Village Bank & Trust Financial Corp.
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

____

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE EXCHANGE ACT

For the transition period from ______ to ______

____

Commission file number: 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	16-1694602 (I.R.S. Employer Identification No.)

15521 Midlothian Turnpike, Midlothian, Virginia	23113	
(Address of principal executive offices)		(Zip code)

804-897-3900
(Registrant's telephone number, including area code)

Indicate by check whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 x No o.

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

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 o	Accelerated Filer o
Non-Accelerated Filer o (Do not check if smaller reporting company)	Smaller Reporting Company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

4,243,378 shares of common stock, $4.00 par value, outstanding as of November 3, 2011

Village Bank and Trust Financial Corp.
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PART I – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
September 30, 2011 (Unaudited) and December 31, 2010

	September 30, 2011	December 31, 2010
Assets		
Cash and due from banks	$47,964,169	$9,390,377
Federal funds sold	5,787,193	2,621,934
Total cash and cash equivalents	53,751,362	12,012,311
Investment securities available for sale	56,691,242	53,597,174
Loans held for sale	13,786,238	19,871,787
Loans		
Outstandings	436,063,963	453,242,950
Allowance for loan losses	(14,962,062)	(7,311,712)
Deferred fees and costs	729,040	623,851
	421,830,941	446,555,089
Premises and equipment, net	27,106,734	27,437,452
Accrued interest receivable	2,360,571	2,347,211
Bank owned life insurance	6,019,164	5,871,765
Other real estate owned	8,937,045	12,028,111
Other assets	15,357,786	12,058,315
	$605,841,083	$591,779,215
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest bearing demand	$62,865,964	$41,036,262
Interest bearing	441,305,236	457,975,931
Total deposits	504,171,200	499,012,193
Long-term debt - trust preferred securities	8,764,000	8,764,000
Federal Home Loan Bank advances	37,750,000	28,750,000
Other borrowings	5,107,402	4,165,430
Accrued interest payable	514,280	404,801
Other liabilities	5,537,305	2,362,597
Total liabilities	561,844,187	543,459,021
Stockholders' equity		
Preferred stock, $4 par value, $1,000 liquidation preference, 1,000,000 shares authorized, 14,738 shares issued and outstanding	58,952	58,952
Common stock, $4 par value - 10,000,000 shares authorized 4,243,378 shares issued and outstanding at September 30, 2011 4,238,416 shares issued and outstanding at December 31, 2011	16,973,512	16,953,664

Additional paid-in capital	40,702,568	40,633,581
Retained earnings (deficit)	(14,758,254)	(9,192,552)
Common stock warrant	732,479	732,479
Discount on preferred stock	(383,108)	(492,456)
Accumulated other comprehensive income (loss)	670,747	(373,474)
Total stockholders' equity	43,996,896	48,320,194
	$605,841,083	$591,779,215

See accompanying notes to consolidated financial statements

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Income
Three and Nine Months Ended September 30, 2011 and 2010
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest income				
Loans	$6,586,170	$7,409,474	$20,394,359	$21,713,276
Investment securities	356,893	237,059	1,010,017	879,976
Federal funds sold	19,464	13,747	58,268	43,983
Total interest income	6,962,527	7,660,280	21,462,644	22,637,235
Interest expense				
Deposits	1,693,205	2,168,903	5,638,873	6,958,389
Borrowed funds	305,307	450,301	885,156	1,520,365
Total interest expense	1,998,512	2,619,204	6,524,029	8,478,754
Net interest income	4,964,015	5,041,076	14,938,615	14,158,481
Provision for loan losses	9,507,884	1,410,000	11,410,884	3,150,000
Net interest income after provision for loan losses	(4,543,869)	3,631,076	3,527,731	11,008,481
Noninterest income				
Service charges and fees	495,165	484,981	1,366,547	1,375,554
Gain on sale of loans	1,724,730	1,922,868	4,733,648	4,761,092
Gain (loss) on sale of assets	108,473	-	171,617	840,941
Rental income	168,311	118,515	484,540	387,457
Other	100,804	136,111	303,348	494,196
Total noninterest income	2,597,483	2,662,475	7,059,700	7,859,240
Noninterest expense				
Salaries and benefits	3,060,285	3,180,292	9,305,684	8,934,796
Occupancy	540,929	492,012	1,552,537	1,529,597
Equipment	224,334	192,505	668,554	631,619
Supplies	98,621	111,941	324,565	363,127
Professional and outside services	599,893	460,308	1,689,339	1,476,927
Advertising and marketing	84,740	109,584	319,163	335,244
Expenses related to foreclosed real estate	387,666	327,261	1,211,878	1,008,597
Other operating expenses	973,426	913,419	2,850,734	2,645,798
Total noninterest expense	5,969,894	5,787,322	17,922,454	16,925,705
Net income before income taxes	(7,916,280)	506,229	(7,335,023)	1,942,016
Income tax expense (benefit)	(2,671,535)	172,117	(2,429,829)	660,285
Net income (loss)	(5,244,745)	334,112	(4,905,194)	1,281,731

