

FIRST NATIONAL CORP /VA/
Form 10-Q
November 10, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2011

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: 0-23976

(Exact name of registrant as specified in its charter)

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Virginia (State or other jurisdiction of incorporation or organization)	54-1232965 (I.R.S. Employer Identification No.)
112 West King Street, Strasburg, Virginia (Address of principal executive offices)	22657 (Zip Code)
(540) 465-9121 (Registrant's telephone number, including area code)	

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input checked="" type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of November 9, 2011, 2,955,649 shares of common stock, par value \$1.25 per share, of the registrant were outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****FIRST NATIONAL CORPORATION****Consolidated Balance Sheets***(in thousands, except share and per share data)*

	(unaudited) September 30, 2011	December 31, 2010
Assets		
Cash and due from banks	\$ 6,409	\$ 5,048
Interest-bearing deposits in banks	16,316	10,949
Federal funds sold		7,500
Securities available for sale, at fair value	85,460	60,420
Restricted securities, at cost	2,889	3,153
Loans held for sale		271
Loans, net of allowance for loan losses, 2011, \$18,502, 2010, \$16,036	390,706	418,994
Other real estate owned, net of valuation allowance, 2011, \$3,999, 2010, \$3,341	5,576	3,961
Premises and equipment, net	19,657	20,302
Interest receivable	1,660	1,667
Other assets	12,848	12,364
Total assets	\$ 541,521	\$ 544,629
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	\$ 81,836	\$ 78,964
Savings and interest-bearing demand deposits	190,388	178,685
Time deposits	185,798	205,851
Total deposits	\$ 458,022	\$ 463,500
Other borrowings	25,106	20,122
Trust preferred capital notes	9,279	9,279
Other liabilities	3,099	3,230
Total liabilities	\$ 495,506	\$ 496,131
Shareholders Equity		
Preferred stock, \$1,000 liquidation preference; 14,595 shares issued and outstanding	\$ 14,229	\$ 14,127
Common stock, par value \$1.25 per share; authorized 8,000,000 shares; issued and outstanding, 2011, 2,955,649 shares, 2010, 2,948,901 shares	3,695	3,686

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Surplus	1,644	1,582
Retained earnings	24,859	28,969
Accumulated other comprehensive income, net	1,588	134
Total shareholders' equity	\$ 46,015	\$ 48,498
Total liabilities and shareholders' equity	\$ 541,521	\$ 544,629

See Notes to Consolidated Financial Statements

Table of Contents**FIRST NATIONAL CORPORATION****Consolidated Statements of Operations**

Three months ended September 30, 2011 and 2010

(in thousands, except per share data)

	(unaudited) September 30, 2011	(unaudited) September 30, 2010
Interest and Dividend Income		
Interest and fees on loans	\$ 5,666	\$ 6,239
Interest on federal funds sold	2	1
Interest on deposits in banks	3	5
Interest and dividends on securities available for sale:		
Taxable interest	595	398
Tax-exempt interest	121	132
Dividends	16	15
Total interest and dividend income	\$ 6,403	\$ 6,790
Interest Expense		
Interest on deposits	\$ 1,204	\$ 1,397
Interest on federal funds purchased		1
Interest on trust preferred capital notes	109	112
Interest on other borrowings	42	104
Total interest expense	\$ 1,355	\$ 1,614
Net interest income	\$ 5,048	\$ 5,176
Provision for loan losses	5,575	1,200
Net interest income (loss) after provision for loan losses	\$ (527)	\$ 3,976
Noninterest Income		
Service charges on deposit accounts	\$ 590	\$ 668
ATM and check card fees	391	378
Trust and investment advisory fees	350	330
Fees for other customer services	84	75
Gains on sale of loans	25	76
Gains (losses) on sale of securities available for sale, net		(9)
Other operating income (loss)	33	(10)
Total noninterest income	\$ 1,473	\$ 1,508

