Sunstone Hotel Investors, Inc.
Form 424B5
March 30, 2011
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The information in this preliminary prospectus supplement is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell nor do they seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MARCH 30, 2011

PRELIMINARY PROSPECTUS SUPPLEMENT

(To Prospectus dated January 14, 2011)

Shares

Sunstone Hotel Investors, Inc.

% Series D Cumulative Redeemable

Preferred Stock

(Liquidation Preference $25.00 Per Share)

We are offering shares of our % Series D Cumulative Redeemable Preferred Stock, par value $0.01 per share, which we refer to in this prospectus supplement as our series D preferred. We will pay cumulative dividends on our series D preferred in the amount of $ per share each year, which is equivalent to % of the $25.00 liquidation preference per share. Dividends on our series D preferred sold in this offering will be payable quarterly in arrears on the 15th day of each of January, April, July and October of each year, commencing July 15, 2011. Our series D preferred is not subject to any sinking fund. Upon liquidation, dissolution or winding up, our series D preferred will rank senior to our common stock, par value $0.01 per share (the common stock), with respect to the payment of distributions and amounts.

We are not allowed to redeem our series D preferred prior to , 2016, except as described in the immediately following paragraph and in limited circumstances to preserve our status as a real estate investment trust, or REIT. On or after , 2016, we may, at our option, redeem our series D preferred, in whole or from time to time in part, for cash at a redemption price of $25.00 per share, plus all accrued and unpaid dividends on such series D preferred up to, but not including, the redemption date.

In addition, upon the occurrence of a Change of Control (as defined herein), we may, at our option, redeem the series D preferred, in whole or in part and within 120 days after the first date on which such Change of Control occurred, by paying $25.00 per share, plus any accrued and unpaid dividends to, but not including, the date of redemption.

If we exercise any of our redemption rights relating to the series D preferred, the holders of series D preferred will not have the conversion right described below. The series D preferred have no maturity date and will remain outstanding indefinitely unless redeemed by us or converted in connection with a Change of Control by the holders of series D preferred. Holders of our series D preferred will generally have no voting rights except for limited voting rights if we fail to pay dividends for six or more quarterly periods (whether or not consecutive) and in certain other events.

Upon the occurrence of a Change of Control, each holder of series D preferred will have the right (unless, prior to the Change of Control Conversion Date (as defined herein), we have provided or provide notice of our election to redeem the series D preferred) to convert some or all of the series D preferred held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per series D preferred to be converted equal to the lesser of:

the quotient obtained by dividing (i) the sum of the $25.00 liquidation preference plus the amount of any accrued and unpaid dividends to, but not including, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a record date for a series D preferred dividend payment and prior to the corresponding series D preferred dividend payment date, in which case no additional amount for such accrued and unpaid dividend will be included in this sum) by (ii) the Common Share Price (as defined herein); and

, or the Share Cap, subject to certain adjustments;

subject, in each case, to provisions for the receipt of alternative consideration as described in this prospectus supplement.

The series D preferred ranks *pari passu* with our 8.0% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share, and Series C Cumulative Convertible Redeemable Preferred Stock, par value $0.01 per share.

The series D preferred are subject to certain restrictions on ownership designed to preserve our qualification as a REIT for federal income tax purposes.

We intend to file an application to list the series D preferred on the NYSE under the symbol SHO PR D .

Investing in the series D preferred involves a high degree of risk. Before buying any series D preferred, you should carefully read the discussion of material risks of investing in the series D preferred under the heading Risk Factors beginning on page S-11 of this prospectus supplement and beginning on page 8 of our Annual Report on Form 10-K for the year ended December 31, 2010.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price (1)	$	$
Underwriting discount	$	$
Proceeds to Sunstone Hotel Investors, Inc. (before expenses)	$	$

(1) Plus accrued dividends, if any, from April , 2011.

We have granted the underwriters the right to purchase up to an additional shares of series D preferred at the public offering price, less the underwriting discount, to cover overallotments within 30 days from the date of this prospectus supplement.

The underwriters expect that the shares will be delivered in global form through the book-entry delivery system of The Depository Trust Company on or about April , 2011.

Joint Book-Running Managers

J.P. Morgan **BofA Merrill Lynch** **Wells Fargo Securities**

The date of this Prospectus Supplement is March , 2011.

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ABOUT THIS PROSPECTUS SUPPLEMENT

You should read this prospectus supplement along with the accompanying prospectus, as well as the information incorporated by reference herein and therein, carefully before you invest in our preferred stock. These documents contain important information that you should consider before making your investment decision. This prospectus supplement and the accompanying prospectus contain the terms of this offering of preferred stock. The accompanying prospectus contains information about our securities generally, some of which does not apply to the preferred stock covered by this prospectus supplement. This prospectus supplement may add, update or change information contained in or incorporated by reference in the accompanying prospectus. If the information in this prospectus supplement is inconsistent with any information contained in or incorporated by reference in the accompanying prospectus, the information in this prospectus supplement will apply and will supersede the inconsistent information contained in or incorporated by reference in the accompanying prospectus.

It is important for you to read and consider all of the information contained in this prospectus supplement and the accompanying prospectus before making your investment decision. You should also read and consider the additional information incorporated by reference in this prospectus supplement and the accompanying prospectus before making your investment decision. See Incorporation of Certain Information by Reference in this prospectus supplement.

You should rely only on the information contained in or incorporated by reference in this prospectus supplement, the accompanying prospectus and any related free writing prospectus required to be filed with the Securities and Exchange Commission, or the SEC. Neither we nor the underwriters have authorized any other person to provide you with additional or different information. If anyone provides you with additional or different information, you should not rely on it. Neither we nor the underwriters are making an offer to sell the series D preferred in any jurisdiction where the offer or sale is not permitted.

You should assume that the information appearing in this prospectus supplement, the accompanying prospectus, any such free writing prospectus and the documents incorporated by reference herein and therein is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

Unless this prospectus supplement otherwise indicates or the context otherwise requires, the terms our, us, our company and we as used in this prospectus supplement refer to Sunstone Hotel Investors, Inc. and its consolidated subsidiaries. We also use the term Operating Partnership to specifically refer to Sunstone Hotel Partnership, LLC and its consolidated subsidiaries in cases where it is important to distinguish between us and the Operating Partnership. Unless otherwise expressly stated or the context otherwise requires, all information in this prospectus supplement assumes that the over-allotment option granted to the underwriters is not exercised in whole or in part.

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INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC s rules allow us to incorporate by reference information into this prospectus supplement and the accompanying prospectus. This means that we can disclose important information to you by referring you to another document. Any information referred to in this way is considered part of this prospectus supplement and the accompanying prospectus from the date we file that document. Any reports filed by us with the SEC after the date of this prospectus supplement and before the date that the offering of the securities by means of this prospectus supplement is terminated will automatically update and, where applicable, supersede any information contained, or incorporated by reference, in this prospectus supplement or in the accompanying prospectus.

We incorporate by reference into this prospectus supplement and the accompanying prospectus the documents or information referred to under the heading Incorporation of Certain Information by Reference in the accompanying prospectus:

- our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on February 17, 2011 (including information specifically incorporated by reference therein from our Proxy Statement for our 2011 Annual Meeting filed with the SEC on March 25, 2011);

- our Current Reports on Form 8-K filed with the SEC on March 29, 2011; and

- all documents we file with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, on or after the date of this prospectus supplement and before the termination of this offering.

We are not, however, incorporating by reference any documents or portions thereof, whether specifically listed above or filed in the future, that are not deemed filed with the SEC. The documents incorporated by reference in this prospectus supplement and the accompanying prospectus and, in particular, our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on February 17, 2011, contain important information about us.

You should read Incorporation of Certain Information by Reference in the accompanying prospectus for information about how to obtain the documents incorporated by reference.

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SUMMARY

The information below is a summary of the more detailed information included elsewhere in, or incorporated by reference in, this prospectus supplement. You should read carefully the following summary in conjunction with the more detailed information contained in this prospectus supplement, the accompanying prospectus and the information incorporated by reference herein and therein. This summary is not complete and does not contain all of the information you should consider before purchasing shares of our series D preferred. You should carefully read the Risk Factors section beginning on page S-11 of this prospectus supplement and beginning on page 8 of our Annual Report on Form 10-K for the year ended December 31, 2010 to determine whether an investment in our series D preferred is appropriate for you.

Sunstone Hotel Investors, Inc.

We are a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code. As of the date of this prospectus supplement, we owned 33 hotels or the 33 hotels. The 33 hotels are comprised of 12,676 rooms, located in 14 states and in Washington, D.C. We also own other non-hotel investments.

Our primary business is to acquire, own, asset manage and renovate full-service hotels in the United States. As part of our ongoing portfolio management strategy, we may also sell hotels from time to time. Our hotels are operated under leading brand names, such as Marriott, Fairmont, Hilton, Hyatt and Starwood. Our portfolio primarily consists of upper upscale and upscale full-service hotels. We also own luxury and upper midscale hotels. The classifications luxury, upper upscale, upscale and upper midscale are defined by Smith Travel Research, an independent provider of lodging industry statistical data.

Our hotels are operated by third-party managers pursuant to management agreements with Sunstone Hotel TRS Lessee, Inc. or its subsidiaries. As of the date of this prospectus supplement, a subsidiary of Interstate Hotels & Resorts, Inc. managed 13 of our 33 hotels. Additionally, subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. managed 13 of our 33 hotels, and Davidson Hotel Company, a subsidiary of Denihan Hospitality Group, Fairmont Hotels & Resorts (U.S.), Highgate Hotels, L.P., Hilton Worldwide, Hyatt Corporation and Sage Hospitality Resources each managed one of our 33 hotels. We have attempted to align the interests of our managers with our own interests by structuring our management agreements to allow our managers to earn incentive management fees upon the attainment of certain profit thresholds.

Our headquarters are located at 120 Vantis, Suite 350, Aliso Viejo, California 92656, and our telephone number is (949) 330-4000. We were incorporated in Maryland on June 28, 2004.

Recent Developments

Hilton San Diego Bayfront Hotel

On March 29, 2011, we executed a definitive agreement to acquire a 75% majority interest in a joint venture that owns the 1,190-room Hilton San Diego Bayfront hotel located in San Diego, California for a total valuation of $475.0 million or approximately $399,000 per key. The total valuation of $475.0 million represents a 13.8x 2010 EBITDA multiple. Upon acquisition, the joint venture expects to enter into $240.0 million of non-recourse senior mortgage debt with an expected maturity in April 2016, which will bear an annual interest rate of LIBOR plus approximately 325 basis points. The expected mortgage debt is subject to completion of final documentation and closing conditions that may impact the final terms. Hilton Worldwide will continue to manage the hotel and will remain as the 25% minority equity partner in the joint venture. The acquisition is expected to close during the second quarter of 2011, although there can be no assurance the acquisition will close, or if it does, when the acquisition will close.

Royal Palm Hotel

On March 28, 2011, we executed a definitive agreement to sell the 409-room Royal Palm hotel for $130.0 million. At closing, we will receive $40.0 million in cash and will originate a $90.0 million secured purchase money loan to the seller. We will also retain an earn out right which will enable us to receive a future payment of up to $20.0 million in the event that the hotel achieves certain return hurdles. The purchaser will be obligated to complete the planned renovation of the hotel, which is budgeted to cost approximately $42.5 million, and which is expected to be completed in 2012. The seller loan is expected to bear an interest rate of 5% over LIBOR with a 1% LIBOR floor, and is expected to mature on December 31, 2013. We expect the disposition to close in April 2011, although there can be no assurance the disposition will close, or if it does, when the disposition will close.

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The Offering

The following is a brief summary of certain terms of this offering. For a more complete description of the terms of our series D preferred, see Description of the Series D Preferred in this prospectus supplement and Description of our Capital Stock Preferred Stock on page 5 of the accompanying prospectus. We will contribute the net proceeds of the sale of our series D preferred to the Operating Partnership and the Operating Partnership will issue to us series D preferred units, the economic terms of which will be substantially similar to the series D preferred.

Issuer	Sunstone Hotel Investors, Inc.
Securities Offered	shares of our series D preferred.
Ranking	The series D preferred ranks, with respect to dividend rights and rights upon our liquidation, dissolution or winding-up: senior to all classes or series of our common stock, and to any other class or series of our capital stock expressly designated as ranking junior to the series D preferred; on parity with any class or series of our capital stock expressly designated as ranking on parity with the series D preferred, including the 8.0% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share, or series A preferred, and Series C Cumulative Convertible Redeemable Preferred Stock, par value $0.01 per share, or series C preferred; and junior to any other class or series of our capital stock expressly designated as ranking senior to the series D preferred. Any future authorization or issuance of a class or series of our capital stock expressly designated as ranking senior to the series D preferred would require the affirmative vote of at least two-thirds of the outstanding shares of series D preferred.
Dividends	Investors that purchase our series D preferred in this offering will be entitled to receive cumulative cash dividends on the series D preferred, payable quarterly in arrears on the 15th day of each January, April, July and October of each year (or if not a business day, on the next succeeding business day), commencing July 15, 2011, at the rate of % per annum of the $25.00 liquidation preference per share (equivalent to an annual rate of $ per annum per share). Any dividend payable on the series D preferred for any partial dividend period (other than the first dividend period after the sale of shares of series D preferred in this offering) shall be computed on the basis of a 360−day year consisting of twelve 30-day months. Dividends on

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the series D preferred will accrue whether or not we have earnings, whether or not there are funds legally available for the payment of such dividends and whether or not such dividends are authorized or declared.

Generally, dividends paid by regular C corporations to persons or entities that are taxed as United States individuals are taxed for U.S. federal income tax purposes at the rate applicable to long-term capital gains, which is currently a maximum of 15%, subject to certain limitations. Because we are a REIT, however, our dividends, including dividends paid on our series D preferred, generally will continue to be taxed at regular ordinary income tax rates for such purposes, except to the extent that the special rules relating to qualified dividend income and capital gains dividends paid by a REIT apply. See U.S. Federal Income Tax Considerations in the accompanying prospectus.

Liquidation Preference	If we liquidate, dissolve or wind-up, holders of the series D preferred will have the right to receive $25.00 per share, plus accrued and unpaid dividends (whether or not earned or declared) up to, but not including, the date of payment, before any payment is made to holders of our common stock and any other class or series of capital stock ranking junior to the series D preferred as to liquidation rights. The rights of holders of series D preferred to receive their liquidation preference will be subject to the proportionate rights of any other class or series of our capital stock ranking senior to or on parity with the series D preferred as to liquidation, including our series A preferred and series C preferred.
Optional Redemption	We may not redeem the series D preferred prior to , 2016, except as described below under Special Optional Redemption and in limited circumstances to preserve our status as a REIT. On and after , 2016, the series D preferred will be redeemable at our option, in whole or in part at any time or from time to time, for cash at a redemption price of $25.00 per share, plus all accrued and unpaid dividends up to, but not including, the redemption date. Any partial redemption will be on a pro rata basis.
Special Optional Redemption	Upon the occurrence of a Change of Control (as defined in Description of the Series D Preferred Special Optional Redemption), we may, at our option, redeem the series D preferred, in whole or in part and

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	within 120 days after the first date on which such Change of Control occurred, by paying $25.00 per share, plus any accrued and unpaid dividends to, but not including, the date of redemption. If, prior to the Change of Control Conversion Date (as defined below), we exercise our redemption right (whether our optional redemption right or our special optional redemption right), you will not have the conversion right described below.
No Maturity, Sinking Fund or Mandatory Redemption	The series D preferred has no maturity date and we are not required to redeem the series D preferred at any time. Accordingly, the series D preferred will remain outstanding indefinitely, unless we decide, at our option, to exercise our redemption right or, under circumstances where the holders of series D preferred have a conversion right, the holders of series D preferred decide to convert the series D preferred. The series D preferred is not subject to any sinking fund.
Further Issuances	We may create and issue further series D preferred ranking equally and ratably with the series D preferred offered by this prospectus supplement in all respects, so that such further series D preferred will be consolidated and form a single series with the series D preferred offered by this prospectus supplement and will have the same terms as to status, redemption or otherwise.
Limited Voting Rights	Holders of series D preferred will generally have no voting rights. However, if we are in arrears on dividends on the series D preferred for six or more quarterly periods, whether or not consecutive, holders of the series D preferred (voting together as a class with the holders of all other classes or series of parity preferred stock upon which like voting rights have been conferred and are exercisable) will be entitled to vote at our next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on our board of directors until all unpaid dividends and the dividend for the then current period with respect to the series D preferred and any other class or series of parity preferred stock have been fully paid or declared and a sum sufficient for the payment thereof set aside for payment. In addition, we may not make certain material adverse changes to the terms of the series D preferred without the affirmative vote of the holders of at least two-thirds of the outstanding shares of series D preferred and all other shares of any class or series

	ranking on parity with the series D preferred that are entitled to similar voting rights (voting together as a single class).

Among other things, we may, without any vote of the holders of the series D preferred, issue additional shares of series D preferred.

Information Rights	During any period in which we are not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and any series D preferred are outstanding, we will (i) transmit by mail or other permissible means under the Exchange Act to all holders of series D preferred as their names and addresses appear in our record books and without cost to such holders, copies of the Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q that we would have been required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act if we were subject thereto (other than any exhibits that would have been required) and (ii) within 15 days following written request, supply copies of such reports to any prospective holder of the series D preferred. We will mail (or otherwise provide) the reports to the holders of series D preferred within 15 days after the respective dates by which we would have been required to filed such reports with the SEC if we were subject to Section 13 or 15(d) of the Exchange Act.
Listing	We intend to file an application to list the series D preferred on the NYSE under the symbol SHO PR D . If listing is approved, we expect trading to commence within 30 days after initial delivery of the series D preferred.
Restrictions on Ownership and Transfer	For us to qualify as a REIT under the Internal Revenue Code of 1986, as amended, or the Code, not more than 50% in value of our outstanding shares of capital stock may be owned, directly or indirectly, by five or fewer individuals, as defined in the Code. In order to assist us in meeting these requirements, no one person may own, actually or constructively, more than 9.8% (in value or in number of shares, whichever is more restrictive) of the outstanding shares of our series D preferred or more than 9.8% in value of the aggregate of the outstanding shares of our classes of stock. See Description of the Series D Preferred Restrictions on Ownership and Transfer.

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Conversion Rights

Upon the occurrence of a Change of Control, each holder of series D preferred will have the right (unless, prior to the Change of Control Conversion Date, we have provided or provide notice of our election to redeem the series D preferred) to convert some or all of the shares of series D preferred held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per series D preferred to be converted equal to the lesser of:

the quotient obtained by dividing (i) the sum of the $25.00 liquidation preference plus the amount of any accrued and unpaid dividends to, but not including, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a record date for a series D preferred dividend payment and prior to the corresponding series D preferred dividend payment date, in which case no additional amount for such accrued and unpaid dividend will be included in this sum) by (ii) the Common Share Price (as defined below); and

, or the Share Cap, subject to certain adjustments;

subject, in each case, to provisions for the receipt of alternative consideration, as described in the prospectus supplement.

The Share Cap is subject to pro rata adjustments for any Share Splits (as defined below) with respect to shares of our common stock as follows: the adjusted Share Cap as the result of a Share Split will be the number of shares of our common stock that is equivalent to the product of (i) the Share Cap in effect immediately prior to such Share Split multiplied by (ii) a fraction, the numerator of which is the number of shares of our common stock outstanding after giving effect to such Share Split and the denominator of which is the number of shares of our common stock outstanding immediately prior to such Share Split.

If we have provided or provide a redemption notice, whether pursuant to our special optional redemption right in connection with a Change of Control or our optional redemption right, holders of series D preferred will not have any right to convert the series D preferred in connection with the Change of Control Conversion Right (as defined below) and any series D preferred subsequently selected for redemption that have been tendered for conversion will be redeemed on

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the related date of redemption instead of converted on the Change of Control Conversion Date.

For definitions of Change of Control Conversion Right, Change of Control Conversion Date, Common Share Price and Share Split and for a description of the adjustments and provisions for the receipt of alternative consideration that may be applicable to the Change of Control Conversion Right, see Description of the Series D Preferred Conversion Rights.

Except as provided above in connection with a Change of Control, the series D preferred are not convertible into or exchangeable for any other securities or property.

Notwithstanding any other provision of our series D preferred, no holder of our series D preferred will be entitled to convert such series D preferred for shares of our common stock to the extent that receipt of such shares of common stock would cause such holder (or any other person) to exceed the share ownership limits contained in our charter, including the articles supplementary setting forth the terms of the series D preferred. See Description of Our Capital Stock Restrictions on Ownership and Transfer in the accompanying prospectus.

Use of Proceeds	We estimate that the net proceeds to us from this offering will be approximately $, after deducting the underwriting discount and other estimated offering expenses payable by us. We will contribute the net proceeds from this offering to our Operating Partnership in exchange for series D preferred units, the economic terms of which are substantially similar to the series D preferred. The Operating Partnership will subsequently use the net proceeds from this offering primarily for growth capital expenditures, future acquisitions and other general corporate purposes, including working capital. See Use of Proceeds.
Tax Considerations	The material federal income tax considerations of purchasing, owning and disposing of the series D preferred are summarized in Supplemental Material U.S. Federal Income Tax Considerations.
Form	The series D preferred will be issued and maintained in book-entry form registered in the name of the nominee of The Depository Trust Company, except under limited circumstances.

RISK FACTORS

See the information under the heading Risk Factors beginning on page 8 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on February 17, 2011, which information has been incorporated by reference into this prospectus supplement, and other information included in this prospectus supplement and the accompanying prospectus and reports we file from time to time with the SEC that we incorporate by reference herein for a discussion of factors you should carefully consider before deciding to invest in shares of our series D preferred. In addition to the risk factors incorporated by reference herein, please see the additional risk factors referenced below:

Our series D preferred has not been rated and is subordinated to our existing and future debt, and your interest could be diluted by the issuance of additional parity preferred securities and by other transactions.

Our series D preferred has not been rated by any nationally recognized statistical rating organization, which may negatively affect its market value and your ability to sell it. It is possible that one or more rating agencies might independently determine to issue such a rating or that such a rating, if issued, could adversely affect the market price of our series D preferred. In addition, we may elect in the future to obtain a rating of our series D preferred, which could adversely impact their market price. Ratings only reflect the views of the rating agency or agencies issuing the ratings and they could be revised downward or withdrawn entirely at the discretion of the issuing rating agency if in its judgment circumstances so warrant. Any such downward revision or withdrawal of a rating could have an adverse effect on the market price of our series D preferred.

The payment of amounts due on the series D preferred will be subordinated to all of our existing and future debt. We may also issue additional shares of series D preferred or additional preferred shares in the future which are on a parity with (or, upon the affirmative vote or consent of the holders of two-thirds of the outstanding series D preferred and each other class or series of preferred stock ranking on a parity with the series D preferred which are entitled to similar voting rights, voting as a single class, senior to) the series D preferred with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up. In addition to our series D preferred, as of March 29, 2011 we also have 7,050,000 shares of series A preferred outstanding and 4,102,564 shares of series C preferred outstanding, both of which are parity stock. Any of these factors may affect the trading price for the series D preferred.

As a holder of series D preferred, you have extremely limited voting rights.

Your voting rights as a holder of series D preferred will be limited. Our shares of common stock are the only class carrying full voting rights. Voting rights for holders of series D preferred exist primarily with respect to adverse changes in the terms of the series D preferred, the creation of additional classes or series of preferred shares that are senior to the series D preferred and our failure to pay dividends on the series D preferred for six or more quarterly periods (whether or not consecutive).

The change of control conversion feature may not adequately compensate you, and the change of control conversion and redemption features of the series D preferred may make it more difficult for a party to take over our company or discourage a party from taking over our company.

Upon a Change of Control, holders of our series D preferred will have the right (subject to our special optional redemption right) to convert some or all of their series D preferred into shares of our common stock (or equivalent value of alternative consideration) and under these circumstances we will also have a special optional redemption right to redeem the series D preferred. See Description of the Series D Preferred Special Optional Redemption and Conversion Rights. Upon such a conversion, holders will be limited to a maximum number of shares equal to the Share Cap. If the Common Share Price is less than $ (which is approximately % of the per-share closing sale price of our common shares on , 2011), subject

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to adjustment, holders will receive a maximum of shares of our common stock per series D preferred, which may result in a holder receiving value that is less than the liquidation preference of the series D preferred. In addition, those features of our series D preferred may have the effect of inhibiting a third party from making an acquisition proposal for our company or of delaying, deferring or preventing a change in control of our company under circumstances that otherwise could provide the holders of shares of our common stock and series D preferred with the opportunity to realize a premium over the then current market price or that shareholders may otherwise believe is in their best interests.

There is no established trading market for the series D preferred, listing on the NYSE does not guarantee a market for the series D preferred and the market price and trading volume of the series D preferred may fluctuate significantly.

The series D preferred are a new issue of securities with no trading market. We intend to file an application to list the series D preferred on the NYSE. However, an active and liquid trading market to sell the series D preferred may not develop after the issuance of the series D preferred offered hereby or, even if it develops, may not be sustained. Because the series D preferred have no stated maturity date, investors seeking liquidity may be limited to selling their shares in the secondary market. If an active trading market does not develop, the market price and liquidity of the series D preferred may be adversely affected. Even if an active public market does develop, we cannot guarantee you that the market price for the series D preferred will equal or exceed the price you pay for your shares of series D preferred.

The market determines the trading price for the series D preferred and may be influenced by many factors, including our history of paying dividends on the series D preferred, variations in our financial results, the market for similar securities, investors perception of us, our issuance of additional preferred equity or indebtedness and general economic, industry, interest rate and market conditions. Because the series D preferred carry a fixed dividend rate, their value in the secondary market will be influenced by changes in interest rates and will tend to move inversely to such changes. In particular, an increase in market interest rates may result in higher yields on other financial instruments and may lead purchasers of series D preferred to demand a higher yield on the price paid for the series D preferred, which could adversely affect the market price of the series D preferred.

We cannot assure you that the purchase or financing of the Hilton San Diego Bayfront hotel will be completed on a timely basis or at all.

