		4,459		4,853		5,144	
Net income1	$ 18,020		$ 6,572		$ 13,459		$ 12,530		$ 12,344	
Share Data:										
Earnings per share—basic1	$ 5.15		$ 1.89		$ 3.90		$ 3.68		$ 3.63	
Earnings per share—assuming dilution1	5.15		1.88		3.89		3.68		3.59	
Dividends per share	1.41		1.33		1.29		1.22		1.19	
Weighted average number of shares—basic	3,501,221		3,486,510		3,454,282		3,401,426		3,404,112	
Weighted average number of shares—assuming dilution	3,501,221		3,486,589		3,455,883		3,401,834		3,436,278	
Significant Ratios:										
Net interest margin	5.80	%	5.99	%	6.30	%	6.35	%	6.55	%
Return on average assets1	1.19		0.45		0.96		0.92		0.93	
Return on average equity1	12.40		4.58		9.90		9.87		10.32	
Dividend payout ratio	27.38		70.37		33.08		33.20		32.80	
Average equity to average assets	9.63		9.82		9.65		9.29		9.02	
Asset Quality:										
Allowance for loan losses (ALL)										
Retail banking	$ 10,426		$ 10,775		$ 11,115		$ 11,017		$ 10,961	
Mortgage banking	598		598		598		598		553	
Consumer finance	22,999		24,353		25,353		23,954		24,092	
Ratio of ALL to total loans										
Retail banking	1.37	%	1.48	%	1.63	%	1.86	%	2.08	%
Mortgage banking	17.19		18.22		18.26		17.12		16.82	
Consumer finance	7.77		8.34		8.33		8.21		8.50	

[1] In connection with the reduction in the federal corporate income tax rate as a result of the enactment of the Tax Cuts and Jobs Act of 2017, the Corporation recognized a one-time remeasurement of its federal net deferred tax asset in 2017, which resulted in additional income tax expense and a decrease in net income of $6.6 million.

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ITEM 7.MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Corporation’s expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute “forward-looking statements” as defined by federal securities laws and may include, but are not limited to: statements regarding expected future financial performance; strategic business initiatives and the anticipated effects thereof, including personnel additions and the expansion of the indirect lending program to include marine and recreational vehicles; development of our digital platform; liquidity and capital levels; net interest margin compression; the effect of future market and industry trends, including competitive trends in the non-prime consumer finance markets, the Corporation’s and each business segment’s loan portfolio, and business prospects related to each segment’s loan portfolio, including future lending and growth in loans outstanding; asset quality and adequacy of the allowance for loan losses and the level of future charge-offs; trends regarding the provision for loan losses, net loan charge-offs, levels of nonperforming assets and troubled debt restructurings (TDRs); expenses associated with nonperforming assets; the utilization of scorecard models and the performance of loans purchased using those models; the effects of future interest rate levels and fluctuations; the amount and timing of accretion associated with the fair value accounting adjustments recorded in connection with the 2013 acquisition of CVBK; adequacy of the allowance for indemnification losses; levels of noninterest income and expense; interest rates and yields including possible future interest rate increases; the deposit portfolio including trends in deposit maturities and rates; interest rate sensitivity; market risk; regulatory developments; monetary policy implemented by the Federal Reserve Board including changes to the Federal Funds rate; capital requirements; growth strategy; hedging strategy; and, financial and other goals. These statements may address issues that involve estimates and assumptions made by management, management’s current beliefs, and risks and uncertainties. These statements are inherently uncertain and there can be no assurance that the underlying estimates, assumptions or beliefs will be proven to be accurate. Actual results could differ materially from historical results or those anticipated or implied by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

- interest rates, such as increases or volatility in the Federal Funds rate, yields on U.S. Treasury securities or mortgage rates

- general business conditions, as well as conditions within the financial markets

- general economic conditions, including unemployment levels and slowdowns in economic growth

- the legislative/regulatory climate with respect to financial institutions, including the Dodd-Frank Act and regulations promulgated thereunder, the CFPB and the regulatory and enforcement activities of the CFPB, the application of the

Basel III capital standards to the Corporation and C&F Bank and the Economic Growth, Regulatory Relief and Consumer Protection of 2018 and regulations promulgated thereunder

- the effect of the Tax Cuts and Jobs Act of 2017 (the Tax Act) and changes in the effect of the Tax Act due to issuance of interpretive regulatory guidance or enactment of corrective or supplemental legislation

- monetary and fiscal policies of the U.S. Government, including policies of the U.S. Department of the Treasury and the Federal Reserve Board, and the effect of these policies on interest rates and business in our markets

- the value of securities held in the Corporation's investment portfolios

- demand for loan products

- the quality or composition of the loan portfolios and the value of the collateral securing those loans

- the commercial and residential real estate markets

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- the inventory level and pricing of new and used automobiles, including sales prices of repossessed vehicles
- the level of net charge-offs on loans and the adequacy of our allowance for loan losses
- deposit flows
- demand in the secondary residential mortgage loan markets
- the level of indemnification losses related to mortgage loans sold
- the strength of the Corporation's counterparties and the economy in general
- competition from both banks and non-banks, including competition in the non-prime automobile finance markets
- demand for financial services in the Corporation's market area
- the Corporation's branch and market expansions and technology initiatives
- cyber threats, attacks or events
- reliance on third parties for key services
- C&F Bank's product offerings
- accounting principles, policies and guidelines and elections made by the Corporation thereunder

These risks and uncertainties, and the risks discussed in more detail in Item 1A. "Risk Factors," should be considered in evaluating the forward-looking statements contained herein. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report. We undertake no obligation to update or revise any forward-looking statement to reflect events or circumstances arising after the date on which the statement was made, except as otherwise required by law.

The following discussion supplements and provides information about the major components of the results of operations, financial condition, liquidity and capital resources of the Corporation. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires us to make estimates and assumptions. Those accounting policies with the greatest uncertainty and that require management’s most difficult, subjective or complex judgments affecting the application of these policies, and the likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are described below.

Allowance for Loan Losses: We establish the allowance for loan losses through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. Our judgment in determining the level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs for relevant periods of time, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower’s ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available. For more information see the section titled “Asset Quality” within Item 7.

Allowance for Indemnifications: The allowance for indemnifications is established through charges to earnings in the form of a provision for indemnifications, which is included in other noninterest expenses. A loss is charged against the allowance for indemnifications when a purchaser (investor) of a loan sold by C&F Mortgage incurs a validated indemnified loss due to borrower misrepresentation, fraud, early default, or underwriting error. The allowance represents an amount that, in management's judgment, will be adequate to absorb any losses that are probable of arising from valid indemnification requests for loans that have been sold by C&F Mortgage. Management's judgment in determining the level of the allowance is based on the volume of loans sold, historical experience, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. For more information see the section titled "Off-Balance-Sheet Arrangements" within Item 7.

Impairment of Loans: We consider a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. We measure impairment on a loan-by-loan basis based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment in the loan. All TDRs are also considered impaired loans and are evaluated individually. A TDR occurs when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. For more information see the section titled "Asset Quality" within Item 7.

Loans Acquired in a Business Combination: Acquired loans are classified as either (i) purchased credit-impaired (PCI) loans or (ii) purchased performing loans and are recorded at fair value on the date of acquisition.

PCI loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments. When determining fair value, PCI loans are aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the "nonaccretable difference." Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the "accretable yield" and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

On a quarterly basis, we evaluate our estimate of cash flows expected to be collected on PCI loans. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from

nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan, or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

The Corporation's PCI loans currently consist of loans acquired in connection with the acquisition of CVB. PCI loans that were classified as nonperforming loans by CVB are no longer classified as nonperforming so long as, at quarterly re-estimation periods, we believe we will fully collect the new carrying value of the pools of loans.

The Corporation accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required for any deterioration in these loans in future periods.

Impairment of Securities: Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net

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income if either (i) we intend to sell the security or (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If, however, we do not intend to sell the security and it is not more-likely-than-not that we will be required to sell the security before recovery, we must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

We regularly review unrealized losses in our investments in securities based on criteria including the extent to which market value is below amortized cost, the duration of that market decline, the financial health of and specific prospects for the issuer, our best estimate of the present value of cash flows expected to be collected from debt securities, our intention with regard to holding the security to maturity and the likelihood that we would be required to sell the security before recovery.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at the fair value less estimated costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations indicate a further deterioration in market conditions.

Goodwill: The Corporation's goodwill was recognized in connection with the Corporation's acquisition of CVBK in October 2013 and C&F Bank's acquisition of C&F Finance Company in September 2002. The Corporation reviews the carrying value of goodwill at least annually or more frequently if certain impairment indicators exist. In testing goodwill for impairment, the Corporation may first consider qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events and circumstances, we conclude that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then no further testing is required and the goodwill of the reporting unit is not impaired. If the Corporation elects to bypass the qualitative assessment or if we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the fair value of the reporting unit is compared with its carrying value to determine whether an impairment exists. In the fourth quarter of 2018 and 2017, the Corporation evaluated goodwill for impairment at the retail banking segment and the consumer finance segment and concluded that no impairment existed based on an assessment of qualitative factors.

Retirement Plan: C&F Bank maintains a non-contributory, defined benefit pension plan for eligible full-time employees as specified by the plan. Plan assets, which consist primarily of mutual funds invested in marketable equity securities and corporate and government fixed income securities, are measured at fair value. The projected benefit

obligation and net periodic pension cost or income are actuarially determined using a number of key assumptions, which may include discount rates, rates of return on plan assets, employee compensation and mortality and interest crediting rates. Changes in these assumptions in the future, if any, or in the method under which benefits are calculated may affect the projected benefit obligation in the year of the change, and may affect net periodic pension cost or income in the year of the change or in future periods.

Derivative Financial Instruments: The Corporation uses derivatives primarily to manage risk associated with changing interest rates and to assist customers with their risk management objectives. The Corporation's derivative financial instruments may include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be held for sale and the related forward sales commitments, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify and are designated as cash flow hedges of the Corporation's trust preferred capital notes. The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the Consolidated Balance Sheets. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are not designated as hedging instruments, adjustments to reflect unrealized gains and losses resulting from changes in fair value of these instruments are reported in the Consolidated Statements of Income. The gains or losses on the Corporation's cash flow hedges are reported as a component of other comprehensive income, net of deferred income taxes, and are reclassified into earnings in the same period or periods

during which the hedged transactions affect earnings. For more information see the section titled “Off-Balance-Sheet Arrangements” within Item 7.

Income Taxes: Determining the Corporation’s effective tax rate requires judgment. The Corporation’s net deferred tax asset is determined annually based on temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, there may be transactions and calculations for which the ultimate tax outcomes are uncertain and the Corporation’s tax returns are subject to audit by various tax authorities. Although we believe that estimates related to income taxes are reasonable, no assurance can be given that the final tax outcome will not be materially different than that which is reflected in the consolidated financial statements.

For further information concerning accounting policies, refer to Item 8. “Financial Statements and Supplementary Data” under the heading “Note 1: Summary of Significant Accounting Policies.”

OVERVIEW

Our primary financial goals are to maximize the Corporation’s earnings and to deploy capital in profitable growth initiatives that will enhance long-term shareholder value. We track three primary financial performance measures in order to assess the level of success in achieving these goals: (1) return on average assets (ROA), (2) return on average equity (ROE), and (3) growth in earnings. In addition to these financial performance measures, we track the performance of the Corporation’s three principal business segments: retail banking, mortgage banking, and consumer finance. We also actively manage our capital through growth, dividends and share repurchases, while considering the need to maintain a strong capital position.

Financial Performance Measures

Net income for the Corporation was $18.0 million in 2018, or $5.15 per share assuming dilution, compared to net income of $6.6 million in 2017, or $1.88 per share assuming dilution, and net income of $13.5 million in 2016, or $3.89 per share assuming dilution. The results for 2017 included the effect of the Tax Act, which was signed into law on December 22, 2017. As a result of the permanent reduction in the federal corporate income tax rate, the Corporation recorded a one-time remeasurement adjustment to its net federal deferred tax asset of $6.6 million, which was recognized in income tax expense. Excluding the one-time effects of the Tax Act, adjusted net income for 2017 was $13.2 million, or $3.79 per share assuming dilution.

The Corporation's ROE and ROA were 12.40 percent and 1.19 percent, respectively, for the year ended December 31, 2018, compared to 4.58 percent and 0.45 percent, respectively, for the year ended December 31, 2017 and 9.90 percent and 0.96 percent, respectively, for the year ended December 31, 2016. Excluding the effect of the remeasurement of the Corporation's net deferred tax asset, the Corporation's adjusted ROE and adjusted ROA were 9.20 percent and 0.90 percent, respectively, for the year ended December 31, 2017.

Refer to "Use of Certain Non-GAAP Financial Measures," below, for a reconciliation of adjusted net income, adjusted earnings per share, adjusted ROE and adjusted ROA, which are non-GAAP financial measures, to the most directly comparable financial measures calculated in accordance with U.S. GAAP.