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Noninterest Expense

Salaries and employee benefits	\$ 2,299	\$ 2,239
Occupancy	347	358
Equipment	325	344
Marketing	109	142
Stationery and supplies	88	110
Legal and professional fees	276	210
ATM and check card fees	162	219
FDIC assessment	181	177
Bank franchise tax	103	109
Provision for other real estate owned	927	111
Other real estate owned expense	133	30
Net (gains) losses on sale of other real estate owned	(36)	(29)
Telecommunications expense	63	72
Data processing	79	66
Other operating expense	332	348
Total noninterest expense	\$ 5,388	\$ 4,506
Income (loss) before income taxes	\$ (4,442)	\$ 978
Income tax provision (benefit)	(1,556)	284
Net income (loss)	\$ (2,886)	\$ 694
Effective dividend on preferred stock	224	221
Net income (loss) available to common shareholders	\$ (3,110)	\$ 473
Earnings (loss) per common share, basic and diluted	\$ (1.05)	\$ 0.16

See Notes to Consolidated Financial Statements

Table of Contents**FIRST NATIONAL CORPORATION****Consolidated Statements of Operations**

Nine months ended September 30, 2011 and 2010

(in thousands, except per share data)

	(unaudited) September 30, 2011	(unaudited) September 30, 2010
Interest and Dividend Income		
Interest and fees on loans	\$ 17,317	\$ 18,728
Interest on federal funds sold	13	1
Interest on deposits in banks	15	9
Interest and dividends on securities available for sale:		
Taxable interest	1,618	1,298
Tax-exempt interest	365	419
Dividends	50	43
Total interest and dividend income	\$ 19,378	\$ 20,498
Interest Expense		
Interest on deposits	\$ 3,810	\$ 4,574
Interest on federal funds purchased		12
Interest on trust preferred capital notes	327	329
Interest on other borrowings	175	356
Total interest expense	\$ 4,312	\$ 5,271
Net interest income	\$ 15,066	\$ 15,227
Provision for loan losses	9,395	2,611
Net interest income after provision for loan losses	\$ 5,671	\$ 12,616
Noninterest Income		
Service charges on deposit accounts	\$ 1,626	\$ 1,959
ATM and check card fees	1,172	1,058
Trust and investment advisory fees	1,076	934
Fees for other customer services	231	239
Gains on sale of loans	94	141
Gains (losses) on sale of securities available for sale, net	41	(7)
Other operating income	58	46
Total noninterest income	\$ 4,298	\$ 4,370

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Noninterest Expense

Salaries and employee benefits	\$ 6,867	\$ 6,756
Occupancy	1,019	1,053
Equipment	973	1,035
Marketing	314	394
Stationery and supplies	254	292
Legal and professional fees	746	630
ATM and check card fees	492	605
FDIC assessment	588	548
Bank franchise tax	312	318
Provision for other real estate owned	1,103	151
Other real estate owned expense	325	211
Net (gains) losses on sale of other real estate owned	(28)	23
Telecommunications expense	239	206
Data processing	220	187
Other operating expense	1,035	1,071
Total noninterest expense	\$ 14,459	\$ 13,480
Income (loss) before income taxes	\$ (4,490)	\$ 3,506
Income tax provision (benefit)	(1,662)	1,044
Net income (loss)	\$ (2,828)	\$ 2,462
Effective dividend on preferred stock	670	664
Net income (loss) available to common shareholders	\$ (3,498)	\$ 1,798
Earnings (loss) per common share, basic and diluted	\$ (1.18)	\$ 0.61

See Notes to Consolidated Financial Statements

Table of Contents**FIRST NATIONAL CORPORATION****Consolidated Statements of Cash Flows**

Nine months ended September 30, 2011 and 2010

(in thousands)