Although we have executed a definitive agreement to acquire a 75% majority interest in a joint venture that owns the Hilton San Diego Bayfront hotel, the agreement is subject to customary closing requirements and conditions including ground lessor approval from the Port of San Diego. We cannot assure you that the requirements or conditions to closing the proposed acquisition, including approval from the Port of San Diego, will be satisfied, that we will complete the proposed acquisition on a timely basis or at all, that we will complete the proposed acquisition on the announced terms, or that we will complete the financing on the terms contemplated. Our failure to complete the proposed acquisition or the contemplated financing on the terms contemplated may impede our growth and cause us to incur non-recoverable costs.

If the proposed acquisition is completed, the risks associated with joint venture investments generally discussed in detail in the Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on February 17, 2011, will apply to the proposed acquisition, including, without limitation, the following:

- the risk that the proposed acquisition may not yield the returns we expect;
- the potential for our profitability to suffer because of acquisition-related costs or amortization costs for acquired intangible assets; and
- other risks discussed under Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on February 17, 2011.

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Our acquisition of the Hilton San Diego Bayfront hotel will increase our asset and geographic concentration, and accordingly we may be disproportionately harmed by matters affecting that hotel or California.

On a pro forma basis, the San Diego Bayfront hotel would represent approximately 14% of our revenues for the year ended December 31, 2010 and approximately 11% of our assets as of December 31, 2010. Furthermore, following the acquisition on a pro forma basis, approximately 32% of our rooms and approximately 34% of our revenues for the year ended December 31, 2010 are located in California. The size of this hotel and the concentration of our hotels in California expose our business to economic conditions, competition and real and personal property tax rates unique to California. Natural disasters in California, such as earthquakes, fires or mudslides, would disproportionately affect our hotel portfolio. The California economy and tourism industry, in comparison to other parts of the country, is negatively affected to a greater extent by changes and downturns in certain industries, including the entertainment and high technology industries. It is also possible that because of our California concentration, a change in California laws applicable to hotels and the lodging industry may have a greater impact on us than a change in comparable laws in another geographical area in which we have hotels. Adverse developments with the Hilton San Diego Bayfront hotel or in California generally could harm our revenue or increase our operating expenses in that state.

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USE OF PROCEEDS

We estimate that the net proceeds to us from this offering will be approximately $, after deducting the underwriting discount and other estimated offering expenses payable by us. We will contribute the net proceeds that we receive to the Operating Partnership in exchange for additional membership units in the Operating Partnership, the economic terms of which are substantially similar to the series D preferred. The Operating Partnership will subsequently use those net proceeds primarily for growth capital expenditures, future acquisitions and other general corporate purposes, including working capital.

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RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS

(in thousands, except ratio amounts)

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008	Year E Decer 3 20
continuing operations	$ (38,163)	$ (43,184)	$ 29,067	$ 29
ons:				
) losses of unconsolidated joint ventures	(555)	27,801	1,445	3
unconsolidated joint ventures	900	500	5,675	
d amortization of deferred financing fees	70,830	76,539	83,176	77
rental expense	3,218	3,226	3,235	3
ations:				
d amortization of deferred financing fees	17,172	22,698	18,618	25
rental expense	133	163	165	
	$ 53,535	$ 87,743	$ 141,381	$ 139
harges and Preferred Stock Dividends:				
ons:				
d amortization of deferred financing fees	$ 70,830	$ 76,539	$ 83,176	$ 77

rentalnder the Act, established, among other things: (i) new requirements for audit committees, including independence, onsibilities; (ii) additional responsibilities regarding financial statements for the Chief Executive Officer and Chief f the reporting company; (iii) new standards for auditors and regulation of audits, including independence provisions dit services that accountants may provide to their audit clients; (iv) increased disclosure and reporting obligations for the and their directors and executive officers, including accelerated reporting of stock transactions and a prohibition on sion blackout periods; and (v) a range of new and increased civil and criminal penalties for fraud and other violations of In addition, Sarbanes-Oxley required stock exchanges, such as NASDAQ, to institute additional requirements relating nance in their listing rules.

the Sarbanes-Oxley Act requires the Company to include in its Annual Report on Form 10-K a gement. Management's internal control report must, among other things, set forth management's he effectiveness of the Company's internal control over financial reporting.

onomic Stabilization Act of 2008. In response to unprecedented market turmoil during the third 8, the Emergency Economic Stabilization Act ("EESA") of 2008 was enacted on October 3, authorizes the U.S. Treasury to provide up to $700 billion to support the financial services uant to the EESA, the U.S. Treasury was initially authorized to use $350 billion for the Troubled rogram ("TARP"). Of this amount, the U.S. Treasury allocated $250 billion to the TARP Capital ram. On January 15, 2009, the second $350 billion of TARP monies was released to the U.S. Secretary's

r TARP was to expire on December 31, 2009, unless the Secretary certifies to Congress that
cessary provided that his authority may not extend beyond October 3, 2010. On December 9,
tary sent such a letter to the Congress, extending his authority under the TARP through October 3,

9, the Company issued preferred shares and a warrant to purchase its common shares to the U.S.
articipant in the TARP Capital Purchase Program. The amount of capital raised in that transaction
ion, approximately three percent of the Company's risk-weighted assets. Prior to May 1, 2012,
nt company has redeemed all such preferred shares or the U.S. Treasury has transferred all such
s to a third party, the consent of the U.S. Treasury will be required for us to, among other things,
on the Company's common shares or repurchase our common shares or outstanding preferred
n limited circumstances. No dividends may be paid on common stock unless dividends have been
or preferred stock. The senior preferred will not have voting rights other than the right to vote as a
uance of any preferred stock ranking senior, any change in its terms or any merger, exchange or
ion that would adversely affect its rights. The senior preferred will also have the right to elect two
dends have not been paid for six periods. The Company filed a registration statement on Form S-3
arrant as required under the terms of the TARP investment, on May 29, 2009. The registration
declared effective by the SEC on June 16, 2009.

il the U.S. Treasury ceases to own any of the Company's securities sold under the TARP Capital
am, the compensation arrangements for our senior executive officers must comply in all respects
l the rules and regulations there under. In compliance with such requirements, each of our senior
cers agreed in writing to accept the compensation standards in existence at that time under the
Purchase Program and thereby cap or eliminate some of their contractual or legal rights.

overy and Reinvestment Act of 2009. On February 17, 2009, President Obama signed the
overy and Reinvestment Act of 2009 ("ARRA") into law. ARRA modified the compensation-related
tained in the TARP Capital Purchase Program (the "CPP"), created additional compensation-related
directed the Secretary of the Treasury to establish standards for executive compensation applicable
in TARP. Thus, the newly enacted compensation-related limitations are applicable to the
h have been added or modified by ARRA are as follows, which provisions must be included in
lished by the U.S. Treasury:

Payments. Under ARRA "golden parachutes" were redefined as any severance payment resulting
ary termination of employment, or from bankruptcy of the employer, except for payments for
rmed or benefits accrued. Consequently under ARRA the Company is prohibited from making any
ment to our "senior executive officers" (defined in ARRA as the five highest paid executive officers)
ve most highly compensated employees during the CPP Covered Period.

Incentive Compensation if Based on Certain Material Inaccuracies. ARRA also contains the
ovision" discussed above but extends its application to any bonus or retention awards and other
npensation paid to any of our senior executive officers or next 20 most highly compensated
ring the CPP Covered Period that is later found to have been based on materially inaccurate
ments or other materially inaccurate measurements of performance

ation Arrangements That Encourage Earnings Manipulation. Under ARRA, during the CPP
od, the Company is not allowed to enter into compensation arrangements that encourage

of the reported earnings of the Company to enhance the compensation of any of our employees.

entive Compensation. ARRA contains a provision that prohibits the payment or accrual of any on award or incentive compensation to any of our 5 most highly compensated employees during red Period other than awards of long-term

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k that (i) do not fully vest during the CPP Coverage Period, (ii) have a value not greater than
e total annual compensation of the awardee and (iii) are subject to such other restrictions as
the Secretary of the Treasury. The prohibition on bonus, incentive compensation and retention
ot preclude payments required under written employment contracts entered into on or prior to
09.

Committee Functions. ARRA requires that our Compensation Committee be comprised solely of
irectors and that it meet at least semiannually to discuss and evaluate our employee compensation
of an assessment of any risk posed to us from such compensation plans.

ertifications. ARRA also requires a written certification by our Chief Executive Officer and Chief
cer of our compliance with the provisions of ARRA. These certifications must be contained in the
nnual Report on Form 10-K for the year ended December 31, 2009 and any subsequent year during
rchase Plan Covered Period the relevant U.S. Treasury regulations are issued.

ew of Excessive Bonuses Previously Paid. ARRA directs the Secretary of the Treasury to review
ion paid to our senior executive officers and our next 20 most highly compensated employees to
ether any such payments were inconsistent with the purposes of ARRA or were otherwise contrary
nterest. If the Secretary of the Treasury makes such a finding, the Secretary of the Treasury is
egotiate with the TARP Capital Purchase Program recipient and the subject employee for
mbursements to the federal government with respect to the compensation and bonuses.

Under ARRA the SEC promulgated rules requiring a non-binding say on pay vote by the
n executive compensation at the annual meeting during the CPP Covered Period.

ovides that the U.S. Treasury, after consultation with the Company's federal regulator, permit the
y time to redeem our Series A Preferred Shares at liquidation value. Upon such redemption, the
chase the parent company's common stock that was issued to the U.S. Treasury would also be
its then current fair value.

09, the U.S. Treasury issued guidance on the compensation and corporate governance standards
ARP recipients, as summarized below:

ued or paid before the effective date of the rule adopted by the U.S. Treasury are not subject to the
ayment limitation. In addition, separation pay for departures that occurred before receipt of TARP
is not subject to the limits of the rule (even if payments continue to be made after effectiveness).

st highly compensated employees" covers all employees, not only executive officers or other policy
determination of the most highly compensated employees is based on annual compensation for the
ulated in accordance with SEC disclosure rules.

its salary paid in property, including stock, so long as it is based on a dollar amount (not a number
fully vested and accrues as cash salary would. The rule also permits salary paid in stock units in

res of the TARP recipient, or subsidiaries or divisions of the TARP recipient (though not below the division for which the employee directly provides services). Holding periods also are permitted.

payments for sales, brokerage and asset management services for unrelated customers will not be bonus restrictions, but only if they are consistent with an existing plan of the TARP recipient in February 17, 2009.

es a restrictive set of “best practices” on TARP recipients: (i) the five senior executive officers and ost highly compensated employees may not receive any tax “gross-up” payment of any kind, nents to cover taxes due on company-provided benefits or separation payments; (ii) the prohibition payments to the five senior executive officers and the next five most highly compensated xtended to payments in connection with a change in control; (iii) the compensation committee l employee compensation plans every six months for unnecessary risk and provide an expanded cluding narrative disclosure of its analysis and conclusions; (iv) TARP recipients must exercise x rights unless doing so would be unreasonable; and (v) TARP recipients must adopt a policy gned to eliminate excessive or luxury expenditures.

will not become subject to the compensation standards merely as a result of acquiring a TARP addition, if an acquiror is not subject to the standards immediately after the transaction, any the acquiror (including former employees of the TARP recipient who become acquiror employees he transaction) will not be subject to the standards.

eriod” during which the compensation standards apply ceases when the obligations arising from tance cease and specifically excludes any period when the only outstanding obligation of a TARP sts of U.S. Treasury warrants to purchase common stock.

e Financial Stability Plan of 2009. On February 10, 2009, the Treasury Secretary announced a new financial stability plan (the “Financial Stability Plan”), which earmarked the second $350 billion of riginally authorized under the EESA. The major elements of the Financial Stability Plan included: istance program that has invested in convertible preferred stock of certain qualifying institutions, and business lending initiative to fund new consumer loans, small business loans and commercial -backed securities issuances, (iii) a public/private investment fund intended to leverage public and with public financing to purchase up to $500 billion to $1 trillion of legacy “toxic assets” from utions, and (iv) assistance for homeowners by providing up to $75 billion to reduce mortgage nterest rates and establishing loan modification guidelines for government and private programs.

orm. In June 2009, the Obama administration proposed a wide range of regulatory reforms that, if ave significant effects on the financial services industry in the United States. Significant aspects of ninistration’s proposals included, among other things, proposals (i) that any financial firm whose size, leverage and interconnectedness could pose a threat to financial stability be subject to certain atory requirements, (ii) that federal bank regulators require loan originators or sponsors to retain dit risk of securitized exposures, (iii) that there be increased regulation of broker-dealers and isers, (iv) for the creation of a federal consumer financial protection agency that would, among charged with applying consistent regulations to similar products (such as imposing certain notice quirements on consumer overdraft lines of credit), (v) that there be comprehensive regulation of es, (vi) that the controls on the ability of banking institutions to engage in transactions with ghtened, and (vii) that financial holding companies be required to be “well-capitalized” and ” on a consolidated basis.

state lawmaking bodies and federal and state regulatory agencies continue to consider a number of nd comprehensive proposals for altering the structure, regulation and competitive relationships of ancial institutions, including rules and regulations related to the broad range of reform proposals set ama administration described above. Separate comprehensive financial reform bills intended to posals set forth by the Obama administration were introduced in both houses of Congress in the

2009 and remain under review by both the U.S. House of Representatives and the U.S. Senate. In
he U.S. Treasury Department and the Basel Committee on Banking

e "Basel Committee") have issued policy statements regarding proposed significant changes to the
tal framework applicable to banking organizations.

dict whether or in what form further legislation and/or regulations may be adopted or the extent to
pany's business may be affected thereby.

pensation. On October 22, 2009, the Federal Reserve Board issued a comprehensive proposal on
pensation policies (the "Incentive Compensation Proposal") intended to ensure that the incentive
policies of banking organizations do not undermine the safety and soundness of such organizations
g excessive risk-taking. The Incentive Compensation Proposal, which covers all employees that
to materially affect the risk profile of an organization, either individually or as part of a group, is
e key principles that a banking organization's incentive compensation arrangements should (i)
ves that do not encourage risk-taking beyond the organization's ability to effectively identify and
ii) be compatible with effective internal controls and risk management, and (iii) be supported by
e governance, including active and effective oversight by the organization's board of directors. The
pensation Proposal also contemplates a detailed review by the Federal Reserve Board of the
pensation policies and practices of a number of "large, complex banking organizations". Any
compensation practices that are identified may be incorporated into the organization's supervisory
can affect its ability to make acquisitions or perform other actions. The Incentive Compensation
ides that enforcement actions may be taken against a banking organization if its incentive
arrangements or related risk-management control or governance processes pose a risk to the
safety and soundness and the organization is not taking prompt and effective measures to correct the
In addition, on January 12, 2010, the FDIC announced that it would seek public comment on
with compensation plans that encourage risky behavior should be charged at higher deposit
s than such banks would otherwise be charged.

content of the U.S. banking regulators' policies on executive compensation are continuing to
e likely to continue evolving in the near future. It cannot be determined at this time whether
h such policies will adversely affect the ability of the Company to hire, retain and motivate its and
oyees

on. As a Virginia state-chartered FDIC bank that is not a member of the Federal Reserve System,
bject to regulation, supervision and examination by the SCC's Bureau of Financial Institutions
Bank is also subject to regulation, supervision and examination by the FDIC. Federal law also
ivities in which we may engage, the investments we may make and the aggregate amount of loans
anted to one borrower. Various consumer and compliance laws and regulations also affect our
rnings are affected by general economic conditions, management policies and the legislative and
actions of various regulatory authorities, including those referred to above. The following
mmarizes some of the laws to which we are subject. The BFI and the FDIC will conduct regular
reviewing such matters as the overall safety and soundness of the institution, the adequacy of loan
uality of loans and investments, management practices, compliance with laws, and other aspects of
s. In addition to these regular examinations, we must furnish the FDIC with periodic reports
ll and accurate statement of our affairs. Supervision, regulation and examination of banks by these
ended primarily for the protection of depositors rather than shareholders.

ccounts, Assessments and Regulation by the FDIC. Our deposits are insured by the FDIC up to the
n under applicable law, currently $250,000. Deposits are subject to the deposit insurance
the Bank Insurance Fund ("BIF") of the FDIC. The FDIC is authorized to prohibit any BIF-insured
n engaging in any activity that the FDIC determines by regulation or order to pose a serious threat

e insurance fund. Also, the FDIC may initiate enforcement actions against banks, after first giving
s primary regulatory authority an opportunity to take such action. The FDIC may terminate the
ce of any depository institution if it determines, after a hearing, that the institution has

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engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue
has violated any applicable law, regulation, order or any condition imposed in writing by the
may suspend deposit insurance temporarily during the hearing process for the permanent
insurance if the institution has no tangible capital. If deposit insurance is terminated, the deposits
n at the time of termination, less subsequent withdrawals, shall continue to be insured for a period
s to two years, as determined by the FDIC. We are aware of no existing circumstances that could
ation of our deposit insurance.

on October 14, 2008, after receiving a recommendation from the boards of the FDIC and the
ve, and consulting with the President, the Secretary of the Treasury signed the systemic risk
e FDIC Act, enabling the FDIC to establish its Temporary Liquidity Guarantee Program ("TLGP").
mponent of this program, the Transaction Account Guarantee Program ("TAGP"), the FDIC
ovided a full guarantee on all non-interest bearing transaction accounts held by any depositor,
ollar amount, through December 31, 2009. The $250,000 deposit insurance coverage limit was
turn to $100,000 on January 1, 2010, but was extended by congressional action until December 31,
GP has been extended to cover debt of FDIC-insured institutions issued through April 30, 2010,
has been extended through June 30, 2010. The TLGP also guarantees all senior unsecured debt of
ory institutions or their qualified holding companies issued between October 14, 2008 and June 30,
ted maturity greater than 30 days. All eligible institutions were permitted to participate in both of
s of the TLGP without cost for the first 30 days of the program. Following the initial 30 day grace
ions were assessed at the rate of ten basis points for transaction account balances in excess of
e transaction account guarantee program and at the rate of either 50, 75, or 100 basis points of the
issued, depending on the maturity date of the guaranteed debt, for the debt guarantee program.
ere required to opt-out of the TLGP if they did not wish to participate. The Company and its
idiaries elected to participate in both of these programs.

DIC has issued risk-based and leverage capital guidelines applicable to banking organizations they
der the risk-based capital requirements, we are generally required to maintain a minimum ratio of
risk-weighted assets (including certain off-balance sheet activities, such as standby letters of
At least half of the total capital is to be composed of common equity, retained earnings and
petual preferred stock, less certain intangibles ("Tier 1 capital"). The remainder may consist of
nated debt, certain hybrid capital instruments and other qualifying preferred stock and a limited
oan loss allowance ("Tier 2 capital" and, together with Tier 1 capital, "total capital"). In addition, each
bank regulatory agencies has established minimum leverage capital ratio requirements for banking
These requirements provide for a minimum leverage ratio of Tier 1 capital to adjusted average
equal to 4% for banks and bank holding companies that meet certain specified criteria. All other
holding companies will generally be required to maintain a leverage ratio of at least 100 to 200
bove the stated minimum. The risk-based capital standards of the FDIC explicitly identify
of credit risk and the risk arising from non-traditional activities, as well as an institution's ability to
sks, as important factors to be taken into account by the agency in assessing an institution's overall
cy. The capital guidelines also provide that an institution's exposure to a decline in the economic
ital due to changes in interest rates be considered by the agency as a factor in evaluating a bank's
y.

ct. The USA Patriot Act became effective on October 26, 2001 and provides for the facilitation of
aring among governmental entities and financial institutions for the purpose of combating terrorism
undering. Among other provisions, the USA Patriot Act permits financial institutions, upon
ce to the United States Treasury, to share information with one another in order to better identify
he federal government concerning activities that may involve money laundering or terrorists'

USA Patriot Act is considered a significant banking law in terms of information disclosure
ain customer transactions. Certain provisions of the USA Patriot Act impose the obligation to
noney

grams, including the development of a customer identification program, and the screening of all
nst any government lists of known or suspected terrorists. Although it
eporting obligation and compliance costs, the USA Patriot Act has not materially affected the
s, services or other business activities.

rorist Activities. The Office of Foreign Assets Control (OFAC), which is a division of the
the Treasury, is responsible for helping to insure that United States entities do not engage in
with "enemies" of the United States, as defined by various Executive Orders and Acts of
AC has sent, and will send, our banking regulatory agencies lists of names of persons and
suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any
ount or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity
fy the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its
he filing of any notifications. The Bank actively checks high-risk OFAC areas such as new
transfers and customer files. The Bank performs these checks utilizing software, which is updated
dification is made to the lists provided by OFAC and other agencies of Specially Designated
Blocked Persons.

nd Soundness Regulations. There are a number of obligations and restrictions imposed on
tutions by federal law and regulatory policy that are designed to reduce potential loss exposure to
of such depository institutions and to the FDIC insurance funds in the event the depository
omes in danger of default or is in default. The Federal banking agencies also have broad powers
Federal law to take prompt corrective action to resolve problems of insured depository
he extent of these powers depends upon whether the institution in question is well-capitalized,
italized, undercapitalized, significantly undercapitalized or critically undercapitalized, as defined
deral regulatory authorities also have broad enforcement powers over us, including the power to
d other civil and criminal penalties, and to appoint a receiver in order to conserve the assets of any
n for the benefit of depositors and other creditors. Village Bank is currently classified as well
ncial institution.

Borrower. Under applicable laws and regulations the amount of loans and extensions of credit
xtended by a bank to any one borrower, including related entities, generally may not exceed 15%
red capital and unimpaired surplus of the institution. Loans in an amount equal to an additional
ired capital and unimpaired surplus also may be made to a borrower if the loans are fully secured
ketable securities. An institution's "unimpaired capital and unimpaired surplus" includes, among
e amount of its core capital and supplementary capital included in its total capital under Federal

einvestment. The requirements of the Community Reinvestment Act ("CRA") are applicable to the
CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit
ocal communities, including low and moderate income neighborhoods, consistent with the safe and
n of those institutions. A financial institution's efforts in meeting community credit needs currently
as part of the examination process pursuant to 12 assessment factors. These factors also are
valuating mergers, acquisitions and applications to open a branch or facility.

Monetary Policies. Our operations are affected not only by general economic conditions, but also
ic and monetary policies of various regulatory authorities. In particular, the Federal Reserve
y, credit and interest rates in order to influence general economic conditions. These policies have a
uence on overall growth and distribution of loans, investments and deposits and affect interest rates
ns or paid for time and savings deposits. Federal Reserve monetary policies have had a significant

erating results of commercial banks in the past and are expected to continue to do so in the future.

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er 31, 2009, the Company and its subsidiaries had a total of 194 full-time employees and 13
oyees. None of the Company's employees are covered by a collective bargaining agreement. The
ders its relations with its employees to be good.

tain Shareholders

has one shareholder who owns 8.38% of its outstanding Common Stock. As a group, the Board of
the Company's Executive Officers control 16.42% of the outstanding Common Stock of the
f March 1, 2009. Accordingly, such persons, if they were to act in concert, would not have
l of the Bank and would not have the ability to approve certain fundamental corporate transactions
of the Board of Directors.

rmation

files annual, quarterly and current reports, proxy statements and other information with the
Exchange Commission. You may read and copy any reports, statements and other information we
s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC
0330 for further information on the operations of the Public Reference Room. Our SEC filings are
n the SEC's Internet site (http://www.sec.gov).

s common stock trades under the symbol "VBFC" on the Nasdaq Capital Market. You may also read
statements and other information we file at the offices of the National Association of Securities
735 K Street, N.W., Washington, DC 20006.

s Internet address is www.villagebank.com. At that address, we make available, free of charge, the
nual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and
o those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act (see
ions" section of website), as soon as reasonably practicable after we electronically file such material
it to, the SEC.

will provide, at no cost, paper or electronic copies of our reports and other filings made with the
or exhibits). Requests should be directed to C. Harril Whitehurst, Jr., Chief Financial Officer,
nd Trust Financial Corp., PO Box 330, Midlothian, VA 23113.

n on the websites listed above is not and should not be considered to be part of this annual report
and is not incorporated by reference in this document.

K FACTORS

in the parent company's common stock is subject to risks inherent to the Company's business,
material risks and uncertainties that are described below. Before making an investment decision,
refully consider the risks and uncertainties described below together with all of the other
luded or incorporated by reference in this report. The risks and uncertainties described below are
es facing the Company. Additional risks and uncertainties that management is not aware of or
r that management currently deems immaterial, may also impair the Company's business
is report is qualified in its entirety by these risk factors. If any of the following risks adversely

pany's business, financial condition or results of operations, the value of the parent company's
could decline significantly and you could lose all or part of your investment.