2019 Outlook

Management believes the Corporation's financial performance in 2019 will be affected by (1) lower accretion income related to the fair value accounting adjustments for the CVBK acquisition, (2) an increase in interest income from growth in average loans outstanding, (3) an uncertain interest rate environment and potential fluctuations in interest rates that may depress loan production levels in the mortgage banking segment, and (4) continued competition for automobile loan contracts and higher borrowing costs in the consumer finance segment. The following additional factors could influence the Corporation's financial performance in 2019:

- Retail Banking: Growth in higher-yielding earning assets, specifically loans, will continue to be our primary focus at the Bank during 2019. We expanded our lending capabilities in January 2019 by adding a new commercial lending team in the Richmond market. Our growing lending team and continued economic strength in our markets, particularly in real estate development and construction, has led us to expect continued growth in our loan portfolio during 2019. However, it will be challenging to maintain the retail banking segment's net interest margin at its current level, as interest income from PCI loans that resulted from improvements in certain credits that were repaid in 2018 is unlikely to be realized at the same level in 2019. Additionally, increasing competition for deposits as rates have risen may result in a higher cost of funds. We also expect an increase in occupancy expense in 2019 related to new facilities, which will replace existing premises near the end of their lease. Also in 2019, we expect to continue to focus on our digital strategy, because online and mobile access are quickly becoming the primary means of banking for many businesses and individuals, and we believe our digital strategy commitment is critical to remaining competitive within the financial services industry.

- Mortgage Banking: C&F Mortgage generates significant noninterest income from the sale of residential loan products into the secondary market. Increasing future profitability at the current origination levels will be challenging due to (1) recent margin compression resulting from lower mortgage industry loan production volume and increased competition and (2) the fixed costs of maintaining the personnel, compliance and technology infrastructure required to support mortgage banking activities. While our goal is to increase origination volume through internal growth in existing markets and through strategic initiatives, our ability to maintain a level of loan production in 2019 sufficient to sustain and increase profitability will be dependent on market factors beyond our control, such as the interest rate environment and changes in interest rates, housing inventory and loan demand. If mortgage interest rates continue to rise during 2019, C&F Mortgage may experience a lower loan demand, particularly for mortgage refinancings, which could negatively affect earnings of the mortgage banking segment in 2019. In addition, during 2019, C&F Mortgage anticipates it will continue to (1) compete to retain and attract qualified loan officers, (2) incur costs associated with updating and enhancing our compliance management system and processes for originating residential loans to mitigate compliance and regulatory risks, as well as improving the quality of our loan origination process and (3) utilize technology to its fullest capability in order to realize efficiencies overall in our mortgage banking processes and to create opportunities for revenue generation.

- Consumer Finance: C&F Finance provides automobile financing through programs that are designed to serve customers in the non-prime sector and marine and RV financing for borrowers in the prime sector. As has been the case for the last several years, competition in the non-prime automobile loan business remains aggressive, resulting in lower interest rates and in many cases, less restrictive underwriting standards by several of our competitors. As a result, the expansion of our consumer finance loan portfolio into marine and RV loans in 2018 was partially offset by a slight decline in the automobile portfolio, and we expect organic loan growth to continue to be challenging in 2019. However, C&F Finance's scorecard model for purchasing automobile loan contracts, which was implemented in 2016 and results in the purchase of loans with higher credit metrics, as well as our expansion into marine and RV loans, are expected to result in charge-offs at C&F Finance remaining at a level lower than that experienced prior to 2018. We believe it will be challenging to maintain the consumer finance segment's net interest margin at its current level as: (1) the expansion of our loan portfolio into marine and RV loans will reduce average yields on loans compared to 2018, (2) competition in the market for non-prime automobile loans may cause yields to continue to decline and (3) further increases in the federal funds rate may trigger higher-cost variable-rate borrowings. We also expect to continue investing in technology at C&F Finance in order to capture more business, improve efficiencies, and manage the rigorous regulatory burdens and evolving compliance issues in the indirect lending industry.

Principal Business Segments

An overview of the financial results for each of the Corporation’s principal segments is presented below. A more detailed discussion is included in the section “Results of Operations.”

Retail Banking: The retail banking segment reported net income of $10.6 million for the year ended December 31, 2018, compared to net income of $5.0 million for the year ended December 31, 2017. The retail banking segment’s results for the year ended December 31, 2017 included income tax expense of $3.5 million associated with the

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remeasurement of C&F Bank's net deferred tax asset. The retail banking segment's income before income taxes for the year ended December 31, 2018 was $12.6 million, compared to $10.7 million for the year ended December 31, 2017.

In addition to favorable income tax factors as discussed below under "Results of Operations," positive factors affecting net income of C&F Bank for the year ended December 31, 2018 compared to the year ended December 31, 2017 included: (1) higher interest income from loans, primarily due to (a) improvement in the performance of certain PCI loans, as discussed below, (b) higher yields on variable rate loans resulting from rising interest rates and (c) loan growth and (2) higher yields on excess cash balances. Partially offsetting these factors were (1) higher operating expenses associated with C&F Bank continuing to (a) expand its retail and lending presence, (b) strengthen its technology infrastructure, (c) expand its capabilities in administrative and compliance functions, (d) expand its product offerings and (e) promote brand awareness, and (2) an increase in average rates on interest-bearing customer deposits.

The recognition of interest income on PCI loans is based on management's expectation of future payments of principal and interest. Expectations of the timing and amount of future payments on certain acquired loans that are PCI loans improved during 2018, resulting in an acceleration of the recognition of interest income in 2018 compared to 2017. Interest income recognized on PCI loans was $3.7 million for the year ended December 31, 2018, compared to $2.7 million for the year ended December 31, 2017.

Average loans, excluding loans to affiliates, increased $27.4 million or 3.9 percent during the year ended December 31, 2018, compared to the year ended December 31, 2017. C&F Bank's total nonperforming assets were $1.7 million at December 31, 2018, compared to $5.4 million at December 31, 2017. Nonperforming assets at December 31, 2018 consisted primarily of $1.5 million in nonaccrual loans, compared to $5.3 million at December 31, 2017. The decline in nonaccrual loans since December 31, 2017 resulted primarily from the resolution of one commercial relationship.

Mortgage Banking: The mortgage banking segment reported net income of $1.9 million for the year ended December 31, 2018, compared to net income of $985,000 for the year ended December 31, 2017. The mortgage banking segment's results for the year ended December 31, 2017 included income tax expense of $589,000 associated with the remeasurement of the mortgage banking segment's net deferred tax asset. The mortgage banking segment's income before income taxes was $2.6 million for each of the years ended December 31, 2018 and 2017.

The increase in net income of the mortgage banking segment for the year ended December 31, 2018 was due primarily to the favorable income tax factors discussed below under "Results of Operations." For the year ended December 31, 2018, income before income taxes of the mortgage banking segment was essentially unchanged, as lower gains on sales of loans, which resulted from lower loan production, were offset by a decrease in operating expenses, which resulted from operational efficiencies and management of personnel costs. While loan production decreased by 6.1 percent for the year ended December 31, 2018 compared to the year ended December 31, 2017, C&F Mortgage

Corporation's loan production volume outperformed loan production trends in the broader mortgage industry. Mortgage loan originations during the the year ended December 31, 2018 for refinancings and home purchases were $76.9 million and $566.2 million, respectively, compared to $99.6 million and $611.9 million, respectively, during the year ended December 31, 2017.

Consumer Finance: The consumer finance segment reported net income of $6.7 million for the year ended December 31, 2018, compared to net income of $2.3 million for the year ended December 31, 2017. The consumer finance segment's results for the year ended December 31, 2017 included income tax expense of $1.7 million associated with the remeasurement of the consumer finance segment's net deferred tax asset. The consumer finance segment's income before income taxes for the year ended December 31, 2018 was $9.2 million, compared to $6.5 million for the year ended December 31, 2017.

In addition to favorable income tax factors as discussed below under "Results of Operations," positive factors affecting net income of C&F Finance Company for the year ended December 31, 2018 included (1) a decline in the provision for loan losses of $5.3 million compared to the year ended December 31, 2017, as a result of lower charge-offs and improving credit quality of the portfolio, as discussed below, and (2) lower personnel and operating expenses resulting from underwriting efficiencies and the purchase of loan contracts with higher credit metrics. Partially offsetting these factors were (1) lower loan yields resulting from competition in the non-prime automobile loan business and the acquisition of loan contracts with higher credit metrics, as well as relatively lower yields on marine and RV loans, as discussed below

and (2) higher-cost variable-rate borrowings resulting from increases in short-term interest rates since the first quarter of 2017.

The net charge-off ratio for 2018 decreased to 4.14 percent from 5.82 percent for 2017. The decline reflects a lower number of charge-offs during 2018 as a result of C&F Finance Company's purchasing loan contracts with higher credit metrics beginning in 2016 based on the utilization of C&F Finance's scorecard model for purchasing automobile loan contracts. At December 31, 2018, total delinquent loans as a percentage of total loans was 4.76 percent, compared to 5.17 percent at December 31, 2017. The allowance for loan losses was $23.0 million, or 7.77 percent of total loans at December 31, 2018, compared to $24.4 million, or 8.34 percent of total loans at December 31, 2017. The decrease in the level of the allowance for loan losses as a percentage of total loans was primarily due to lower net charge-offs on non-prime automobile loans and the purchase of marine and RV loans beginning in 2018, as discussed below, which require a lower allowance for loan losses. At December 31, 2018, compared to December 31, 2017, the higher composition within the consumer finance segment's loan portfolio of marine and RV loans accounted for 28 basis points of the 57 basis points decrease in this ratio. If factors influencing the consumer finance segment result in a higher net charge-off ratio in the future, or if the consumer finance segment's loan portfolio should grow, the segment may need to increase the level of its allowance for loan losses, which would negatively affect future earnings.

During the first quarter of 2018, C&F Finance Company began the expansion of its indirect lending programs to include marine and RV loans. These contracts are for prime loans made to individuals with higher credit scores and are priced at rates substantially lower than its non-prime automobile portfolio. While these loans may contribute to net interest margin compression, management expects they will require both a lower provision for loan losses and allowance for loan losses than the consumer finance segment's non-prime automobile loans.

Other and Eliminations: The other segment, which principally includes the Corporation's holding company operations and wealth management subsidiary, reported aggregate net losses of $1.2 million and $1.7 million for the years ended December 31, 2018 and 2017, respectively. The other segments' loss before income taxes was $1.8 million and $1.9 million for the years ended December 31, 2018 and 2017, respectively. The lower net loss during 2018, compared to 2017, was primarily due to increased earnings at the Corporation's wealth management subsidiary.

Capital Management

Total shareholders' equity was $152.0 million at December 31, 2018, compared to $141.7 million at December 31, 2017. Capital growth resulted primarily from earnings for the year ended December 31, 2018, offset in part by dividends and share repurchases during the year.

The Corporation's Board of Directors continued its policy of paying dividends in 2018. For the year ended December 31, 2018, the Corporation declared dividends of $1.41 per share. Annual dividends per share increased 6.0 percent over dividends of $1.33 per share declared in 2017, resulting from two increases in the quarterly dividend during 2018. At December 31, 2018, the Corporation's annualized dividend was $1.48 per share, compared to $1.36 per share at December 31, 2017, or an increase of 8.8 percent. The Board of Directors of the Corporation continually reviews the amount of cash dividends per share and the resulting dividend payout ratio in light of changes in economic conditions, current and future capital levels and requirements and expected future earnings.

In April 2018, the Corporation's Board of Directors reauthorized a share repurchase program for the Corporation's outstanding common stock (the Repurchase Program) to purchase up to $5.0 million of the Corporation's common stock through May 2019. As of December 31, 2018, the Corporation had repurchased 21,232 shares of its common stock at an aggregate cost of $1.1 million, and remained authorized to purchase up to $3.9 million of its common stock under the Repurchase Program.

RESULTS OF OPERATIONS

NET INTEREST INCOME

The following table shows the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for each of the years ended December 31,

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2018, 2017 and 2016. Loans include loans held for sale. Loans placed on a nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Accretion and amortization of fair value purchase adjustments are included in the computation of yields on loans and investments and on the cost of borrowings acquired in connection with the purchase of CVB. The CVB accretion contributed approximately 28 basis points to the yield on loans and 21 basis points to both the yield on interest earning assets and net interest margin for the year ended December 31, 2018, compared to approximately 14 basis points to the yield on loans and 11 basis points to both the yield on interest earning assets and the net interest margin for the year ended December 31, 2017 and approximately 24 basis points to the yield on loans and 17 basis points to both the yield on interest earning assets and the net interest margin for the year ended December 31, 2016. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid using the federal corporate income tax rate of 21 percent for the year ended December 31, 2018 and 34 percent for the years ended December 31, 2017 and 2016).