	(unaudited) September 30, 2011	(unaudited) September 30, 2010
Cash Flows from Operating Activities		
Net income (loss)	\$ (2,828)	\$ 2,462
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	896	933
Origination of loans held for sale	(6,277)	(10,745)
Proceeds from sale of loans held for sale	6,642	10,169
Gains on sale of loans held for sale	(94)	(141)
Provision for loan losses	9,395	2,611
Provision for other real estate owned	1,103	151
(Gains) losses on sale of securities available for sale, net	(41)	7
Net (gains) losses on sale of other real estate owned	(28)	23
Accretion of discounts and amortization of premiums on securities, net	339	243
Shares acquired by leveraged ESOP		42
Changes in assets and liabilities:		
Decrease in interest receivable	7	38
(Increase) decrease in other assets	(1,233)	43
Decrease in other liabilities	(231)	(1,764)
Net cash provided by operating activities	\$ 7,650	\$ 4,072
Cash Flows from Investing Activities		
Proceeds from sales of securities available for sale	\$ 2,557	\$ 1,509
Proceeds from maturities, calls, and principal payments of securities available for sale	11,075	8,103
Purchase of securities available for sale	(36,768)	(6,664)
Proceeds from sales of restricted securities	264	184
Decrease in federal funds sold	7,500	
Purchase of premises and equipment	(251)	(248)
Proceeds from sale of other real estate owned	784	2,353
Net decrease in loans	15,520	1,011
Net cash provided by investing activities	\$ 681	\$ 6,248
Cash Flows from Financing Activities		
Net increase in demand deposits and savings accounts	\$ 14,575	\$ 17,192
Net decrease in time deposits	(20,053)	(27,955)
Proceeds from other borrowings	33,001	23,601
Principal payments on other borrowings	(28,017)	(23,659)

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Cash dividends paid on common stock	(541)	(1,072)
Cash dividends paid on preferred stock	(568)	(568)
Shares issued to leveraged ESOP		(26)
Net cash used in financing activities	\$ (1,603)	\$ (12,487)
Increase (decrease) in cash and cash equivalents	\$ 6,728	\$ (2,167)
Cash and Cash Equivalents		
Beginning	\$ 15,997	\$ 14,977
Ending	\$ 22,725	\$ 12,810

See Notes to Consolidated Financial Statements

Table of Contents**FIRST NATIONAL CORPORATION****Consolidated Statements of Cash Flows**

(Continued)

Nine months ended September 30, 2011 and 2010

(in thousands)

	(unaudited) September 30, 2011	(unaudited) September 30, 2010
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	\$ 4,422	\$ 5,459
Income taxes	\$	\$ 3,061
Supplemental Disclosures of Noncash Investing and Financing Activities		
Unrealized gain on securities available for sale	\$ 2,202	\$ 537
Transfer from loans to other real estate owned	\$ 3,373	\$ 2,865
Loan originated from sale of other real estate owned	\$ 640	\$
Issuance of common stock, dividend reinvestment plan	\$ 71	\$ 161
<i>See Notes to Consolidated Financial Statements</i>		

Table of Contents**FIRST NATIONAL CORPORATION****Consolidated Statements of Changes in Shareholders' Equity**

Nine months ended September 30, 2011 and 2010

*(in thousands, except share and per share data)**(unaudited)*

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Comprehensive Income	Total
Balance, December 31, 2009	\$ 13,998	\$ 3,664	\$ 1,418	\$ 35,104	\$ (42)	\$ 665		\$ 54,807
Comprehensive income:								
Net income				2,462			\$ 2,462	2,462
Other comprehensive income, net of tax:								
Unrealized holding gains arising during the period (net of tax, \$181)							349	
Reclassification adjustment (net of tax, \$2)							5	
Other comprehensive income (net of tax, \$183)						354	\$ 354	354
Total comprehensive income							\$ 2,816	
Shares acquired by leveraged ESOP			(26)		42			16
Cash dividends on common stock (\$0.42 per share)				(1,233)				(1,233)
Issuance of 13,323 shares common stock, dividend reinvestment plan		17	144					161
Cash dividends on preferred stock				(568)				(568)
Accretion on preferred stock discount	96			(96)				
Balance, September 30, 2010	\$ 14,094	\$ 3,681	\$ 1,536	\$ 35,669	\$	\$ 1,019		\$ 55,999

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Comprehensive Income (Loss)	Total
Balance, December 31, 2010	\$ 14,127	\$ 3,686	\$ 1,582	\$ 28,969	\$	\$ 134		\$ 48,498
Comprehensive income (loss):								
Net loss				(2,828)			\$ (2,828)	(2,828)
Other comprehensive income, net of tax:								
Unrealized holding gains arising during the period (net of tax, \$762)							1,481	
Reclassification adjustment (net of tax, \$14)							(27)	