’s business may be adversely affected by conditions in the financial markets and economic
erally.

ber 2007, the United States has experienced a recession and a slowing of economic
ess activity across a wide range of industries and regions is greatly reduced, and local governments
nesses are in serious difficulty, due to the lack of consumer spending and the lack of liquidity in the
Unemployment has increased significantly.

ervices industry and the securities markets generally were materially and adversely affected by
ines in the values of nearly all asset classes and by a serious lack of liquidity. This was initially
clines in home prices and the values of subprime mortgages, but spread to all mortgage and real
ses, to leveraged bank loans and to nearly all asset classes, including equities. The global markets
racterized by substantially increased volatility and short selling and an overall loss of investor
tially in financial institutions, but more recently in companies in a number of other industries and
markets.

ons have also led to the failure or merger of a number of prominent financial institutions. Financial
res or near-failures have resulted in further losses as a consequence of defaults on securities issued
efaults under contracts entered into with such entities as counterparties. Furthermore, declining
efaults on mortgages and consumer loans, and the lack of market and investor confidence, as well
, have all combined to increase credit default swap spreads, to cause rating agencies to lower credit
otherwise increase the cost of and decrease the availability of liquidity, despite very significant
eral Reserve borrowing rates and other government actions. Some banks and other lenders have
cant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of
e impact of declining asset values on the value of collateral. The foregoing has significantly
strength and liquidity of some financial institutions worldwide. In 2008 and 2009, the U.S.
he Federal Reserve and other regulators took numerous steps to increase liquidity and to restore
ence, including investing approximately $200 billion in the equity of other banking organizations,
have continued to decline and access to liquidity continues to be very limited.

ate of increase in unemployment and the rate of decline in housing prices have slowed and the
ding and liquidity in the credit markets have been somewhat improved towards the end of 2009,
lowdown generally continues and there can be no assurance such indicia of recovery would herald
period of economic recovery and growth in 2010.

s financial performance generally, and in particular the ability of borrowers to pay interest on and
ipal of outstanding loans and the value of collateral securing those loans, is highly dependent upon
nvironment in the market where the Company operates, the Richmond Metropolitan area. A
ness environment is generally characterized by, among other factors, economic growth, efficient
, low inflation, high business and investor confidence, and strong business earnings. Unfavorable
onomic and market conditions can be caused by: declines in economic growth, business activity, or
siness confidence; limitations on the availability or increases in the cost of credit and capital;
lation or interest rates; natural disasters; or a combination of these or other factors. Overall, during
ness environment was adverse for many households and businesses in the United States and
e business environment in the Richmond Metropolitan area, the United States and worldwide may
eriorate for the foreseeable future. There can be no assurance that these conditions will improve in
Such conditions could adversely affect the credit quality of the Company’s loans, results of
financial condition.

in economic indicators disproportionately affecting the financial services industry may lag
n the general economy.

bilization of the U.S. economy lead to a general economic recovery, the improvement of certain
ators, such as unemployment and real estate asset values and rents, may nevertheless continue to
overall economy. These economic indicators typically affect certain industries, such as real estate
ervices, more significantly. For example, improvements in commercial real estate fundamentals
oad economic recovery by 12 to 18 months. The Company's clients include entities active in these
thermore, financial services companies with a substantial lending business are dependent upon the
borrowers to make debt service payments on loans. Should unemployment or real estate asset
cover for an extended period of time, the Company could be adversely affected.

perations are significantly affected by the ability of our borrowers to repay their loans.

ource of risk is the possibility that losses will be sustained because borrowers, guarantors and
may fail to perform in accordance with the terms of their loan agreements. Most of the Company's
ed but some loans are unsecured. With respect to the secured loans, the collateral securing the
hese loans may be insufficient to cover the obligations owed under such loans. Collateral values
ly affected by changes in economic, environmental and other conditions, including declines in the
tate, changes in interest rates, changes in monetary and fiscal policies of the federal government,
sease, terrorist activity, environmental contamination and other external events. In addition,
raisals that are out of date or that do not meet industry recognized standards may create the
t a loan is adequately collateralized when it is not. The Company has adopted underwriting and
ing procedures and policies, including regular reviews of appraisals and borrower financial
management believes are appropriate to mitigate the risk of loss.

er 31, 2009, approximately 77.5% of the Company's loan portfolio consisted of commercial and
struction and commercial real estate loans. These types of loans are generally viewed as having
fault than residential real estate loans or consumer loans. These types of loans are also typically
dential real estate loans and consumer loans. Because the Company's loan portfolio contains a
nber of commercial and industrial, construction and commercial real estate loans with relatively
s, the deterioration of one or a few of these loans could cause a significant increase in
g loans. An increase in nonperforming loans could result in a net loss of earnings from these loans,
he provision for loan losses and an increase in loan charge-offs, all of which could have a material
on the Company's financial condition and results of operations. Further, if repurchase and
ands with respect to the Company's loan portfolio increase, its liquidity, results of operations and
ion will be adversely affected.

s allowance for loan losses may be insufficient.

maintains an allowance for loan losses, which is a reserve established through a provision for loan
to expense, that represents management's best estimate of probable losses that have been incurred
ing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for
losses and risks inherent in the loan portfolio.

e allowance reflects management's continuing evaluation of industry concentrations; specific credit
experience; current loan portfolio quality; present economic, political and regulatory conditions
d losses inherent in the current loan portfolio. The determination of the appropriate level of the
oan losses inherently involves a high degree of subjectivity and requires the Company to make

stimates of current credit risks and future trends, all of which may undergo material
tinuing deterioration of economic conditions affecting borrowers, new information regarding
identification of additional

and other factors, both within and outside the Company's control, may require an increase in the
oan losses. In addition, bank regulatory agencies periodically review the Company's allowance for
may require an increase in the provision for loan
recognition of further loan charge-offs, based on judgments different than those of
Further, if charge-offs in future periods exceed the allowance for loan losses, the Company will
l provisions to increase the allowance for loan losses. Any increases in the allowance for loan
lt in a decrease in net income and, possibly, capital, and may have a material adverse effect on the
ancial condition and results of operations.

rest rates may have an adverse effect on the Company's profitability.

s of financial institutions such as the Company are dependent to a large degree on net interest
is the difference between interest income from loans and investments and interest expense on
rrowings. An institution's net interest income is significantly affected by market rates of interest
affected by prevailing economic conditions, by the fiscal and monetary policies of the federal
d by the policies of various regulatory agencies. The Federal Reserve Board (FRB) regulates the
supply in order to manage recessionary and inflationary pressures. In doing so, the FRB may use
as engaging in open market transactions of U.S. Government securities, changing the discount
ing reserve requirements against bank deposits. The use of these techniques may also affect
arged on loans and paid on deposits. The interest rate environment, which includes both the level
es and the shape of the U.S. Treasury yield curve, has a significant impact on net interest
all financial institutions, the Company's balance sheet is affected by fluctuations in interest
y in interest rates can also result in disintermediation, which is the flow of deposits away from
tutions into direct investments, such as US Government and corporate securities and other
icles, including mutual funds, which, because of the absence of federal insurance premiums and
ments, generally pay higher rates of return than bank deposit products. See "Item 7: Management's
Financial Condition and Results of Operations" and "Item 7A: Quantitative and Qualitative
t Market Risk".

ue may adversely impact the investment portfolio.

ealized any non-cash, other-than-temporary impairment charges during 2009 as a result of
ir value below original cost of any investments in our investment portfolio. However, we could be
rd future impairment charges on our investment securities if they suffer any declines in value that
other-than-temporary. Considerations used to determine other-than-temporary impairment status
oldings include the length of time the stock has remained in an unrealized loss position, and the
nrealized loss compared to the carrying cost of the stock, dividend reduction or suspension, market
and expectations, and other pertinent news that would affect expectations for recovery or further

may not be able to meet the cash flow requirements of its depositors and borrowers or meet its
needs.

e ability to meet cash flow needs on a timely basis at a reasonable cost. The liquidity of the
ed to service its debt. The liquidity of the Bank is used to make loans and leases and to repay
es as they become due or are demanded by customers. Liquidity policies and limits are established
directors. The overall liquidity position of the Company and the Bank are regularly monitored to
ous alternative strategies exist to cover unanticipated events that could affect liquidity. Funding
Federal funds purchased, securities sold under repurchase agreements and non-core deposits. The

ber of the Federal Home Loan Bank of Atlanta, which provides funding through advances to
re collateralized with mortgage-related assets.

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y is unable to access any of these funding sources when needed, we might be unable to meet
ds, which could adversely impact our financial condition, results of operations, cash flows, and
ory-qualifying capital

eptions associated with the Company's continued participation in the U.S. Treasury's Capital
ram may adversely affect its ability to retain customers, attract investors and compete for new
unities.

al institutions which participated in the TARP Capital Purchase Program received approval from
ury to exit the program during the second half of 2009. These institutions have, or are in the
purchasing the preferred stock and repurchasing or auctioning the warrant issued to the U.S.
t of the program. The Company has not yet requested the U.S. Treasury's approval to repurchase
ock and warrant from the U.S. Treasury. In order to repurchase one or both securities, in whole or
mpany must establish that it has satisfied all of the conditions to repurchase and must obtain the
e U.S. Treasury. There can be no assurance that the Company will be able to repurchase these
the U.S. Treasury. The Company's customers, employees and counterparties in its current and
relationships may draw negative implications regarding the strength of the Company as a financial
d on its continued participation in the program following the exit of one or more of its competitors
ial institutions. Any such negative perceptions may impair the Company's ability to effectively
other financial institutions for business or to retain high performing employees. If this were to
pany's business, financial condition and results of operations may be adversely affected, perhaps

of other financial institutions could adversely affect us.

ngage in routine funding transactions could be adversely affected by the actions and commercial
ther financial institutions. Financial services institutions are interrelated as a result of trading,
erparty or other relationships. We have exposure to many different industries and counterparties,
ly execute transactions with counterparties in the financial industry. As a result, defaults by, or
r questions about, one or more financial services institutions, or the financial services industry
e led to market-wide liquidity problems and could lead to losses or defaults by us or by other
any of these transactions expose us to credit risk in the event of default of our counterparty or
on, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is
ices not sufficient to recover the full amount of the financial instrument exposure due us. There is
at any such losses would not materially and adversely affect our results of operations.

onomic conditions and related uncertainties may have an adverse affect on the Company's

anking is affected, directly and indirectly, by local, domestic, and international economic and
ions, and by governmental monetary and fiscal policies. Conditions such as inflation, recession,
, volatile interest rates, tight money supply, real estate values, international conflicts and other
the Company's control may adversely affect the potential profitability of the Company. Any future
rates, while increasing the income yield on the Company's earnings assets, may adversely affect
nd the cost of funds and, consequently, the profitability of the Company. Any future decreases in
ay adversely affect the Company's profitability because such decreases may reduce the amounts
ny may earn on its assets. A continued recessionary climate could result in the delinquency of
ans. Management does not expect any one particular factor to have a material effect on the
ults of operations. However, downtrends in several areas, including real estate, construction and

ding, could have a material adverse impact on the Company's profitability.

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n and regulation to which the Company is subject can be a competitive disadvantage.

of the Company and the Bank are heavily regulated and will be affected by present
slation and by the policies established from time to time by various federal and state regulatory
particular, the monetary policies of the Federal Reserve have had a significant effect on the
s of banks in the past, and are expected to continue to do so in the future. Among the instruments
olicy used by the Federal Reserve to implement its objectives are changes in the discount rate
nk borrowings and changes in the reserve requirements on bank deposits. It is not possible to
hanges, if any, will be made to the monetary polices of the Federal Reserve or to existing federal
ation or the effect that such changes may have on the future business and earnings prospects of the

is subject to changes in federal and state tax laws as well as changes in banking and credit
ounting principles and governmental economic and monetary policies.

several years, significant legislative attention has been focused on the regulation and deregulation
services industry. Non-bank financial institutions, such as securities brokerage firms, insurance
l money market funds, have been permitted to engage in activities that compete directly with
k business.

he financial services industry is undergoing major changes, and future legislation could increase
g business or harm our competitive position.

emergency government programs enacted in 2008 in response to the financial crisis and the
ed or wound down, and global regulatory and legislative focus has generally moved to a second
er reform and a restructuring of financial institution regulation. Legislators and regulators in the
re currently considering a wide range of proposals that, if enacted, could result in major changes to
g operations are regulated. Some of these major changes may take effect as early as 2010, and
y impact the profitability of our business, the value of assets we hold or the collateral available for
ire changes to business practices or force us to discontinue businesses and expose us to additional
bilities, enforcement actions and reputational risk.

proposals under consideration could result in our becoming subject to stricter capital requirements
mits, and could also affect the scope, coverage, or calculation of capital, all of which could require
siness levels or to raise capital, including in ways that may adversely impact our shareholders or
ldition, we anticipate the enactment of certain reform proposals under consideration that would
ter substantive standards, oversight and enforcement of rules governing consumer financial
ervices, with particular emphasis on retail extensions of credit and other consumer-directed
cts or services. We cannot predict whether new legislation will be enacted and, if enacted, the
any regulations, would have on our business, financial condition, or results of operations.

n the Company faces is increasing and may reduce our customer base and negatively impact the
ults of operations.

cant competition among banks in the market areas served by the Company. In addition, as a result
of the financial industry, the Bank also competes with other providers of financial services such as
n associations, credit unions, consumer finance companies, securities firms, insurance companies,
ls industry, full service brokerage firms and discount brokerage firms, some of which are subject to
egulations than the Company with respect to the products and services they provide. Some of the

mpetitors have greater resources than the Corporation and, as a result, may have higher lending
offer other services not offered by our Company. See "Item 1: Business — Competition."

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urance premium could be substantially higher in the future which would have an adverse effect on
ngs.

res deposits at FDIC-insured financial institutions, including Village Bank. The FDIC
sured financial institutions premiums to maintain the Deposit Insurance Fund at a certain
economic conditions have increased bank failures and expectations for further failures, which may
IC making more payments from the Deposit Insurance Fund and, in connection therewith, raising
ms. In addition, the FDIC instituted two temporary programs to further insure customer deposits at
anks: deposit accounts are currently insured up to $250,000 per customer (up from $100,000) and
aring transactional accounts at institutions participating in the Transaction Account Guarantee
rrently fully insured (unlimited coverage). These programs have placed additional stress on the
nce Fund.

09, the FDIC finalized a rule that increases premiums paid by insured institutions and makes other
assessment system. Due to mounting losses from failed banking institutions in 2009, the FDIC
rim rule that imposed an emergency special assessment in the second quarter of 2009 and further
C authority to impose additional emergency special assessments of up to 10 basis points in
rters. In addition, on November 12, 2009, the FDIC adopted a rule requiring banks to prepay three
premiums to replenish the depleted fund. The Company is generally unable to control the amount
at it is required to pay for FDIC insurance. If there are additional bank or financial institution
ompany may be required to pay even higher FDIC premiums than the recently increased
, on January 12, 2010, the FDIC requested comments on a proposed rule tying assessment rates of
nstitutions to the institution's employee compensation programs. The exact requirements of such a
known, but such a rule could increase the amount of premiums the Company must pay for FDIC
ese announced increases and any future increases or required prepayments of FDIC insurance
adversely impact its earnings.

tomers over deposit insurance may cause a decrease in deposits.

nuing news about bank failures, customers are increasingly concerned about the extent to which
re insured by the FDIC. Customers may withdraw deposits in an effort to ensure that the amount
eposit with us is fully insured. Decreases in deposits may adversely affect our funding costs and

the stock market could negatively affect the value of the Company's common stock.

s common stock trades under the symbol "VBFC" on the Nasdaq Capital Market. There can be no
a regular and active market for the Common Stock will develop in the foreseeable future. See
t for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity
nvestors in the shares of common stock may, therefore, be required to assume the risk of their
an indefinite period of time. Current lack of investor confidence in large banks may keep investors
banking sector as a whole, causing unjustified deterioration in the trading prices of well-capitalized
ks such as the Company.

fails to maintain an effective system of internal controls, it may not be able to accurately report its
s or prevent fraud. As a result, current and potential shareholders could lose confidence in the
ancial reporting, which could harm its business and the trading price of its common stock.

has established a process to document and evaluate its internal controls over financial reporting in the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations, annual management assessments of the effectiveness of the Company's internal controls over ing. In this regard,

as dedicated internal resources, engaged outside consultants and adopted a detailed work plan to
document the adequacy of internal controls over financial reporting, (ii) take steps to improve
ses, where appropriate, (iii) validate through testing that controls are functioning as documented
ement a continuous reporting and improvement process for internal control over financial
Company's efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related
arding the Company's assessment of its internal controls over financial reporting. The Company's
nd audit committee have given the Company's compliance with Section 404 a high priority. The
ot be certain that these measures will ensure that the Company implements and maintains adequate
ts financial processes and reporting in the future. Any failure to implement required new or
rols, or difficulties encountered in their implementation, could harm the Company's operating
the Company to fail to meet its reporting obligations. If the Company fails to correct any issues
r operating effectiveness of internal controls over financial reporting or fails to prevent fraud,
ential shareholders could lose confidence in the Company's financial reporting, which could harm
the trading price of its common stock.

is subject to a variety of operational risks, including reputational risk, legal and compliance risk,
fraud or theft by employees or outsiders.

is exposed to many types of operational risks, including reputational risk, legal and compliance
of fraud or theft by employees or outsiders, and unauthorized transactions by employees or
ors, including clerical or record-keeping errors or those resulting from faulty or disabled computer
ications systems. Negative public opinion can result from its actual or alleged conduct in any
vities, including lending practices, corporate governance and acquisitions and from actions taken
regulators and community organizations in response to those activities. Negative public opinion
affect its ability to attract and keep customers and can expose the Company to litigation and
on.

ture of the financial services business involves a high volume of transactions, certain errors may be
mpounded before they are discovered and successfully rectified. The Company's necessary
on automated systems to record and process its transaction volume may further increase the risk
aws or employee tampering or manipulation of those systems will result in losses that are difficult
Company also may be subject to disruptions of its operating systems arising from events that are
ially beyond its control (for example, computer viruses or electrical or telecommunications
h may give rise to disruption of service to customers and to financial loss or liability. The
urther exposed to the risk that its external vendors may be unable to fulfill their contractual
will be subject to the same risk of fraud or operational errors by their respective employees as the
nd to the risk that its (or its vendors') business continuity and data security systems prove to be
he occurrence of any of these risks could result in a diminished ability of the Company to operate
tential liability to clients, reputational damage and regulatory intervention, which could adversely
ss, financial condition and results of operations, perhaps materially.

relies on other companies to provide key components of its business infrastructure.

rovide key components of the Company's business infrastructure, for example, system support, and
tions and network access. While the Company has selected these third party vendors carefully, it
l their actions. Any problems caused by these third parties, including those resulting from their
de services for any reason or their poor performance of services, could adversely affect its ability
ucts and services to its customers and otherwise conduct its business. Replacing these third party
also entail significant delay and expense.

may have to rely on dividends from the Bank.

is a separate and distinct legal entity from its subsidiary bank. Although the Company has never
vidends from the Bank, it is entitled to receive dividends in accordance
d state regulations. These federal and state regulations limit the amount of dividends that the Bank
Company. In the event the Bank is unable to pay dividends to the Company, the Company may
ervice debt, pay obligations or pay dividends on the Company's common stock. The inability of
o receive dividends from the Bank could have a material adverse effect on the Company's business,
ion and results of operations.

not be able to remain well capitalized

ory agencies are required by law to adopt regulations defining five capital tiers: well capitalized,
italized, under capitalized, significantly under capitalized, and critically under capitalized. The
e criteria to be categorized as a "well capitalized" institution as of December 31, 2009 and
r, the Bank may not be able to remain well capitalized for various reasons including a change in
ets or a lack of profitability. When capital falls below the "well capitalized" requirement,
can include: new branch approval could be withheld; more frequent examinations by the FDIC;
its cannot be renewed without a waiver from the FDIC; and other potential limitations as described
s and Regulations sections 337.6 and 303, and FDIC Act section 29. In addition, the FDIC
sment increases when an institution falls below the "well capitalized" classification.

RESOLVED STAFF COMMENTS

PERTIES

and administrative offices are owned by the Company and are located at 15521 Midlothian
othian, Virginia 23113 in Chesterfield County where an 80,000 square foot corporate headquarters
center was opened in August 2008. The Company and the Bank currently occupy approximately
f the space, which includes a full service branch location leased by the Bank. The Company leases
ons to unrelated parties. In addition to leasing the branch to the Bank, the Bank's wholly-owned
age Bank Mortgage Corporation, also leases space in the building from the Company.

he branch in the corporate headquarters and operations center, the Bank owns 9 full service branch
ding the land on those buildings and leases an additional five full service branch buildings. Eight
offices are located in Chesterfield County, with three branch offices in Hanover County, three in
y and one in Powhatan County.

are maintained in good operating condition and are suitable and adequate for our operational

AL PROCEEDINGS

f its operations, the Company may become a party to legal proceedings. There are no material
roceedings to which the Company is a party or of which the property of the Company is subject.

ERVED

PART II

KET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS
PURCHASES OF EQUITY SECURITIES

ation

ompany's Common Stock trade on the Nasdaq Capital Market under the symbol "VBFC". The high
of shares of the Company's Common Stock for the periods indicated were as follows:

	High	Low
2008		
1st quarter	$ 11.47	$ 9.25
2nd quarter	10.99	8.08
3rd quarter	9.58	6.11
4th quarter	8.43	3.38
2009		
1st quarter	$ 5.00	$ 3.77
2nd quarter	4.95	4.12
3rd quarter	5.98	3.85
4th quarter	4.43	2.01

has not paid any dividends on its Common Stock. We intend to retain all of our earnings to finance
operations and we do not anticipate paying cash dividends for the foreseeable future. Any decision
oard of Directors to declare dividends in the future will depend on the Company's future earnings,
ments, financial condition and other factors deemed relevant by the Board. Banking regulations
unt of cash dividends that may be paid without prior approval of the Bank's regulatory
h dividends are limited to the lesser of the Bank's retained earnings or the net income of the
ears combined with the current year net income. In addition, for as long as the U.S. Treasury holds
preferred stock, the consent of the U.S. Treasury will be required prior to the payment of any
ur common stock.

10, there were approximately 1,634 holders of record of Common Stock.

n concerning the Company's Equity Compensation Plans, see "Item 12: Security Ownership of
cial Owners and Management and Related Stockholder Matters".

Unregistered Securities

quity Securities

did not repurchase any of its Common Stock during the fourth quarter of 2009.

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raph

graph shows the yearly percentage change in the Company's cumulative total shareholder return on
ck from December 31, 2004 to December 31, 2009 compared with the NASDAQ Composite Index
indexes based on asset size.

	Period Ending					
ndex	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
Village Bank and Trust Financial Corp.	100.00	110.78	122.41	92.24	38.79	20.11
NASDAQ Composite	100.00	101.37	111.03	121.92	72.49	104.31
NL Bank $250M-$500M	100.00	106.17	110.93	90.16	51.49	47.66
NL Bank $500M-$1B	100.00	104.29	118.61	95.04	60.90	58.00

CTED FINANCIAL DATA

	Year Ended December 31,				
	2009	2008	2007	2006	2005
	$ 602,962,943	$ 572,407,993	$ 393,263,999	$ 291,217,760	$214,974,952
ne	467,568,547	470,722,286	327,343,013	241,051,025	172,378,272
	54,857,211	24,300,962	13,711,399	12,787,644	2,981,903
	-	7,422,141	689,108	689,108	689,108
	498,285,124	466,232,043	339,297,258	253,309,881	186,752,807
	52,593,521	57,726,898	24,736,569	9,859,265	9,641,810
	48,941,989	46,162,574	26,893,299	25,644,115	17,151,893
res	4,230,628	4,229,372	2,575,985	2,562,088	1,854,618
	600,034,107	442,604,327	337,750,179	246,562,178	184,498,899
	56,089,455	31,067,165	27,798,307	22,278,897	16,410,583
ge	4,230,462	3,013,175	2,569,529	2,269,092	1,800,061
ent					
	$ 33,195,973	$ 29,072,146	$ 25,665,235	$ 19,019,111	$ 11,925,133
e	16,407,679	15,969,783	13,806,715	8,786,600	4,877,376
	16,788,294	13,102,363	11,858,520	10,232,511	7,047,757
an	13,220,000	2,005,633	1,187,482	796,006	460,861
	8,285,100	4,184,727	2,666,956	2,482,793	2,890,316
	7,422,141	-	-	-	-
	20,915,737	14,572,271	11,821,232	9,817,089	7,778,004
t)	(4,973,116)	241,097	515,699	702,990	468,025
ss)	$ (11,511,368)	$ 468,089		$ 1,399,219	$ 1,231,183

			$ 1,001,063		
c	$ (2.84)	$ 0.16	$ 0.39	$ 0.62	$ 0.68
ted	$ (2.84)	$ 0.16	$ 0.37	$ 0.59	$ 0.61
	$ 8.07	$ 10.91	$ 10.44	$ 10.01	$ 9.25
age	(1.92)%	0.11%	0.30%	0.57%	0.67%
age	(20.52)%	1.51%	3.60%	6.28%	7.50%
	3.13%	3.25%	3.80%	4.48%	4.15%
	83.42%	84.30%	81.38%	77.21%	78.26%
its	93.84%	100.96%	96.48%	95.16%	92.30%
.	8.12%	8.06%	6.84%	8.81%	7.98%
at	2.25%	1.29%	1.06%	1.06%	1.12%
ns	49.37%	71.05%	134.20%	91.12%	105.28%
nd	7.95%	2.43%	0.87%	1.16%	1.06%
to	1.84%	0.60%	0.10%	0.12%	0.03%

ratio is computed by dividing noninterest expense by the sum of net interest income and
ome.

npairment write-off is excluded in 2009 from noninterest expense.

AGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS
ONS

discussion is intended to assist readers in understanding and evaluating the financial condition, ncial condition and the results of operations of the Company, consisting of the parent company and ned subsidiary, the Bank. This discussion should be read in conjunction with the consolidated nents and other financial information contained elsewhere in this report.

Forward-Looking Statements

historical information, this report may contain forward-looking statements. For this purpose, any is not a statement of historical fact may be deemed to be a forward-looking statement. These g statements may include statements regarding profitability, liquidity, allowance for loan losses, nsitivity, market risk, growth strategy and financial and other goals. Forward-looking statements s such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," her words of similar meaning. You can also identify them by the fact that they do not relate strictly r current facts. Forward-looking statements are subject to numerous assumptions, risks and and actual results could differ materially from historical results or those anticipated by such

y factors that could have a material adverse effect on the operations and future prospects of the uding, but not limited to, changes in interest rates, general economic conditions, the quality or the loan or investment portfolios, the level of nonperforming assets and charge-offs, the local real volatility and disruption in national and international financial markets, government intervention in cial system, demand for loan products, deposit flows, competition, and accounting principles, idelines. Monetary and fiscal policies of the U.S. Government could also adversely effect the h policies include the impact of any regulations or programs implemented pursuant to the onomic Stabilization Act of 2008 (EESA), the American Recovery and Reinvestment Act of 2009 ther policies of the Office of the Comptroller of the Currency, U.S. Treasury and the Federal

experienced significant losses during the year related to the current economic climate. A f the turbulence in significant portions of the global financial markets, particularly if it worsens, mpact the Company's performance, both directly by affecting revenues and the value of the sets and liabilities, and indirectly by affecting the Company's counterparties and the economy matic declines in the housing market in the past year have resulted in significant write-downs of y financial institutions in the United States. Concerns about the stability of the U.S. financial lly have reduced the availability of funding to certain financial institutions, leading to a tightening tion of business activity, and increased market volatility. It is not clear at this time what impact nding initiatives of the Treasury and other bank regulatory agencies that have been announced or programs that may be initiated in the future will have on the financial markets and the financial ry. The extreme levels of volatility and limited credit availability currently being experienced to affect the U.S. banking industry and the broader U.S. and global economies, which would have financial institutions, including the Company.

uncertainties should be considered in evaluating the forward-looking statements contained herein, cautioned not to place undue reliance on such statements. Any forward-looking statement speaks ate on which it is made, and the Company undertakes no obligation to update any forward-looking

eflect events or circumstances after the date on which it is made. In addition, past results of
ot necessarily indicative of future results.