TABLE 1: Average Balances, Income and Expense, Yields and Rates

(Dollars in thousands)	2018 Average Balance	Income/ Expense	Yield/ Rate		2017 Average Balance	Income/ Expense	Yield/ Rate		2016 Average Balance	Incom Expen
Assets										
Securities:										
Taxable	$ 138,053	$ 3,197	2.32	%	$ 115,392	$ 2,517	2.18	%	$ 99,564	$ 2,23
Tax-exempt	86,436	3,451	3.99		98,526	4,868	4.94		109,979	5,67
Total securities	224,489	6,648	2.96		213,918	7,385	3.45		209,543	7,90
Total loans	1,074,834	84,554	7.87		1,043,418	82,789	7.93		994,808	83,0
Interest-bearing deposits in other banks	118,176	2,097	1.77		107,629	1,128	1.05		105,293	509
Total earning assets	1,417,499	93,299	6.58		1,364,965	91,302	6.69		1,309,644	91,4
Allowance for loan losses	(35,409)				(36,101)				(36,192)	
Total non-earning assets	126,814				134,275				135,615	
Total assets	$ 1,508,904				$ 1,463,139				$ 1,409,067	
Liabilities and Shareholders' Equity										

Time and savings deposits:								
Interest-bearing demand deposits	$ 221,750	799	0.36	$ 215,627	482	0.22	$ 211,441	425
Money market deposit accounts	215,662	699	0.32	221,279	606	0.27	213,793	571
Savings accounts	116,896	103	0.09	109,789	87	0.08	102,899	82
Certificates of deposit, $100 or more	172,616	2,206	1.28	163,100	1,839	1.13	142,115	1,49
Other certificates of deposit	177,279	1,879	1.06	181,746	1,734	0.95	198,061	1,81
Total time and savings deposits	904,203	5,686	0.63	891,541	4,748	0.53	868,309	4,39
Borrowings	165,290	5,341	3.23	165,662	4,853	2.93	170,490	4,57
Total interest-bearing liabilities	1,069,493	11,027	1.03	1,057,203	9,601	0.91	1,038,799	8,96
Demand deposits	266,415			236,937			210,520	
Other liabilities	27,678			25,353			23,842	
Total liabilities	1,363,586			1,319,493			1,273,161	
Shareholders' equity	145,318			143,646			135,906	
Total liabilities and shareholders' equity	$ 1,508,904			$ 1,463,139			$ 1,409,067	
Net interest income		$ 82,272			$ 81,701			$ 82,4
Interest rate spread			5.55 %			5.78 %		
Interest expense to average earning assets			0.78 %			0.70 %		
Net interest margin			5.80 %			5.99 %		

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Interest income and expense are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table shows the direct causes of the year-to-year changes in the components of net interest income on a taxable-equivalent basis. The Corporation calculates the rate and volume variances using a formula prescribed by the SEC. Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the absolute dollar amounts of each.

TABLE 2: Rate-Volume Recap

	2018 from 2017 Increase (Decrease) Due to		Total	2017 from 2016 Increase (Decrease) Due to		Total
(Dollars in thousands)	Rate	Volume	Increase (Decrease)	Rate	Volume	Increase (Decrease)
Interest income:						
Loans	$ (646)	$ 2,411	$ 1,765	$ (4,205)	$ 3,958	$ (247)
Securities:						
Taxable	168	512	680	(67)	347	280
Tax-exempt	(865)	(552)	(1,417)	(229)	(573)	(802)
Interest-bearing deposits in other banks	848	121	969	607	12	619
Total interest income	(495)	2,492	1,997	(3,894)	3,744	(150)
Interest expense:						
Time and savings deposits:						
Interest-bearing demand deposits	304	13	317	49	8	57
Money market deposit accounts	108	(15)	93	10	25	35
Savings accounts	10	6	16	(1)	6	5
Certificates of deposit, $100 or more	255	112	367	125	218	343
Other certificates of deposit	189	(44)	145	79	(163)	(84)
Total time and savings deposits	866	72	938	262	94	356
Borrowings	499	(11)	488	411	(134)	277
Total interest expense	1,365	61	1,426	673	(40)	633
Change in net interest income	$ (1,860)	$ 2,431	$ 571	$ (4,567)	$ 3,784	$ (783)

2018 Compared to 2017

Net interest income, on a taxable-equivalent basis, for 2018 increased to $82.3 million, compared to $81.7 million for 2017. The net interest margin decreased 19 basis points to 5.80 percent, compared to 5.99 percent for 2017. The net interest margin decline resulted from an 11 basis point decline in the yield on interest-earning assets coupled with a 12 basis point increase in the cost of interest-bearing liabilities for the year ended December 31, 2018, compared to the year ended December 31, 2017. The decline in yield on interest-earning assets was primarily attributable to a decrease in the yields on the loan and investment securities portfolios for 2018 compared to 2017, partially offset by an increase in the yield on interest-earning deposits in other banks. The decrease in the net interest margin was offset in part by average earning asset growth of $52.5 million for 2018, compared to 2017.

Average loans, which includes both loans held for investment and loans held for sale, increased $31.4 million to $1.07 billion for the year ended December 31, 2018, compared to 2017. Average loans held for investment of the retail banking segment increased $27.4 million, or 3.9 percent, for the year ended December 31, 2018, compared to 2017. Average loans at the retail banking segment increased for 2018 because of growth in the real estate construction and commercial real estate segments of the loan portfolio, which was driven by the continued strong loan demand in the real estate development and construction sectors of our markets and by C&F Bank strengthening its commercial lending team. Average loans held for investment at the consumer finance segment increased $2.0 million, or 0.7 percent, for 2018 compared to 2017 due to the consumer finance segment's expansion into purchases of marine and RV loan contracts beginning in the first quarter of 2018, partially offset by a decrease in average automobile loans. Average loans held for sale increased $2.0 million, or 5.2 percent for 2018, compared to 2017.

The overall yield on average loans decreased 6 basis points to 7.87 percent for 2018, compared to 2017. Negative factors affecting average loan yield for 2018, compared to 2017, were (1) the increased composition within the loan portfolio of lower-yielding loans at the retail banking segment relative to the higher-yielding non-prime loans at the consumer finance segment and (2) the decline in the average yield on loans at the consumer finance segment due primarily to continued competition in the non-prime automobile loan business and growth in lower-yielding, higher quality loans

including marine and RV loans. Partially offsetting these factors were (1) improvements during 2018 in expectations of the timing and amount of future payments on certain PCI loans, which resulted in an acceleration of the recognition of interest income in 2018 compared to 2017 and (2) higher yields on variable rate and fixed rate loans resulting from increases in interest rates.

Average securities available for sale increased $10.6 million for 2018, compared to 2017. However, the average yield on the securities portfolio decreased 49 basis points for 2018, compared to 2017, primarily due to (1) the decrease in the federal corporate income tax rate as a result of the Tax Act, which reduced the tax equivalent yield on tax-exempt bonds, and (2) the reinvestment of proceeds from called or matured securities at lower yields.

Average interest-bearing deposits in other banks, consisting primarily of excess cash reserves maintained at the Federal Reserve Bank, increased $10.5 million during 2018, compared to 2017. The increase during 2018 resulted from customer deposit growth and net operating cash flow exceeding net growth in loan and securities. The average yield on these overnight funds increased 72 basis points for 2018, compared to 2017, because of the Federal Reserve Bank’s increases in the interest rate on excess cash reserve balances from 0.75 percent in December 2016 to 2.40 percent by the end of 2018.

Average interest-bearing time deposits increased $5.0 million for 2018, compared to 2017, and average savings and interest-bearing demand deposits increased $7.6 million for 2018, compared to 2017. Although interest rates have risen since the beginning of 2017, the increase in the average cost of interest-bearing deposits was only 10 basis points during 2018, as the repricing of deposit accounts lagged market interest rate increases.

Average borrowings decreased $372,000 for 2018, compared to 2017. The decrease resulted from maturities during 2018 of a $5.0 million repurchase agreement with a third-party correspondent bank and a $2.5 million advance from the FHLB, partially offset by fluctuations in repurchase agreements with commercial deposit customers. The average cost of borrowings increased 30 basis points during 2018, compared to 2017, because of increases in short-term interest rates, to which variable-rate borrowing at the consumer finance segment is indexed.

The Corporation believes that it may be challenging to maintain net interest margin at its current level, even with the projected loan growth at the Bank during 2019, because of (1) the potential for further increases in short-term interest rates, which will trigger a higher cost of variable-rate borrowing at the consumer finance segment and may drive higher costs of customer deposits, (2) repricing of time deposits at current market rates, (3) lower yields on consumer finance segment loans resulting from continued market competition and growth in lower-yielding higher-quality loans (including marine and RV loans) and (4) lower accretion of purchase discounts on PCI loans, which is included in yields on loans.

2017 Compared to 2016

Net interest income, on a taxable-equivalent basis, for 2017 decreased to $81.7 million, compared to $82.5 million for 2016. The net interest margin for 2017 decreased 31 basis points to 5.99 percent, compared to 6.30 percent for 2016. The net interest margin decline resulted from a decline in the yield on interest-earning assets of 29 basis points and an increase in the cost of funds of 5 basis points for the year ended December 31, 2017, compared to the year ended December 31, 2016. The decline in yield on interest-earning assets for the year ended December 31, 2017 was primarily attributable to decreases in the yields on the loan and investment securities portfolios. These decreases were offset in part by earning asset growth of $55.3 million for the year ended December 31, 2017.

Average loans, which includes both loans held for investment and loans held for sale, increased $48.6 million to $1.04 billion for the year ended December 31, 2017, compared to 2016. Average loans held for investment of the retail banking segment increased $57.3 million, or 8.8 percent, for the year ended December 31, 2017, compared to 2016. Average loans at the retail banking segment increased for 2017 because of growth in the commercial real estate and real estate mortgage segments of the loan portfolio, which was driven by successfully recruiting experienced commercial lending personnel over the past several years and the continued strong loan demand in the real estate development and construction sectors of our markets. Average loans held for investment at the consumer finance segment decreased $3.4 million, or 1.1 percent, during 2017, compared to 2016, which was the result of competition within the non-prime automobile finance industry. Average loans held for sale decreased $5.2 million, or 11.9 percent for 2017, compared to 2016, because of the shorter duration between loan closings and fundings during 2017.

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The overall yield on average loans decreased 42 basis points to 7.93 percent during 2017, compared to 2016. The decrease in the average loan yield was due to (1) the increased concentration of lower-yielding loans at the retail banking segment relative to the higher-yielding loans at the consumer finance segment, (2) the lower accretion of fair value purchase adjustments in connection with the purchase of CVB and (3) the decline in the average yield on loans at the consumer finance segment due to the continued competitive pressure on loan pricing strategies and a strategic decision to purchase loans with higher credit quality metrics, but lower yields.

Average securities available for sale increased $4.4 million during 2017, compared to 2016, while the overall yield declined 32 basis points, due to the purchase of lower-yielding shorter-term securities to replace maturities and calls of longer-term, higher yielding securities. The Corporation has shortened the security portfolio’s duration by investing in lower-yielding, short-term securities in order to mitigate interest-rate risk of an anticipated rising interest rate environment.

Average interest-bearing deposits in other banks, consisting primarily of excess reserves maintained at the Federal Reserve Bank, increased $2.3 million during 2017, compared to 2016, because of the lower loan funding requirements at the mortgage banking and consumer finance segments, coupled with customer deposit growth, the effects of which were offset in part by loan growth at the retail banking segment. The average yield on these overnight funds increased 57 basis points during 2017 because of the Federal Reserve Bank’s increases in the interest rate on excess reserve balances from 0.75 percent in December 2016 to 1.50 percent by the end of 2017.

Average interest-bearing time deposits increased $4.7 million during 2017, compared to 2016, and average savings and interest-bearing demand deposits increased $18.6 million during 2017, compared to 2016. Although interest rates have risen since December 31, 2016, the increase in the average cost of interest-bearing time and savings deposits was only three basis points during the year ended December 31, 2017 because growth in lower-cost non-term interest-bearing deposits exceeded growth in higher-cost time deposits and the repricing of our deposit accounts lagged market interest rate increases.

Average borrowings decreased $4.8 million for the ended December 31, 2017, compared to 2016. The decrease resulted from the repayment during 2016 of the borrowings used to purchase a consumer finance loan portfolio at the end of the second quarter of 2015. The average cost of borrowings increased 25 basis points during the year ended December 31, 2017, compared to 2016, because of increases in one-month LIBOR, to which variable-rate borrowing at the consumer finance segment is indexed, resulting from the rising interest rate environment, the effect of which was offset in part by the retail banking segment’s restructuring of borrowings from the FHLB.