Preferred stock dividends and amortization of discount	222,281	221,910	660,508	659,399
Net income (loss) available to common shareholders	$(5,467,026)	$112,202	$(5,565,702)	$622,332
Earnings (loss) per share, basic	$(1.29)	$0.03	$(1.31)	$0.15
Earnings (loss) per share, diluted	$(1.29)	$0.03	$(1.31)	$0.15

See accompanying notes to consolidated financial statements

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Stockholders' Equity
and Comprehensive Income
Nine Months Ended September 30, 2011 and 2010
(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Warrant	Discount on Preferred Stock	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2005		7,418,472	9,191,567	585,416			(43,562)	17,151,893
Issuance of common stock		2,829,880	4,374,314	-			-	7,204,194
Stock based compensation		-	23,007	-			-	23,007
Minimum pension adjustment (net of income taxes of								
Balance, December 31, 2010	$58,952	$16,953,664	$40,633,581	$(9,192,552)	$732,479	$(492,456)	$(373,474)	$48,320,194
Amortization of preferred stock discount	-			(109,348)	-	109,348	-	- -
Preferred stock dividend	-	-		(551,160)	-	-	-	(551,160)
Issuance of common stock	-	19,848	(19,848)	-	-	-	-	-
Stock based compensation			88,835					88,835
Minimum pension adjustment (net of income taxes of $3,315)	-	-	-	-	-	-	6,435	6,435
Net income (loss)	-	-	-	(4,905,194)	-	-	-	(4,905,194)
Change in unrealized gain on investment securities available-for-sale, net of reclassification	-	-	-	-	-	-	1,037,786	1,037,786

and tax effect								
Total comprehensive income	-	-	-	-	-	-	-	(3,860,973)
Balance, September 30, 2011	$58,952	$16,973,512	$40,702,568	$(14,758,254)	$732,479	$(383,108)	$670,747	$43,996,896
Balance, December 31, 2009	$58,952	$16,922,512	$40,568,771	$(9,741,459)	$732,479	$(636,959)	$(56,205)	$47,848,091
Amortization of preferred stock discount	-	-		(108,239)	-	108,239	-	- -
Preferred stock dividend	-	-		(551,160)	-	-	-	(551,160)
Issuance of common stock	-	31,152	(31,152)	-	-	-	-	-
Stock based compensation			73,072					73,072
Minimum pension adjustment (net of income taxes of $2,188)	-	-	-	-	-	-	6,435	- 6,435
Net income	-	-	-	1,281,731	-	-	-	1,281,731
Change in unrealized gain on investment securities available-for-sale, net of reclassification and tax effect	-	-	-	-	-	-	297,440	297,440
Total comprehensive income	-	-	-	-	-	-	-	1,585,606
Balance, September 30, 2010	$58,952	$16,953,664	$40,610,691	$(9,119,127)	$732,479	$(528,720)	$247,670	$48,955,609

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2011 and 2010
(Unaudited)