Developments

he financial crises affecting the banking system and financial markets and going concern threats to
ks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act
ESA") was signed into law. Pursuant to EESA, the United States Department of the Treasury (the
y") was given the authority to, among other things, purchase up to $700 billion of mortgages,
ed securities and certain other financial instruments from financial institutions for the purpose of
providing liquidity to the U.S. financial markets.

, 2008, the Secretary of the Department of the Treasury announced that the U.S. Treasury will
stakes in a wide variety of banks and thrifts. Under the program, known as the Troubled Asset
("TARP") Capital Purchase Program, from the $700 billion authorized by EESA, the U.S. Treasury
ion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction
se of preferred stock, the U.S. Treasury received, from participating financial institutions, warrants
nmon stock with an aggregate market price equal to 15% of the preferred investment. Participating
utions were required to adopt the U.S. Treasury's standards for executive compensation and
rnance for the period during which the U.S. Treasury holds equity issued under the TARP Capital
am. On May 1, 2009, the Company elected to participate in the TARP Capital Purchase Program,
he Company issued preferred shares and a warrant to purchase common shares to the U.S.
f the date of this report, the Company has not yet repurchased the preferred stock or the warrant to
on stock.

21, 2008, the Board of Directors of the FDIC adopted a final rule relating to the Temporary
antee Program ("TLG Program"). The TLG Program was announced by the FDIC on October 14,
d by the determination of systemic risk by the Secretary of the Department of Treasury (after
ith the President), as an initiative to counter the system-wide crisis in the nation's financial
he TLG Program (as amended from time to time thereafter) the FDIC would (i) guarantee, through
aturity or June 30, 2012, certain newly issued senior unsecured debt issued by participating
d (ii) provide full FDIC deposit insurance coverage for noninterest bearing transaction deposit
tiable Order of Withdrawal ("NOW") accounts paying less than 0.5% interest per annum and Interest
ust Accounts ("IOLA") accounts held at participating FDIC-insured institutions. The transaction
ntee program described in clause (ii) will expire on June 30, 2010. Coverage under the TLG
vailable for the first 30 days without charge. The fee assessment for coverage of senior unsecured
m 50 basis points to 100 basis points per annum, depending on the initial maturity of the debt. The
for deposit insurance coverage is 10 basis points per quarter on amounts in covered accounts
,000.

0, 2009, the Treasury Secretary announced a new comprehensive financial stability plan which
capital assistance program that has invested in convertible preferred stock of certain qualifying
a consumer and business lending initiative to fund new consumer loans, small business loans and
rtgage asset-backed securities issuances, (iii) a public-private investment fund intended to leverage
ate capital with public financing to purchase legacy "toxic assets" from financial institutions, and (iv)
homeowners to reduce mortgage payments and interest rates and establishing loan modification
overnment and private programs.

concerns relating to capital adequacy of large financial institutions, the Federal Reserve Board
upervisory Capital Assessment Program ("SCAP") under which all banking institutions with assets
on were required to undergo a comprehensive "stress test" to determine if they had sufficient capital
nding and to absorb losses that could result from a more severe decline in the economy than

results of the stress test were announced on May 7, 2009. In addition, on September 3, 2009, the
ssued a policy statement relating to bank capital requirements, which calls for higher and stronger
nents for bank and non-bank financial firms that are deemed to pose a risk to financial stability due
ation of size, leverage, interconnectedness and liquidity risk. Also, on

2009, the Basel Committee issued a set of proposals relating to the capital adequacy and liquidity
of financial institutions.

tore the depleted Deposit Insurance Fund ("DIF") and maintain a sound reserve ratio, the FDIC
r base assessment rates and special one-time assessments and required prepayment of deposit
ium. The FDIC stated that, after its semi-annual reviews, it may further increase assessment rates
tions to bring the DIF's reserve ratio back to a desirable level.

9, the Obama administration proposed a wide range of regulatory reforms that included, among
roposals (i) that any financial firm whose combination of size, leverage and interconnectedness
reat to financial stability be subject to certain enhanced regulatory requirements, (ii) that federal
s require loan originators or sponsors to retain part of the credit risk of securitized exposures, (iii)
ncreased regulation of broker-dealers and investment advisers, (iv) for the creation of a federal
ncial protection agency that would, among other things, be charged with applying consistent
imilar products (such as imposing certain notice and consent requirements on consumer overdraft
(v) that there be comprehensive regulation of OTC derivatives, (vi) that the controls on the ability
titutions to engage in transactions with affiliates be tightened, and (vii) that financial holding
equired to be "well-capitalized" and "well-managed" on a consolidated basis.

, 2009, the Federal Reserve Board issued a comprehensive proposal on incentive compensation
ed to ensure that the incentive compensation policies of banking organizations do not undermine
soundness of such organizations by encouraging excessive risk-taking. The proposal covers all
have the ability to materially affect the risk profile of an organization, either individually or as

was organized under the laws of the Commonwealth of Virginia to engage in commercial and retail
Bank opened to the public on December 13, 1999 as a traditional community bank offering deposit
es to individuals and businesses in the Richmond, Virginia metropolitan area. During 2003, the
ired or formed three wholly owned subsidiaries of the Bank, Village Bank Mortgage Corporation
Mortgage"), a full service mortgage banking company, Village Insurance Agency, Inc. ("Village
full service property and casualty insurance agency, and Village Financial Services Corporation
ncial Services"), a financial services company. On October 14, 2008, the Company completed its
iver City Bank pursuant to an Agreement and Plan of Reorganization and Merger, dated as of
, by and among the Company, the Bank and River City Bank. The merger had previously been
th companies' shareholders at their respective annual meetings on September 30, 2008 as well as
ulators.

le range of banking and related financial services, including checking, savings, certificates of
ther depository services, and commercial, real estate and consumer loans. We are a
ented and locally managed financial institution focusing on providing a high level of responsive
ed services to our customers, delivered in the context of a strong direct relationship with our
conduct our operations from our main office/corporate headquarters location and fourteen branch

s primary source of earnings is net interest income, and its principal market risk exposure is interest
Company is not able to predict market interest rate fluctuations and its asset/liability management
ot prevent interest rate changes from having a material adverse effect on the Company's results of

financial condition.

agement endeavors to minimize the credit risk inherent in the Company's loan portfolio, it must ke various assumptions and judgments about the collectibility of the loan portfolio based on its evaluation of economic conditions. If such assumptions

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rove to be incorrect, the current allowance for loan losses may not be sufficient to cover loan losses
o the allowance may be necessary, which would have a negative impact on net income.

e competition in all areas in which the Company conducts its business. The Company competes
d other financial institutions, including savings and loan associations, savings banks, finance
l credit unions. Many of these competitors have substantially greater resources and lending limits
wider array of banking services. To a limited extent, the Company also competes with other
inancial services, such as money market mutual funds, brokerage firms, consumer finance
insurance companies. Competition is based on a number of factors, including prices, interest
availability of products and geographic location.

had a net loss of $11,511,000 in 2009 as compared to net income of $468,000 in 2008 and of
2007. The single most significant factor in our declining earnings the last two years has been the
onomy.

creased to $602,963,000 at December 31, 2009 from $572,408,000 at December 31, 2008 and
t December 31, 2007, representing increases of 5% in 2009 and 46% in 2008. The growth in total
s attributable to our merger with River City Bank, which added approximately $157.7 million in
ne of merger. The growth in 2009 was primarily a result of an increase in investment securities of
unded by an increase in deposits of $32,053,000.

ternal growth has been driven by lending on real estate. As a result, the material decline in real
experienced in 2009 had a significant adverse effect on the growth and profitability of the
December 31, 2009, 89.0% of our loan portfolio was collateralized by real estate. Declines in real
an reduce projected cash flows from commercial properties and the ability of borrowers to use
support borrowings and increase the loan-to-value ratios of loans previously made by us, thereby
lateral coverage and increasing the possibility of a loss in the event of default. In addition,
foreclosures and losses generally increase during economic slowdowns or recessions.

presents management's discussion and analysis of the financial condition of the Company at
2009 and 2008, and results of operations for the Company for the years ended December 31, 2009,
. This discussion should be read in conjunction with the Company's audited Financial Statements
hereto appearing elsewhere in this Annual Report.

ent Analysis

ome, which represents the difference between interest earned on interest-earning assets and interest
erest-bearing liabilities, is the Company's primary source of earnings. Net interest income can be
anges in market interest rates as well as the level and composition of assets, liabilities and
equity. Net interest spread is the difference between the average rate earned on interest-earning
verage rate paid on interest-bearing liabilities. The net yield on interest-earning assets ("net interest
culated by dividing tax equivalent net interest income by average interest-earning assets. Generally,
margin will exceed the net interest spread because a portion of interest-earning assets are funded
nterest-bearing sources, principally noninterest-bearing deposits and shareholders' equity.

net loss of $11,511,000, or $2.84 per fully diluted share, in 2009, compared to net income of
0.16 per fully diluted share, in 2008, and $1,001,000, or $0.37 per fully diluted share, in 2007. The
profitability in 2009 was attributable to four significant increases in expenses from 2008 to 2009 as

	2009	2008	Increase
Provision for loan losses	$13,220,000	$2,005,633	$11,214,367
Goodwill impairment	7,422,141	-	7,422,141
Expenses related to foreclosed real estate	1,475,338	165,455	1,309,883
FDIC insurance premium	1,366,612	400,394	966,218
			$20,912,609

creases in expenses are attributable primarily to the recessionary economy that dominated
reases in the provision for loan losses and in expenses related to foreclosed real estate reflect the
many of our borrowers experienced with their ability to repay our loans to them. The write-off of
based on our annual evaluation of the value of goodwill which was performed by an independent
oodwill was considered fully impaired at December 31, 2009 primarily because the value of the
ck, and thus its overall value, declined significantly in 2009 as did many other banks' stock. The
FDIC insurance premium was related to the losses the FDIC incurred in 2009 in closing 140 banks
estore the DIF to a desirable level. Total assets of failed banks in 2009 totaled $170.9 billion with
DIF of $4.6 billion.

earnings from $1,001,000 in 2007 to $468,000 in 2008 was attributable to a decline in our net
from 3.80% for 2007 to 3.27% for 2008, as well as an increase in the provision for loan losses of
$1,187,000 in 2007 to $2,005,000 in 2008. The decline in our net interest margin is attributable
terest rates and our acquisition of River City Bank which had a lower net interest margin. The
provision for loan losses was a result of deteriorating asset quality.

ome

come is our primary source of earnings and represents the difference between interest and fees
rest-earning assets and the interest paid on interest-bearing liabilities. The level of net interest
ted primarily by variations in the volume and mix of those assets and liabilities, as well as changes
when compared to previous periods of operation.

ns and deposits has resulted in net interest income increasing from $11,859,000 in 2007, to
2008 and to $16,788,000 in 2009. However, net interest income as a percentage of average assets
clined the last two years, from 3.5% in 2007 to 3.0% in 2008 and to 2.8% in 2009. The growth in
ome has not kept pace with the growth of the Company. This is attributable to a declining net
, from 3.80% in 2007 to 3.27% in 2008 and to 3.13% in 2009. This declining interest margin
declines in short-term interest rates that started in 2007 and continued into 2008. A significant
loan portfolio, the primary source of revenue to Village Bank, has interest rates that adjust
e direction of short-term interest rates. Accordingly, as short-term rates were reduced by the
e, the income from our loan portfolio was reduced. While the reduction of short-term interest rates
e rates we pay on deposits, our largest expense, the reduction in interest rates paid on deposits was
reduction of interest rates on our loan portfolio as our deposits generally do not reprice as quickly
onsequently, our net interest income, the primary source of our earnings, was negatively impacted
terest rates were reduced by the Federal Reserve.

ear to year comparison reflects a declining net interest margin, we are starting to experience a
his decline. During 2009, the average interest rate we paid on deposits declined by 1.42%. This
ed the decline in the average interest rate earned on loans of ..67%, which had a positive impact on
margin. While the net interest margin of 3.13% for the full year of 2009 was lower than the net
of 3.27% for 2008, it increasedfrom 3.29% for the month of December 2008 to 3.38% for the
mber 2009. If short-term interest rates remain stable in 2010, we expect further declines in the
id on

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improving net interest margin.

st-earning assets increased by $135,350,000, or 34%, in 2009 and by $88,383,000, or 28%, in creases in interest-earning assets were due primarily to the growth of our loan portfolio. However, eld on interest-earning assets decreased to 6.19% in 2009 from 7.26% in 2008 and 8.22% in f our loans are indexed to short-term rates affected by the Federal Reserve's decisions about est rates, and, accordingly, as the Federal Reserve increases or decreases short-term rates, the yield ning assets is affected. As the Federal Reserve decreased interest rates starting in 2007 and ugh 2008, decreasing short-term interest rates by 5% over twelve months, the average yield on our assets decreased.

terest-bearing liabilities increased by $120,065,000, or 31%, in 2009 and by $96,873,000, or 34%, increases in average interest-bearing liabilities were due to strong growth in average deposits of n 2009 and $70,321,000 in 2008 as well as borrowings of $19,990,000 in 2008. The average cost aring liabilities decreased to 3.27% in 2009, from 4.18% in 2008 and 4.84% in 2007. The rease in our cost of funds in 2009 and 2008 was a result of decreases in short-term interest rates by serve in 2007 and 2008. As with our interest-earning assets, the declines in the short-term interest deral Reserve also reduced the interest rates we pay on interest-bearing liabilities in 2008, however, interest rates on our interest-bearing liabilities has been slower than the reduction of interest rates earning assets as the liabilities generally do not reprice as quickly as the assets. Consequently, our ome, the primary source of our earnings, is negatively impacted as long as short-term interest rates reduced by the Federal Reserve. See “Interest rate sensitivity” on page 48 for further discussion of assets and liabilities.

able illustrates average balances of total interest-earning assets and total interest-bearing liabilities indicated, showing the average distribution of assets, liabilities, shareholders' equity and related e and corresponding weighted-average yields and rates. The average balances used in these tables stical data were calculated using daily average balances. We have no tax exempt assets for the ed.

Average Balance Sheets
(In thousands)

Year Ended December 31, 2009			Year Ended December 31, 2008			Year Ended December 31, 2007		
Average Balance	Interest Income/ Expense	Annualized Yield Rate	Average Balance	Interest Income/ Expense	Annualized Yield Rate	Average Balance	Interest Income/ Expense	Annualized Yield Rate
$47,607	$2,959	6.22%	$39,275	$2,034	5.18%	$21,791	$1,795	8.24%
89,386	5,802	6.49%	61,416	5,291	8.62%	42,461	3,418	8.05%
230,621	15,591	6.76%	160,019	10,968	6.85%	120,797	9,722	8.05%
99,103	6,038	6.09%	105,732	8,965	8.48%	92,886	8,707	9.37%
10,642	788	7.40%	7,779	657	8.45%	6,488	582	8.97%
477,359	31,178	6.53%	374,221	27,915	7.46%	284,423	24,224	8.52%
33,174	1,458	4.40%	12,125	699	5.76%	16,471	847	5.14%
10,305	533	5.17%	3,721	225	6.05%	2,368	155	6.55%
15,034	27	0.18%	10,455	233	2.23%	8,877	439	4.95%
535,872	33,196	6.19%	400,522	29,072	7.26%	312,139	25,665	8.22%
(8,367)			(4,309)			(2,956)		
15,998			8,179			5,169		
27,880			23,951			13,901		
28,651			14,261			9,497		
$600,034			$442,604			$337,750		
26,530	443	1.67%	$12,735	$159	1.25%	$10,454	$104	0.99%
69,267	1,242	1.79%	28,215	561	1.99%	21,618	726	3.36%
7,009	85	1.21%	6,891	193	2.80%	3,669	42	1.14%
347,698	12,664	3.64%	291,629	13,435	4.61%	233,408	12,078	5.17%

450,504	14,434	3.20%	339,470	14,348	4.23%	269,149	12,950	4.81%
8,764	392	4.47%	8,764	508	5.80%	6,173	447	7.24%
26,348	970	4.22%	20,620	834	4.22%	7,945	340	4.22%
16,337	612	1.77%	13,034	280	1.77%	1,748	70	1.77%
501,953	16,408	3.27%	381,888	15,970	4.18%	285,015	13,807	4.84%
39,626			27,657			22,686		
2,366			1,992			2,251		
543,945			411,537			309,952		
56,089			31,067			27,798		
$600,034			$442,604			$337,750		
	$16,788			$13,102			$11,858	
		2.93%			3.08%			3.38%
		3.13%			3.27%			3.80%

and interest expense are affected by changes in both average interest rates and average volumes of
g assets and interest-bearing liabilities. The following table analyzes changes in net interest income
changes in the volume of interest-sensitive assets and liabilities compared to changes in interest
ual loans are included in average loans outstanding. The changes in interest due to both rate and
een allocated to changes due to volume and changes due to rate in proportion to the relationship of
llar amounts of the changes in each.

Rate/Volume Analysis
(In thousands)

	2009 vs. 2008 Increase (Decrease) Due to Changes in			2008 vs. 2007 Increase (Decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
	$6,333	$(2,762)	$3,571	$5,297	$(1,606)	$3,691
urities	879	(120)	759	(273)	125	(148)
and other	187	(393)	(206)	169	(305)	(136)
ncome	7,399	(3,275)	4,124	5,193	(1,786)	3,407
e						
ng	217	66	283	24	31	55
accounts	731	(48)	683	489	(654)	(165)
ts	3	(110)	(107)	57	94	151
deposit	8,613	(9,386)	(773)	2,423	(1,066)	1,357
	9,564	(9,478)	86	2,993	(1,595)	1,398
t	-	(116)	(116)	18	43	61
es	201	(65)	136	512	(18)	494
gs	332	-	332	210	-	210
xpense	10,097	(9,659)	438	3,733	(1,570)	2,163
ome	$(2,698)	$6,384	$3,686	$1,460	$(216)	$1,244

ined effect on interest due to changes in both volume and rate, which cannot be
cified, has been allocated proportionately to the change due to volume and the
ate.

oan losses

the loan loss provision is determined by an evaluation of the level of loans outstanding, the level
ning loans, historical loan loss experience, delinquency trends, underlying collateral values, the
ual losses charged to the reserve in a given period and assessment of present and anticipated
itions.

e allowance reflects changes in the size of the portfolio or in any of its components as well as
continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current
quality, present economic, and political and regulatory conditions. Portions of the allowance may
r specific credits; however, the entire allowance is available for any credit that, in management's
uld be charged off. While management utilizes its best judgment and information available, the
uacy of the allowance is dependent upon a variety of factors beyond the Company's control,
erformance of the Company's loan portfolio, the economy, changes in interest rates and the view of
uthorities toward loan classifications.

as been negatively impacted the last two years by increasing provisions for loan losses. The
oan losses increased from $1,187,000 in 2007 to $2,006,000 in 2008 and to $13,220,000 in
ncreases in the provision for loan losses are attributable to the growth in our loan portfolio and a
n asset quality as the depressed economy has negatively impacted the ability of our borrowers to
deterioration in asset quality has occurred primarily in loans secured by real estate. Loans secured
epresent 89% of our total loan portfolio at December 31, 2009.

t the level of the provision for loan losses experienced in 2009 will not be repeated in 2010, as the
wing some signs of recovery which should help the ability of borrowers to repay loans. However,
an be given that the provision for loan losses in 2010 will not equal or exceed that in 2009.

ome

ome includes service charges and fees on deposit accounts, fee income related to loan origination,
losses on sale of mortgage loans and securities held for sale. Over the last three years the most
nterest income item has been gain on loan sales generated by Village Bank Mortgage, representing
007 and 2008 and 70% in 2009 of total noninterest income. Noninterest income amounted to
007, $4,185,000 in 2008 and $8,285,000 in 2009.

noninterest income in 2009 of $4,100,000 is primarily attributable to an increase in gain on sale of
,000 and increased service charges and fees on transactional deposit accounts of $452,000. The
loans resulted from an increase in loan production by our mortgage company, from $100 million in
2008 to $252 million in 2009. Despite the depressed economic conditions in 2009, the mortgage
ble to increase loan production due to the addition of new loan officers. Management expects the
pany to further increase loan production in 2010 due to declining mortgage loan interest rates that
re borrowers to qualify for loans and provide refinance opportunities for existing home
ce charges and fees increased because transactional deposits grew by $108,215,000, or 132%, in
of maturing time deposits moving to money market accounts.

noninterest income in 2008 of $1,518,000 is primarily attributable to increased service charges
ransactional deposit accounts of $412,000 and an increase in gain on sale of loans of
nsactional deposits grew by $26,112,000, or 47%, in 2008 as a result of the maturing of our branch
d with the addition of the deposits of River City Bank, resulting in the increase in service charges
gain on sale of loans resulted from an increase in loan production by our mortgage company, from
oan closings in 2007 to $100 million in 2008.

pense

pense includes all expenses of the Company with the exception of interest expense on deposits and
ovision for loan losses and income taxes. Some of the primary components of noninterest expense
d benefits, and occupancy and equipment costs. Over the last three years, the most significant
ense item has been salaries and benefits, representing 58%, 55% and 50% of noninterest expense
write-off of goodwill in 2009) in 2007, 2008 and 2009, respectively. Noninterest expense
$11,821,000 in 2007, to $14,572,000 in 2008 and to $28,338,000 in 2009. In 2009 the write-off of
$7,422,141 was included in noninterest expense. This was a one time expense as we no longer
will.

noninterest expense of $13,766,000 in 2009 resulted from the goodwill write-off of $7,422,000 as
es in expenses related to foreclosed assets of $1,310,000 and the FDIC insurance premium of
er growth related increases in noninterest expense in 2009 were increases in salaries and benefits of
cupancy of $493,000, loan underwriting expense of $430,000, data processing of $159,000 and
126,000.

n noninterest expense of $2,751,000 in 2008 resulted from the addition of new branches and the
Company overall as well as the merger with River City Bank. Growth related increases in
pense in 2008 were increases in salaries and benefits of $1,133,000, professional and outside
'2,000, occupancy of $364,000, loan underwriting expense of $271,000 and the FDIC insurance
25,000.

(benefit) amounted to $(4,973,000), $241,000 and $516,000 in 2009, 2008 and 2007, The $5,241,000 decline in income tax expense in 2009 is related to the loss of $(16,484,000) and ne in 2008 were attributable to the lower taxable income.

anking organizations conducting business in Virginia are not subject to Virginia income , they are subject to a franchise tax based on bank capital. The Bank recorded a franchise tax 5,000, $180,000 and $210,000 for 2009, 2008 and 2007, respectively.

Analysis

urities

1, 2009 and 2008, all of our investment securities were classified as available-for-sale. Investment fied as available for sale may be sold in the future, prior to maturity. These securities are carried at aggregate unrealized gains or losses on these securities are included, net of taxes, as a component ' equity. Given the generally high credit quality of the portfolio, management expects to realize all nt upon market recovery or, the maturity of such instruments and thus believes that any impairment est rate related and therefore temporary. Available for sale securities included net unrealized gains December 31, 2009 and net unrealized losses of $26,000 at December 31, 2008. As of December agement does not have the intent to sell any of the securities classified as available for sale and elieves that it is more likely than not that the Company will not have to sell any such securities ry of cost.

able presents the composition of our investment portfolio at the dates indicated.

Investment Securities Available-for-Sale
(Dollars in thousands)

	Par Value	Amortized Cost	Unrealized Gain (Loss)	Estimated Fair Value	Average Yield
December 31, 2009					
JS Government gencies					
One to five years	$ 9,000	$ 9,315	$ (66)	$ 9,249	2.32%
ive to ten years	3,000	3,029	32	3,061	4.50%
More than ten years	34,250	35,284	75	35,359	5.22%
otal	46,250	47,628	41	47,669	4.61%
Mortgage-backed ecurities					
One to five years	389	435	(37)	398	4.40%
ive to ten years	471	471	29	500	5.24%
More than ten years	3,141	3,227	53	3,280	5.53%
otal	4,001	4,133	45	4,178	5.39%
Municipals					
More than ten years	1,000	1,026	1	1,027	5.28%
Other investments					
More than five ears	2,000	1,973	10	1,983	5.65%
otal investment ecurities	$53,251	$ 54,760	$ 97	$ 54,857	4.72%
December 31, 2008					
JS Government gencies					
Within one year	$ 360	$ 360	$ (4)	$ 356	4.50%
More than five ears	16,546	16,095	564	16,659	5.73%
otal	16,906	16,455	560	17,015	5.70%
Mortgage-backed ecurities					
One to five years	874	905	(23)	$882	4.47%
More than five ears	4,603	4,694	(76)	4,618	5.42%
	5,477	5,599	(99)	5,500	5.27%
Other investments					
More than five ears	2,000	1,970	(184)	1,786	5.65%

Total investment securities	$ 24,383	$ 24,024	$ 277	$ 24,301	5.60%

t objective is to maintain the quality of the loan portfolio. The Company seeks to achieve this aintaining rigorous underwriting standards coupled with regular evaluation of the creditworthiness gnation of lending limits for each borrower. The portfolio strategies include seeking industry and sification in order to minimize credit exposure and originating loans in markets with which the miliar.

's real estate loan portfolios, which represent approximately 89% of all loans, are secured by eal property located principally in the Commonwealth of Virginia. Sources of repayment are from operating profits, cash flows and liquidation of pledged collateral. The Company's commercial loan sents approximately 8.5% of all loans. Loans in this category are typically made to individuals, ium-sized businesses and range between $250,000 and $2.5 million. Based on underwriting mercial and

s may be secured in whole or in part by collateral such as liquid assets, accounts receivable, entory, and real property. The collateral securing any loan may depend on the type of loan and lue based on market conditions. The remainder of our loan portfolio is in consumer loans which of the total.

ables present the composition of our loan portfolio at the dates indicated and maturities of selected ber 31, 2009.