NONINTEREST INCOME

TABLE 3: Noninterest Income

	Year Ended December 31, 2018				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	$ —	$ 7,841	$ —	$ —	$ 7,841
Service charges on deposit accounts	4,213	—	—	—	4,213
Other service charges and fees	1,379	3,686	7	—	5,072
Net gains on calls of available for sale securities	10	—	—	—	10
Wealth management services income, net	—	—	—	1,860	1,860
BOLI income	320	—	104	—	424
Swap fee income	83	—	—	—	83
Interchange income	3,882	—	—	—	3,882
Other income	1,142	329	627	275	2,373
Total noninterest income	$ 11,029	$ 11,856	$ 738	$ 2,135	$ 25,758

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	Year Ended December 31, 2017				
	Retail	Mortgage	Consumer	Other and	
(Dollars in thousands)	Banking	Banking	Finance	Eliminations	Total
Gains on sales of loans	$ —	$ 8,553	$ —	$ —	$ 8,553
Service charges on deposit accounts	4,458	—	—	—	4,458
Other service charges and fees	1,336	3,885	7	—	5,228
Net gains on calls of available for sale securities	10	—	—	—	10
Wealth management services income, net	—	—	—	1,619	1,619
BOLI income	328	—	105	—	433
Swap fee income	193	—	—	—	193
Interchange income	3,476	—	—	—	3,476
Other income	1,325	768	883	286	3,262
Total noninterest income	$ 11,126	$ 13,206	$ 995	$ 1,905	$ 27,232

	Year Ended December 31, 2016				
	Retail	Mortgage	Consumer	Other and	
(Dollars in thousands)	Banking	Banking	Finance	Eliminations	Total
Gains on sales of loans	$ —	$ 8,120	$ —	$ —	$ 8,120
Service charges on deposit accounts	4,262	—	—	—	4,262
Other service charges and fees	1,577	3,404	10	—	4,991
Net gains on calls of available for sale securities	52	—	—	—	52
Wealth management services income, net	—	—	—	1,165	1,165
BOLI income	828	—	99	—	927
Swap fee income	418	—	—	—	418
Interchange income	3,562	—	—	—	3,562
Other income	1,121	509	812	108	2,550
Total noninterest income	$ 11,820	$ 12,033	$ 921	$ 1,273	$ 26,047

2018 Compared to 2017

Total noninterest income decreased $1.5 million, or 5.4 percent, for the year ended December 31, 2018, compared to the year ended December 31, 2017. The decrease in noninterest income was primarily due to (1) a gain of $1.3 million in 2017, included primarily in other income of the retail banking segment and mortgage banking segment, on assets held in a rabbi trust related to the Corporation's nonqualified defined contribution plan, compared to no such gain in 2018, (2) a decrease in gains on sales of loans at the mortgage banking segment as a result of lower mortgage loan volume and pricing pressure, as rising interest rates have led to declines in mortgage industry loan production volume and increased competition, (3) decreased service charges on deposit accounts, which consists of overdraft and account maintenance fees, at the retail banking segment and (4) decreased ancillary income at the mortgage banking segment as a result of lower mortgage loan volume, partially offset by (1) increased debit card interchange income at the retail banking segment, (2) higher income from other components of net periodic pension benefit income at the retail banking segment, included in other income, resulting primarily from the Bank's $3.0 million contribution to its cash balance pension plan in 2018, (3) increased wealth management services income and (4) a gain of $168,000, included in other income at the retail banking segment, resulting from the disposition of land in 2018. Changes in the fair value of assets held in the rabbi trust that are recorded as items of income or loss are offset by adjustments to the Corporation's deferred compensation liability to participants in the nonqualified plan, which are recorded in salaries and employee benefits expense.

2017 Compared to 2016

Total noninterest income increased $1.2 million, or 4.5 percent, for the year ended December 31, 2017, compared to the year ended December 31, 2016. Total noninterest income for 2017 increased primarily due to higher (1) gains on sales of loans and ancillary loan origination fees at the mortgage banking segment because of higher loan production, (2) debit card interchange income and overdraft charges at the retail banking segment, and (3) wealth management income at C&F Wealth Management because of the addition of a new wealth management group in Williamsburg and Newport News, Virginia in the fourth quarter of 2016, which were offset in part at the retail banking segment by lower swap fee income. In addition, noninterest income of the retail banking segment for 2016 included one-time revenue items of

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$359,000 in other service charges and fees associated with one of the Bank’s debit card programs, $493,000 associated with bank-owned life insurance, and a $139,000 gain on sale of a Bank-owned property included in other income.

NONINTEREST EXPENSE

TABLE 4: Noninterest Expense

	Year Ended December 31, 2018				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	$ 26,355	$ 5,007	$ 8,500	$ 2,141	$ 42,003
Occupancy expense	5,483	1,980	782	63	8,308
Other expenses:					
Data processing	6,097	54	1,263	38	7,452
Other expenses	8,580	3,329	3,511	549	15,969
Total noninterest expense	$ 46,515	$ 10,370	$ 14,056	$ 2,791	$ 73,732

	Year Ended December 31, 2017				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	$ 25,757	$ 6,503	$ 9,389	$ 1,948	$ 43,597
Occupancy expense	4,671	1,957	1,035	67	7,730
Other expenses:					
Data processing	5,343	53	1,256	35	6,687
Other expenses	7,937	3,175	3,130	567	14,809
Total noninterest expense	$ 43,708	$ 11,688	$ 14,810	$ 2,617	$ 72,823

	Year Ended December 31, 2016				
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total

Salaries and employee benefits	$ 25,033	$ 5,664	$ 10,102	$ 1,546	$ 42,345
Occupancy expense	4,484	1,820	907	17	7,228
Other expenses:					
Data processing	4,844	47	1,412	20	6,323
Other expenses	8,105	2,948	3,118	493	14,664
Total noninterest expense	$ 42,466	$ 10,479	$ 15,539	$ 2,076	$ 70,560

2018 Compared to 2017

Total noninterest expenses increased $909,000, or 1.2 percent, for the year ended December 31, 2018, compared to 2017. The increase in noninterest expenses resulted primarily from higher operating costs at the retail banking segment attributable to (1) increased personnel costs associated with expanding the Bank's capabilities in administrative and compliance functions, (2) higher data processing and occupancy expenses associated with enhancing our technology infrastructure, expanding our digital product offerings and increased debit and credit card interchange activity and (3) increased marketing expenses associated with promoting brand awareness. Partially offsetting these factors were (1) a decrease in salaries and employee benefits expense associated with the Corporation's nonqualified defined contribution plan, primarily at the retail banking segment and mortgage banking segment, (2) decreased personnel costs at the mortgage banking segment resulting from lower loan origination volume, operating efficiencies and managing personnel costs and (3) decreased personnel costs at the consumer finance segment resulting from underwriting efficiencies and the purchase of loans that have higher credit metrics, resulting in lower servicing cost. The Corporation records compensation expense for participants in its nonqualified deferred compensation plan based on amounts contributed to the plan and changes in the fair value of assets held in the rabbi trust associated with the plan, which are allocated to plan participants. In 2017, salaries and employee benefits expense included $1.3 million related to changes in fair value of the assets in the rabbi trust. In 2018, the assets held in the rabbi trust gave rise to losses of $610,000 recognized in other expense and a corresponding reduction of salaries and employee benefits expense.

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2017 Compared to 2016

Total noninterest expenses increased $2.3 million, or 3.2 percent, for the year ended December 31, 2017, compared to 2016. The increase in noninterest expenses resulted primarily from higher personnel costs at (1) the Bank principally because of increased staff levels and support positions associated with the Bank's retail banking and commercial lending growth and expansion into Charlottesville, Virginia, (2) C&F Mortgage because of higher loan production and the mortgage banking segment’s expansion in Chesapeake, Virginia, which began in the fourth quarter of 2016, and (3) the Corporation’s wealth management subsidiary because of the addition of a new wealth management group in Williamsburg and Newport News, Virginia in the fourth quarter of 2016. Occupancy expense increased (1) at the Bank, C&F Mortgage, and at C&F Finance due to expenses associated with strengthening the technology infrastructure and (2) at the Bank, C&F Mortgage, and C&F Wealth Management due to higher rent expense for the addition of locations in Charlottesville, Chesapeake, and Williamsburg, respectively. These increases in noninterest expenses were offset in part at C&F Finance by lower (1) personnel costs due to fewer sales contracts purchased during 2017, (2) repossession expenses due to normal fluctuations in the timing of repossessed asset sales, (3) data processing fees due to a lower volume of loan activity and (4) collection expenses due to costs associated with the transition to new systems that were incurred during the first quarter of 2016.

INCOME TAXES

Income tax expense on 2018 earnings was $4.5 million, resulting in an effective tax rate of 20.1 percent, compared with $11.4 million, or 63.4 percent, in 2017 and $4.5 million, or 24.9 percent, in 2016. The lower effective tax rate in 2018 compared to 2017, and the higher effective tax rate in 2017 compared to 2016, were primarily a result of the Tax Act, which was signed into law on December 22, 2017 and permanently lowered the federal corporate income tax rate to 21 percent, effective January 1, 2018. In connection with the reduction in the federal corporate income tax rate, the Corporation recognized a one-time remeasurement of its federal net deferred tax asset in 2017, which resulted in additional income tax expense and a decrease in net income of $6.6 million. The lower federal corporate income tax rate also had a favorable effect on the net income of each of the Corporation’s principal business segments in 2018 compared to 2017, the benefit of which was offset in part by lower tax savings on tax-exempt investment securities income during 2018, resulting from the lower income tax rate coupled with a decline in the average balance of tax-exempt securities.

ASSET QUALITY

Allowance and Provision for Loan Losses

Allowance for Loan Losses Methodology – Retail Banking and Mortgage Banking. We conduct an analysis of the collectibility of the loan portfolio on a regular basis. This analysis does not apply to PCI loans, loans carried at fair value, loans held for sale or off-balance sheet credit exposure (e.g., unfunded loan commitments and standby letters of credit). We use this analysis to assess the sufficiency of the allowance for loan losses and to determine the necessary provision for loan losses.

The analysis, at a minimum, considers the following factors:

- Changes in lending policies and procedures, including underwriting, collection, charge-off and recovery;
- Changes in international, national, regional and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;
- Changes in the nature and volume of the portfolio and in the terms of loans;
- Changes in the experience, ability and depth of lending management and other relevant staff;
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans and the volume and severity of adversely classified or graded loans;
- Changes in the quality of our loan review system;
- Changes in the value of the underlying collateral for collateral-dependent loans;
- The existence and effect of any concentrations of credit and changes in the level of such concentrations;
- The effect of other external factors, such as competition;
- Historical trends of actual loan losses based on volume and types of loans; and
- Significant one-time transactions affecting the allowance for loan losses.

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In conjunction with the factors described above, we consider the following risk elements that are inherent in the loan portfolio as part of the analysis:

- Real estate residential mortgage loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.
- Real estate construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.
- Commercial, financial and agricultural loans carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because the repayment of these loans may be dependent upon the profitability and cash flows of the business or project. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.
- Equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.
- Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

The review process generally begins with loan officers or management identifying problem loans to be reviewed on an individual basis for impairment. This review of individual loans is limited to those loans that have indications of probable loss or that may result in significant losses to the Corporation, while all other loans, which may include delinquent loans and loans classified as special mention or substandard, are evaluated as a group, as discussed below. In addition, all TDRs are considered impaired loans and are individually evaluated. We consider a loan impaired when it is probable that we will be unable to collect all interest and principal payments as scheduled in the loan agreement. A loan is not considered impaired during a period of delay in payment if the ultimate collectibility of all amounts due is expected. If a loan is considered impaired, impairment is measured 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. A valuation allowance is established for an impaired loan to the extent that this measure of the impaired loan is less than the recorded investment in the loan. When a loan is determined to be impaired, we follow a consistent process to measure that impairment in our loan portfolio. For collateral dependent loans we obtain an updated appraisal if we do not have a current one on file. Appraisals are

performed by independent third party appraisers with relevant industry experience. We may make adjustments to the appraised value based on recent sales of similar properties or general market conditions when appropriate. We also estimate costs to sell collateral in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan.

The remaining non-impaired loans are grouped by loan type (e.g., commercial real estate, commercial, residential mortgage, consumer). We assign each loan type an allowance factor based on the historical loss rate for that type of loan and an evaluation of the qualitative factors mentioned above to determine a general allowance. We assign classified loans (i.e., special mention, substandard, doubtful, loss) a higher allowance factor than non-classified loans within a particular loan type based on our concerns regarding collectibility. Our allowance factors increase with the severity of classification. Allowance factors used for unclassified loans are based on our analysis of charge-off history for relevant periods of time which can vary depending on economic conditions, and our judgment based on the overall analysis of the lending environment including the general economic conditions. Our analysis of charge-off history also considers economic cycles and the trends during those cycles. The allowance for loan losses is the aggregate of specific allowances and the general allowance for each portfolio type.

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As discussed above we segregate loans meeting the criteria for special mention, substandard, doubtful and loss from non-classified, or pass rated, loans. We review the characteristics of each rating at least annually, generally during the first quarter. The characteristics of these loan ratings are as follows:

- Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.

- Special mention loans have a specific, identified weakness in the borrower's operations and in the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history is characterized by late payments. The Corporation's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.

- Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet the Corporation's definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.

- Substandard nonaccrual loans have the same characteristics as substandard loans; however, they have a nonaccrual classification because it is probable that the Corporation will not be able to collect all amounts due.

- Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but with 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. The possibility of loss is extremely high.

- Loss rated loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

Allowance for Loan Losses Methodology - PCI Loans - As previously described, on a quarterly basis we evaluate our estimate of cash flows expected to be collected on PCI loans. These evaluations require the continued assessment of key assumptions and estimates similar to the initial estimate of fair value, such as the effect of collateral value changes, changing loss severities, estimated and experienced prepayment speeds and other relevant factors. Subsequent decreases to the expected cash flows to be collected on a PCI loan will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. For a more detailed description, see "Critical

Accounting Policies" in this Item 7.