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Other comprehensive income (net of tax, \$748)					1,454	1,454	1,454
Total comprehensive loss						\$ (1,374)	
Cash dividends on common stock (\$0.20 per share)				(612)			(612)
Issuance of 6,748 shares common stock, dividend reinvestment plan		9	62				71
Cash dividends on preferred stock				(568)			(568)
Accretion on preferred stock discount	102			(102)			
Balance, September 30, 2011	\$ 14,229	\$ 3,695	\$ 1,644	\$ 24,859	\$	\$ 1,588	\$ 46,015

See Notes to Consolidated Financial Statements

Table of Contents**FIRST NATIONAL CORPORATION****Notes to Consolidated Financial Statements***(unaudited)***Note 1. General**

The accompanying unaudited consolidated financial statements of First National Corporation (the Company) and its subsidiaries, including First Bank (the Bank), have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at September 30, 2011 and December 31, 2010, the results of operations for the three and nine months ended September 30, 2011 and 2010 and cash flows and changes in shareholders' equity for the nine months ended September 30, 2011 and 2010. The statements should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2010. Operating results for the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Note 2. Securities

The Company invests in U.S. agency and mortgage-backed securities, obligations of state and political subdivisions and corporate equity securities. Amortized costs and fair values of securities available for sale at September 30, 2011 and December 31, 2010 were as follows:

	0000000000	0000000000	0000000000	0000000000
	<i>(in thousands)</i>			
	September 30, 2011			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	(Losses)	
U.S. agency and mortgage-backed securities	\$ 68,880	\$ 2,793	\$	\$ 71,673
Obligations of states and political subdivisions	12,875	803	(7)	13,671
Corporate equity securities	23	93		116
	\$ 81,778	\$ 3,689	\$ (7)	\$ 85,460

	0000000000	0000000000	0000000000	0000000000
	<i>(in thousands)</i>			
	December 31, 2010			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	(Losses)	
U.S. agency and mortgage-backed securities	\$ 45,627	\$ 1,508	\$ (211)	\$ 46,924
Obligations of states and political subdivisions	13,290	225	(214)	13,301

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Corporate equity securities	23	172	195
	\$ 58,940	\$ 1,905	\$ (425) \$ 60,420

At September 30, 2011 and December 31, 2010, investments in an unrealized loss position that were temporarily impaired were as follows:

	000000	000000	000000	000000	000000	000000
			<i>(in thousands)</i>			
			September 30, 2011			
	Less than 12 months	Unrealized	12 months or more	Unrealized	Total	Unrealized
	Fair Value	(Loss)	Fair Value	(Loss)	Fair Value	(Loss)
U.S. agency and mortgage-backed securities	\$	\$	\$	\$	\$	\$
Obligations of states and political subdivisions			480	(7)	480	(7)
	\$	\$	\$ 480	\$ (7)	\$ 480	\$ (7)

Table of Contents**Notes to Consolidated Financial Statements***(unaudited)*

	000000	000000	000000	000000	000000	000000
			<i>(in thousands)</i>			
			December 31, 2010			
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
U.S. agency and mortgage-backed securities	\$ 11,286	\$ (211)	\$	\$	\$ 11,286	\$ (211)
Obligations of states and political subdivisions	2,923	(128)	893	(86)	3,816	(214)
	\$ 14,209	\$ (339)	\$ 893	\$ (86)	\$ 15,102	\$ (425)

The tables above provide information about securities that have been in an unrealized loss position for less than twelve consecutive months and securities that have been in an unrealized loss position for twelve consecutive months or more. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Impairment is considered to be other-than temporary if the Company (1) intends to sell the security, (2) more likely than not will be required to sell the security before recovering its cost, or (3) does not expect to recover the security's entire amortized cost basis. Presently, the Company does not intend to sell any of these securities, will not be required to sell these securities, and expects to recover the entire amortized cost of all the securities.

At September 30, 2011, there was one obligation of state and political subdivisions in an unrealized loss position. One hundred percent of the Company's investment portfolio is considered investment grade. The weighted-average re-pricing term of the portfolio was 3.2 years at September 30, 2011.

The Company's investment in Federal Home Loan Bank (FHLB) stock totaled \$2.0 million at September 30, 2011. FHLB stock is generally viewed as a long-term investment and as a restricted security, which is carried at cost, because there is a minimal market for the stock. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider this investment to be other-than-temporarily impaired at September 30, 2011, and no impairment has been recognized. FHLB stock is shown in restricted securities on the balance sheet and is not part of the available for sale securities portfolio.