Loan Portfolio, Net
(In thousands)

	December 31,				
	2009	2008	2007	2006	2005
Commercial	$ 39,576	$ 52,438	$ 23,152	$ 17,889	$ 14,121
Real estate - esidential	93,657	84,612	51,281	36,408	30,043
Real estate - ommercial	240,830	220,400	140,176	100,039	66,274
Real estate - onstruction	81,688	103,161	106,556	80,324	56,146
Consumer	11,609	10,307	6,611	6,730	6,161
Total loans	467,360	470,918	327,776	241,390	172,745
Less: unearned ncome, net	209	(196)	(433)	(339)	(367)
Less: Allowance for oan losses	(10,522)	(6,059)	(3,469)	(2,553)	(1,931)
Total loans, net	$ 457,047	$ 464,663	$ 323,874	$ 238,498	$ 170,447

Maturities of Selected Loans
December 31, 2009
(In thousands)

		Fixed Rate			Variable Rate			
	Within 1 Year	1 to 5 Years	After 5 Years	Total	1 to 5 Years	After 5 Years	Total	Total Maturities
nmercial	$19,657	$13,451	$6,309	$19,760	$ 159	$ -	$ 159	$39,576
l estate nmercial	37,346	80,191	93,119	173,310	28,155	2,019	30,174	240,830
struction	67,283	10,211	3,911	14,122	283	-	283	81,688
idential	53,433	6,466	33,328	39,794	430	-	430	93,657

loan losses

e for loan losses is an estimate of the losses that may be sustained in our loan portfolio. An
oan losses is established through a provision for loan losses based upon industry standards, known
tics, management's evaluation of the risk inherent in the loan portfolio and changes in the nature
loan activity. Such evaluation considers among other factors, the estimated market value of the
ateral, and current economic conditions.

e allowance for loan losses is determined by an ongoing detailed analysis of risk and loss potential
tfolio as a whole. Outside of our own analysis, our reserve adequacy and methodology are
egular basis by an independent firm and bank regulators.

lowance for loan losses is equivalent to approximately 2.25% of total loans net of deferred
dule below, Allocation of the Allowance for Loan Losses, reflects the pro rata allocation by the
ypes. The methodology as to how the allowance was derived is

of specific allocations and percentage allocations of the unallocated portion of the allowance for discussed below. The Company has developed a comprehensive risk weighting system based on characteristics that enables the Company to allocate the composition of the allowance for loan of loans.

gy as to how the allowance was derived is detailed below. Unallocated amounts included in the oan losses have been applied to the loan classifications on a percentage basis.

e reserve is assessed, and appropriate expense and charge-offs are taken, no less frequently than at ch fiscal quarter end. The methodology by which we systematically determine the amount of our orth by the board of directors in our Loan Policy. Under this Policy, management is charged with ach loan is individually evaluated and the portfolio characteristics are evaluated to arrive at an regate reserve. The results of the analysis are documented, reviewed and approved by the board of ss than quarterly. The following elements are considered in this analysis: individual loan risk staff changes, loan review and board oversight, loan policies and procedures, portfolio trends with me, delinquency, composition/concentrations of credit, risk rating migration, levels of classified nce sheet credit exposure, any other factors considered relevant from time to time (the "general estimates on specific problem credits (the "specific reserve"), and, finally, an "unallocated reserve" to reseen factors as a result of current economic conditions. Each of the reserve components, general, allocated are discussed in further detail below.

the general reserve, all loans are graded or "Risk Rated" individually for loss potential at the time of as warranted thereafter, but no less frequently than quarterly. Loss potential factors are applied end of the following criteria: our own direct experience; our collective management experience in similar loan portfolios in the market; and peer data contained in statistical releases issued by the ement's collective experience at this company and other banks is the most heavily weighted he weighting is subjective and varies by loan type, amount, collateral, structure, and repayment ng economic conditions generally and within each individual borrower's business sector are well as any changes in the borrower's own financial position and, in the case of commercial loans, ructure and business operations.

tion develops in an individual credit, the loan is placed on a "Watch List" and the loan is monitored All loans on the watch list are evaluated for specific loss potential based upon either an evaluation d value of the collateral or cash flow deficiencies. If management believes that, with respect to a n impaired source of repayment, collateral impairment or a change in a debtor's financial condition htened risk of non-performance of a particular loan, a portion of the reserve may be specifically t individual loan. The aggregation of this loan by loan loss analysis comprises the specific reserve.

d reserve is maintained to absorb risk factors outside of the general and specific reserves. To arrive ated reserve, the loan portfolio is "shocked" or downgraded by a certain percentage based on subjective assessment of the state of the economy. The depressed economy in 2008 and 2009 has ncrease in the percentage downgrade of the loan portfolio.

for loan losses was $10,522,000, $6,059,000 and $3,469,000 at December 31, 2009, 2008 and ely. The ratio of the allowance for loan losses to gross loans was 2.25% at December 31, 2009, mber 31, 2008, and 1.06% December 31, 2007. The increase in the allowance for loan losses in higher level of problem loans, management's concern about the uncertainty in the economy and the wide credit crisis. The increase in 2008 is attributable to the increase in loans outstanding, result of the merger with River City Bank, and a deterioration of asset quality. We believe the

llowance for loan losses at December 31, 2009 is adequate to absorb the losses that can reasonably
rom the loan portfolio at that date.

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able presents an analysis of the changes in the allowance for loan losses for the periods indicated.

Analysis of Allowance for Loan Losses
(In thousands)

	Year Ended December 31,				
	2009	2008	2007	2006	2005
Beginning balance	$ 6,059	$ 3,469	$ 2,553	$ 1,931	$ 1,514
Provision for loan losses	13,220	2,006	1,187	796	461
Charge-offs					
Commercial and industrial	$ (1,273)	$ (468)	(31)	(183)	-
Real estate - residential	-	(202)	(120)	-	-
Real estate - commercial	(783)	(96)	-	-	-
Real estate - construction	(5,779)	(1,475)	(66)	-	-
Consumer	(932)	(2)	(54)	(72)	(46)
	(8,767)	(2,243)	(271)	(255)	(46)
Recoveries					
Commercial and industrial	-	7	-	-	-
Real estate - residential	-	2	-	-	-
Real estate - commercial	-	-	-	74	-
Real estate - construction	3	395	-	-	-
Consumer	7	19	-	7	2
	10	423	-	81	2
Net charge-offs	(8,757)	(1,820)	(271)	(174)	(44)
Acquisition of River City Bank	-	2,404	-	-	-
Ending balance	$ 10,522	$ 6,059	$ 3,469	$ 2,553	$ 1,931
Loans outstanding at end of year (1)	$ 467,569	$ 470,722	$ 327,343	$ 241,051	$ 172,378
Ratio of allowance for loan losses as a percent of loans outstanding at					

nd of year	2.25%	1.29%	1.06%	1.06%	1.12%
verage loans utstanding for the ear (1)	$ 477,359	$ 374,221	$ 284,423	$ 205,978	$ 150,432
atio of net harge-offs to verage loans utstanding for the ear	1.84%	0.60%	0.10%	0.12%	0.03%

1) Loans are net of nearned income.

reased significantly from $2,243,000 in 2008 to $8,767,000 in 2009. This increase in charge-offs attributable to loans for real estate acquisition, development and construction in Chesterfield mary lending market. The elevated charge-off levels experienced in the current year warrant the el of provisioning in 2009 and justify management's use of a higher historical charge-off factor ng the losses currently inherent in the loan portfolio during the calculation of the allowance for ue to the state of the economy, the duration of the loss history used in calculating the allowance during 2009 to better reflect current market conditions.

ted the allowance for loan losses according to the amount deemed to be reasonably necessary to possibility of losses being incurred within each of the categories of loans. The allocation of the hown in the table below should not be interpreted as an indication that losses in future years will ame proportions or that the allocation indicates future loss trends. Furthermore, the portion ch loan category is not the total amount available for future losses that might occur within such the total allowance is a

nce applicable to the entire portfolio.

Allocation of the Allowance for Loan Losses
(In thousands)

December 31, 2009		December 31, 2008		December 31, 2007		December 31, 2006		December 31, 2005	
Total	%	Total	%	Total	%	Total	%	Total	%
$ 710	6.7%	$ 1,664	27.5%	$ 479	13.8%	$ 377	14.8%	$ 568	29.5%
1,515	14.4%	1,142	18.8%	712	20.5%	512	20.1%	358	18.5%
3,500	33.3%	2,166	35.7%	1,204	34.7%	884	34.5%	444	23.0%
4,442	42.2%	965	15.9%	989	28.5%	694	27.2%	485	25.1%
355	3.4%	122	2.0%	85	2.5%	86	3.4%	76	3.9%
$ 10,522	100.0%	$ 6,059	100.0%	$ 3,469	100.0%	$ 2,553	100.0%	$ 1,931	100.0%

ommercial real estate loans have had the largest allocation of the allowance for loan losses as this s represented the largest category in our loan portfolio (52% in 2009 and 47% in 2008). However, gest allocation of the allowance for loan losses changed to real estate construction loans. This is a xperience with loan charge-offs in 2009 as charge-offs on real estate construction loans were 66%, of the total charge-offs of $8,767,000. The allocation of the allowance for loan losses to al estate loans continues to be a significant percentage due to the high concentration of this loan n portfolio. In addition to our charge-off experience in 2009, the recessionary conditions and the of national and local housing trends noted during 2009 and 2008 also support this shift in the

able summarizes asset quality information at the dates indicated:

	December 31,				
	2009	2008	2007	2006	2005
ns	$ 25,913	$ 8,528	$ 2,585	$ 2,801	$ 1,834
ans	-	-	-	-	-

perties	11,279	2,932	270	-	-
rming assets	$ 37,192	$ 11,460	$ 2,855	$ 2,801	$ 1,834
90 days and still nonaccrual loans	$ 4,787	$ 6,197	$ 1,219	$ 6,520	$ 4,932
assets to loans at	7.95%	2.43%	0.87%	1.16%	1.06%
assets to total	6.17%	2.00%	0.73%	0.96%	0.85%
oan losses to ns	40.6%	71.0%	134.2%	91.1%	105.3%

et of unearned

rued on outstanding loan principal balances, unless the Company considers collection to be
mercial and unsecured consumer loans are designated as non-accrual when the

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iders collection of expected principal and interest doubtful. Mortgage loans and most other types
ans past due 90 days or more may remain on accrual status if management determines that concern
to collect principal and interest is not significant. When loans are placed in non-accrual status,
rued and unpaid interest is reversed against interest income in the current period and interest is
ecognized only to the extent cash is received. Interest accruals are resumed on such loans only
dgment of management, the loans are estimated to be fully collectible as to both principal and

naccrual loans of $25,913,000 at December 31, 2009 that were considered impaired, seventeen
$17,525,000 had specific allowances for loan losses totaling $5,522,000. This compares to
nonaccrual loans at December 31, 2008 of which three loans totaling $1,369,000 had specific
loan losses of $235,000 at December 31, 2008. The increase in nonaccrual loans is due to the
conomy and is the primary factor in the higher overall allowance for loan losses at December 31,
eased level of classified loans impacted the level of allocations required based upon historical loss
lting in increased provisioning and allowance levels.

ssified as nonaccrual had been current in accordance with the original terms the gross amount of
that would have been earned in 2009 and 2008 was $569,000 and $95,000 respectively. Twelve
$4,787,000 at December 31, 2009 were past due 90 days or more and interest was still being
amounts were considered collectible.

able gives the composition of our deposits at the dates indicated.

Deposits
(In thousands)

	December 31, 2009		December 31, 2008		December 31, 2007	
	Amount	%	Amount	%	Amount	%
nts	$ 38,521	7.7%	$ 34,483	7.4%	$ 22,223	6.6%
g accounts	36,441	7.3%	17,427	3.7%	10,518	3.1%
accounts	115,167	23.1%	30,003	6.4%	22,060	6.5%
ts	8,901	1.8%	5,388	1.2%	3,373	1.0%
f $100,000	119,352	24.0%	148,173	31.8%	101,987	30.1%
osits	179,903	36.1%	230,758	49.5%	178,136	52.7%
	$498,285	100.0%	$466,232	100.0%	$338,297	100.0%

ncreased by 7%, 37% and 34% in 2009, 2008 and 2007, respectively. Although total deposits did
nificantly in 2009, the composition did change. Transactional deposit accounts (demand, interest
ey market and savings accounts) increased to 39.9% of total deposits compared to 18.7% and
mber 31, 2008 and 2007, respectively. This increase in transactional deposit accounts was the
ank offering attractive interest rates on money market accounts to encourage customers with
ficates of deposit to transfer those funds to money market accounts as well as improved deposit

s by our branch personnel.

deposit accounts offered by the Company has allowed us to be competitive in obtaining funds and to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of om depository institutions such as banking institutions into direct investment vehicles such as d corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, ue to be, significantly affected by money market conditions.

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table is a schedule of average balances and average rates paid for each deposit category for the
ed:

Average Deposits and Rates Paid
(In thousands)

	Year Ended December 31,					
	2009		2008		2007	
nt Type	Amount	Rate	Amount	Rate	Amount	Rate
aring demand	$39,626	-	$27,657	-	$22,686	-
deposits						
g accounts	26,530	1.67%	12,735	1.25%	10,454	0.99%
accounts	69,267	1.79%	28,215	1.99%	21,618	3.36%
ts	7,009	1.21%	6,891	2.81%	3,669	1.16%
of $100,000 and	121,440	3.72%	100,840	4.90%	81,828	5.23%
osits	226,258	3.60%	190,789	4.44%	151,580	5.14%
earing deposits	450,504	3.20%	339,470	4.23%	269,149	4.81%
ge deposits	$490,130		$367,127		$291,835	

able is a schedule of maturities for time deposits of $100,000 or more at December 31, 2009.

Maturities of Time Deposits of $100,000 or More
(In thousands)

Due within three months	$33,478
Due after three months through six months	10,509
Due after six months through twelve months	29,689
Over twelve months	45,676
	$119,352

owings to supplement deposits when they are available at a lower overall cost to us or they can be
sitive rate of return.

f the Federal Home Loan Bank of Atlanta (“FHLB”), the Bank is required to own capital stock in the
uthorized to apply for borrowings from the FHLB. Each FHLB credit program has its own interest
y be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to
nces may be put, as well as on the size of the advances and repayment provisions. Borrowings
B were $29,000,000 and $25,000,000 at December 31, 2009 and 2008 respectively. The FHLB
ecured by the pledge of residential mortgage loans and our FHLB stock. Available borrowings at
2009 were approximately $9.5 million.

purchased represent unsecured borrowings from other banks and generally mature daily. We did
urchased federal funds at December 31, 2009 or 2008.

12, 2007, the Company entered into a promissory note payable to Community Bankers’ Bank for
bearing interest at thirty day LIBOR plus 2.375% and maturing September 12, 2009. The
f the note was effective July 1, 2009 converting to 6.60% with principal and interest payments of
for 60 months, then converting to the five year T-Bill rate plus 2.40% adjusted every sixty months
ceeds advanced under the

e were used to finance the construction of the Company's new principal administrative offices in County which was completed in July 2008. The balances outstanding were $9,943,873 and December 31, 2009 and 2008 respectively, and included in other borrowings.

igations and other commitments

is a party to financial instruments with off-balance sheet risk in the normal course of business to eing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These uments include commitments to extend credit and standby letters of credit. These instruments nts of credit risk and interest rate risk in excess of the amount recognized in the consolidated The contractual amounts of these instruments reflect the extent of the Company's involvement in es of financial instruments.

's exposure to credit loss in the event of nonperformance by the other party to the financial commitments to extend credit and letters of credit written is represented by the contractual amount ments. The Company uses the same credit policies in making commitments and conditional t does for on-balance sheet instruments. Unless noted otherwise, the Company does not require ner security to support financial instruments with credit risk.

to extend credit are agreements to lend to a customer as long as there is no violation of any blished in the contract. Commitments generally have fixed expiration dates or other termination y require payment of a fee. Since many of the commitments may expire without being completely e total commitment amounts do not necessarily represent future cash requirements.

es

quity at December 31, 2009 was $48,942,000, compared to $46,163,000 at December 31, 2008 and December 31, 2007. On May 1, 2009, the Company received a $14,738,000 investment by the Department of the Treasury under its Capital Purchase Program (the TARP Program). The TARP oluntary program designed to provide capital for healthy banks to improve the flow of funds from customers. Under the TARP Program, the Company issued to the Treasury $14,738,000 of and warrants to purchase 499,030 shares of the Company's common stock at a purchase price of . The preferred stock issued by the Company under the TARP Capital Purchase Program carries a r each of the first 5 years of the investment, and 9% thereafter, unless the shares are redeemed by The increase in equity in 2009 of $2,779,000 is primarily due to the receipt of the capital er the TARP Program of $14,738,000, offset by the net loss of $11,511,000 for the year, and the to the U.S. Treasury on the TARP investment of $494,600.

d quarter of 2008, the Company took steps to increase the capital position of both the Company n connection with the planned merger with River City Bank. Such actions were taken, in part, to to consider the merger application on an expedited/delegated basis. In that regard, the Company hares of common stock and received proceeds of $500,000 as a result of the exercise of previously to its directors, all of which was contributed to the Bank as capital. In addition, the Company for $2,250,000 from Virginia Community Bank of which it contributed $2,000,000 to the Bank as stly, the Company issued 106,250 shares of common stock to the Company's largest shareholder $850,000, all of which was contributed to the Bank as capital. The merger with River City Bank dditional $5,764,000 in common stock and $10,505,000 of surplus. All of the above transactions he $19,270,000 increase in equity during 2008. The balance outstanding on the loan at December 2,000,000 and included in other borrowings.

quarter of 2005, the Company issued $5.2 million in Trust Preferred Capital Notes to increase its tal and to help fund its expected growth in 2005. During the third quarter of 2007, the Company lion in Trust Preferred Capital Notes to partially fund the construction of an 80,000 square foot uilding completed in July 2008. The Trust Preferred Capital Notes may be included in Tier 1 latory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. See Notes to Consolidated Financial Statements for a more detailed discussion of the Trust Preferred

able presents the composition of regulatory capital and the capital ratios at the dates indicated for

Analysis of Capital
(In thousands)

	As of December 31,		
	2009	2008	2007
ier 1 capital			
referred stock	$ 59		
ommon stock	16,922	$ 16,917	$ 10,304
dditional paid-in capital	40,569	25,737	13,726
etained earnings (deficit)	(8,648)	3,454	2,986
Varrant Surplus	732		
iscount on preferred tock	(636)		
ualifying trust preferred ecurities	8,764	8,764	8,764
otal equity	57,762	54,872	35,780
ess: goodwill	-	(7,422)	(689)
otal Tier 1 capital	57,762	47,450	35,091
ier 2 capital			
llowance for loan losses	6,310	6,059	3,469
otal Tier 2 capital	6,310	6,059	3,469
otal risk-based capital	64,072	53,509	38,560
isk-weighted assets	$500,602	$500,689	$378,020
apital ratios			
ier 1 capital to isk-weighted assets	11.5%	9.4%	9.3%
otal capital to isk-weighted assets	12.8%	10.6%	10.2%
everage ratio (Tier 1 apital to verage assets)	9.4%	8.4%	16.4%
quity to total assets	8.1%	8.1%	6.8%

ory agencies are required by law to adopt regulations defining five capital tiers: well capitalized,
italized, under capitalized, significantly under capitalized, and critically under capitalized. The
e criteria to be categorized as a "well capitalized" institution as of December 31, 2009 and
apital falls below the "well capitalized" requirement, consequences can include: new branch approval
eld; more frequent examinations by the FDIC; brokered deposits cannot be renewed without a
e FDIC; and other potential limitations as described in FDIC Rules and Regulations sections 337.6
DIC Act section 29. In addition, the FDIC insurance assessment increases when an institution falls
l capitalized" classification.

ides us with the ability to meet normal deposit withdrawals, while also providing for the credit
ners. We are committed to maintaining liquidity at a level sufficient to protect depositors, provide
growth, and fully comply with all regulatory requirements.

1, 2009, cash, cash equivalents and investment securities available-for-sale totaled $75,519,000, or
assets.

31, 2009, we had commitments to originate $72,876,000 of loans. Fixed commitments to incur
tures were less than $25,000 at December 31, 2009. Certificates of deposit scheduled to mature in
eriod ending December 31, 2009 total $184,051,000. We believe that a significant portion of such
main with us. We further believe that deposit growth, loan repayments and other sources of funds
e to meet our foreseeable short-term and long-term liquidity needs.

ensitivity

element of asset/liability management is the monitoring of our sensitivity to interest rate
n order to measure the effects of interest rates on our net interest income, management takes into
he expected cash flows from the securities and loan portfolios and the expected magnitude of the
ecific asset and liability categories. We evaluate interest sensitivity risk and then formulate
nanage this risk based on management's outlook regarding the economy, forecasted interest rate
d other business factors. Our goal is to maximize and stabilize the net interest margin by limiting
erest rate changes.

ncipal repayments of loans do not necessarily reflect the actual term of our loan portfolio. The
f mortgage loans are substantially less than their contractual terms because of loan prepayments
enforcement of due-on-sale clauses, which gives us the right to declare a loan immediately due
the event, among other things, the borrower sells the real property subject to the mortgage and the
aid. In addition, certain borrowers increase their equity in the security property by making
cess of those required under the terms of the mortgage.

d rate loans is intended to protect us from precipitous changes in the general level of interest rates.
of adjustable rate mortgage loans is not as directly dependent on the level of interest rates as is the
rate loans. As with other investments, we regularly monitor the appropriateness of the level of
mortgage loans in our portfolio and may decide from time to time to sell such loans and reinvest
other adjustable rate investments.

e following table reflects repricing or expected maturities of various assets and liabilities at
2009. The gap analysis represents the difference between interest-sensitive assets and liabilities in
interval. Interest sensitivity gap analysis presents a position that existed at one particular point in
nes that assets and liabilities with similar repricing characteristics will reprice at the same time and
ree.

Village Bank and Trust Financial Corp.
Interest Rate Sensitivity GAP Analysis
December 31, 2009
(In thousands)

	Within 3 Months	3 to 6 Months	6 to 12 Months	13 to 36 Months	More than 36 Months	Total
ensitive						
	$ 41,620	$ 13,432	$ 22,143	$ 26,716	$ 154,846	$ 258,757
	135,345	3,332	8,093	14,808	47,025	208,603
urities	-	-	162	78	54,617	54,857
sale	7,506	-	-	-	-	7,506
old	6,777	-	-	-	-	6,777
tive						
	191,248	16,764	30,398	41,602	256,488	536,500
e						
	191,248	208,012	238,410	280,012	536,500	
ensitive						
ng (2)	-	-	-	36,441	-	36,441
	115,166	-	-	-	-	115,166
	-	-	-	8,901	-	8,901
deposit	88,654	29,044	69,612	100,666	11,279	299,255
s	-	15,000	-	14,000	-	29,000
	-	-	-	-	8,764	8,764
	-	-	-	-	-	-
gs	2,928	2,041	84	266	9,511	14,830
tive						
	206,748	46,085	69,696	160,274	29,554	512,357
e						
ties	206,748	252,833	322,529	482,803	512,357	
gap						
	$(15,500)	$(29,321)	$(39,298)	$(118,672)	$ 226,934	$ 24,143
e						
	$(15,500)	$(44,821)	$(84,119)	$(202,791)	$ 24,143	

ative ets	(2.6)%	(7.4)%	(14.0)%	(33.6)%	4.0%
ative ative	92.5%	82.3%	73.9%	58.0%	104.7%
ative ve ssets	(8.1)%	(21.5)%	(35.3)%	(72.4)%	4.5%

naccrual loans of approximately $21,313,000, which are
out the categories.
t believes that interest checking and savings accounts are generally not
nges in interest
ore has placed such deposits in the "13
ategory.