Allowance for Loan Losses Methodology – Consumer Finance. The consumer finance segment's loans consist of non-prime automobile loans and prime marine and RV loans. These loans carry risks associated with (1) the continued credit-worthiness of borrowers and (2) the value of rapidly-depreciating collateral. These loans do not lend themselves to a classification process because of the short duration of time between default, repossession and charge-off. Therefore, the loan loss allowance review process generally focuses on an analysis of charge-off history for relevant periods of time, which can vary depending on economic conditions. Further consideration is given to the following factors:

- An overall analysis of the lending environment;
- Changes in the volume and severity of past due loans;
- Changes in the value of the underlying collateral;
- Changes in lending policies and procedures, including underwriting, collection and recovery;
- Changes in the composition of the portfolio; and
- The effect of external factors, such as competition.

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Loans are segregated between performing and nonperforming loans. Performing loans are those that have made timely payments in accordance with the terms of the loan agreement and that are not past due 90 days or more. Nonperforming loans are those that do not accrue interest and are greater than 90 days past due.

In accordance with its policies and guidelines and consistent with industry practices, C&F Finance, at times, offers payment deferrals to non-prime automobile borrowers, whereby the borrower is allowed to move up to two payments within a twelve-month rolling period to the end of the loan. A fee will be collected for extensions only in states that permit it. An account for which all delinquent payments are deferred is classified as current at the time the deferment is granted and therefore is not included as a delinquent account. Thereafter, such an account is aged based on the timely payment of future installments in the same manner as any other account. We evaluate the results of this deferment strategy based upon the amount of cash installments that are collected on accounts after they have been deferred versus the extent to which the collateral underlying the deferred accounts has depreciated over the same period of time. Based on this evaluation, we believe that payment deferrals granted according to our policies and guidelines are an effective portfolio management technique and result in higher ultimate cash collections. Payment deferrals may affect the ultimate timing of when an account is charged off. Increased use of deferrals may result in a lengthening of the loss confirmation period, which would increase expectations of credit losses inherent in the portfolio and therefore increase the allowance for loan losses and related provision for loan losses. The average amounts deferred on a monthly basis, as a percentage of average non-prime automobile loans outstanding, was 2.30 percent in 2018, 2.57 percent in 2017 and 2.21 percent in 2016.

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The allowance for loan losses represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. The provision for loan losses increases the allowance, and loans charged off, net of recoveries, reduce the allowance. The following table presents the Corporation’s loan loss experience for the periods indicated:

TABLE 5: Allowance for Loan Losses

	Year Ended December 31,				
(Dollars in thousands)	2018	2017	2016	2015	2014
Balance, beginning of period	$ 35,726	$ 37,066	$ 35,569	$ 35,606	$ 34,852
Provision for loan losses:					
Retail Banking	100	200	—	—	—
Mortgage Banking	—	—	—	45	60
Consumer Finance	10,906	16,235	18,040	15,467	16,270
Total provision for loan losses	11,006	16,435	18,040	15,512	16,330
Loans charged off:					
Real estate—residential mortgage	(42)	(179)	(82)	(144)	(161)
Commercial, financial and agricultural1	(409)	(349)	(87)	(21)	(271)
Equity lines	—	(42)	(57)	(19)	(80)
Consumer	(344)	(301)	(281)	(317)	(312)
Consumer finance	(16,477)	(21,525)	(20,663)	(19,816)	(19,022)
Total loans charged off	(17,272)	(22,396)	(21,170)	(20,317)	(19,846)
Recoveries of loans previously charged off:					
Real estate—residential mortgage	57	118	163	257	59
Commercial, financial and agricultural1	59	21	206	31	210
Equity lines	—	2	—	1	—
Consumer	230	189	236	268	250
Consumer finance	4,217	4,291	4,022	4,211	3,751
Total recoveries	4,563	4,621	4,627	4,768	4,270
Net loans charged off	(12,709)	(17,775)	(16,543)	(15,549)	(15,576)
Balance, end of period	$ 34,023	$ 35,726	$ 37,066	$ 35,569	$ 35,606
Ratio of net charge-offs (recoveries) to average total loans outstanding during period for Retail Banking	0.06 %	0.08 %	(0.02) %	(0.01) %	0.06 %
Ratio of net charge-offs to average total loans outstanding during period for Consumer Finance	4.14 %	5.82 %	5.55 %	5.50 %	5.39 %

[1]Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

For further information regarding the adequacy of our allowance for loan losses, refer to "Nonperforming Assets" within this Item 7.

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The allocation of the allowance for loan losses at December 31 for the years indicated and the ratio of corresponding outstanding loan balances to total loans are as follows:

TABLE 6: Allocation of Allowance for Loan Losses

	December 31,				
(Dollars in thousands)	2018	2017	2016	2015	2014
Allocation of allowance for loan losses:					
Real estate—residential mortgage	$ 2,246	$ 2,371	$ 2,559	$ 2,471	$ 2,313
Real estate—construction 1	727	605	816	94	434
Commercial, financial and agricultural 2	6,688	7,478	7,393	7,755	7,744
Equity lines	1,106	688	685	1,052	812
Consumer	257	231	261	243	211
Consumer finance	22,999	24,353	25,352	23,954	24,092
Total allowance for loan losses	$ 34,023	$ 35,726	$ 37,066	$ 35,569	$ 35,606
Ratio of loans to total period-end loans:					
Real estate—residential mortgage	17 %	19 %	19 %	21 %	21 %
Real estate—construction 1	5	4	6	1	1
Commercial, financial and agricultural 2	43	43	39	39	37
Equity lines	5	5	5	6	6
Consumer	2	1	1	1	1
Consumer finance	28	28	30	32	34
	100 %	100 %	100 %	100 %	100 %

[1] Includes the Corporation’s real estate construction lending and consumer real estate lot lending.

[2] Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Loans by credit quality indicators as of December 31, 2018 were as follows:

TABLE 7A: Credit Quality Indicators

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	$ 180,232	$ 2,832	$ 1,243	$ 594	$ 184,901
Real estate – construction 2	54,461	—	—	—	54,461
Commercial, financial and agricultural 3	440,832	14,625	454	24	455,935
Equity lines	54,289	389	99	883	55,660
Consumer	14,998	5	6	—	15,009
	$ 744,812	$ 17,851	$ 1,802	$ 1,501	$ 765,966

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	$ 295,442	$ 712	$ 296,154

[1] At December 31, 2018, the Corporation did not have any loans classified as Doubtful or Loss.
[2] Includes the Corporation’s real estate construction lending and consumer real estate lot lending.
[3] Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

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Loans by credit quality indicators as of December 31, 2017 were as follows:

TABLE 7B: Credit Quality Indicators

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total[1]
Real estate – residential mortgage	$ 179,963	$ 1,235	$ 2,835	$ 830	$ 184,863
Real estate – construction [2]	44,782	—	—	—	44,782
Commercial, financial and agricultural [3]	410,890	2,908	20,256	3,830	437,884
Equity lines	53,870	465	251	651	55,237
Consumer	12,693	3	322	—	13,018
	$ 702,198	$ 4,611	$ 23,664	$ 5,311	$ 735,784

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	$ 291,240	$ 764	$ 292,004

[1] At December 31, 2017, the Corporation did not have any loans classified as Doubtful or Loss.

[2] Includes the Corporation's real estate construction lending and consumer real estate lot lending.

[3] Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

The retail banking segment allowance for loan losses as a percentage of total loans, excluding PCI loans, declined to 1.37 percent at December 31, 2018, compared to 1.48 percent at December 31, 2017, because of a decrease in the allowance related to impaired loans, loan growth during 2018 and overall better credit quality. We believe that the current level of the allowance for loan losses at the retail banking segment is adequate to absorb probable losses inherent in the loan portfolio, based on the relevant history of charge-offs and recoveries, current economic conditions, overall portfolio quality and review of specific criticized loans. If loan concentrations within the retail banking segment's loan portfolio result in higher credit risk or if economic conditions deteriorate in future periods, a higher level of nonperforming loans may be experienced, which may then require a higher provision for loan losses.

The consumer finance segment's allowance for loan losses decreased by $1.4 million to $23.0 million at December 31, 2018 from $24.4 million at December 31, 2017, and its provision for loan losses decreased $5.3 million for the year ended December 31, 2018, as compared to 2017. The decrease in the allowance and the lower provision resulted primarily from C&F Finance purchasing loan contracts with higher credit metrics beginning in 2016, which has led to an overall improvement in the credit quality of the portfolio and lower charge-offs. Delinquent loans as a percentage of total loans decreased to 4.76 percent at December 31, 2018 from 5.17 percent at December 31, 2017 and the net charge-off ratio for 2018 decreased to 4.14 percent from 5.82 percent for 2017. The allowance for loan losses as a percentage of loans decreased to 7.77 percent at December 31, 2018, compared to 8.34 percent at December 31, 2017, primarily as a result of lower net charge-offs on non-prime automobile loans and the purchase of prime marine and RV loans beginning in 2018, which require a lower allowance for loan losses. Management expects the marine and RV loan contracts purchased by the consumer finance segment beginning in the first quarter of 2018, which are contracts for prime loans made to borrowers with higher credit scores, to require both a lower provision for loan losses and allowance for loan losses than the consumer finance segment's non-prime automobile loans, contributing to a decrease in the overall level of the consumer finance segment's allowance for loan losses as a percentage of total loans. At December 31, 2018, compared to December 31, 2017, the higher composition within the consumer finance segment's loan portfolio of marine and RV loans accounted for 28 basis points of the 57 basis points decrease in this ratio.

As previously described, the consumer finance segment, at times, offers payment deferrals to non-prime automobile borrowers as a management technique to achieve higher ultimate cash collections on select loan accounts. Payment deferrals may affect the ultimate timing of when an account is charged off. A significant reliance on deferrals as a means of managing collections may result in a lengthening of the loss confirmation period, which would increase expectations of credit losses inherent in the portfolio. The average amounts deferred on a monthly basis, as a percentage of average non-prime automobile loans outstanding was 2.30 percent in 2018, 2.57 percent in 2017 and 2.21 percent in 2016.

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Because C&F Finance primarily focuses on non-prime borrowers, the anticipated rates of delinquencies, defaults, repossessions and losses on the consumer finance loans are higher than those experienced in the general automobile finance industry and could be more dramatically affected by a general economic downturn. These periods also may be accompanied by decreased consumer demand for used automobiles and declining values of automobiles securing outstanding loans, which weakens collateral coverage and increases the amount of a loss in the event of default. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed automobiles or delay the timing of these sales. While we manage the higher risk inherent in loans made to non-prime borrowers through the underwriting criteria, portfolio management and collection methods employed by C&F Finance, we cannot guarantee that these criteria or methods will afford adequate protection against these risks. However, we believe that the current allowance for loan losses is adequate to absorb probable losses on existing consumer finance segment loans that may become uncollectible. If factors influencing the consumer finance segment result in higher net charge-off ratios in future periods, the consumer finance segment may need to increase the level of its allowance for loan losses through additional provisions for loan losses, which could negatively affect future earnings of the consumer finance segment.

Nonperforming Assets

A loan's past due status is based on the contractual due date of the most delinquent payment due. Loans are generally placed on nonaccrual status when the collection of principal or interest is 90 days or more past due, or earlier, if collection is uncertain based on an evaluation of the net realizable value of the collateral and the financial strength of the borrower. Loans greater than 90 days past due may remain on accrual status if management determines it has adequate collateral to cover the principal and interest. For those loans that are carried on nonaccrual status, payments are first applied to principal outstanding. A loan may be returned to accrual status if the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms of the loan and there is reasonable assurance the borrower will continue to make payments as agreed. These policies are applied consistently across our loan portfolio.

Assets acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of like properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. We may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations indicate a further deterioration in market conditions. Revenue and expenses from operations and changes in the property valuations are included in net expenses from foreclosed assets and improvements are capitalized.

At the consumer finance segment, the repossession process is generally initiated after a loan becomes more than 60 days delinquent. Borrowers have an opportunity to redeem their repossessed vehicles by paying all outstanding balances, including finance charges and fees. Vehicles that are not redeemed within the prescribed waiting period

before C&F Finance has the legal right to sell the repossessed vehicle then become available-for-sale at the end of that period and are reclassified from loans to other assets and are recorded initially at fair value less estimated costs to sell. The difference between the carrying amount of each loan and the fair value of the vehicle (i.e. the deficiency) is charged against the allowance for loan losses. Accounts still in process of collection or for which the Corporation does not have the legal right to sell continue to be classified as loans until such legal authority is obtained. After the vehicles have been sold in third-party auctions, we credit the proceeds from the sale of the vehicles, and any other recoveries, to the carrying value of the repossessed vehicles. C&F Finance pursues collection of deficiencies, as allowed by state law, when it deems such action to be appropriate.

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Table 8 summarizes nonperforming assets at December 31 of each of the past five years.