Note 3. Loans

Loans at September 30, 2011 and December 31, 2010 are summarized as follows:

	<i>(in thousands)</i>	
	September 30, 2011	December 31, 2010
Real estate loans:		
Construction	\$ 49,310	\$ 52,591
Secured by 1-4 family residential	120,014	121,506
Other real estate loans	195,486	207,371
Commercial and industrial loans	32,649	40,683

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Consumer and other loans	11,749	12,879
Total loans	\$ 409,208	\$ 435,030
Allowance for loan losses	18,502	16,036
Loans, net	\$ 390,706	\$ 418,994

Consumer loans included \$165 thousand and \$231 thousand of demand deposit overdrafts at September 30, 2011 and December 31, 2010, respectively.

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The Company has a credit concentration of loans secured by real estate. These loans totaled \$364.8 million, or 89% of total loans, and \$381.5 million, or 88% of total loans, at September 30, 2011 and December 31, 2010, respectively. Although the Company believes that its underwriting standards are generally conservative, the ability of its borrowers to meet their mortgage obligations may be impacted by local economic conditions.

The Company has a concentration of credit risk within the loan portfolio involving loans secured by hotels. This concentration totaled \$35.1 million at September 30, 2011, representing 76% of total equity and 9% of total loans. At December 31, 2010, this concentration totaled \$41.6 million representing 86% of total equity and 10% of total loans. These loans are included in other real estate loans in the above table. The Company charged down \$2.0 million related to this concentration of credit risk during the nine month period ended September 30, 2011 and \$147 thousand related to these loans during the year ended December 31, 2010.

Table of Contents**Notes to Consolidated Financial Statements***(unaudited)*

The following table provides a summary of loan classes and an aging of past due loans as of September 30, 2011 and December 31, 2010:

	0000000	0000000	0000000	0000000	0000000	0000000	0000000	0000000
	September 30, 2011 (in thousands)							
	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Nonaccrual loans	90 Days or More Past Due and Accruing
Real estate loans:								
Construction	\$ 3,998	\$ 351	\$ 4,156	\$ 8,505	\$ 40,805	\$ 49,310	\$ 4,146	\$ 361
1-4 family residential	4,981	557	706	6,244	113,770	120,014	3,953	
Other real estate loans	7,787	1,813	1,012	10,612	184,874	195,486	12,558	
Commercial and industrial	203	112	312	627	32,022	32,649	2,040	312
Consumer and other	69	6	10	85	11,664	11,749	10	
Total	\$ 17,038	\$ 2,839	\$ 6,196	\$ 26,073	\$ 383,135	\$ 409,208	\$ 22,707	\$ 673

	0000000	0000000	0000000	0000000	0000000	0000000	0000000	0000000
	December 31, 2010 (in thousands)							
	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Nonaccrual loans	90 Days or More Past Due and Accruing
Real estate loans:								
Construction	\$ 525	\$	\$ 3,665	\$ 4,190	\$ 48,401	\$ 52,591	\$ 5,780	\$
1-4 family residential	2,642	178	315	3,135	118,371	121,506	628	315
Other real estate loans	10,225	3,475	751	14,451	192,920	207,371	4,407	283
Commercial and industrial	1,033	3	1,036	39,647	40,683			
Consumer	168	10	1	179	12,700	12,879	2	
Total	\$ 14,593	\$ 3,666	\$ 4,732	\$ 22,991	\$ 412,039	\$ 435,030	\$ 10,817	\$ 598

Credit Quality Indicators

As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grading of specified classes of loans.

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The Company utilizes a risk grading matrix to assign a rating to each of its loans. The loan ratings are summarized into the following categories: pass, special mention, substandard, doubtful and loss. Pass rated loans include all risk rated credits other than those included in special mention, substandard or doubtful. Loans classified as loss are charged-off. Loan officers assign risk grades to loans at origination and as renewals arise. The Bank's Credit Administration department reviews risk grades for accuracy on a quarterly basis and as delinquency issues arise. In addition, a certain amount of loans are reviewed each year through the Company's internal and external loan review process. A description of the general characteristics of the loan grading categories is as follows:

Special Mention Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the Bank's credit position at some future date.