1, 2009, our liabilities that reprice within one year exceeded assets that reprice within one year by
d therefore we were in a liability-sensitive position. A negative gap can adversely affect earnings
creasing interest rates. This negative position is due primarily to the short maturity of certificates
ell as an increase in money market accounts.

ting Policies

g and reporting policies followed by the Company conform, in all material respects, to U.S.
ted accounting principles ("U.S. GAAP") which, effective for all interim and annual periods ending
r 15, 2009, principally consist of the Financial Standards Board Accounting Standards Codification
cation"). FASB Codification Topic 105: Generally Accepted Accounting Principles establishes the
tion as the source of authoritative accounting principles recognized by the FASB to be applied by
ntal entities in the preparation of financial statements in conformity with generally accepted
nciples. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under
deral securities laws are also sources of authoritative guidance for SEC registrants. All guidance
he FASB Codification carries an equal level of authority. All non-grandfathered, non SEC
rature not included in the FASB Codification is superseded and deemed non-authoritative. In
onsolidated financial statements,

ns made estimates, assumptions and judgments based on information available as of the date of the
ments; accordingly, as this information changes, the financial statements may reflect different
mptions and judgments. Certain policies inherently have greater reliance on the use of estimates,
d judgments and, as such, have a greater possibility of producing results that could be materially
riginally reported. Estimates, assumptions and judgments are necessary when assets and liabilities
be recorded at fair value, when a decline in the value of an asset not carried on the financial
ir value warrants an impairment write-down or valuation allowance to be established, or when an
y must be recorded contingent upon a future event. Carrying assets and liabilities at fair value
lts in more financial statement volatility. The fair values and the information used to record
tments for certain assets and liabilities are based either on quoted market prices or are provided by
ty sources, when readily available. Management evaluates its estimates and assumptions on an
using historical experience and other factors, including the current economic environment, which
elieves to be reasonable under the circumstances. The Company adjusts such estimates and
hen the Company believes facts and circumstances dictate. Illiquid credit markets, volatile equity,
cy and energy markets and declines in consumer spending have combined to increase the
erent in such estimates and assumptions. As future events and their effects cannot be determined
actual results could differ significantly from these estimates. Changes in those estimates resulting
g changes in the economic environment will be reflected in the financial statements in the future

ondition and results of operations presented in the financial statements, accompanying notes to the
ments and management's discussion and analysis are, to a large degree, dependent upon the
ounting policies. The selection and application of these accounting policies involve judgments,
uncertainties that are susceptible to change. Presented below is discussion of those accounting
anagement believes are the most important accounting policies to the portrayal and understanding
condition and results of operations. These critical accounting policies require management's most
tive and complex judgments about matters that are inherently uncertain. In the event that different
conditions were to prevail, and depending upon the severity of such changes, the possibility of
erent financial condition or results of operations is a reasonable likelihood. See also Note 1 of the
lidated Financial Statements.

oan losses

d maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the
We maintain policies and procedures that address the systems of controls over the following areas
e of the allowance: the systematic methodology used to determine the appropriate level of the
rovide assurance they are maintained in accordance with accounting principles generally accepted
tates of America; the accounting policies for loan charge-offs and recoveries; the assessment and
f impairment in the loan portfolio; and the loan grading system.

reflects management's best estimate of probable losses within the existing loan portfolio and of the
various components of the loan portfolio, including loans identified as impaired as required by
cation Topic 310: Receivables. Loans evaluated individually for impairment include
g loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and
cted by management. The evaluations are based upon discounted expected cash flows or collateral
he evaluation shows that a loan is individually impaired, then a specific reserve is established for
mpairment.

ped by similar characteristics, including the type of loan, the assigned loan classification and the
al type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon
fault rates for a given loan grade, the predominant collateral type for the group and the terms of the
ting estimate of losses for groups of loans is adjusted for relevant environmental factors and other
e portfolio of loans and leases, including: borrower and industry concentrations; levels and trends

charge-offs and recoveries; changes in underwriting standards and risk selection; level of
lity and depth of lending management; and national and local economic conditions.

f estimated impairment for individually evaluated loans and groups of loans are added together for
e of loan losses. This estimate of losses is compared to our allowance for loan losses as of the
e and, if the estimate of losses is greater than the allowance, an additional provision to the
ld be made. If the estimate of losses is less than the allowance, the degree to which the allowance
imate is evaluated to determine whether the allowance falls outside a range of estimates. If the
ses is below the range of reasonable estimates, the allowance would be reduced by way of a credit
n for loan losses. We recognize the inherent imprecision in estimates of losses due to various
nd variability related to the factors used, and therefore a reasonable range around the estimate of
d and used to ascertain whether the allowance is too high. If different assumptions or conditions
and it is determined that the allowance is not adequate to absorb the new estimate of probable
tional provision for loan losses would be made, which amount may be material to the financial

sents the cost in excess of the fair value of net assets acquired (including identifiable intangibles)
accounted for as business combinations. Goodwill has an indefinite useful life and is evaluated for
ually, or more frequently if events and circumstances indicate that the asset might be impaired. An
s is recognized to the extent that the carrying amount exceeds the asset's fair value. The goodwill
lysis is a two-step test. The first, used to identify potential impairment, involves comparing each
s estimated fair value to its carrying value, including goodwill. If the estimated fair value of a
xceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds
value, there is an indication of potential impairment and the second step is performed to measure
mpairment. If required, the second step involves calculating an implied fair value of goodwill for
unit for which the first step indicated impairment. The implied fair value of goodwill is determined
nilar to the amount of goodwill calculated in a business combination, by measuring the excess of
air value of the reporting unit, as determined in the first step, over the aggregate estimated fair
dividual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in
bination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to
nit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds
r value of the goodwill, an impairment charge is recorded for the excess. The Company's annual
irment evaluation in 2009 resulted in a goodwill impairment charge of $7,422,000 which was
ninterest expense for the year ended December 31, 2009. Of the total $7,422,000 in goodwill,
ted to the acquisition of River City Bank and $689,000 related to the acquisition of the mortgage
s impairment charge, representing the full amount of goodwill on the consolidated balance sheet,
due to a significant decline in the market value of the Company's common stock during 2009 to
book value for an extended period of time. Other intangible assets include premiums paid for
core deposits and other identifiable intangible assets. Intangible assets other than goodwill, which
to have finite lives, are amortized based upon the estimated economic benefits received.

e tax assets and liabilities are determined using the liability (or balance sheet) method. Under this
deferred tax asset or liability is determined based on the tax effects of the temporary differences
ok and tax bases of the various balance sheet assets and liabilities and gives current recognition to
rates and laws. Deferred taxes are reduced by a valuation allowance when, in the opinion of

it is more likely than not that some portion or all of the deferred tax assets will not be agement is also required to identify, estimate and disclose positions they have taken where the tment of the

is not 100% certain. Our evaluation of the deductibility or taxability of items included in the returns has not resulted in the identification of any material, uncertain tax positions.

g standards

ne FASB issued guidance on subsequent events that standardizes accounting for and disclosures of ur after the balance sheet date but before financial statements are issued or are available to be blic entity, the Company is required to evaluate subsequent events through the date its financial issued. Accordingly, the Company has completed an evaluation of subsequent events through 2009. These rules became effective for the Company during its interim period ending after June 15, ot have a material impact on its consolidated financial statements.

ne FASB issued standards on accounting for transfers of financial assets, removing the concept of ial-purpose entities as an accounting criteria that had provided an exception to consolidation, and ional guidance on requirements for consolidation. This guidance is effective for annual periods ovember 15, 2009, and did not have a material impact on the Company's consolidated financial

tive accounting guidance under ASC Topic 715, "Compensation—Retirement Benefits," provides d to an employer's disclosures about plan assets of defined benefit pension or other post-retirement Under ASC Topic 715, disclosures should provide users of financial statements with an of how investment allocation decisions are made, the factors that are pertinent to an understanding olicies and strategies, the major categories of plan assets, the inputs and valuation techniques used fair value of plan assets, the effect of fair value measurements using significant unobservable ges in plan assets for the period and significant concentrations of risk within plan assets. The new ccounting guidance under ASC Topic 715 became effective for the Company's consolidated nents for the year-ended December 31, 2009 and the required disclosures are reported in Note 17 - ns.

v authoritative accounting guidance under ASC Topic 715, "Compensation—Retirement Benefits," ognition of a liability and related compensation expense for endorsement split-dollar life insurance ovide a benefit to an employee that extends to post-retirement periods. Under ASC Topic 715, life cies purchased for the purpose of providing such benefits do not effectively settle an entity's e employee. Accordingly, the entity must recognize a liability and related compensation expense ployee's active service period based on the future cost of insurance to be incurred during the rement. The Company does not have any split-dollar life insurance policies.

th Securities and Exchange Commission ("SEC") requirements, the FASB repealed the requirement rants disclose the date through which an evaluation of subsequent events has been conducted as FASB ASC Update 2010-09 "Subsequent Events".

ive accounting guidance under ASC Topic 860, "Transfers and Servicing," amends prior accounting nance reporting about transfers of financial assets, including securitizations, and where companies g exposure to the risks related to transferred financial assets. The new authoritative accounting inates the concept of a "qualifying special-purpose entity" and changes the requirements for financial assets. The new authoritative accounting guidance also requires additional disclosures nuing involvements with transferred financial assets including information about gains and losses transfers during the period. The new authoritative accounting guidance under ASC Topic 860 will nuary 1, 2010 and is not expected to have a significant impact on the Company's consolidated

nents.

ion and changing prices

s financial statements included herein have been prepared in accordance with generally accepted
nciples in the United States, which require the Company to measure financial position and
ts primarily in terms of historical dollars. Changes in the relative value of money due to inflation
e generally not considered. The primary effect of inflation on the operations of the Company is
reased operating costs. In management's opinion, changes in interest rates affect the financial
financial institution to a far greater degree than changes in the inflation rate. While interest rates
uenced by changes in the inflation rate, they do not necessarily change at the same rate or in the
de as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the
Company, including changes in the expected rate of inflation, the influence of general and local
ditions and the monetary and fiscal policies of the United States government, its agencies and
overnmental regulatory authorities.

NCIAL STATEMENTS AND SUPPLEMENTARY DATA

ed financial statements and related footnotes of the Company are presented below.

pendent Registered Public Accounting Firm

tors
nd Trust Financial Corp.
rginia

ed the accompanying consolidated balance sheets of Village Bank and Trust Financial Corp. and
f December 31, 2009 and 2008, and the related consolidated statements of income, stockholders'
n flows for each of the three years in the period ended December 31, 2009. These consolidated
ments are the responsibility of the Company's management. Our responsibility is to express an
e consolidated financial statements based on our audits.

our audits in accordance with the standards of the Public Company Accounting Oversight Board
. Those standards require that we plan and perform the audits to obtain reasonable assurance about
nancial statements are free of material misstatement. The Company is not required to have, nor
ged to perform, an audit of its internal control over financial reporting. Our audits included
of internal control over financial reporting as a basis for designing audit procedures that are
the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the
ernal control over financial reporting. Accordingly, we express no such opinion. An audit also
nining, on a test basis, evidence supporting the amounts and disclosures in the financial
n audit also includes assessing the accounting principles used and significant estimates made by
as well as evaluating the overall financial statement presentation. We believe that our audits
nable basis for our opinion.

the consolidated financial statements referred to above present fairly, in all material respects, the
nancial position of Village Bank and Trust Financial Corp. and Subsidiary as of December 31,
, and the consolidated results of its operations and its cash flows for each of the three years in the
December 31, 2009, in conformity with accounting principles generally accepted in the United
ca.

n, LLP

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Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
December 31, 2009 and 2008

	2009	2008
rom banks	$ 13,884,581	$ 13,107,245
old	6,777,239	13,493,584
urities available for sale	54,857,211	24,300,962
sale	7,506,252	4,325,746
	467,359,664	470,918,182
oan losses	(10,521,931)	(6,059,272)
nd costs	208,883	(195,896)
	457,046,616	464,663,014
quipment, net	27,799,084	28,173,518
t receivable	3,366,718	3,499,793
	-	7,422,141
e insurance	5,431,002	5,099,022
e owned	11,278,532	2,932,101
	15,015,708	5,390,867
	$602,962,943	$572,407,993
Stockholders' Equity		
	$498,285,124	$466,232,043
oan bank advances	29,000,000	25,000,000
- trust preferred securities	8,764,000	8,764,000
gs	14,829,521	23,962,898
t payable	501,069	1,014,534
	2,641,410	1,271,944
	554,021,124	526,245,419
quity		
, $4 par value, $1,000 liquidation		
res authorized, 14,738 shares issued		
g	58,952	-
, $4 par value - 10,000,000 shares		
es issued and outstanding at		
2009		
es issued and outstanding at		
2008	16,922,512	16,917,488
-in capital	40,568,771	25,737,048
gs	(8,647,731)	3,453,788

	732,479	-
eferred stock	(636,959)	-
ther comprehensive income (loss)	(56,205)	54,250
ers' equity	48,941,819	46,162,574
	$602,962,943	$572,407,993

ing notes to consolidated financial

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Income
Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
	$ 31,711,644	$ 28,140,129	$ 24,379,103
urities	1,457,694	698,790	847,364
old	26,635	233,227	438,768
ncome	33,195,973	29,072,146	25,665,235
e			
	14,433,943	14,348,287	12,949,807
s	1,973,736	1,621,496	856,908
xpense	16,407,679	15,969,783	13,806,715
ome	16,788,294	13,102,363	11,858,520
an losses	13,220,000	2,005,633	1,187,482
ome after provision			
	3,568,294	11,096,730	10,671,038
ome			
and fees	1,612,769	1,160,500	748,695
loans	5,828,006	2,381,023	1,513,318
sale of equipment	(43,637)	57,827	-
	187,786	4,183	-
	700,176	581,194	404,943
st income	8,285,100	4,184,727	2,666,956
pense			
nefits	10,476,065	7,976,472	6,842,990
	1,757,939	1,264,757	900,913
	877,205	751,698	659,014
	495,562	464,900	353,573
d outside services	1,726,130	1,544,895	1,173,135
d marketing	308,598	315,985	439,749
	1,475,338	165,455	-
nt	1,366,612	464,395	175,763
expense	2,432,286	1,623,714	1,276,095
rment	7,422,141	-	-
st expense	28,337,876	14,572,271	11,821,232
ss) before income			
	(16,484,482)	709,186	1,516,762
nefit) expense	(4,973,114)	241,097	515,699
ss)	(11,511,368)	468,089	1,001,063

dividends	494,631	-	-
ss) available to holders	$(12,005,999)	$ 468,089	$ 1,001,063
per share, basic	$ (2.84)	$ 0.16	$ 0.39
per share, diluted	$ (2.84)	$ 0.16	$ 0.37

ing notes to
nancial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Stockholders' Equity
and Comprehensive Income
Years Ended December 31, 2009, 2008 and 2007

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Warrant	Discount on Preferred Stock	Accumulated Other Comprehensive Income (loss)	Total
	$	$	$	$	$	$	$	$
	-	10,248,352	13,588,888	1,984,634	-	-	(177,759)	25,644,115
	-	55,588	77,646	-	-	-	-	133,234
	-	-	59,735	-	-	-	-	59,735
)	-	-	-	-	-	-	8,579	8,579
	-	-	-	1,001,063	-	-	-	1,001,063
f								
	-	-	-	-	-	-	46,573	46,573
	-	-	-	-	-	-	-	1,047,636
	-	10,303,940	13,726,269	2,985,697	-	-	(122,607)	26,893,299
	-	849,652	950,712	- -	-	-	-	1,800,364
							-	-
	-	5,763,896	10,504,700	-	-	-		16,268,596
	-	-	555,367	-	-	-	-	555,367

)	-	-	-	-	-	-	8,580	8,580
	-	-	-	468,091	-	-	-	468,091
	-	-	-	-	-	-	168,277	168,277
	-	-	-	-	-	-	-	636,368
	-	16,917,488	25,737,048	3,453,788	-	-	54,250	46,162,574
	58,952	-	14,679,048	-	732,479	(732,479)	-	14,738,000
f								
t	-	-	-	(95,520)	-	95,520	-	-
	-	-	-	(494,631)	-	-	-	(494,631)
	-	5,024	(5,024)	-	-	-	-	-
	-	-	157,699	-	-	-	-	157,699
)	-	-	-	-	-	-	8,580	8,580
	-	-	-	(11,511,368)	-	-	-	(11,511,368)
	-	-	-	-	-	-	(119,035)	(119,035)
	-	-	-	-	-	-	-	(11,621,823)
	$ 58,952	$ 16,922,512	$ 40,568,771	$ (8,647,731)	$ 732,479	$ (636,959)	$ (56,205)	$ 48,941,819

ing notes to
nancial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
m Operating			
ss)	$ (11,511,368)	$ 468,089	$ 1,001,063
reconcile net			
y (used in)			
ties:			
d amortization	1,250,315	798,965	673,110
e taxes	(3,031,268)	(291,679)	(236,072)
an losses	13,220,000	2,005,633	1,187,482
other real estate			
	1,329,991	-	-
odwill	7,422,141	-	-
ies	(329,183)	(23,194)	-
old	(5,828,006)	(2,381,023)	(1,513,318)
sale of premises			
	43,353	(57,827)	-
other real estate			
	(46,173)	-	-
ation expense	157,699	555,367	59,735
sale of other real			
	2,875,478	-	-
sale of mortgage			
	255,007,702	101,624,820	68,667,081
mortgage loans			
	(252,360,202)	(100,079,657)	(67,494,471)
f premiums and			
scounts on			
	337,251	(31,098)	37,759
ease in interest			
	133,075	(43,355)	(451,491)
k owned life			
	(331,980)	(1,108,511)	(1,382,788)
r assets	(6,523,672)	(1,945,210)	(751,544)
ase) in interest			
	(513,465)	(178,382)	157,994
ase) in other			
	1,369,466	262,945	(501,892)
n operating			
	2,671,154	(424,117)	(547,352)
m Investing			
	(46,117,779)	-	(23,532,491)

ailable for sale						
calls of available es		15,373,106		16,619,003		22,641,205
loans		(18,109,329)		(32,209,599)		(86,562,804)
emises and		(1,023,928)		(8,954,314)		(8,080,207)
sale of premises		104,693		1,144,595		-
of cash required		-		(57,175)		-
n investing		(49,773,237)		(23,457,490)		(95,534,297)
m Financing						
ferred stock		14,738,000		-		-
nmon stock		-		1,800,364		133,234
ecrease) in		32,053,081		(3,277,260)		85,987,377
Loan Bank		4,000,000		13,000,000		8,000,000
issuance of trust ties		-		-		3,609,000
ecrease) in other		(9,133,377)		16,844,328		3,268,539
referred stock		(494,631)		-		-
led by financing		41,163,073		28,367,432		100,998,150
increase in cash alents		(5,939,009)		4,485,825		4,916,501
equivalents, riod		26,600,829		22,115,004		17,198,503
equivalents, end	$	20,661,820	$	26,600,829	$	22,115,004
chedule of Non						
ned assets lement of loans	$	12,505,727	$	1,337,306	$	-
ing notes to nancial						

Village Bank and Trust Financial Corp. and Subsidiary
Notes to Consolidated Financial Statements
Years Ended December 31, 2009, 2008 and 2007

Summary of Significant Accounting Policies

g and reporting policies of Village Bank and Trust Financial Corp. and subsidiary (the "Company") counting principles generally accepted in the United States of America and to general practice ing industry. The following is a description of the more significant of those policies:

s the holding company of and successor to the Village Bank (the "Bank"). Effective April 30, 2004, cquired all of the outstanding stock of the Bank in a statutory share exchange transaction. In the shares of the Bank's common stock were exchanged for shares of the Company's common stock, per share ("Common Stock"), on a one-for-one basis. As a result, the Bank became a wholly owned ne Company, the Company became the holding company for the Bank and the shareholders of the hareholders of the Company.

ed to the public on December 13, 1999 as a traditional community bank offering deposit and loan ividuals and businesses in the Richmond, Virginia metropolitan area. During 2003, the Bank med three wholly owned subsidiaries, Village Bank Mortgage Corporation ("Village Mortgage"), a ortgage banking company, Village Insurance Agency, Inc. ("Village Insurance"), a full service sualty insurance agency, and Village Financial Services Corporation ("Village Financial Services"), ices company. Through these subsidiaries, the Bank provides a broad array of financial services to

, 2008, the Company completed its merger with River City Bank pursuant to an Agreement and nization and Merger, dated as of March 9, 2008, by and among the Company, the Bank and River e merger had previously been approved by both companies' shareholders at their respective annual ptember 30, 2008 as well as the banking regulators.

is subject to intense competition from existing bank holding companies, commercial banks and which have been in business for many years and have established customer bases. Competition n a variety of other non-bank businesses that offer financial services. Many of these competitors same geographic market where the Company operates, are well-known with long-standing vith businesses and individuals in the communities, and are substantially larger with greater the Company.

o subject to regulations of certain federal and state agencies and undergoes periodic examinations tory authorities. As a consequence of the extensive regulation of commercial banking activities, ness is susceptible to being affected by state and federal legislation and regulations.

f the Company's real estate loans are collateralized by properties in markets in the Richmond, politan area. Accordingly, the ultimate collectibility of those loans collateralized by real estate is ceptible to changes in market conditions in the Richmond area.

tation and Consolidation
ated financial statements include the accounts of the Company, the Bank and the Bank's
ll material intercompany balances and transactions have been eliminated in consolidation.

s
n of the consolidated financial statements in conformity with accounting principles generally
United States of America requires management to make estimates and assumptions that affect the
nts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the
inancial condition and revenues and expenses during the reporting period. Actual results could
ntly from those estimates. A material estimate that is particularly susceptible to significant change
relates to the determination of the allowance for loan losses.

urities
f purchase, debt securities are classified into the following categories: held-to-maturity,
ale or trading. Debt securities that the Company has both the positive intent and ability to hold to
assified as held-to-maturity. Held-to-maturity securities are stated at amortized cost adjusted for
f premiums and accretion of discounts on purchase using a method that approximates the effective
. Investments classified as trading or available-for-sale are stated at fair market value. Changes in
ading investments are included in current earnings while changes in fair value of available-for-sale
re excluded from current earnings and reported, net of taxes, as a separate component of
quity. Presently, the Company does not maintain a portfolio of trading securities.

e market value of any available-for-sale or held-to-maturity security below cost that is deemed
porary results in a charge to earnings and the corresponding establishment of a new cost basis for
o such declines have occurred.

me is recognized when earned. Realized gains and losses for securities classified as
ale and held-to-maturity are included in earnings and are derived using the specific identification
ermining the cost of securities sold.

sale
through the Bank's mortgage banking subsidiary, Village Bank Mortgage, originates residential
s for sale in the secondary market. Mortgage loans originated and intended for sale in the
ket are carried at the lower of cost or estimated fair value on an individual loan basis as determined
g commitments from investors. The Company requires a firm purchase commitment from a
estor before a loan can be closed, thus limiting interest rate risk. Net unrealized losses, if any, are
ugh a valuation allowance by charges to income.

rtgage loans held for sale are sold to the permanent investor with the mortgage servicing rights
s or losses on sales of mortgage loans are recognized based on the difference between the selling
arrying value of the related mortgage loans sold. This difference arises primarily as a result of the
rtgage servicing rights.

tial mortgage loan is sold to a permanent investor, the Company has no further involvement or
t in the loan. There are limited circumstances in which the permanent investor can contractually
mpany to repurchase the loan. The Company makes no provision for any such recourse related to
story has shown repurchase of loans under these circumstances has been remote.

d at the principal amount outstanding, net of unearned income. Loan origination fees and certain gination costs are deferred and amortized to interest income over the life of the loan as an ne loan's yield over the term of the loan.

crued on outstanding principal balances, unless the Company considers collection to be mercial and unsecured consumer loans are designated as non-accrual when payment is delinquent ne point which the Company considers collection doubtful, if earlier. Mortgage loans and most consumer loans past due 90 days or more may remain on accrual status if management determines nts are collectible. When loans are placed in non-accrual status, previously accrued and unpaid rsed against interest income in the current period and interest is subsequently recognized only to h is received. Interest accruals are resumed on such loans only when in the judgment of ne loans are estimated to be fully collectible as to both principal and interest.

through the Bank's mortgage banking subsidiary, Village Bank Mortgage, enters into commitments dential mortgage loans in which the interest rate on the loan is determined prior to funding, termed mitments. Such rate lock commitments on mortgage loans to be sold in the secondary market are e derivatives. The period of time between issuance of a loan commitment and closing and sale of lly ranges from 30 to 45 days. The Company protects itself from changes in interest rates during equiring a firm purchase agreement from a permanent investor before a loan can be closed. As a pany is not exposed to losses nor will it realize gains or losses related to its rate lock commitments in interest rates.

ue of rate lock commitments and best efforts contracts is not readily ascertainable with precision ck commitments and best efforts contracts are not actively traded in stand-alone markets. The mines the fair value of rate lock commitments and best efforts contracts by measuring the change the underlying asset while taking into consideration the probability that the rate lock commitments e to high correlation between rate lock commitments and best efforts contracts, no significant gains occurred on the rate lock commitments.

oan losses
for loan losses is established as losses are estimated to have occurred through a provision for loan to earnings. Loan losses are charged against the allowance when management believes the of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

represents an amount that, in management's judgment, will be adequate to absorb any losses on that may become uncollectible. Management's judgment in determining the adequacy of the ased on evaluations of the collectibility of loans while taking into consideration such factors as nature and volume of the loan portfolio, current economic conditions which may affect a borrower's , overall portfolio quality, and review of specific potential losses. This evaluation is inherently it requires estimates that are susceptible to significant revision as more information becomes

e consists of general, specific and unallocated components. The general component covers loans and is based on historical loss experience adjusted for qualitative factors. The specific ates to loans that we have concluded, based on the value of collateral, guarantees and any other ors, have known losses. For such loans that are also classified as impaired, an allowance is en the discounted cash flows (or collateral value or observable market price) of the impaired loan is carrying value of

nallocated component is maintained to cover uncertainties that could affect management's estimate ses. The unallocated component of the allowance reflects the margin of imprecision inherent in the mptions used in the methodologies for estimating specific and general losses in the portfolio.

dered impaired when, based on current information and events, it is probable that the Company to collect the scheduled payments of principal or interest when due according to the contractual an agreement. Factors considered by management in determining impairment include payment ral value, and the probability of collecting scheduled principal and interest payments when t experience insignificant payment delays and payment shortfalls generally are not classified as agement determines the significance of payment delays and payment shortfalls on a case-by-case to consideration all of the circumstances surrounding the loan and the borrower, including the elay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall e principal and interest owed. Impairment is measured on a loan by loan basis for commercial and ans by either the present value of the expected future cash flows discounted at the loan's effective e loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

f smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the not separately identify individual consumer and residential loans for impairment disclosures.

quipment
d at cost. Premises and equipment are carried at cost less accumulated depreciation and Depreciation of buildings and improvements is computed using the straight-line method over the ul lives of the assets of 39 years. Depreciation of equipment is computed using the straight-line he estimated useful lives of the assets ranging from 3 to 7 years. Amortization of premises rovements) is computed using the straight-line method over the term of the lease or estimated lives ments, whichever is shorter.

sents the cost in excess of the fair value of net assets acquired (including identifiable intangibles) accounted for as business combinations. Goodwill has an indefinite useful life and is evaluated for nnually, or more frequently if events and circumstances indicate that the asset might be impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair odwill impairment analysis is a two-step test. The first, used to identify potential impairment, aring each reporting unit's estimated fair value to its carrying value, including goodwill. If the value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If lue exceeds estimated fair value, there is an indication of potential impairment and the second step measure the amount of impairment. If required, the second step involves calculating an implied odwill for each reporting unit for which the first step indicated impairment. The implied fair value determined in a manner similar to the amount of goodwill calculated in a business combination, by excess of the estimated fair value of the reporting unit, as determined in the first step, over the nated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting acquired in a business combination. If the implied fair value of goodwill exceeds the carrying will assigned to the reporting unit, there is no impairment. If the carrying value of goodwill eporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for

s annual goodwill impairment evaluation in 2009 resulted in a goodwill impairment charge of ch was recorded to noninterest expense for the year ended December 31,

otal $7,422,000 in goodwill, $6,733,000 related to the acquisition of River City Bank and $689,000
cquisition of the mortgage company. This impairment charge, representing the full amount of
e consolidated balance sheet, was primarily due to a significant decline in the market value of the
mmon stock during 2009 to below tangible book value for an extended period of time. Other
ets include premiums paid for acquisitions of core deposits and other identifiable intangible
ble assets other than goodwill, which are determined to have finite lives, are amortized based upon
conomic benefits received.

ne taxes are recognized for the tax consequences of "temporary differences" by applying enacted tax
e to future years to differences between the financial statement carrying amounts and the tax bases
ts and liabilities. The effect on recorded deferred income taxes of a change in tax laws or rates is
ncome in the period that includes the enactment date. To the extent that available evidence about
ses doubt about the realization of a deferred income tax asset, a valuation allowance is
tax position is recognized as a benefit only if it is "more likely than not" that the tax position would
a tax examination, with a tax examination being presumed to occur. The amount recognized is the
of tax benefit that is greater than 50% likely of being realized on examination. For tax positions
e "more likely than not" test, no tax benefit is recorded. The primary temporary differences are the
loan losses and depreciation and amortization. The Company has not identified any material
ositions. As such, the disclosures required by GAAP pertaining to uncertain tax positions have

atements of cash flows
f reporting cash flows, cash and cash equivalents include cash on hand, due from banks (including
process of collection), interest-bearing deposits with banks and federal funds sold. Generally,
re purchased and sold for one-day periods. Cash flows from loans originated by the Bank and
ported net. The Company paid interest of $16,921,000, $15,543,000 and $13,649,000 in 2009,
7, respectively. The Company paid income taxes of $290,000, $260,400 and $800,400 in 2009,
, respectively. Non-cash investing activities included loans converted to real estate owned of
337,000 and $0 in 2009, 2008 and 2007.respectively.

e income
e income is defined to include all changes in equity except those resulting from investments by
tributions to owners. Total comprehensive income (loss) consists of net income (loss) and other
e income (loss). The Company's other comprehensive income (loss) and accumulated other
e income (loss) are comprised of unrealized gains and losses on certain investments in debt
amortization of the unfunded pension liability. At December 31, 2009 the accumulated other
e income was comprised of unrealized gains on securities available for sale of $63,862 and
on liability of $120,067.

mmon share
(loss) per common share represent net income available to common stockholders, which represents
s) less dividends paid or payable to preferred stock shareholders, divided by the weighted-average
mon shares outstanding during the period. For diluted earnings per common share, net income
mmon shareholders is divided by the weighted average number of common shares issued and
each period plus amounts representing the dilutive effect of stock options and warrants, as well as
to income that would result from the assumed issuance. The effects of stock options and warrants
om the computation of diluted earnings per common share in periods in which the effect

ilutive. Stock options and warrants are antidilutive if the underlying average market price of the
be purchased for the period is less than the exercise price of the option or warrant. Potential
s that may be issued by the Company relate solely to outstanding stock options and warrants and
using the treasury stock method.

plan
s shareholders approved the Company's 2000 stock incentive plan which authorizes the issuance of
shares of common stock (increased from 255,000 shares by amendment to the Incentive Plan
e Company's shareholders at its 2006 annual meeting on May 23, 2006) to assist the Company in
retaining key personnel. The incentive plan includes issuances of stock options and awards of
on shares. The expiration date on options granted is ten years with a three year vesting schedule.
r more information on the stock incentive plan.

inancial instruments
of an asset or liability is the price that would be received to sell that asset or paid to transfer that
orderly transaction between market participants. A fair value measurement assumes that the
ell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the
incipal market, the most advantageous market for the asset or liability. The price in the principal
tageous) market used to measure the fair value of the asset or liability shall not be adjusted for
s. An orderly transaction is a transaction that assumes exposure to the market for a period prior to
nt date to allow for marketing activities that are usual and customary for transactions involving
liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal
independent, knowledgeable, able to transact and willing to transact. The Bank uses the following
sumptions in estimating fair values of financial instruments:

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

urities – The fair value of investment securities held-to-maturity and available-for-sale is estimated
uotations received from independent pricing services. The carrying amount of other investments
air value.

riable rate loans that reprice frequently and have no significant change in credit risk, fair values are
ng values. For all other loans, fair values are calculated by discounting the contractual cash flows
d market discount rates which reflect the credit and interest rate risk inherent in the loans, or by
nt rates at which similar loans would be made to borrowers with similar credit ratings and for the
g maturities.