	2011	2010
Cash Flows from Operating Activities		
Net income (loss)	$(4,905,194)	$1,281,731
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,065,855	976,201
Deferred income taxes	(3,710,085)	-
Provision for loan losses	11,410,884	3,150,000
Write-down of other real estate owned	546,331	184,000
Gain on securities sold	(172,994)	(597,375)
Gain on loans sold	(4,733,648)	(4,761,092)
Gain loss on sale of premises and equipment	-	(242,936)
(Gain) loss on sale of other real estate owned	239,532	(17,546)
Stock compensation expense	88,835	73,072
Proceeds from sale of other real estate owned	5,155,942	4,032,682
Proceeds from sale of mortgage loans	175,498,993	192,149,659
Origination of mortgage loans for sale	(164,679,796)	(206,404,127)
Amortization of premiums and accrection of discounts on securities, net	106,229	367,149
(Increase) decrease in interest receivable	(13,360)	775,417
Increase in bank owned life insurance	(147,399)	(392,312)
(Increase) decrease in other assets	(117,566)	1,485,722
Increase (decrease) in interest payable	109,479	(69,225)
Increase (decrease) in other liabilities	3,174,706	(625,450)
Net cash provided by (used in) operating activities	18,916,744	(8,634,430)
Cash Flows from Investing Activities		
Purchases of available for sale securities	(76,141,951)	(15,138,493)
Proceeds from the sale or calls of available for sale securities	803,100	40,670,661
Proceeds from maturities and principal payments of available for sale securities	73,883,951	1,694,167
Net decrease (increase) in loans	10,462,525	(775,672)
Purchases of premises and equipment	(735,137)	(863,782)
Proceeds from sale of premises and equipment	-	377,321
Net cash provided by investing activities	8,272,488	25,964,202
Cash Flows from Financing Activities		
Net increase in deposits	5,159,007	(8,232,051)
Net increase (decrease) in Federal Home Loan Bank Advances	9,000,000	(250,000)
Net increase (decrease) in other borrowings	941,972	(10,045,070)
Dividends on preferred stock	(551,160)	(551,160)
Net cash provided by (used in) financing activities	14,549,819	(19,078,281)
Net increase (decrease) in cash and cash equivalents	41,739,051	(1,748,509)
Cash and cash equivalents, beginning of period	12,012,311	20,661,820

Cash and cash equivalents, end of period	$53,751,362	$18,913,311
Supplemental Schedule of Non Cash Activities		
Real estate owned assets acquired in settlement of loans	$2,714,621	$5,861,491

See accompanying notes to consolidated financial statements.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 - Principles of presentation

Village Bank and Trust Financial Corp. (the “Company”) is the holding company of Village Bank (the “Bank”). The consolidated financial statements include the accounts of the Company, the Bank and the Bank’s three wholly-owned subsidiaries, Village Bank Mortgage Company, Village Insurance Agency, Inc., and Village Financial Services Company. All material intercompany balances and transactions have been eliminated in consolidation.

The Company’s financial statements are prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) which, principally consist of the Financial Accounting Standards Board Accounting Standards Codification (“FASB Codification”). FASB Codification Topic 105: Generally Accepted Accounting Principles establishes the FASB codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the Securities and Exchange Commission (“SEC”) under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the FASB Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the FASB Codification is superseded and deemed non-authoritative.

In the opinion of management, the accompanying condensed consolidated financial statements of the Company have been prepared on the accrual basis in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, all adjustments that are, in the opinion of management, necessary for a fair presentation have been included. The results of operations for the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year ending December 31, 2011. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission.

Note 2 - Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheets and statements of income for the period. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

Note 3 - Earnings (loss) per common share

The following table presents the basic and diluted earnings per share computations:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Numerator				
Net income (loss) - basic and diluted	$(5,244,745)	$334,112	$(4,905,194)	$1,281,731
Preferred stock dividend and accretion	222,281	221,910	660,508	659,399
Net income (loss) available to common shareholders	$(5,467,026)	$112,202	$(5,565,702)	$622,332
Denominator				
Weighted average shares outstanding - basic	4,243,378	4,238,416	4,242,905	4,237,505
Dilutive effect of common stock options and restricted stock awards	-	-	-	-
Weighted average shares outstanding - diluted	4,243,378	4,238,416	4,242,905	4,237,505
Earnings (loss) per share - basic and diluted				
Earnings (loss) per share - basic	$(1.29)	$0.03	$(1.31)	$0.15
Effect of dilutive common stock options	-	-	-	-
Earnings (loss) per share - diluted	$(1.29)	$0.03	$(1.31)	$0.15

Outstanding options and warrants to purchase common stock were considered in the computation of diluted earnings per share for the periods presented. Stock options for 310,205 shares of common stock were not included in computing diluted earnings per share for the three and nine months ended September 30, 2011 and 2010 because their effects were anti-dilutive. Warrants to acquire 499,029 shares of common stock were not included in computing earnings per share in 2011 and 2010 because their effects were also anti-dilutive.

Note 4 – Loans and Allowance for Loan Losses

The following table presents the composition of our loan portfolio (excluding mortgage loans held for sale) at the dates indicated.