TABLE 8: Nonperforming Assets

Retail Banking Segment

(Dollars in thousands)	2018	2017	2016	2015	2014
Loans, excluding purchased loans	$ 723,778	$ 686,605	$ 629,523	$ 525,283	$ 447,614
Purchased performing loans1	36,874	42,793	53,329	67,022	80,146
Purchased credit impaired loans1	1,835	3,103	9,256	13,908	21,424
Total loans	$ 762,487	$ 732,501	$ 692,108	$ 606,213	$ 549,184
Nonaccrual loans2	$ 1,464	$ 5,272	$ 4,235	$ 6,157	$ 4,717
OREO	246	168	195	942	786
Total nonperforming assets	$ 1,710	$ 5,440	$ 4,430	$ 7,099	$ 5,503
Accruing loans past due for 90 days or more	$ 324	$ 306	$ 6	$ 761	$ 14
Troubled debt-restructurings (TDRs)2	$ 5,451	$ 10,896	$ 5,825	$ 5,344	$ 5,827
Allowance for loan losses (ALL)	$ 10,426	$ 10,775	$ 11,115	$ 11,017	$ 10,961
Nonperforming assets to total loans and OREO	0.22 %	0.74 %	0.64 %	1.17 %	1.00 %
ALL to total loans, excluding purchased credit impaired loans	1.37	1.48	1.63	1.86	2.08
ALL to total nonaccrual loans	712.16	204.38	262.46	178.93	232.37
Net (recoveries) charge-offs to average total loans	0.06	0.08	(0.02)	(0.01)	0.06

[1] Acquired loans are tracked in two separate categories – “purchased performing” and “purchased credit impaired.” The remaining discount for the purchased performing loans was $1.9 million at December 31, 2018, $2.3 million at December 31, 2017, $2.9 million at December 31, 2016, $4.0 million at December 31, 2015 and $4.9 million at December 31, 2014. The remaining discount for the purchased credit impaired loans was $7.9 million at December 31, 2018, $9.8 million at December 31, 2017, $10.5 million at December 31, 2016, $11.8 million at December 31, 2015 and $15.1 million at December 31, 2014.

[2] Nonaccrual loans include nonaccrual TDRs of $166,000 at December 31, 2018, $3.9 million at December 31, 2017, $2.0 million at December 31, 2016, $2.5 million at December 31, 2015 and $2.0 million at December 31, 2014.

Mortgage Banking Segment

(Dollars in thousands)	2018	2017	2016	2015	2014
Nonaccrual loans	$ 37	$ 39	$ 41	$ —	$ 187
Total loans	$ 3,479	$ 3,283	$ 3,275	$ 3,493	$ 3,288
Allowance for loan losses	$ 598	$ 598	$ 598	$ 598	$ 553
Nonaccrual loans to total loans	1.06 %	1.19 %	1.25 %	— %	5.69 %
Allowance for loan losses to total loans	17.19	18.22	18.26	17.12	16.82

Consumer Finance Segment

(Dollars in thousands)	2018	2017	2016	2015	2014
Nonaccrual loans	$ 712	$ 764	$ 1,215	$ 1,321	$ 1,040
Accruing loans past due for 90 days or more	$ —	$ —	$ —	$ —	$ —
Repossessed assets	$ 371	$ 250	$ 580	$ 392	$ 312
Total loans	$ 296,154	$ 292,004	$ 304,357	$ 293,480	$ 283,333
Allowance for loan losses	$ 22,999	$ 24,353	$ 25,353	$ 23,954	$ 24,092
Nonaccrual loans to total loans	0.24 %	0.26 %	0.40 %	0.28 %	0.37 %
Allowance for loan losses to total loans	7.77	8.34	8.33	8.21	8.50
Net charge-offs to average total loans	4.14	5.82	5.55	5.50	5.39

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Table 9 presents the changes in the OREO balance for 2018 and 2017.

TABLE 9: OREO Changes

	Year Ended December 31,	
(Dollars in thousands)	2018	2017
Balance at the beginning of year, gross	$ 225	$ 281
Transfers between loans and other real estate owned	98	208
Charge-offs	—	(29)
Sales proceeds	(18)	(245)
(Loss) gain on disposition	(2)	10
Balance at the end of year, gross	303	225
Less valuation allowance	(57)	(57)
Balance at the end of year, net	$ 246	$ 168

Nonperforming assets of the retail banking segment totaled $1.7 million at December 31, 2018, compared to $5.4 million at December 31, 2017. Nonperforming assets at December 31, 2018 consisted primarily of $1.5 million in nonaccrual loans, compared to $5.3 million at December 31, 2017. The decline in nonaccrual loans during 2018 resulted primarily from the resolution of one commercial relationship that had a total carrying amount at December 31, 2017 of $3.80 million.

Nonaccrual loans at the consumer finance segment decreased to $712,000 at December 31, 2018 from $764,000 at December 31, 2017. As noted above, the allowance for loan losses at the consumer finance segment decreased from $24.4 million at December 31, 2017 to $23.0 million at December 31, 2018, and the ratio of the allowance for loan losses to total consumer finance loans was 7.77 percent as of December 31, 2018, compared to 8.34 percent at December 31, 2017. Nonaccrual consumer finance loans remain low relative to the allowance for loan losses and the total consumer finance loan portfolio because the consumer finance segment generally initiates repossession of loan collateral once a loan becomes more than 60 days delinquent. Repossessed vehicles of the consumer finance segment are classified as other assets and consist only of vehicles the Corporation has the legal right to sell. Prior to the reclassification from loans to repossessed vehicles, the difference between the carrying amount of each loan and the fair value of each vehicle (i.e. the deficiency) is charged against the allowance for loan losses. At December 31, 2018, repossessed vehicles at fair value less estimated costs to sell included in other assets totaled $371,000, compared to $250,000 at December 31, 2017.

If interest on nonaccrual loans had been recognized, we would have recorded additional gross interest income of $325,000 for 2018, $462,000 for 2017, and $304,000 for 2016. Interest received on nonaccrual loans was $384,000 for 2018, $89,000 in 2017, $247,000 in 2016.

As discussed above, we measure impaired loans either based on fair value of the loan using the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent, or using the present value of expected future cash flows discounted at the loan's effective interest rate. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. TDRs occur when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. These concessions typically are made for loss mitigation purposes and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs are considered impaired loans.

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Impaired loans, which included TDRs of $5.45 million, and the related allowance at December 31, 2018, were as follows:

TABLE 10A: Impaired Loans

(Dollars in thousands)	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	$ 3,057	$ 1,288	$ 1,677	$ 92	$ 3,056	$ 142
Commercial, financial and agricultural:						
Commercial real estate lending	2,468	1,498	927	10	2,653	132
Commercial business lending	33	25	—	—	26	—
Equity lines	365	31	326	326	359	2
Consumer	5	—	5	—	5	—
Total	$ 5,928	$ 2,842	$ 2,935	$ 428	$ 6,099	$ 276

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2017, were as follows:

TABLE 10B: Impaired Loans

(Dollars in thousands)	Unpaid Principal Balance	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	$ 3,745	$ 1,603	$ 2,033	$ 214	$ 3,743	$ 184
Commercial, financial and agricultural:						
Commercial real estate lending	6,981	2,841	4,031	615	7,818	168

Commercial business lending	41	35	—	—	45	—
Equity lines	32	31	—	—	32	2
Consumer	321	322	—	—	321	13
Total	$ 11,120	$ 4,832	$ 6,064	$ 829	$ 11,959	$ 367

TDRs at December 31, 2018 and 2017 were as follows:

TABLE 11: Troubled Debt Restructurings

(Dollars in thousands)	December 31, 2018	December 31, 2017
Accruing TDRs	$ 5,285	$ 7,015
Nonaccrual TDRs1	166	3,881
Total TDRs2	$ 5,451	$ 10,896

[1] Included in nonaccrual loans in Table 8: Nonperforming Assets.
[2] Included in impaired loans in Tables 10A and 10B: Impaired Loans.

The decrease in impaired loans during 2018 consisted primarily of the resolution of one commercial relationship that had a total carrying amount at December 31, 2017 of $3.80 million. While TDRs are considered impaired loans, not all TDRs are on nonaccrual status. If a loan was on nonaccrual status at the time of the TDR modification, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on the Corporation’s policy for returning loans to accrual status. If a loan was accruing prior to being modified as a TDR and if management concludes that the borrower is able to make such modified payments, and there are no other factors or circumstances that would cause management to conclude otherwise, the TDR will remain on an accruing status.

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FINANCIAL CONDITION

SUMMARY

A financial institution's primary sources of revenue are generated by its earning assets and sales of financial assets, while its major expenses are produced by the funding of those assets with interest-bearing liabilities, provisions for loan losses and compensation to employees. Effective management of these sources and uses of funds is essential in attaining a financial institution's maximum profitability while maintaining an acceptable level of risk.

At December 31, 2018, the Corporation had total assets of $1.52 billion compared to $1.51 billion at December 31, 2017. The significant components of the Corporation's Consolidated Balance Sheets are discussed below.

LOAN PORTFOLIO

General

Through the retail banking segment, we engage in a wide range of lending activities, which include the origination, primarily in the retail banking segment's market area, of (1) one-to-four family and multi-family residential mortgage loans, (2) commercial real estate loans, (3) construction loans, (4) land acquisition and development loans, (5) consumer loans and (6) commercial business loans. We engage in non-prime automobile, and marine and RV lending through the consumer finance segment and in residential mortgage lending through the mortgage banking segment with substantially all of the loans originated through the mortgage banking segment sold to third-party investors. At December 31, 2018, the Corporation's loans held for investment in all categories, net of the allowance for loan losses, totaled $1.0 billion and loans held for sale had a fair value of $41.9 million.

Tables 12 and 13 present information pertaining to the composition of loans held for investment and the maturity/repricing of certain loans held for investment.

TABLE 12: Summary of Loans Held for Investment

	December 31,				
(Dollars in thousands)	2018	2017	2016	2015	2014
Real estate—residential mortgage	$ 184,901	$ 184,863	$ 188,264	$ 186,763	$ 179,817
Real estate—construction [1]	54,461	44,782	55,732	7,759	7,325
Commercial, financial, and agricultural [2]	455,935	437,884	390,388	356,062	306,845
Equity lines	55,660	55,237	52,600	50,111	50,321
Consumer	15,009	13,018	8,399	9,011	8,163
Consumer finance	296,154	292,004	304,357	291,755	283,333
Total loans	1,062,120	1,027,788	999,740	901,461	835,804
Less allowance for loan losses	(34,023)	(35,726)	(37,066)	(35,569)	(35,606)
Total loans, net	$ 1,028,097	$ 992,062	$ 962,674	$ 865,892	$ 800,198

[1] Includes the Corporation’s real estate construction lending and consumer real estate lot lending.

[2] Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

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TABLE 13: Maturity/Repricing Schedule of Loans Held for Investment

	December 31, 2018	
(Dollars in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction
Variable Rate:		
Within 1 year	$ 135,775	$ —
1 to 5 years	90,440	242
After 5 years	27,730	28,905
Fixed Rate:		
Within 1 year	$ 43,830	$ 2,703
1 to 5 years	63,420	—
After 5 years	94,740	22,611

The increase in total loans from December 31, 2017 to December 31, 2018 was primarily due to commercial and construction loan growth at the retail banking segment resulting from additions of experienced lenders to our commercial lending team over the past several years and demand for commercial lending in our established markets, as well as expansion into new markets.

Total loans at December 31, 2018 and 2017 included loans purchased in connection with the Corporation's acquisition of CVB on October 1, 2013. These loans were recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses. On the date of acquisition, the Corporation acquired PCI loans with a fair value of $35.3 million and purchased performing loans with a fair value of $111.8 million. The following tables present the outstanding principal balance and the carrying amount of purchased loans that are included in the Corporation's Consolidated Balance Sheets at December 31, 2018 and 2017.

TABLE 14: PCI and Purchased Performing Loans

December 31, 2018	
Purchased Credit	Purchased

(Dollars in thousands)	Impaired	Performing	Total
Outstanding principal balance	$ 9,734	$ 38,768	$ 48,502
Carrying amount			
Real estate – residential mortgage	$ 284	$ 8,823	$ 9,107
Commercial, financial and agricultural	1,461	18,982	20,443
Equity lines	90	9,063	9,153
Consumer	—	6	6
Total acquired loans	$ 1,835	$ 36,874	$ 38,709

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	December 31, 2017		
(Dollars in thousands)	Purchased Credit Impaired	Purchased Performing	Total
Outstanding principal balance	$ 12,856	$ 45,083	$ 57,939
Carrying amount			
Real estate – residential mortgage	$ 492	$ 10,855	$ 11,347
Commercial, financial and agricultural	2,472	22,305	24,777
Equity lines	139	9,621	9,760
Consumer	—	12	12
Total acquired loans	$ 3,103	$ 42,793	$ 45,896

For a description of the Corporation's accounting for purchased performing and PCI loans, see "Critical Accounting Policies" in this Item 7.

Credit Policy

The Corporation's credit policy establishes minimum requirements and provides for appropriate limitations on overall concentration of credit within the Corporation. The policy provides guidance in general credit policies, underwriting policies and risk management, credit approval, and administrative and problem asset management policies. The overall goal of the Corporation's credit policy is to ensure that loan growth is accompanied by acceptable asset quality with uniform and consistently applied approval, administration, and documentation practices and standards.