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

The fair value of FHLB borrowings is based on the discounted value of contractual cash flows using
tly offered for borrowings of similar remaining maturities. The carrying amounts of federal funds
roximate their fair values. Other borrowings are short-term in nature and the carrying amounts
r value.

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

eet instruments – The fair value of off-balance-sheet lending commitments is equal to the amount of
utstanding at December 31, 2009 of $72,876,000. This is based onthe fact that the Bank generally
ending commitments or standby letters of credit to its customers for long periods, and therefore,
rates of the commitments approximate market rates.

g pronouncements

he FASB issued guidance on subsequent events that standardizes accounting for and disclosures of
ur after the balance sheet date but before financial statements are issued or are available to be
blic entity, the Company is required to evaluate subsequent events through the date its financial
issued. Accordingly, the Company has completed an evaluation of subsequent events through
2009. These rules became effective for the Company during its interim period ending after June 15,
ot have a material impact on its consolidated financial statements.

he FASB issued standards on accounting for transfers of financial assets, removing the concept of
ial-purpose entities as an accounting criteria that had provided an exception to consolidation, and
ional guidance on requirements for consolidation. This guidance is effective for annual periods
ovember 15, 2009, and did not have a material impact on the Company's consolidated financial

tive accounting guidance under ASC Topic 715, "Compensation—Retirement Benefits," provides
d to an employer's disclosures about plan assets of defined benefit pension or other post-retirement
Under ASC Topic 715, disclosures should provide users of financial statements with an
of how investment allocation decisions are made, the factors that are pertinent to an understanding
olicies and strategies, the major categories of plan assets, the inputs and valuation techniques used
fair value of plan assets, the effect of fair value measurements using significant unobservable
ges in plan assets for the period and significant concentrations of risk within plan assets. The new
ccounting guidance under ASC Topic 715 became effective for the Company's consolidated
nents for the year-ended December 31, 2009 and the required disclosures are reported in Note 17 -
ns.

v authoritative accounting guidance under ASC Topic 715, "Compensation—Retirement Benefits,"
ognition of a liability and related compensation expense for endorsement split-dollar life insurance
ovide a benefit to an employee that extends to post-retirement periods. Under ASC Topic 715, life
cies purchased for the purpose of providing such benefits do not effectively settle an entity's
e employee. Accordingly, the entity must recognize a liability and related compensation expense
ployee's active service period based on the future cost of insurance to be incurred during the
rement. The Company does not have any split-dollar life insurance policies.

th Securities and Exchange Commission ("SEC") requirements, the FASB repealed the requirement
rants disclose the date through which an evaluation of subsequent events has been conducted as
FASB ASC Update 2010-09 "Subsequent Events".

ive accounting guidance under ASC Topic 860, "Transfers and Servicing," amends prior accounting
hance reporting about transfers of financial assets, including securitizations, and where companies
g exposure to the risks related to transferred financial assets. The new authoritative accounting
inates the concept of a "qualifying special-purpose entity" and changes the requirements for
financial assets. The new authoritative accounting guidance also requires additional disclosures
uing

with transferred financial assets including information about gains and losses resulting from g the period. The new authoritative accounting guidance under ASC Topic 860will be effective 10 and is not expected to have a significant impact on the Company's consolidated financial

Business Combination

30, 2008 the Company acquired River City Bank for approximately $20,720,000. The total ncluded approximately $16,269,000 of common stock, representing approximately 1,441,000 sh of $3,962,244 paid to stockholders of River City Bank. The transaction requires no future sideration payments. The merger of the Company and River City Bank resulted in a combined approximately $572 million in assets and increases the Company's market presence in Henrico ablishes a presence in Hanover County continuing our goal of expanding our franchise into other Richmond metropolitan area.

.7 million recorded in this transaction was subsequently determined to be impaired at December n impairment of goodwill was recorded as of that date. The Company also recorded $809,318 in tangibles which is being amortized over eight years using the straight line method. The balance of was $687,000 and $785,000 at December 31, 2009 and 2008, respectively. Amortization expense $24,000 was included in other operating expense at December 31, 2009 and 2008, respectively. xpense of $98,000 per year will be recognized through 2016.

Investment securities available-for-sale

cost and estimated fair value of investment securities available-for-sale as of December 31, 2009 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
ecember 31, 2009				
.S. Government gencies	$ 47,627,779	$ 301,365	$ (259,967)	$47,669,177
ortgage-backed ecurities	4,133,353	91,937	(46,983)	4,178,307
unicipals	1,026,422	233	-	1,026,655
ther investments	1,972,896	10,175	-	1,983,071
otal	$ 54,760,450	$ 403,710	$ (306,950)	$54,857,210
ecember 31, 2008				
.S. Government gencies	$ 16,454,727	$ 565,175	$ (4,873)	$17,015,029
ortgage-backed ecurities	5,599,176	7,607	(106,818)	5,499,965
ther investments	1,969,943	-	(183,975)	1,785,968

Total	$ 24,023,846	$ 572,782	$ (295,666)	$24,300,962

urities with book values of approximately $6,000,000 and $12,000,000 at December 31, 2009 and
ely, were pledged to secure municipal deposits.

urities available for sale that have an unrealized loss position at December 31, 2009 and December
tailed below:

	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)			
le						
t	$ 19,542	$ (264)	$ -	$ -	$ 19,542	$ (264)
	$ 19,542	$ (264)	$ -	$ -	$ 19,542	$ (264)

	Securities in a loss Position for less than 12 Months		Securities in a loss Position for more than 12 Months		Total	
2008	Fair Value	Unrealized Losses	Fair Value (Loss)	Unrealized Losses	Fair Value	Unrealized Losses
			(In Thousands)			
urities le						
t	$ 1,350	$ (9)	$ -	$ -	$ 1,350	$ (9)
ed	3,044	(40)			3,044	(40)
nts	1,786	(184)	-	-	1,786	(184)
	$ 6,180	$ (233)	$ -	$ -	$ 6,180	$ (233)

does not believe that any individual unrealized loss as of December 31, 2009 is other than a
pairment. These unrealized losses are primarily attributable to changes in interest rates. The
the ability to hold these securities for a time necessary to recover the amortized cost or until
full repayment would be received.

cost and estimated fair value of investment securities available-for-sale as of December 31, 2009,
maturity, are as follows:

Amortized Cost	Estimated Fair Value

One to five years	$ 9,749,636	$ 9,647,303
ive to ten years	5,473,345	5,544,527
More than ten ears	39,537,469	39,665,380
otal	$ 54,760,450	$ 54,857,210

and 2008, investment securities available-for-sale totaling $15,373,000 and $16,336,000 ere called or matured with no net losses.

Loans

d by type as of December 31, 2009 and 2008 are as follows:

	2009	2008
Commercial	$ 39,576,219	$ 52,438,487
Real estate - residential	93,656,979	84,611,678
Real estate - commercial	240,829,484	220,399,707
Real estate - construction	81,688,330	103,161,425
Consumer	11,608,652	10,306,885
Total loans	467,359,664	470,918,182
Deferred loan cost (unearned income), net	208,883	(195,896)
Less: Allowance for loan losses	(10,521,931)	(6,059,272)
	$ 457,046,616	$ 464,663,014

le of loans totaling approximately $5,828,000, $2,381,000 and $1,513,000 were realized during the cember 31, 2009, 2008 and 2007, respectively.

otaling $4,787,000 at December 31, 2009 were past due 90 days or more yet interest was still being

s a summary of loans directly or indirectly with executive officers or directors of the Company for December 31, 2009 and 2008:

	2009	2008
Beginning balance	$ 9,985,486	$ 5,434,997
Additions	8,131,630	10,178,165
Reductions	(8,392,325)	(5,627,676)
Ending balance	$ 9,724,791	$ 9,985,486

ers and directors also had unused credit lines totaling $3,864,000 and $4,411,000 at December 31, , respectively. All loans and credit lines to executive officers and directors were made in the e of business at the Company's normal credit terms, including interest rate and collateralization e time for comparable transactions with other persons.

Allowance for loan losses

allowance for loan losses in 2009, 2008 and 2007 was as follows:

	2009	2008	2007
Beginning balance	$ 6,059,272	$ 3,469,274	$ 2,552,608
	13,220,000	2,005,633	1,187,482

rovision for loan osses			
River City Bank, cquisition	-	2,403,551	
Charge-offs	(8,767,522)	(2,242,761)	(271,016)
Recoveries	10,181	423,575	200
Ending balance	$ 10,521,931	$ 6,059,272	$ 3,469,274

er 31, 2009, 2008 and 2007, the Company had impaired loans of $25,913,000, $1,369,000 and
ectively, which were on nonaccrual status. These loans had valuation allowances of $5,522,000,
$200,000 as of December 31, 2009, 2008 and 2007, respectively. The Company does not record
e on impaired loans. Interest income that would have been recorded had impaired loans been
uld have been $569,000, $95,000 and $93,000 for 2009, 2008 and 2007, respectively.

Premises and equipment

s a summary of premises and equipment as of December 31, 2009 and 2008:

	2009	2008
Land	$ 6,318,761	$ 6,318,761
Buildings and improvements	21,556,836	20,747,905
Furniture, fixtures and equipment	4,404,084	4,858,610
Total premises and equipment	32,279,681	31,925,276
Less: Accumulated depreciation and amortization	(4,480,597)	(3,751,758)
Premises and equipment, net	$ 27,799,084	$ 28,173,518

nd amortization of premises and equipment for 2009, 2008 and 2007 amounted to $1,250,000,
673,000 respectively.

Investment in bank owned life insurance

wner and designated beneficiary on life insurance policies in the face amount of $15,391,000
in of its directors and executive officers. The earnings from these policies are used to offset
d to retirement plans. The cash surrender value of these policies at December 31, 2009 and 2008
) and $5,099,000, respectively.

Deposits

December 31, 2009 and 2008 were as follows:

	2009	2008
Demand accounts	$ 38,520,878	$ 34,483,360
Interest checking accounts	36,441,259	17,427,061
Money market accounts	115,166,477	30,002,756
Savings accounts	8,901,299	5,387,828
Time deposits of $100,000 and over	119,352,471	148,172,837
Other time deposits	179,902,740	230,758,201

Total	$ 498,285,124	$ 466,232,043

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

Year Ending December 31,	Less Than $100,000	Greater than or Equal to $100,000	Total
2010	$ 110,375,362	$ 73,676,055	$ 184,051,417
2011	45,409,688	30,042,971	75,452,659
2012	13,827,040	8,601,274	22,428,314
2013	4,185,381	2,705,386	6,890,767
2014	6,105,269	4,326,785	10,432,054
	$ 179,902,740	$ 119,352,471	$ 299,255,211

t the Company by related parties, which include officers, directors, greater than 5% shareholders in which directors of the Board have a significant ownership interest, approximated $6,660,000 at December 31, 2008 and 2009, respectively.

Borrowings

uses both short-term and long-term borrowings to supplement deposits when they are available at a ost to the Company or they can be invested at a positive rate of return.

12, 2007, the Company entered into a promissory note payable to Community Bankers' Bank for The note was modified on July 1, 2009 and bears interest at a fixed interest rate of 6.60% with nterest payments of $68,906 for 60 months, then converts to the five year T-Bill rate plus 2.40%, sixty months thereafter. The note matures on July 1, 2029 and the balance at December 31, 2009 ,943,873 and $10,021,871, respectively.. Proceeds advanced under the promissory note were used construction of the Company's new principal administrative offices in Chesterfield County which in July 2008.

24, 2008 the Company obtained a note payable from Virginia Community Bank for $2,250,000 t at 5% payable quarterly and matured September 24, 2009. At maturity, the note was reduced to d extended to April 23, 2010. The balance at December 31, 2009 and 2008 was 2,000,000 and pectively..

f the Federal Home Loan Bank of Atlanta, the Bank is required to own capital stock in the FHLB zed to apply for advances from the FHLB. The Company held $2,308,000 in FHLB stock at 2009 which is held at cost and included in other assets. Each FHLB credit program has its own hich may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable he advances may be put, as well as on the size of the advances and repayment provisions. The ngs are secured by the pledge of U.S. Government agency securities, FHLB stock and qualified rst mortgage loans. The FHLB advances held at December 31, 2009 mature $5,000,000 on April 00,000 on June 28, 2010, $5,000,000 on April 11, 2011, $5,000,000 April 9, 2012 and $4,000,000 2013.

uses federal funds purchased and repurchase agreements for short-term borrowing needs. Federal d represent unsecured borrowings from other banks and generally mature daily. Securities sold

nts to repurchase are classified as borrowings and generally mature within one to four days from date. Securities sold under agreements to repurchase are reflected at the amount of cash received with the transaction. The Company may be required to provide additional collateral based on the e underlying securities. There were no securities sold under agreements to repurchase at December 9,425,000 at

2008.

also has securities sold under agreements to repurchase, which are secured transactions with generally mature the day following the date sold. The carrying value of these repurchase s $2,885,648 and $2,266,027 at December 31, 2009 and 2008, respectively.

ated to borrowings is as follows:

	Year Ended December 31, 2009	2008
Maximum outstanding during he year		
FHLB advances	$ 29,000,000	$ 25,000,000
Federal funds purchased	373,000	29,405,248
Community Bankers' Bank	10,003,958	6,962,518
Balance outstanding at end of ear		
FHLB advances	29,000,000	25,000,000
Virginia Community Bank	2,000,000	2,250,000
Community Bankers' Bank	9,943,873	10,021,871
Average amount outstanding uring the year		
FHLB advances	26,347,945	20,620,438
Federal funds purchased	3,726	2,329,358
Community Bankers' Bank	10,003,958	6,962,518
Average interest rate during he year		
FHLB advances	3.68%	4.04%
Federal funds purchased	0.61%	1.78%
Community Bankers' Bank	4.77%	2.94%
Average interest rate at end f year		
FHLB advances	3.57%	3.41%
Federal funds purchased	-	-
Community Bankers' Bank	2.82%	2.82%
Virginia Community Bank	5.00%	5.05%

Income taxes

summarizes the tax effects of temporary differences which compose net deferred tax assets and cember 31, 2009, 2008 and 2007:

	2009	2008	2007
sets			
oss carryforward	$ 1,235,858	$ -	$ -
oan losses	3,577,456	1,771,460	1,099,684
e	61,864	66,279	70,695
	-	-	6,781
ax assets	4,875,178	1,837,739	1,177,160
bilities			
	384,183	467,219	235,447
f intangibles	98,066	19,613	-
	28,741	33,857	
	24,780	110,428	26,771
ax liabilities	535,770	631,117	262,217
x asset	$ 4,339,408	$ 1,206,622	$ 914,943

d tax asset is included in other assets on the balance sheet.

x expense (benefit) charged to operations for the years ended December 31, 2009, 2008 and 2007 following:

	2009	2008	2007
ense (benefit)	$(1,941,846)	$ 532,776	$ 778,775
pense (benefit)	(3,031,268)	(291,679)	(263,076)
fit) for income taxes	$(4,973,114)	$ 241,097	$ 515,699

on of income taxes computed at the federal statutory income tax rate to total income taxes is as years ended December 31, 2009, 2008 and 2007:

	2009	2008	2007
ss) before income taxes	$(16,484,489)	$ 709,186	$ 1,516,762
ected" tax expense	$ (5,604,727)	$ 241,123	$ 515,699
rment	2,523,528	-	-
value of life insurance	(55,684)	(36,894)	(28,148)
expenses	15,495	19,504	17,580
oss carryforward	(1,851,726)	-	-
	-	17,363	10,568
come taxes	$ (4,973,114)	$ 241,097	$ 515,699

anking organizations conducting business in Virginia are not subject to Virginia income they are subject to a franchise tax based on bank capital. The Company recorded franchise tax 5,000, $180,000 and $210,000 for 2009, 2008 and 2007, respectively, which is included in other

nses.

Earnings (loss) per share

able presents the basic and diluted earnings per share computations:

	Year Ended December 31,		
	2009	2008	2007
ss)	$ (11,511,368)	$ 468,089	$ 1,001,063
dividend	(494,631)	-	
ss) available to olders	$ (12,005,999)	$ 468,089	$ 1,001,063
ge shares outstanding -	4,230,462	3,013,175	2,569,529
of common stock options	-	19,895	125,480
ge shares outstanding -	4,230,462	3,033,070	2,695,009
per share - basic and			
per share - basic	$ (2.84)	$ 0.16	$ 0.39
ve common stock options	-	-	(0.02)
per share - diluted	$ (2.84)	$ 0.16	$ 0.37

ptions and warrants to purchase common stock (see Notes 13 and 14) were considered in the diluted earnings per share for the years presented. Stock options for 336,005, 333,955 and 4,000 mon stock were not included in computing diluted earnings per share in 2009, 2008 and 2007, ecause their effects were anti-dilutive. Warrants for 4,196,202 and 1,500,000 shares of common included in computing earnings per share in 2009 and 2008, because their effects were also

Lease commitments

ses and equipment are leased under various operating leases. Total rent expense charged to $435,000, $455,000 and $406,000 in 2009, 2008 and 2007, respectively. At December 31, 2009, otal rental commitment under such non-cancelable operating leases was as follows:

	$	$
2010	441,000	440,836
2011	419,000	418,780
2012	431,000	430,813
2013	446,000	445,704
2014	437,000	436,890
Thereafter	396,000	395,775

$	$
2,570,000	2,568,797

Commitments and contingencies

is a party to financial instruments with off-balance-sheet risk in the normal course of business to
ial needs of its customers. These financial instruments include commitments to extend credit and
of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in
nounts recognized in the

ments. The contract amounts of these instruments reflect the extent of involvement that the
n particular classes of instruments.

's exposure to credit loss in the event of non-performance by the other party to the financial
commitments to extend credit, and to potential credit loss associated with letters of credit issued, is
the contractual amount of those instruments. The Company uses the same credit policies in
tments and conditional obligations as it does for loans and other such on-balance sheet instruments.

31, 2009, the Company had outstanding the following approximate off-balance-sheet financial
ose contract amounts represent credit risk:

	Contract Amount
Undisbursed credit lines	$ 49,621,000
Commitments to extend or originate credit	19,078,000
Standby letter of credit	4,177,000
Total commitments to extend credit	$ 72,876,000

to extend credit are agreements to lend to a customer as long as there is no violation of any
blished in the contract. Commitments generally have fixed expiration dates or other termination
y require the payment of a fee. Historically, many commitments expire without being drawn upon;
otal commitment amounts shown in the above table are not necessarily indicative of future cash
The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of
ned, as deemed necessary by the Company upon extension of credit, is based on management's
on of the customer. Collateral held varies but may include personal or income-producing
l estate, accounts receivable, inventory and equipment.

of credit risk – All of the Company's loans, commitments to extend credit, and standby letters of
en granted to customers in the Company's market area. Although the Company is building a
portfolio, a substantial portion of its clients' ability to honor contracts is reliant upon the economic
Richmond, Virginia area, including the real estate markets in the area. The concentrations of credit
n are set forth in Note 4. The distribution of commitments to extend credit approximates the
oans outstanding.

Stockholders' equity and regulatory matters

n of River City Bank was consummated as of October 1, 2008 and resulted in an addition of
common stock. The company also issued 106,250 shares of common stock to the Company's
der for proceeds of $850,000 during the fourth quarter of 2008.

onal Investors Warrant Plan made available 140,000 warrants for grant to the Company's initial
) investors for certain risks associated with the establishment of the Bank. The warrants have an
of $10 per share (which approximates the fair value per share of common stock at issuance date)
April 30, 2008. Prior to expiration, warrants to purchase 47,000 shares were exercised resulting in
ditional capital.

9, as part of the Capital Purchase Program established by the U.S. Department of the Treasury (the
der the Emergency Economic Stabilization Act of 2008 (“EESA”), the Company entered into a Letter
Securities Purchase Agreement—Standard Terms (collectively, the “Purchase Agreement”) with the
uant to which the Company sold (i) 14,738 shares of the Company’s Fixed Rate Cumulative
rred Stock, Series A, par value $4.00 per share, having a liquidation preference of $1,000 per share
Stock”) and (ii) a warrant (the “Warrant”) to purchase 499,029 shares of the Company’s common stock
ercise price of $4.43 per share, subject to certain anti-dilution and other adjustments, for an
chase price of $14,738,000 in cash. The fair value of the preferred stock was estimated using
flow methodology at an assumed market equivalent rate of 13%, with 20 quarterly payments over
od, and was determined to be $10,208,000. The fair value of the warrant was estimated using the
option pricing model, with assumptions of 25% volatility, a risk-free rate of 2.03%, a yield of
estimated life of 5 years, and was determined to be $534,000. The aggregate fair value for both
tock and common stock warrants was determined to be $10,742,000 with 95% of the aggregate
he preferred stock and 5% attributable to the common stock warrant. Therefore, the $14,738,000
llocated with $14,006,000 being assigned to the preferred stock and $732,000 being allocated to
ock warrant. The difference between the $14,738,000 face value of the preferred stock and the
ed of $14,006,000 to the preferred stock is being accreted as a discount on the preferred stock using
terest rate method over five years.