	September 30, 2011 Amount	%	December 31, 2010 Amount	%
Commercial	$37,961,852	8.7 %	$37,227,599	8.2 %
Real estate - Construction, land development & other loans	86,467,444	19.8 %	90,773,214	20.0 %
Real estate - Commercial	166,807,984	38.3 %	173,227,491	38.2 %
Real estate - 1-4 Residential	140,034,966	32.1 %	146,646,780	32.4 %
Consumer	4,791,717	1.1 %	5,367,866	1.2 %
Total loans	436,063,963	100.0 %	453,242,950	100.0 %
Deferred loan cost (unearned income), net	729,040		623,851	
Less: Allowance for loan losses	(14,962,062)		(7,311,712)	

	$421,830,941	$446,555,089

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

- Risk rated 1 to 4 loans are considered of sufficient quality to preclude an adverse rating. 1-4 assets generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral;
    - Risk rated 5 loans are defined as having potential weaknesses that deserve management's close attention;
- Risk rated 6 loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any, and;
- Risk rated 7 loans have all the weaknesses inherent in substandard loans, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following tables provide information on the risk rating of loans at the dates indicated.

	September 30, 2011				
	Risk Rated 1-4	Risk Rated 5	Risk Rated 6	Risk Rated 7	Total Loans
Commercial	$ 33,335,341	$ 1,581,393	$ 2,600,679	$ 444,439	$ 37,961,852
Real estate - construction, land development and other loans	53,953,677	4,743,187	27,770,580	-	86,467,444
Real estate - commercial	98,128,635	21,906,607	46,459,498	313,244	166,807,984
Real estate - 1-4 residential	120,080,357	9,293,980	10,602,621	58,008	140,034,966
Consumer	3,509,806	678,697	464,006	139,208	4,791,717
	$ 309,007,816	$ 38,203,864	$ 87,897,384	$ 954,899	$ 436,063,963

	December 31, 2010				
	Risk Rated 1-4	Risk Rated 5	Risk Rated 6	Risk Rated 7	Total Loans
Commercial	$25,320,711	$2,577,779	$3,283,334	$524,415	$31,706,239
Real estate - construction, land development and other loans	17,132,832	3,438,546	24,648,900	-	45,220,278
Real estate - commercial	212,375,139	20,391,192	28,557,575	193,251	261,517,157
Real estate - 1-4 residential	87,598,976	5,717,843	9,904,670	163,825	103,385,314
Consumer	10,383,486	623,556	299191	107,729	11,413,962
	$352,811,144	$32,748,916	$66,693,670	$989,220	$453,242,950

The following table presents the aging of the recorded investment in past due loans at the dates indicated.

	September 30, 2011						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial	$52,401	$72,666	$11,558	$136,625	$37,825,227	$37,961,852	$11,558
Real estate - construction, land development and other loans	569,219	991,594	-	1,560,813	84,906,631	86,467,444	-
	694,707	2,645,910	71,620	3,412,237	163,395,747	166,807,984	71,620

Real estate - commercial							
Real estate - 1-4 residential	1,012,321	2,254,390	18,700	3,285,411	136,749,555	140,034,966	18,700
Consumer	136,830	2,992	-	139,822	4,651,895	4,791,717	-
	$2,465,478	$5,967,552	$101,878	$8,534,908	$427,529,055	$436,063,963	$101,878

	December 31, 2010						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial	$ 190,585	$ 501,378	$ -	$ 691,963	$ 31,014,276	$ 31,706,239	$ -
Real estate - construction, land development and other loans	5,515,931	673,204	79,343	6,268,478	300,468,956	306,737,434	79,343
Real estate - 1-4 residential	2,672,157	973,269	213,478	3,858,904	99,526,410	103,385,314	213,478
Consumer	149,804	42,645	22,322	214,771	11,199,192	11,413,963	22,322
	$ 8,528,477	$ 2,190,496	$ 315,143	$ 11,034,116	$ 442,208,834	$ 453,242,950	$ 315,143

Loans are considered impaired when, based on current information and events it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible. Impaired loans at the dates indicated are set forth in the following table.