Residential Mortgage Lending – Held for Sale

The mortgage banking segment's guidelines for underwriting conventional conforming loans comply with the underwriting criteria established by Fannie Mae, Freddie Mac and/or the applicable third party investor. The guidelines for non-conforming conventional loans are based on the requirements of private investors and information provided by third-party investors. The guidelines used by C&F Mortgage to originate FHA-insured, USDA-guaranteed and VA-guaranteed loans comply with the criteria established by HUD, the USDA, the VA and/or the applicable third party investor. The conventional loans that C&F Mortgage originates that have loan-to-value ratios greater than 80 percent at origination are generally insured by private mortgage insurance.

Residential Mortgage Lending – Held for Investment

The retail banking segment originates residential mortgage loans secured by first and second liens on properties located in its primary market area in the Hampton to Charlottesville corridor in Virginia. The Bank offers various types of residential first mortgage loans in addition to traditional long-term, fixed-rate loans. The majority of such loans include 10, 15 and 30 year amortizing mortgage loans with fixed rates of interest and fixed-rate mortgage loans with terms of 20, 25 and 30 years but subject to call after five years at the Bank’s option. Second mortgage loans are offered with fixed and adjustable rates. Second mortgage loans are granted for a fixed period of time, usually between 5 and 20 years. Call option provisions are included in the loan documents for some longer-term, fixed-rate second mortgage loans, and these provisions allow the Bank to make interest rate adjustments for such loans.

Loans associated with residential mortgage lending are included in the real estate—residential mortgage category in Table 12: Summary of Loans Held for Investment.

Construction Lending

The retail banking segment has a real estate construction lending program. We make loans primarily for the construction of one-to-four family residences and, to a lesser extent, multi-family dwellings. The Bank also makes construction loans for office and warehouse facilities and other nonresidential projects, generally limited to borrowers that present other business opportunities for the retail banking segment.

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The amounts, interest rates and terms for construction loans vary, depending upon market conditions, the size and complexity of the project, and the financial strength of the borrower and any guarantors of the loan. The term for a typical construction loan ranges from 9 months to 15 months for the construction of an individual residence and from 15 months to a maximum of 3 years for larger residential or commercial projects. We do not typically amortize construction loans, and the borrower pays interest monthly on the outstanding principal balance of the loan. The Bank offers fixed and variable interest rates on construction loans. We do not generally finance the construction of commercial real estate projects built on a speculative basis. For residential builder loans, we limit the number of models and/or speculative units allowed depending on market conditions, the builder’s financial strength and track record and other factors. Generally, the maximum loan-to-value ratio for one-to-four family residential construction loans is 80 percent of the property’s fair market value, or 85 percent of the property’s fair market value if the property will be the borrower’s primary residence. The fair market value of a project is determined on the basis of an appraisal of the project conducted by an appraiser approved by the Bank. For larger projects where unit absorption or leasing is a concern, we may also obtain a feasibility study or other acceptable information from the borrower or other sources about the likely disposition of the property following the completion of construction.

Construction loans for nonresidential projects and multi-unit residential projects are generally larger and involve a greater degree of risk to the Bank than residential mortgage loans. We attempt to minimize such risks (1) by making construction loans in accordance with our underwriting standards and to established customers in our primary market area and (2) by monitoring the quality, progress and cost of construction. Generally, our maximum loan-to-value ratio for non-residential projects and multi-unit residential projects is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis.

Loans associated with construction lending are included in the real estate—construction category in Table 12: Summary of Loans Held for Investment.

Consumer Lot Lending

The retail banking segment’s consumer lot loans are made to individuals for the purpose of acquiring an unimproved building site for the construction of a residence that generally will be occupied by the borrower. Consumer lot loans are made only to individual borrowers, and each borrower generally must certify his or her intention to build and occupy a single-family residence on the lot. These loans typically have a maximum term of either three or five years with a balloon payment of the entire balance of the loan being due in full at the end of the initial term. The interest rate for these loans is fixed or variable at a rate that is slightly higher than prevailing rates for one-to-four family residential mortgage loans. We do not believe consumer lot loans bear as much risk as land acquisition and development loans because such loans are not made for the construction of residences for immediate resale, are not made to developers and builders, and are not concentrated in any one subdivision or community.

Loans associated with consumer lot lending are included in the real estate—construction category in Table 12: Summary of Loans Held for Investment.

Commercial Real Estate Lending

The retail banking segment's commercial real estate loans are primarily secured by the value of real property. The proceeds of commercial real estate loans are generally used by the borrower to finance or refinance the cost of acquiring and/or improving a commercial property. The properties that typically secure these loans are office and warehouse facilities, hotels, apartment complexes, retail facilities, restaurants and other commercial properties. Present policy authorizes commercial real estate loans to borrowers who will occupy or use the financed property in connection with their normal business operations. We also will consider making commercial real estate loans secured by non-owner-occupied properties under the following two conditions: (1) the borrower is in strong financial condition and presents a substantial business opportunity for the Corporation and (2) the borrower has substantially pre-leased the property to high-caliber tenants.

Our commercial real estate loans are usually amortized over a period of time ranging from 15 years to 25 years and usually have a term to maturity ranging from 5 years to 15 years. These loans normally have provisions for interest rate

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adjustments after the loan is three to five years old. The maximum loan-to-value ratio for a commercial real estate loan is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis. Most commercial real estate loans are further secured by one or more unconditional personal guarantees.

In recent years, we have structured a portion of our commercial real estate loans as mini-permanent loans. The amortization period, term and interest rates for these loans vary based on borrower preferences and our assessment of the loan and the degree of risk involved. If the borrower prefers a fixed rate of interest, we usually offer a loan with a fixed rate of interest for a term of 3 to 10 years with an amortization period of up to 25 years. The remaining balance of the loan is due and payable in a single balloon payment at the end of the initial term. We believe these loan terms provide some protection from changes in the borrower's business and income as well as changes in general economic conditions. In the case of fixed-rate commercial real estate loans, shorter maturities also provide an opportunity to adjust the interest rate on this type of interest-earning asset in accordance with our asset and liability management strategies. Certain commercial customers qualify for participation in an interest rate swap program. This program provides flexible pricing structures for our larger borrowers who wish to pay a fixed rate of interest, while preserving a floating rate for the Bank, which protects C&F Bank from exposure to rising interest rates.

Loans secured by commercial real estate are generally larger and involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate are usually dependent on successful operation or management of the properties securing such loans, repayment of such loans is subject to changes in both general and local economic conditions and the borrower's business and income. As a result, events beyond our control, such as a downturn in the local economy, could adversely affect the performance of the commercial real estate loan portfolio. We seek to minimize these risks by lending to established customers and generally restricting our commercial real estate loans to our primary market area. Emphasis is placed on the income producing characteristics and quality of the collateral.

Loans associated with commercial real estate lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Land Acquisition and Development Lending

The retail banking segment makes land acquisition and development loans to builders and developers for the purpose of acquiring unimproved land to be developed for residential building sites, residential housing subdivisions, multi-family dwellings and a variety of commercial uses. Our policy is to make land acquisition loans to borrowers for the purpose of acquiring developed lots for single-family, townhouse or condominium construction. We will make both land acquisition and development loans to residential builders, experienced developers and others in strong financial condition to provide additional construction and mortgage lending opportunities for the Bank.

We underwrite and process land acquisition and development loans in much the same manner as commercial construction loans and commercial real estate loans. For land acquisition and development loans, we use lower loan-to-value ratios, which are a maximum of 65 percent for raw land, 75 percent for land development and improved lots and 80 percent of the discounted appraised value of the property as determined in accordance with the appraisal policies for developed lots for single-family or townhouse construction. We can waive the maximum loan-to-value ratio for particularly strong borrowers on an exception basis. The term of land acquisition and development loans ranges from a maximum of two years for loans relating to the acquisition of unimproved land to, generally, a maximum of three years for other types of projects. All land acquisition and development loans generally are further secured by one or more unconditional personal guarantees. Because these loans are usually larger in amount and involve more risk than consumer lot loans, we carefully evaluate the borrower's assumptions and projections about market conditions and absorption rates in the community in which the property is located and the borrower's ability to carry the loan if the borrower's assumptions prove inaccurate.

Loans associated with land acquisition and development lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

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Builder Line Lending

The retail banking segment offers builder lines of credit to residential home builders to support their land and lot inventory needs. A construction loan facility for a builder will typically have an expiration of 12 months or less. Each loan that is made under the master loan facility will have a stated maturity that allows time for the residential unit to be constructed and sold to a homebuyer under prevailing market conditions. Specific terms vary based on the purpose of the loan (e.g., lot inventory, spec or non pre-sold units, pre-sold units) and previous sales activity to new homebuyers in the particular development. Repayment relies upon the successful performance of the underlying residential real estate project. This type of lending carries a higher level of risk related to residential real estate market conditions, a functioning first and secondary market in which to sell residential properties, and the borrower’s ability to manage inventory and run projects. We manage this risk by lending to experienced builders and by using specific underwriting policies and procedures for these types of loans.

Loans associated with builder line lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Commercial Business Lending

The retail banking segment’s commercial business loan products include revolving lines of credit to provide working capital, term loans to finance the purchase of vehicles and equipment, letters of credit to guarantee payment and performance, and other commercial loans. In general, these credit facilities carry the unconditional guaranty of the owners and/or stockholders.

Revolving and operating lines of credit are typically secured by all current assets of the borrower, provide for the acceleration of repayment upon any event of default, are monitored monthly or quarterly to ensure compliance with loan covenants, and are re-underwritten or renewed annually. Interest rates generally will float at a spread tied to the Bank’s prime lending rate. Term loans are generally advanced for the purchase of, and are secured by, vehicles and equipment and are normally fully amortized over a term of two to five years, on either a fixed or floating rate basis.

Loans associated with commercial business lending are included in the commercial, financial and agricultural category in Table 12: Summary of Loans Held for Investment.

Equity Line Lending

The retail banking segment offers its customers home equity lines of credit that enable customers to borrow funds secured by the equity in their homes. Currently, home equity lines of credit are offered with adjustable rates of interest that are generally priced at a spread to the prime lending rate. Home equity lines of credit are made on an open-end, revolving basis. Home equity loans generally do not present as much risk to the Bank as other types of consumer loans. These loans must satisfy our underwriting criteria, including loan-to-value and credit score guidelines.

Loans associated with equity line lending are included in the equity lines category in Table 12: Summary of Loans Held for Investment.

Consumer Lending

The retail banking segment offers a variety of consumer loans, including automobile, personal secured and unsecured, and loans secured by savings accounts or certificates of deposit. The shorter terms and generally higher interest rates on consumer loans help the Bank maintain a profitable spread between its average loan yield and its cost of funds. Consumer loans secured by collateral other than a personal residence generally involve more credit risk than residential mortgage loans because of the type and nature of the collateral or, in certain cases, the absence of collateral. However, we believe the higher yields generally earned on such loans compensate for the increased credit risk associated with such loans. These loans must satisfy our underwriting criteria, including loan-to-value, debt ratio and credit score guidelines.

Loans associated with consumer lending are included in the consumer category in Table 12: Summary of Loans Held for Investment.

Consumer Finance

The consumer finance segment has an extensive automobile dealer network through which it purchases installment contracts throughout its markets. Credit approval is centralized in two locations, which along with the application processing system, ensures that contract purchase decisions comply with C&F Finance’s underwriting policies and procedures.

Finance contract application packages completed by prospective borrowers are submitted by the automobile dealers electronically through a third-party online automotive sales and finance platform to C&F Finance’s automated origination and application system, which processes the credit bureau report, generates all relevant loan calculations and displays the requested contract structure. C&F Finance personnel with credit authority review the transaction and determine whether to approve or deny the purchase of the contract. The purchase decision is based primarily on the applicant’s credit history with emphasis on prior auto loan history, current employment status, income, collateral type and mileage, and the loan-to-value ratio. In 2016, C&F Finance implemented a scorecard model that improved underwriting and pricing efficiencies.

The consumer finance segment’s underwriting and collateral guidelines form the basis for the purchase decision. Exceptions to credit policies and authorities must be approved by a designated credit officer. C&F Finance’s typical automobile customers have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, we expect C&F Finance to sustain a higher level of credit losses in the automobile portfolio than traditional financing sources. However, C&F Finance generally purchases these contracts with interest at higher rates than those charged by traditional financing sources. These higher rates should more than offset the increase in the provision for loan losses for this segment of the Corporation’s loan portfolio.

In addition to purchasing automobile contracts through a dealer network, C&F Finance began purchasing marine and RV contracts, also on an indirect basis, through a third party provider in 2018. While the approval process is generally the same as the automobile approval process described above, borrowers on marine and RV contracts purchased by C&F Finance have not had prior credit issues and these contracts are considered prime. The rates charged on these loans are significantly less than the automobile portfolio with a much lower expected level of credit losses.

Loans associated with automobile sales finance are included in the consumer finance category in Table 12: Summary of Loans Held for Investment.