Stock will qualify as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum for
ars, and thereafter at a rate of 9% per annum. The Preferred Stock is generally non-voting, other
matters that could adversely affect the Preferred Stock.

immediately exercisable. The Warrant provides for the adjustment of the exercise price and the
es of common stock issuable upon exercise pursuant to customary anti-dilution provisions, such as
its or distributions of securities or other assets to holders of common stock, and upon certain
mmon stock at or below a specified price relative to the then-current market price of common
rrant expires ten years from the issuance date. If, on or prior to December 31, 2009, the Company
ate gross cash proceeds of not less than the purchase price of the Preferred Stock from one or more
ity Offerings” announced after October 13, 2008, the number of shares of common stock issuable
Treasury’s exercise of the Warrant will be reduced by one-half of the original number of shares,
ount all adjustments, underlying the Warrant. Pursuant to the Purchase Agreement, the Treasury
to exercise voting power with respect to any shares of common stock issued upon exercise of the

bject to various regulatory capital requirements administered by the federal and state banking
re to meet minimum capital requirements can initiate certain mandatory, and possible additional
ctions by regulators that, if undertaken, could have a direct material effect on the Bank’s financial
der the capital adequacy guidelines and the regulatory framework for prompt corrective action, the
t specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities, and
nce-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts
on are also subject to qualitative judgments by the regulators about components, risk weightings,
rs.

easures are established by regulation to ensure capital adequacy require the Bank to maintain
unts and ratios (set forth in the table below) of total and Tier 1 Capital (as defined in the
risk-weighted assets, and of Tier 1 Capital to average assets (the Leverage ratio). Management
of December 31, 2009, the Bank meets all capital adequacy requirements to which it is subject.

ory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, italized, under capitalized, significantly under capitalized, and critically under capitalized. The criteria to be categorized as an "well capitalized" institution as of December 31, 2009.

ounts and ratios at December 31, 2009 and 2008 for the Company and the Bank are presented in :

	Actual		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
o						
)						
	$64,072,000	12.80%	$40,048,000	8.00%	$50,060,000	10.00%
	54,796,000	11.33%	38,705,000	8.00%	48,382,000	10.00%
o						
)						
	57,762,000	11.54%	20,024,000	4.00%	30,036,000	6.00%
	48,693,000	10.06%	19,353,000	4.00%	29,029,000	6.00%
ge						
	57,762,000	9.39%	24,607,000	4.00%	30,759,000	5.00%
	48,693,000	8.24%	23,643,000	4.00%	29,554,000	5.00%
o						
)						
	$53,245,000	10.63%	$40,055,000	8.00%	$50,069,000	10.00%
	49,834,000	10.27%	38,835,000	8.00%	48,544,000	10.00%
o						
)						
	47,186,000	9.42%	20,028,000	4.00%	30,041,000	6.00%
	43,775,000	9.02%	19,418,000	4.00%	29,126,000	6.00%

ge

47,186,000	8.40%	21,959,000	4.00%	27,449,000	5.00%
43,775,000	8.20%	21,344,000	4.00%	26,681,000	5.00%

nking regulations limit the amount of cash dividends that may be paid without prior approval of the ory agencies. Such dividends are limited to the lesser of the Bank's retained earnings or the net revious two years combined with the current year net income.

Stock incentive plan

vith accounting standards the Company measures the cost of employee services received in
n award of equity instruments based on the grant-date fair value of the award (with limited
nat cost is recognized over the period during which an employee is required to provide service in
e award rather than disclosed in the financial statements. During the years ended December 31,
2007 the Company granted 3,000, 150,680 and 1,000 stock options, respectively, and the total
e grants to be recognized over the three year vesting period was $8,151, and $7,638 in 2009 and
ely. The stock options to acquire 150,680 shares granted during 2008 are related to the purchase
ank and the value of these options of $489,481 was included as part of the purchase price.

able summarizes options outstanding under the stock incentive plan at the indicated dates:

Year Ended December 31,							
2009				2008			
Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
333,955	$ 9.63	$ 4.77		247,410	$ 10.06	$ 4.69	
3,000	4.45	2.86		150,680	8.49	4.86	
(950)	10.78	5.90		(4,250)	12.23	5.14	
-	-	-		(59,885)	8.36	4.64	$ 20,923
336,005	$ 9.58	$ 4.75	$ -	333,955	$ 9.63	$ 4.77	$ -
300,900				252,100			

Year Ended December 31, 2007			
Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
251,910	$ 10.22	$ 4.67	

1,000	13.96	8.04	
-	-	-	
(5,500)	8.74	4.07	$ 96,246
247,410	$ 10.26	$ 4.70	$1,295,438
229,910			

f each option granted is estimated on the date of grant using the Black-Sholes option

vith the following assumptions used for grants for the years indicated:

	Year Ended December 31,		
	2009	2008	2007
Risk-free interest ate	3.46%	2.88%	4.81%
Dividend yield	0%	0%	0%
Expected weighted verage term	7 years	7 years	7 years
Volatility	50%	50%	50%

able summarizes information about stock options outstanding at December 31, 2009:

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
7.68 - 9.24	144,030	4.7	$ 7.19	126,175	$ 7.28
11.20 - 13.96	191,975	6.4	11.57	174,475	10.40
	336,005	5.7	9.69	300,650	9.09

quarter of 2007, the Company granted to certain officers 5,725 restricted shares of common stock ormance shares of common stock with a weighted average fair market value of $15.95 at the date of the second quarter an additional 175 restricted shares of common stock and 175 performance mon stock were granted with a weighted average fair market value of $16.75 at the date of estricted stock awards have three-year graded vesting and the performance shares cliff vest at the ars. The number of performance shares that ultimately vest is dependent upon achieving specific argets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon employment under certain circumstances. During the first quarter of 2009, we granted to certain restricted shares of common stock with a weighted average fair market value of $4.60 at the date e restricted stock awards have three-year graded vesting. Prior to vesting, these shares are subject us without consideration upon termination of employment under certain circumstances. The total es underlying non-vested restricted stock and performance share awards was 27,219 and 8,709 at 2009 and 2008, respectively.

of the stock is calculated under the same methodology as stock options and the expense is r the vesting period. Unamortized stock-based compensation related to nonvested share based arrangements granted under the Incentive Plan as of December 31, 2009and 2008 was $324,051 respectively. Of the $324,051 of unamortized compensation at December 31, 2009, $91,055

rmance based restricted stock awards. The time based unamortized compensation of $232,966 is
recognized over a weighted average period of 2.0 years. The total fair value of shares vested
ears ended December 31, 2009, 2008 and 2007 was $157,851 $65,886 and $59,735,
here were 1,092 and 350 forfeitures of restricted stock awards in 2009 and 2008, respectively, and

mpensation expense was $157,699 and $555,367 for the years ended December 31,

---

respectively.

mpensation expense was $157,699, $65,887 and $59,734 for the years ended December 31, 2009, respectively.

Trust preferred securities

quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest and 4.97% at December 31, 2009 and 2008, respectively. The securities may be redeemed at par larch 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. The of the Trust is $5.2 million of the Company's junior subordinated debt securities with like ike interest rates to the Trust Preferred Capital Notes.

d quarter of 2007, Village Financial Statutory Trust II, a wholly –owned subsidiary of the Company, r the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust al Notes were issued through a pooled underwriting. The securities have a five year fixed interest payable quarterly, converting after five years to a LIBOR-indexed floating rate of interest IBOR plus 1.4%) which adjusts and is also payable quarterly. The securities may be redeemed at commencing in December 2012 until the securities mature in 2037. The principal asset of the illion of the Company's junior subordinated securities with like maturities and like interest rates to rred Capital Notes.

erred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not ier 1 capital may be included in Tier 2 capital.

of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full nal guarantee by the Company of the Trust's obligations with respect to the Trust Preferred Capital to certain exceptions and limitations, the Company may elect from time to time to defer interest e junior subordinated debt securities, which would result in a deferral of distribution payments on t Preferred Capital Notes and require a deferral of common dividends.

Retirement plans

e Bank provides a qualified 401K plan to all eligible employees which is administered through the rs Association Benefits Corporation. Employees are eligible to participate in the plan after three loyment. Eligible employees may, subject to statutory limitations, contribute a portion of their an through payroll deduction. Due to the recent economic conditions the Bank ceased it matching 09 and does not anticipate making ay contributions in 2010. Prior to 2009 the Bank provided a tribution of $.50 for every $1.00 the participant contributes up to the first 4% of their pants were fully vested in their own contributions and vested equally over three years of service in ching contributions. Total contributions to the plan for the years ended December 31, 2008, and 7,918 and $98,705 respectively.

Executive Retirement Plan: The Bank established the Village Bank Supplemental Executive n (the "SERP") on January 1, 2005 to provide supplemental retirement income to certain executive

ignated by the Personnel Committee and approved by the Board of Directors. The SERP is an
oyee pension plan under the provisions of ERISA. An eligible employee, once designated by the
approved by the Board of

riting to participate in the SERP, becomes a participant in the SERP 60 days following such ss an earlier participation date is approved). There are currently five executive officers who he SERP. The retirement benefit to be received by a participant is determined by the Committee by the Board of Directors and is payable in equal monthly installments over a 15 year period, n the first day of the month following a participant's retirement or termination of employment, articipant has been employed by the Bank for a minimum of 10 years (6 years in the case of one The Personnel Committee, in its sole discretion, may choose to treat a participant who has termination of employment on or after attaining age 65 but prior to completing his service having completed his service requirement. At December 31, 2009 and 2008, the Bank's liability P was $963,122 and $328,880, respectively, and expense for the years ended December 31, 2009, was to $266,829, $112,459 and $166,495, respectively. The increase in cash surrender value of ed to the participants was $331,980, $81,101 and $62,410 for the years ended December 31, 2009, respectively.

erral Plan: The Bank established the Village Bank Outside Directors Deferral Plan (the "Directors on January 1, 2005 under which non-employee Directors of Village Bank have the opportunity to of all or a portion of certain compensation until retirement or departure from the Board of erral of compensation under the Directors Deferral Plan is voluntary by non-employee Directors ate in the plan a director must file a deferral election as provided in the plan. A Director shall ve participant with respect to a plan year (as defined in the plan) only if he is expected to have during the plan year and he timely files a deferral election. A separate account is established for t in the plan and each account shall, in addition to compensation deferred at the election of the credited with interest on the balance of the account, the rate of such interest to be established by irectors in its sole discretion at the beginning of each plan year. At December 31, 2009 and 2008, ility under the Directors Deferral Plan was $367,413 and $263,472, respectively, and expense for December 31, 2009, 2008 and 2007 was $103,941, $82,599 and $74.607, respectively.

Value

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

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

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

s— Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has
ccess as of the measurement date.

s — Significant other observable inputs other than Level 1 prices such as quoted prices for similar
lities; quoted prices in markets that are not active; or other inputs that are observable or can be
y observable market data.

- Significant unobservable inputs that reflect a company's own assumptions about the assumptions
rticipants would use in pricing an asset or liability.

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

urities: The fair values for investment securities are determined by quoted prices for similar assets
evel 2).

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

s: The fair values of impaired loans are measured for impairment using the fair value of the
ollateral-dependent loans on a nonrecurring basis. Collateral may be in the form of real estate or
including equipment, inventory and accounts receivable. The use of discounted cash flow models
nt's best judgment are significant inputs in arriving at the fair value measure of the underlying
re therefore classified within (Level 3).

ned: Real estate owned assets are adjusted to fair value upon transfer of the loans to foreclosed
uently, real estate owned assets are carried at net realizable value. Fair value is based upon
arket prices, appraised values of the collateral or management's estimation of the value of the
en the fair value of the collateral is based on an observable market price or a current appraised
npany records the foreclosed asset as nonrecurring Level 2. When an appraised value is not
nagement determines the fair value of the collateral is further impaired below the appraised value
observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

ilities measured at fair value under Topic 820 on a recurring and non-recurring basis, including
and liabilities for which the Company has elected the fair value option, are summarized below:

Fair Value Measurement at December 31, 2009 Using (In Thousands)

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
s-Recurring				
t Agencies	$ 47,669		$ 47,669	
	4,178		4,178	
	1,027		1,027	
for sale (1)	1,983		1,983	
curring				
	25,913			$ 25,913
ned	11,279			11,279
ns held for sale	7,506		7,506	

stricted stock.

Fair Value Measurement at December 31, 2008 Using (In Thousands)

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
s-Recurring				
t Agencies	$ 17,045		$ 17,045	
	5,470		5,470	
for sale (1)	1,786		1,786	
curring				
	8,528			$ 8,528
ned	2,932			2,932
ns held for sale	4,326		4,326	

stricted stock.

ables present the changes in the Level 3 fair value category for the year ended December 31, 2009.

	Impaired Loans	Real Estate Owned	Total Assets
	(in thousands)		
alance at December 31, 2007	$ 2,585	$ 270	$ 2,855
otal realized and unrealized gains losses)			
ncluded in earnings	-	-	-
ncluded in other comprehensive ncome	-	-	-
et transfers in and/or out of Level 3	5,943	2,662	8,605
alance at December 31, 2008	8,528	2,932	11,460
otal realized and unrealized gains losses)			
ncluded in earnings	-	46	46
ncluded in other comprehensive ncome	-	-	-
et transfers in and/or out of Level 3	17,385	8,301	25,686
alance at December 31, 2009	$ 25,913	$ 11,279	$ 25,732

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

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

urities – The fair value of investment securities held-to-maturity and available-for-sale is estimated uotations received from independent pricing services. The carrying amount of other investments air value.

riable rate loans that reprice frequently and have no significant change in credit risk, fair values are ng values. For all other loans, fair values are calculated by discounting the contractual cash flows d market discount rates which reflect the credit and interest rate risk inherent in the loans, or by nt rates at which similar loans would be made to borrowers with similar credit ratings and for the g maturities.

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

The fair value of FHLB borrowings is based on the discounted value of contractual cash flows using
tly offered for borrowings of similar remaining maturities. The carrying amounts of federal funds
oximate their fair values. Other borrowings are

ature and the carrying amounts approximate fair value.

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

eet instruments – The fair value of off-balance-sheet lending commitments is equal to the amount of
utstanding at December 31, 2009 of $72,876,000. This is based on the fact that the Bank generally
ending commitments or standby letters of credit to its customers for long periods, and therefore,
rates of the commitments approximate market rates.

	2009		2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
s				
equivalents	$ 20,661,820	$ 20,661,820	$ 26,612,829	$ 26,612,829
urities available for sale	54,857,211	54,857,211	24,300,962	24,300,962
sale	7,506,252	7,506,252	4,325,746	4,325,746
	457,046,616	466,271,730	464,663,014	506,263,603
t receivable	3,366,718	3,366,718	3,499,793	3,499,793
ties				
	498,285,124	500,979,984	466,232,043	442,567,544
ngs	29,000,000	29,011,904	25,000,000	24,977,639
securities	8,764,000	8,764,000	8,764,000	8,764,000
gs	14,829,521	14,829,521	23,962,898	23,962,898
t payable	501,069	501,069	1,014,534	1,014,534
eet				
edit lines		49,621,000		70,659,000
o extend or				
		19,078,000		14,109,000
of credit		4,177,000		4,124,000

Parent corporation only financial statements

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Balance Sheets
December 31, 2009 and 2008

	2009	2008
Assets		
Cash and due from banks	$ 2,835,334	$ 721,617
Investment in subsidiaries	48,669,651	51,404,282
Investment in special purpose subsidiary	264,000	264,000
Premises and equipment, net	14,564,323	14,588,892
Prepaid expenses and other assets	7,184,697	1,263,948
	$ 73,518,005	$ 68,242,739
Liabilities and Stockholders' Equity		
Liabilities		
Long-term debt - trust preferred securities	$ 8,764,000	$ 8,764,000
Payable to subsidiary	3,203,546	700,737
Other Borrowings	11,943,873	12,271,871
Other liabilities	664,767	343,557
Total liabilities	24,576,186	22,080,165
Stockholders' equity		
Preferred stock	58,952	-
Common stock	16,922,512	16,917,488
Additional paid-in capital	40,568,771	25,737,048
Retained earnings (deficit)	(8,647,731)	3,453,788
Warrant surplus	732,479	
Discount on preferred stock	(636,959)	-
Accumulated other comprehensive		-
Income (loss)	(56,205)	54,250
Total stockholders' equity	48,941,819	46,162,574
	$ 73,518,005	$ 68,242,739

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Statement of Operations
Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
ome			
	$ 881,496	$ 265,515	$ -
st income	881,496	265,515	-
	978,634	$ 708,020	$ 447,381
	636,053	232,612	11,700
	19,767	7,140	-
d marketing	717	4,468	-
	51,426	52,951	33,850
	22,126	897	15,029
unting	6,719	-	-
ervices	39,676	17,050	6,389
	15,195	6,065	-
	-	44,942	-
	52,452	21,788	-
	1,822,765	1,095,933	514,349
undistributed equity in			
	(941,269)	(830,418)	(514,349)
quity in subsidiary	(12,782,126)	1,016,165	1,340,533
ore income taxes	(13,723,395)	185,747	826,184
benefit)	(2,212,027)	(282,342)	(174,879)
ss)	$(11,511,368)	$ 468,089	$ 1,001,063

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Statement of Cash Flows
Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
m Operating Activities			
	$(11,511,368)	$ 468,089	$ 1,001,063
reconcile net income to			
erating activities			
ation expense	-		
d amortization	392,150	9,012	-
arnings of subsidiary	12,782,126	(1,016,165)	(1,340,533)
se in other assets	(5,920,749)	293,101	1,004,831
r liabilities	2,823,769	1,335,642	(473,426)
led by operations	(1,434,072)	1,089,679	191,935
m Investing Activities			
vestments in and advances to			
	(10,000,000)	(20,108,076)	-
mises and equipment	(367,581)	(7,913,499)	(6,684,405)
n operations	(10,367,581)	(28,021,575)	(6,684,405)
m Financing Activities			
issuance of preferred			
	14,738,000	-	-
issuance of long-term			
	-	-	3,609,000
issuance of common			
	-	18,068,960	133,234
ecrease) in other			
	(327,998)	9,435,781	2,836,090
referred stock	(494,632)		
led by operations	13,915,370	27,504,741	6,578,324
cash	2,113,717	572,845	85,854
g of period	721,617	148,772	62,918
riod	$ 2,835,334	$ 721,617	$ 148,772

Selected quarterly financial data (unaudited)

rterly financial data is shown as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	$ 8,353,428	$ 8,427,816	$ 8,334,206	$ 8,080,523
e	4,446,762	4,259,921	4,009,344	3,691,652
ome				
an				
	3,906,666	4,167,895	4,324,862	4,388,871
an				
	1,100,000	3,100,000	6,000,000	3,020,000
loans	943,116	1,509,971	1,842,129	1,532,790
	513,270	525,773	552,101	874,951
rment	-	-	-	7,422,141
penses	4,376,899	5,803,529	4,916,631	5,818,683
nefit)	(38,708)	(917,962)	(1,427,260)	(2,589,186)
	(75,139)	(1,781,928)	(2,770,279)	(6,884,027)
	$ (0.02)	$ (0.45)	$ (0.70)	$ (1.80)
	$ (0.02)	$ (0.45)	$ (0.70)	$ (1.80)
	$ 6,758,711	$ 6,869,527	$ 6,725,218	$ 8,718,690
e	3,973,172	3,681,656	3,628,988	4,685,967
ome				
an				
	2,785,539	3,187,871	3,096,230	4,032,723
an				
	249,354	498,024	514,827	743,428
loans	426,517	608,344	717,830	628,332
	331,874	373,782	579,737	611,661
penses	3,153,167	3,400,998	3,547,443	4,564,010
ense	48,078	92,131	112,719	(11,831)
ss)	93,331	178,844	218,808	(22,891)
per				
	$ 0.04	$ 0.07	$ 0.08	$ (0.01)
	$ 0.04	$ 0.07	$ 0.08	$ (0.01)

NGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND
DISCLOSURE

NTROLS AND PROCEDURES

hibits to this Form 10-K are certifications of the Company's Chief Executive Officer (CEO) and
Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act
ended (the Exchange Act). This "Controls and Procedures" section includes information concerning
d controls evaluation referred to in the certifications.

garding the Effectiveness of Disclosure Controls and Procedures

f the period covered by this report, the Company carried out an evaluation, under the supervision
articipation of the Company's management, including the Company's Chief Executive Officer and
Officer, of the effectiveness of the design and operation of the Company's disclosure controls and
rsuant to the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the
ief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls
s are effective in recording, processing, summarizing and timely reporting to management
lating to the Company (including its consolidated subsidiaries) required to be included in the
orts that it files or submits under the Exchange Act.

s management is also responsible for establishing and maintaining adequate internal control over
ing. There were no changes in the Company's internal control over financial reporting identified in
n the evaluation of it that occurred during the Company's last fiscal quarter that materially affected,
ly likely to materially affect, internal control over financial reporting.

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agement's Assessment of Internal Control over Financial Reporting

f the Company is responsible for establishing and maintaining adequate internal control over
ting. Internal control is designed to provide reasonable assurance regarding the reliability of
rting and the preparation of financial statements for external purposes in accordance with
nciples generally accepted in the United States of America. Management regularly monitors its
l over financial reporting and takes appropriate action to correct any deficiencies that may be

ssessed the Company's internal control over financial reporting as of December 31, 2009. This
based on criteria established in Internal Control—Integrated Framework issued by the Committee of
ganizations of the Treadway Commission. Based on this assessment, management concluded that
naintained effective internal control over financial reporting as of December 31, 2009.

inherent limitations, internal control over financial reporting may not prevent or detect
Further, because of changes in conditions, internal control effectiveness may vary over time.

port does not include an attestation report of the Company's registered public accounting firm
nal control over financial reporting. Management's report was not subject to attestation by the
gistered public accounting firm pursuant to temporary rules of the Securities and Exchange
at permit the Company to provide only management's report in this annual report.

Winfree
Chief Executive Officer

hitehurst, Jr.
esident and Chief Financial Officer

)

HER INFORMATION

PART III

ECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

n required to be disclosed in this Item 10 is contained in the Company's Proxy Statement for the
Meeting of Shareholders and is incorporated herein by reference.

ECUTIVE COMPENSATION

n required to be disclosed in this Item 11 is contained in the Company's Proxy Statement for the
Meeting of Shareholders and is incorporated herein by reference.

URITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND
OCKHOLDER MATTERS

n required to be disclosed in this Item 12 is contained in the Company's Proxy Statement for the
Meeting of Shareholders and is incorporated herein by reference.

RTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR
NCE

n required to be disclosed in this Item 13 is contained in the Company's Proxy Statement for the
Meeting of Shareholders and is incorporated herein by reference.

NCIPAL ACCOUNTING FEES AND SERVICES

n required to be disclosed in this Item 14 is contained in the Company's Proxy Statement for the
Meeting of Shareholders and is incorporated herein by reference.

PART IV

HIBITS, FINANCIAL STATEMENT SCHEDULES

Statements
consolidated financial statements and reports are included in Part II, Item 8, of this report on Form

pendent Registered Public Accounting Firm (BDO Seidman)
alance Sheets – December 31, 2009 and 2008
tatements of Income – Years Ended December 31, 2009, 2008 and 2007 Consolidated Statements of
ckholders' Equity and
ve Income – Years Ended December 31, 2009, 2008 and 2007
tatements of Cash Flows – Years Ended December 31, 2009, 2008 and 2007
lidated Financial Statements

Statement Schedules
re omitted since they are not required, are not applicable, or the required information is shown in
d financial statements or notes thereto.

exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

Description

ent and Plan of Reorganization and Merger by and among Village Bank and Trust Financial Corp.,
Bank and River City Bank dated as of March 9, 2008 incorporated by reference from Annex A to
proxy statement/prospectus included in the Registration Statement on Form S-4/A filed with the
s and Exchange Commission on August 5, 2008.

f Incorporation of Village Bank and Trust Financial Corp. restated in electronic format only as of
005.

of Amendment to the Company's Articles of Incorporation, designating the terms of the Fixed Rate
ve Perpetual Preferred Stock, Series A, incorporated by reference to Exhibit 3.1 of the Current
n Form 8-K filed with the Securities and Exchange Commission on May 6, 2009

Village Bank and Trust Financial Corp., incorporated by reference to Exhibit 3.1 of the Current
Form 8-K filed with the Securities and Exchange Commission on December 10, 2007.

Certificate for Fixed Rate Cumulative Perpetual Preferred Stock, Series A, incorporated by
e to Exhibit 4.1 of the Current Report on Form 8-K filed with the Securities and Exchange
ion on May 6, 2009.

o Purchase Shares of Common Stock, dated May 1, 2009, incorporated by reference to Exhibit 4.2
rrent Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009.

Plan, as amended and restated May 23, 2006, incorporated by reference to Exhibit 10.1 of the
Report on Form 10-QSB for the period ended June 30, 2006.*

ional Investors Warrant Plan, incorporated by reference to Exhibit 10.2 of the Annual Report on
KSB for the year ended December 31, 2004.

er Loan Referral Warrant Plan, incorporated by reference to Exhibit 10.3 of the Annual Report on
KSB for the year ended December 31, 2004.

e Employment Agreement, effective as of April 1, 2001, between Thomas W. Winfree and
Community Bank & Trust, incorporated by reference to Exhibit 10.4 of the Annual Report on
KSB for the year ended December 31, 2004.*

ncentive Stock Option Agreement, incorporated by reference to Exhibit 10.5 of the Annual Report
0-KSB for the year ended December 31, 2004.*

Non-Employee Director Non-Qualified Stock Option Agreement, incorporated by reference to
).6 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *

reement, dated as of May 1, 2009, by and between Village Bank and Trust Financial Corp. and the
ates Department of the Treasury, incorporated by reference to Exhibit 10.1 of the Current Report
3-K filed with the Securities and Exchange Commission on May 6, 2009.

er Agreement, dated as of May 1, 2009, by and between Village Bank and Trust Financial Crop.
nited States Department of the Treasury, incorporated by reference to Exhibit 10.2 of the Current
Form 8-K filed with the Securities and Exchange Commission on May 6, 2009.

Senior Executive Officer Waiver, incorporated by reference to Exhibit 10.3 of the Current Report
3-K filed with the Securities and Exchange Commission on May 6, 2009.*

Senior Executive Officer Consent Letter, incorporated by reference to Exhibit 10.4 of the Current
n Form 8-K filed with the Securities and Exchange Commission on May 6, 2009.*

s of Village Bank and Trust Financial Corp.

02 Certification by Chief Executive Officer.

02 Certification by Chief Financial Officer.

Certification.

ertification by Chief Executive Officer.

rtification by Chief Financial Officer.

* Management contracts and compensatory plans and arrangements.

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

NK AND TRUST FINANCIAL CORP.

6, 2010 By: /s/ Thomas W. Winfree
Winfree
d Chief Executive Officer

with the Exchange Act, this report has been signed below by the following persons on behalf of the
n the capacities and on the dates indicated.

gnature	Title	Date
Winfree nfree	President and Chief Executive Officer and Director (Principal Executive Officer)	March 26, 2010
hitehurst, Jr. hurst, Jr.	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 26, 2010
III	Director	March 26, 2010
alzer, Jr. er, Jr.	Director and Vice Chairman of the Board	March 26, 2010
l	Director and Chairman of the Board	March 26, 2010
Chandler ndler	Director	March 26, 2010
sleeck, Jr. eck, Jr.	Director	March 26, 2010

Vhittemore ttemore	Director	March 26, 2010

Toalson lson	Director	March 26, 2010
d Hogg, Jr. Hogg, Jr.	Director	March 26, 2010
Katzen zen	Director	March 26, 2010
Walton ton	Director	March 26, 2010
h, Sr. Sr.	Director	March 26, 2010