	September 30, 2011					
	Recorded Investment					
Description of Loans	Unpaid Contractual Principal Balance	Total Recorded Investment	Recorded Investment with Allowance	Recorded Investment with No Allowance	Related Allowance	Recorded Average Investment
Commercial	$282,900	$282,900	$-	$282,900	$-	$1,568,978
Real estate - construction, land development and other loans	21,685,177	16,877,409	7,391,025	9,486,384	4,807,768	21,691,733
Real estate - commercial	21,085,849	18,794,889	11,457,440	7,337,449	2,290,960	8,200,227
Real estate - 1-4 residential	17,601,256	15,822,156	3,495,098	12,327,058	1,779,100	12,905,229
Consumer	493,341	493,341	-	493,341	-	292,430

	$61,148,523	$52,270,695	$22,343,563	$29,927,132	$8,877,828	$44,658,597

	December 30, 2010					
			Recorded Investment			
Description of Loans	Unpaid Contractual Principal Balance	Total Recorded Investment	Recorded Investment with Allowance	Recorded Investment with No Allowance	Related Allowance	Recorded Average Investment
Commercial	$ 3,642,820	$ 3,401,381	$ 178,320	$ 3,223,061	$ 178,320	$ 3,755,382
Real estate - construction, land development and other loans	15,439,512	10,914,812	1,476,524	9,438,288	110,000	16,182,175
Real estate - 1-4 residential	6,122,804	5,728,804	59,622	5,669,182	16,500	6,924,937
Consumer	278,890	278,890	-	278,890	-	288,539
	$ 25,484,026	$ 20,323,887	$ 1,714,466	$ 18,609,421	$ 304,820	$ 27,151,032

Included in impaired loans are loans classified as troubled debt restructurings (TDRs). A modification of a loan’s terms constitutes a TDR if the creditor grants a concession to the borrower for economic or legal reasons related to the borrowers financial difficulties that it would not otherwise consider. As a result of adopting the amendments in Accounting Standards

Update 2011-02, the Company reassessed all loan modifications that occurred since January 1, 2011 for identification as TDRs. There were no additional TDRs identified in this reassessment. For loans classified as impaired TDRs, the Company further evaluates the loans as performing or nonperforming. If, at the time of restructure, the loan is not considered nonaccrual, it will be classified as performing. TDRs originally classified as nonperforming are able to be reclassified as performing if, subsequent to restructure, they experience six months of payment performance according to the restructured terms. The following table provides certain information concerning TDRs as of September 30, 2011.

	Total	Performing	Nonaccrual	Past Due 31-89 Days	Specific Valuation Allowance
Real estate - Construction, land development & other loans	$20,272,438	$12,335,555	$7,936,883	$-	$4,502,948
Real estate - Commercial	6,159,152	3,978,436	-	2,180,716	304,300
Real estate - 1-4 Residential	5,575,961	5,575,961	-	-	404,000
	$32,007,551	$21,889,952	$7,936,883	$2,180,716	$5,211,248
Number of loans	39	29	9	1	12

Interest income recorded on performing TDRs is presented in the following table.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Real estate - Construction, land development & other loans	$ 212,740	$ 638,220
Real estate - Commercial	86,908	260,724
Real estate - 1-4 Residential	45,698	137,093
	$ 345,346	$ 1,036,037

The following table provides information about TDRs identified during the current period.

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance

New TDRs						
Real estate - Construction, land development & other loans	4	$ 3,015,029	$ 3,015,029	8	$ 5,855,511	$ 5,855,511
Real estate - Commercial	2	2,414,805	2,414,805	3	3,190,261	3,190,261
Real estate - 1-4 Residential	2	1,422,772	1,422,772	2	1,422,772	1,422,772
	8	$ 6,852,606	$ 6,852,606	13	$ 10,468,544	$ 10,468,544
Defaults on TDRs						
Real estate - Construction, land development & other loans	6	$ 6,182,810		12	$ 11,835,296	
Real estate - Commercial	1	2,180,716		1	2,180,716	
	7	$ 8,363,526		13	$ 14,016,012	

The Company's recorded investment in loans as of September 30, 2011 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology as follows:

	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Total
Commercial	$ 14,828,282	$ 23,258,515	$ 38,086,797
Real estate - Construction, land development & other loans	33,571,308	52,702,885	86,274,193
Real estate - Commercial	144,051,981	22,871,350	166,923,331
Real estate - 1-4 Residential	16,148,913	123,435,302	139,584,215
Consumer	3,976,796	1,218,631	5,195,427
	$ 212,577,280	$ 223,486,683	$ 436,063,963

Activity in the allowance for loan losses is as follows:

	Commercial	Real estate construction, land development and other	Real estate commercial	Real estate 1-4 residential	Consumer	Total
Balance June 30, 2011	$1,250,929	$ 3,575,106	$108,215	$1,884,733	$437,631	$7,256,614
Charge-offs	(1,042,622)	(193,251)	-	(483,399)	(93,415)	(1,812,687)
Recoveries	-	8,750	-	211	1,290	10,251
Provision	488,209	4,263,747	2,392,867	2,286,693	76,368	9,507,884
Balance September 30, 2011	$696,516	$ 7,654,352	$2,501,082	$3,688,238	$421,874	$14,962,062
Balance December 31, 2010	$1,315,582	$ 3,125,960	$98,921	$2,342,583	$428,665	$7,311,712
Charge-offs	(1,635,256)	(193,251)	(326,803)	(1,442,376)	(186,886)	(3,784,573)
Recoveries	2,000	18,750	-	1,557	1,732	24,039
Provision	1,014,190	4,702,893	2,728,964	2,786,474	178,363	11,410,884
Balance September 30, 2011	$696,516	$ 7,654,352	$2,501,082	$3,688,238	$421,874	$14,962,062

The following table summarizes asset quality information at the dates indicated.

Asset Quality
(in thousands)

	September 30, 2011		December 31, 2010	
Nonaccrual loans	$ 26,643		$ 20,324	
Foreclosed properties	8,937		12,028	
Total nonperforming assets	$ 35,580		$ 32,352	
Restructured loans	$ 32,008		$ 21,695	
Loans past due 90 days and still accruing (not included in nonaccrual loans above)	$ 102		$ 315	
Nonperforming assets to loans at end of period(1)	8.16	%	7.14	%
Nonperforming assets to total assets	5.87	%	5.47	%
Allowance for loan losses to nonaccrual loans	56.2	%	36.0	%

(1) Loans are net of unearned income.

The following table presents an analysis of the changes in nonperforming assets for the dates indicated.

Nonperforming Assets
(In thousands)

	Nonaccrual Loans	Foreclosed Properties	Total
Balance December 31, 2009	$ 25,913	$ 11,279	$ 37,192
Additions, net	10,094	481	10,575
Sales	-	(6,020)	(6,020)
Transfers	(6,717)	6,717	-
Repayments	(600)	-	(600)
Charge-offs	(8,366)	(429)	(8,795)
Balance December 31, 2010	$ 20,324	$ 12,028	$ 32,352
Additions, net	13,778	136	13,914
Sales	-	(5,396)	(5,396)
Transfers	(2,715)	2,715	-

Repayments	(967)	-	(967)
Charge-offs	(3,777)	(546)	(4,323)
Balance September 30, 2011	$ 26,643	$ 8,937	$ 35,580

Note 5 – Investment securities

At September 30, 2011 and December 31, 2010, all of our securities were classified as available-for-sale. The following table presents the composition of our investment portfolio at the dates indicated (dollars in thousands).

	Par Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Average Yield
September 30, 2011						
US Government Agencies						
Five to ten years	$2,775	$2,775	$20	$-	$2,795	3.22 %
Mortgage-backed securities						
One to five years	72	74	-	-	74	2.68 %
More than ten years	40,169	41,111	873	(32)	41,952	2.46 %
Total	40,241	41,185	873	(32)	42,026	2.46 %
Municipals						
More than ten years	4,000	4,084	314	-	4,398	5.14 %
Other investments						
More than ten years	7,442	7,472	10	(10)	7,472	0.52 %
Total investment securities	$54,458	$55,516	$1,217	$(42)	$56,691	2.45 %
December 31, 2010						
US Treasuries						
One to five years	$28,000	$28,017	$-	$-	$28,017	0.22 %
US Government Agencies						
Five to ten years	3,000	3,000		(111)	2,889	2.00 %
Mortgage-backed securities						
One to five years	686	703	31	(10)	724	4.90 %
More than ten years	14,410	14,796	91	(58)	14,829	2.86 %
Total	15,096	15,499	122	(68)	15,553	5.39 %
Municipals						
More than ten years	6,000	6,060	-	(337)	5,723	4.69 %
Other investments						
More than ten years	1,418	1,418	-	(3)	1,415	0.69 %
Total investment securities	$53,514	$53,994	$122	$(519)	$53,597	2.31 %

Investment securities available for sale that have an unrealized loss position at September 30, 2011 and December 31, 2010 are detailed below.