SECURITIES

The investment portfolio plays a primary role in the management of the Corporation's interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, increases in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At December 31, 2018 and 2017, all securities in the Corporation's investment portfolio were classified as available for sale.

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Table 15 sets forth the composition of the Corporation's securities available for sale in dollar amounts at fair value and as a percentage of the Corporation's total securities available for sale at the dates indicated.

TABLE 15: Securities Available for Sale

	December 31, 2018		December 31, 2017	
(Dollars in thousands)	Amount	Percent	Amount	Percent
U.S. government agencies and corporations	$ 17,473	8 %	$ 16,173	8 %
Mortgage-backed securities	104,983	49	97,058	44
Obligations of states and political subdivisions	92,454	43	105,745	48
Total available for sale securities at fair value	$ 214,910	100 %	$ 218,976	100 %

The Corporation seeks to diversify its portfolio to minimize risk, including by purchasing (1) shorter-duration mortgage-backed securities to reduce interest rate risk and for cash flow and reinvestment opportunities and (2) securities issued by states and political subdivisions due to the tax benefits and the higher tax-adjusted yield obtained from these securities. All of the Corporation's mortgage-backed securities are direct issues of United States government agencies or government-sponsored enterprises. At December 31, 2018, approximately 96 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated "A" or better by Standard & Poor's or Moody's Investors Service.

Table 16 presents additional information pertaining to the composition of the securities portfolio at December 31, at amortized cost, by the earlier of contractual maturity or expected maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

TABLE 16: Maturity of Securities

	Year Ended December 31,					
	2018		2017		2016	
(Dollars in thousands)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield

U.S. government agencies and corporations:											
Maturing within 1 year	$	7,266	2.47	%	$	6,770	2.23	%	$	7,032	1.61	%
Maturing after 1 year, but within 5 years		6,596	2.08			3,099	1.88			1,849	1.65	
Maturing after 5 years, but within 10 years		4,146	2.17			6,645	2.10			7,645	2.04	
Total U.S. government agencies and corporations		18,008	2.26			16,514	2.11			16,526	1.81	
Mortgage-backed securities:												
Maturing within 1 year		126	4.95			77	4.36			304	1.96	
Maturing after 1 year, but within 5 years		102,127	2.35			97,061	2.10			71,740	2.03	
Maturing after 5 years, but within 10 years		2,791	2.36			537	3.19			3,890	2.87	
Maturing after 10 years		1,743	3.02			2	3.25			1,276	2.72	
Total mortgage-backed securities		106,787	2.36			97,677	2.11			77,210	2.08	
States and municipals:1												
Maturing within 1 year		41,510	3.89			33,398	5.09			20,703	5.03	
Maturing after 1 year, but within 5 years		41,258	3.17			59,285	4.04			75,898	4.54	
Maturing after 5 years, but within 10 years		7,401	5.45			8,072	6.32			10,587	5.77	
Maturing after 10 years		1,686	4.52			3,222	5.52			6,969	6.11	
Total states and municipals		91,855	3.71			103,977	4.60			114,157	4.84	
Total securities:												
Maturing within 1 year		48,902	3.68			40,245	4.61			28,039	4.14	
Maturing after 1 year, but within 5 years		149,981	2.56			159,445	2.82			149,487	3.30	
Maturing after 5 years, but within 10 years		14,338	3.90			15,254	4.37			22,122	3.97	
Maturing after 10 years		3,429	3.76			3,224	5.52			8,245	5.59	
Total securities	$	216,650	2.92	%	$	218,168	3.30	%	$	207,893	3.58	%

1. Yields on tax-exempt securities have been computed on a taxable-equivalent basis using the federal corporate income tax rate of 21 percent for the year ended December 31, 2018 and 34 percent for the years ended December 31, 2017 and 2016.

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DEPOSITS

The Corporation's predominant source of funds is depository accounts, which are comprised of demand deposits, savings and money market accounts, and time deposits. The Corporation's deposits are principally provided by individuals and businesses located within the communities served.

Deposits totaled $1.18 billion at December 31, 2018, compared to $1.17 billion at December 31, 2017. This increase primarily consisted of a $23.7 million increase in non-interest bearing demand deposits offset by a decrease of $12.1 million in savings, money market and interest-bearing demand deposits, which reflects our continued focus on attracting non-interest bearing deposits as a core funding source and continued competition for interest-bearing deposits as rates have continued to rise.

The Corporation had $2.4 million in brokered money market deposits outstanding at December 31, 2018, compared to $3.3 million in brokered money market deposits at December 31, 2017. The source of these brokered deposits is uninvested cash balances held in third-party brokerage sweep accounts. The Corporation uses brokered deposits as a means of diversifying liquidity sources, as opposed to a long-term deposit gathering strategy.

Table 17 presents the average deposit balances and average rates paid for the years 2018, 2017 and 2016.

TABLE 17: Average Deposits and Rates Paid

	Year Ended December 31,								
	2018			2017			2016		
(Dollars in thousands)	Average Balance	Average Rate		Average Balance	Average Rate		Average Balance	Average Rate	
Noninterest-bearing demand deposits	$ 266,415			$ 236,937			$ 210,520		
Interest-bearing transaction accounts	221,750	0.36	%	215,627	0.22	%	211,441	0.22	%
Money market deposit accounts	215,662	0.32		221,279	0.27		213,793	0.27	
Savings accounts	116,896	0.09		109,789	0.08		102,899	0.08	

Certificates of deposit, $100 thousand or more	172,616	1.28		163,100	1.13		142,115	1.04	
Other certificates of deposit	177,279	1.06		181,746	0.95		198,061	0.91	
Total interest-bearing deposits	904,203	0.63	%	891,541	0.53	%	868,309	0.50	%
Total deposits	$ 1,170,618			$ 1,128,478			$ 1,078,829		

Table 18 details maturities of certificates of deposit with balances of $100,000 or more at December 31, 2018.

TABLE 18: Maturities of Certificates of Deposit with Balances of $100,000 or More

(Dollars in thousands)	December 31, 2018
3 months or less	$ 33,427
3-6 months	33,539
6-12 months	46,697
Over 12 months	58,110
Total	$ 171,773

BORROWINGS

In addition to deposits, the Corporation utilizes short-term and long-term borrowings as sources of funds. Short-term borrowings from the Federal Reserve Bank and the FHLB may be used to fund the Corporation's day-to-day operations. Short-term borrowings also include securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the day sold, as well as overnight unsecured fed funds lines with correspondent banks. Long-term borrowings consist of advances from the FHLB and advances under a non-recourse revolving bank line of credit. All FHLB advances are secured by a blanket floating lien on all of C&F Bank's qualifying closed-end and revolving open-end loans secured by 1-4 family residential properties. All Federal Reserve Bank advances are secured by loan-specific liens on certain qualifying loans of C&F Bank that are not otherwise pledged. The bank line of credit is non-recourse and is secured by loans at C&F Finance.

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In December, 2007, Trust II, a wholly-owned subsidiary of the Corporation, was formed for the purpose of issuing trust preferred capital securities for general corporate purposes including the refinancing of existing debt. On December 14, 2007, Trust II issued $10.0 million of trust preferred capital securities in a private placement to an institutional investor and $310,000 in common equity to the Corporation. The principal asset of Trust II is $10.3 million of the Corporation's trust preferred capital notes. In July 2005, Trust I, a wholly-owned subsidiary of the Corporation, was formed for the purpose of issuing trust preferred capital securities to partially fund the Corporation's purchase of 427,186 shares of its common stock. On July 21, 2005, Trust I issued $10.0 million of trust preferred capital securities in a private placement to an institutional investor and $310,000 in common equity to the Corporation. The principal asset of Trust I is $10.3 million of the Corporation's trust preferred capital notes. In December 2003, CVBK Trust I was formed for the purpose of issuing $5.0 million of trust preferred capital securities in private placements to institutional investors. The principal asset of CVBK Trust I is $5.2 million of trust preferred capital notes originally issued by CVBK and then assumed by the Corporation.

For further information concerning the Corporation's borrowings, refer to Item 8. "Financial Statements and Supplementary Data" under the heading "Note 9: Borrowings."

OFF-BALANCE-SHEET ARRANGEMENTS

To meet the financing needs of customers, the Corporation is a party, in the normal course of business, to financial instruments with off-balance-sheet risk. These financial instruments include commitments to extend credit, commitments to sell loans and standby letters of credit. These instruments involve elements of credit and interest rate risk in addition to the amount on the balance sheet. The Corporation'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 written is represented by the contractual amount of these instruments. We use the same credit policies in making these commitments and conditional obligations as we do for on-balance-sheet instruments. We obtain collateral based on our credit assessment of the customer in each circumstance.

Loan commitments are agreements to extend credit to a customer provided that there are no violations of the terms of the contract prior to funding. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The total amount of unused loan commitments was $244.2 million at December 31, 2018, and $224.5 million at December 31, 2017.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in

extending loans to customers. The total contract amount of standby letters of credit was $19.3 million at December 31, 2018 and $15.5 million at December 31, 2017.

At December 31, 2018, C&F Mortgage had interest rate lock commitments (or IRLCs) to originate mortgage loans aggregating $44.3 million and loans held for sale of $40.6 million. At December 31, 2018, each IRLC and loan held for sale by C&F Mortgage was subject to a forward sales agreement on a best efforts basis. C&F Mortgage enters into IRLCs with customers and will sell the underlying loans to investors on either a best efforts or a mandatory delivery basis. C&F Mortgage mitigates interest rate risk on IRLCs and loans held for sale by (a) entering into forward loan sales contracts with investors for loans to be delivered on a best efforts basis or (b) entering into forward sales contracts of mortgage-backed to-be-announced securities (TBAs) for loans to be delivered on a mandatory basis. Both the IRLCs with customers and the forward sales contracts are considered derivative financial instruments. At December 31, 2018, C&F Mortgage had best efforts forward sales contracts with a notional value of $84.9 million. The fair value of these derivative instruments at December 31, 2018 was $636,000, which was included in other assets. There were no loans to be delivered on a mandatory basis at December 31, 2018.

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party counterparties (i.e., investors). As is customary in the industry, the agreements with these counterparties require C&F Mortgage to extend representations and warranties with respect to lending program compliance, borrower misrepresentation, fraud, and early payment performance. Under the agreements, the counterparties are entitled to make loss claims and repurchase requests

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of C&F Mortgage for loans that contain covered deficiencies. C&F Mortgage has obtained early payment default recourse waivers for a significant portion of its business. Recourse periods for early payment default for the remaining counterparties vary from 90 days up to one year. Recourse periods for borrower misrepresentation or fraud, or underwriting error do not have a stated time limit. C&F Mortgage maintains an indemnification reserve for potential claims that, in management's judgment, will be adequate to absorb any losses arising from valid indemnification requests. Payments made under these recourse provisions were $350,000 in 2016. There were no payments made in 2018 and 2017. Payments made during 2016 primarily resulted from an agreement with a third-party counterparty that resolved all known and unknown indemnification obligations for loans sold to this counterparty prior to August 2016.

Risks also arise from the possible inability of counterparties to meet the terms of their contracts. C&F Mortgage has procedures in place to evaluate the credit risk of investors and does not expect any counterparty to fail to meet its obligations.

The Corporation uses derivatives to manage exposure to interest rate risk through the use of interest rate swaps. Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date with no exchange of underlying principal amounts.

The Corporation has interest rate swaps that qualify and are designated as cash flow hedges. The Corporation's cash flow hedges effectively modify the Corporation's exposure to interest rate risk by converting variable rates of interest on $10.0 million and $15.0 million of the Corporation's trust preferred capital notes to fixed rates of interest until September 2020 and December 2019, respectively. The cash flow hedges' total notional amount is $25.0 million. At December 31, 2018, the cash flow hedges had a fair value of $289,000, which is recorded in other assets. The net gain on the cash flow hedges is recognized as a component of other comprehensive income.

Pursuant to a program the Corporation initiated during 2016, the Corporation also enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Corporation simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net effect of these interest rate swaps and the related loans is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. At December 31, 2018, the total notional amount of the interest rate swaps related to these loans was $91.9 million, and the interest rate swaps had a net fair value of zero, with $1.6 million recognized in other assets and $1.6 million recognized in other liabilities. These swaps are not designated as hedging instruments; therefore, changes in fair value are recorded in other noninterest expense.

LIQUIDITY

The objective of the Corporation's liquidity management is to ensure the continuous availability of funds to satisfy the credit needs of our customers and the demands of our depositors, creditors and investors. Stable core deposits and a strong capital position are the components of a solid foundation for the Corporation's liquidity position. Additional sources of liquidity available to the Corporation include cash flows from operations, loan payments and payoffs, deposit growth, sales of securities, the issuance of brokered certificates of deposit and the capacity to borrow additional funds.

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks, federal funds sold and nonpledged securities available for sale, totaled $220.1 million at December 31, 2018. The Corporation's funding sources, including capacity, amount outstanding and amount available at December 31, 2018 are presented in Table 19.

TABLE 19: Funding Sources

	December 31, 2018		
(Dollars in thousands)	Capacity	Outstanding	Available
Unsecured federal funds agreements	$ 70,000		