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Substandard Loans classified as substandard are inadequately protected by the current net worth and payment capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation in full of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful Loans classified as doubtful have all the weakness inherent in those classified as substandard, 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 Company considers all doubtful loans to be impaired and places the loan on nonaccrual status.

Table of Contents**Notes to Consolidated Financial Statements***(unaudited)*

The following tables provide an analysis of the credit risk profile of each loan class as of September 30, 2011 and December 31, 2010:

	00000000	00000000	00000000	00000000	00000000
	September 30, 2011 <i>(in thousands)</i>				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction	\$ 21,796	\$ 6,028	\$ 19,149	\$ 2,337	\$ 49,310
Secured by 1-4 family residential	104,965	6,729	8,320		120,014
Other real estate loans	143,454	14,579	31,235	6,218	195,486
Commercial and industrial	27,460	1,101	4,088		32,649
Consumer	11,657	82	10		11,749
Total	\$ 309,332	\$ 28,519	\$ 62,802	\$ 8,555	\$ 409,208

	00000000	00000000	00000000	00000000	00000000
	December 31, 2010 <i>(in thousands)</i>				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction	\$ 21,212	\$ 5,237	\$ 21,471	\$ 4,671	\$ 52,591
Secured by 1-4 family residential	106,722	4,435	10,349		121,506
Other real estate loans	143,874	17,915	43,443	2,139	207,371
Commercial and industrial	34,619	4,033	2,031		40,683
Consumer	12,864	13	1	1	12,879
Total	\$ 319,291	\$ 31,633	\$ 77,295	\$ 6,811	\$ 435,030

Note 4. Allowance for Loan Losses

Transactions in the allowance for loan losses for the nine months ended September 30, 2011 and 2010 and for the year ended December 31, 2010 were as follows:

(in thousands)

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	September 30, 2011	December 31, 2010	September 30, 2010
Balance at beginning of year	\$ 16,036	\$ 7,106	\$ 7,106
Provision charged to operating expense	9,395	11,731	2,611
Loan recoveries	208	261	197
Loan charge-offs	(7,137)	(3,062)	(1,320)
Balance at end of period	\$ 18,502	\$ 16,036	\$ 8,594

Table of Contents**Notes to Consolidated Financial Statements***(unaudited)*

The following tables present, as of September 30, 2011 and December 31, 2010, the total allowance for loan losses, the allowance by impairment methodology and loans by impairment methodology.

	000000	000000	000000	000000	000000	000000
	September 30, 2011 (in thousands)					
	Commercial and Industrial	Other Real Estate	Construction	Secured by 1-4 Family Residential	Consumer and Other Loans	Total
Allowance for loan losses:						
Beginning Balance, December 31, 2010	\$ 858	\$ 9,187	\$ 4,050	\$ 1,681	\$ 260	\$ 16,036
Charge-offs	(233)	(3,420)	(2,557)	(726)	(201)	(7,137)
Recoveries	1			4	203	208
Provision for loan losses	2,190	2,387	1,870	3,011	(63)	9,395
Ending Balance, September 30, 2011	\$ 2,816	\$ 8,154	\$ 3,363	\$ 3,970	\$ 199	\$ 18,502
Ending Balance:						
Individually evaluated for impairment	2,192	4,457	1,639	2,386		10,674
Collectively evaluated for impairment	624	3,697	1,724	1,584	199	7,828
Loans:						
Ending Balance	\$ 32,649	\$ 195,486	\$ 49,310	\$ 120,014	\$ 11,749	\$ 409,208
Individually evaluated for impairment	2,373	24,244	10,194	8,382		45,193
Collectively evaluated for impairment	30,276	171,242	39,116	111,632	11,749	364,015
	000000	000000	000000	000000	000000	000000
	December 31, 2010 (in thousands)					
	Commercial and Industrial	Other Real Estate	Construction	Secured by 1-4 Family Residential	Consumer and Other Loans	Total
Allowance for loan losses:						
Ending Balance	\$ 858	\$ 9,187	\$ 4,050	\$ 1,681	\$ 260	\$ 16,036
Ending Balance:						
Individually evaluated for impairment	36	5,020	3,006	536		8,597
Collectively evaluated for impairment	822					