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	Securities in a loss Position for less than 12 Months		Securities in a loss Position for more than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value (Loss)	Unrealized Losses	Fair Value	Unrealized Losses
			(in thousands)			
September 30, 2011						
Investment Securities available for sale						
Mortgage-backed securities	$4,834	$(31)	$270	$(1)	$5,104	$(32)
Municipals	3,965	(10)	-	-	3,965	(10)
Total	$8,799	$(41)	$270	$(1)	$9,069	$(42)
December 31, 2010						
Investment Securities available for sale						
US Treasuries	$30,286	$(114)	$-	$-	$30,286	$(114)
Mortgage-backed securities	7,079	(68)			7,079	(68)
Municipals	5,723	(337)	-	-	5,723	(337)
Total	$43,088	$(519)	$-	$-	$43,088	$(519)

Management does not believe that any individual unrealized loss as of September 30, 2011 and December 31, 2010 is other than a temporary impairment. These unrealized losses are primarily attributable to changes in interest rates. As of September 30, 2011, management does not have the intent to sell any of the securities classified as available for sale and management believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost.

Note 6 – Deposits

Deposits as of September 30, 2011 and December 31, 2010 were as follows:

	September 30, 2011		December 31, 2010	
	Amount	%	Amount	%
Noninterest bearing demand	$ 62,865,964	12.47 %	$ 41,036,262	8.22 %
Interest checking accounts	39,356,483	7.81 %	33,291,777	6.67 %
Money market accounts	83,742,862	16.61 %	90,156,362	18.07 %
Savings accounts	13,561,520	2.69 %	10,538,023	2.11 %
Time deposits of $100,000 and over	126,429,092	25.08 %	140,846,619	28.23 %
Other time deposits	178,215,279	35.35 %	183,143,150	36.70 %

Total	$ 504,171,200	100.00 %	$ 499,012,193	100.00 %

Note 7 – Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate at September 30, 2011 was 2.40%. The securities were redeemable at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. No amounts have been redeemed at September 30, 2011 and there are no plans to do so. The principal asset of the Trust is $5.2 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a five year fixed income rate of 6.29% payable quarterly, converting after five years to a LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.40%) which adjusts, and is also payable, quarterly. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. The principal asset of the Trust is $3.6 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust's obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends. In consideration of the Company's Memorandum of Understanding with the Federal Reserve Bank of Richmond, which requires regulatory approval to make interest payments on these securities, the Company elected to defer interest payments on the junior subordinated debt securities of $89,135 due on June 15, 2011, and $89,135 due on September 15, 2011. We also anticipate deferring interest payments of approximately $89,000 due December 15, 2011. Although we elected to defer payment of the interest due, the amount has been accrued and is included in interest expense.

Note 8 – Stock incentive plan

The Company has a stock incentive plan which authorizes the issuance of up to 455,000 shares of common stock to assist the Company in recruiting and retaining key personnel.

The following table summarizes stock options outstanding under the stock incentive plan at the indicated dates:

	Nine Months Ended September 30,							
	2011				2010			
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	310,205	$9.48	$4.73		336,005	$9.58	$4.75	
Granted	-	-	-		-	-	-	
Forfeited	-	-			(25,800)	10.77	5.02	
Exercised	-	-	-		-	-	-	
Options outstanding, end of period	310,205	$9.48	$4.73	$-	310,205	$9.48	$4.73	$-

Options exercisable, end of period	291,350	291,350

During the first quarter of 2009, we granted to certain officers 26,592 restricted shares of common stock with a weighted average fair market value of $4.60 at the date of grant. These restricted stock awards have three-year graded vesting. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock and performance share awards was 6,271 and 14,881 at September 30, 2011 and 2010, respectively.

The fair value of the stock is calculated under the same methodology as stock options and the expense is recognized over the vesting period. Unamortized stock-based compensation related to nonvested share based compensation arrangements granted under the Incentive Plan as of September 30, 2011 and 2010 was $35,960 and $170,568, respectively. The time based unamortized compensation of $35,960 is expected to be recognized over a weighted average period of 0.35 years.

Stock-based compensation expense was $88,835 and $73,072 for the nine months ended September 30, 2011 and 2010, respectively.

Note 9 — Fair value

Effective January 1, 2008, the Company adopted the provisions of FASB Codification Topic 820: Fair Value Measurements which defines fair value, establishes a framework for measuring fair value under U.S. GAAP, and expands disclosures about fair value measurements.

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transaction involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are independent, knowledgeable, able to transact and willing to transact.

FASB Codification Topic 820: Fair Value Measurements and Disclosures establishes a hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair values hierarch is as follows:

Level 1 Inputs — Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Inputs — Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Inputs- Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods to determine the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities held-to-maturity and available-for-sale is estimated based on quoted prices for similar assets or liabilities determined by bid quotation received from independent pricing services (Levels 1 and 2).

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Impaired loans: The fair values of impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans on a nonrecurring basis. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The vast majority of the Company's collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than two years old, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal if deemed significant using observable market data. Likewise, values for inventory and account receivables collateral are based on financial statement balances or aging reports (Level 3). Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Real Estate Owned: Real estate owned assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, real estate owned assets are carried at net realizable value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring level 3.

Assets and liabilities measured at fair value under Topic 820 on a recurring and non-recurring basis are summarized below for the indicated dates:

		Fair Value Measurement at September 30, 2011 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)		
Financial Assets - Recurring				
US Government Agencies	$ 2,795	$ -	$ 2,795	$ -
MBS	42,026	-	42,026	-
Municipals	4,398	-	4,398	-
Other available for sale(1)	7,472	7,472	-	-
Financial Assets - Non-Recurring				
Impaired loans	47,852	-	31,221	16,631
Real estate owned	8,937	-	-	8,937
Residential loans held for sale	13,786	-	13,786	-

		Fair Value Measurement at September 30, 2010 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)		
Financial Assets - Recurring				
US Government Agencies	$ 8,854	$ -	$ 8,854	$ -
MBS	12,125	-	12,125	-
Municipals	5,285	-	5,285	-
Other available for sale(1)	2,048	-	2,048	-
Financial Assets - Non-Recurring				
Impaired loans	23,943	-	-	23,943
Real estate owned	12,941	-	-	12,941
Residential loans held for sale	26,522	-	26,522	-

(1) Excludes restricted stock.

Fair Value Measurement - Level 3
September 30, 2011

	Impaired Loans	Real Estate Owned	Total Assets
		(In thousands)	
Balance at June 30, 2011	$ 17,901	$ 11,982	$ 29,883
Total realized and unrealized gains (losses) included in earnings	(6,743)	(172)	(6,915)
Net transfers in and/or out of Level 3	36,694	(2,873)	33,821
Balance at September 30, 2011	$ 47,852	$ 8,937	$ 56,789
Balance at December 31, 2010	$ 8,662	$ 12,028	$ 20,690
Total realized and unrealized gains (losses) included in earnings	(8,646)	(786)	(9,432)
Net transfers in and/or out of Level 3	47,836	(2,305)	45,531
Balance at September 30, 2011	$ 47,852	$ 8,937	$ 56,789

In general, fair value of securities is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon market prices determined by an outside, independent entity that primarily uses as inputs, observable market-based parameters. Fair value of loans held for sale is based upon internally developed models that primarily use as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Cash and cash equivalents – The carrying amount of cash and cash equivalents approximates fair value.

Investment securities – The fair value of investment securities available-for-sale is estimated based on bid quotations received from independent pricing services for similar assets. The carrying amount of other investments approximates fair value.

Loans – For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. For all other loans, fair values are calculated by discounting the contractual cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loans, or by using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits – The fair value of deposits with no stated maturity, such as demand, interest checking and money market, and savings accounts, is equal to the amount payable on demand at year-end. The fair value of certificates of deposit is based on the discounted value of contractual cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowings – The fair value of FHLB borrowings is based on the discounted value of contractual cash flows using the rates currently offered for borrowings of similar remaining maturities. The carrying amounts of federal funds purchased approximate their fair values.

Accrued interest – The carrying amounts of accrued interest receivable and payable approximate fair value.

Off-balance-sheet instruments –The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of commitments to extend credit, including letters of credit, is estimated to approximate their aggregate book balance.

	September 30, 2011		December 31, 2010	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 53,751,362	$ 53,751,362	$ 12,012,311	$ 12,012,311
Investment securities available for sale	56,691,242	56,691,242	53,597,174	53,597,174
Loans held for sale	13,786,238	13,786,238	19,871,787	19,871,787
Loans	421,830,941	424,278,543	446,555,089	451,155,101
Accrued interest receivable	2,360,571	2,360,571	2,347,211	2,347,211
Financial liabilities				
Deposits	504,171,200	506,120,173	499,012,193	501,222,836
FHLB borrowings	37,750,000	38,018,506	28,750,000	28,883,669
Trust preferred securities	8,764,000	8,764,000	8,764,000	8,764,000
Other borrowings	5,107,402	5,107,402	4,165,430	4,165,430
Accrued interest payable	514,280	514,280	404,801	404,801