Village Bank & Trust Financial Corp.
Form 10-Q
November 12, 2010

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

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FORM 10-Q
xQUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

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

For the transition period from ______ to ______

____

Commission file number: 0-50765

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

Virginia (State or other jurisdiction of incorporation or organization)	16-1694602 (I.R.S. Employer Identification No.)
15521 Midlothian Turnpike, Midlothian, Virginia Address of principal executive offices)	23113 (Zip code)

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

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

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

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

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

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

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

4,238,416 shares of common stock, $4.00 par value, outstanding as of November 9, 2010

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

ITEM 1 – FINANCIAL STATEMENTS

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
September 30, 2010 (Unaudited) and December 31, 2009

	September 30, 2010	December 31, 2009*
Assets		
Cash and due from banks	$ 12,260,846	$ 13,884,581
Federal funds sold	6,652,465	6,777,239
Investment securities available for sale	28,311,767	54,857,211
Loans held for sale	26,521,812	7,506,252
Loans		
Outstandings	458,126,244	467,359,664
Allowance for loan losses	(9,819,404)	(10,521,931)
Deferred costs	503,957	208,883
	448,810,797	457,046,616
Premises and equipment, net	27,552,281	27,799,084
Accrued interest receivable	2,591,301	3,366,718
Bank owned life insurance	5,823,314	5,431,002
Other real estate owned	12,940,887	11,278,532
Other assets	12,413,607	14,046,120
	$ 583,879,077	$ 601,993,355
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	$ 490,053,073	$ 498,285,124
Trust preferred securities	8,764,000	8,764,000
Federal Home Loan Bank advances	28,750,000	29,000,000
Other borrowings	4,784,451	14,829,521
Accrued interest payable	431,844	501,069
Other liabilities	2,140,100	2,765,550
Total liabilities	534,923,468	554,145,264
Stockholders' equity		
Preferred stock, $4 par value, $1,000 liquidation preference, 1,000,000 shares authorized, 14,738 shares issued and outstanding	58,952	58,952
Common stock, $4 par value, 10,000,000 shares authorized; 4,238,416 shares issued and outstanding at September 30, 2010 and 4,230,628 at December 31, 2009	16,953,664	16,922,512
Additional paid-in capital	40,610,691	40,568,771

Retained earnings deficit	(9,119,127)	(9,741,459)
Warrant surplus	732,479	732,479
Discount on preferred stock	(528,720)	(636,959)
Accumulated other comprehensive income (loss)	247,670	(56,205)
Total stockholders' equity	48,955,609	47,848,091
	$ 583,879,077	$ 601,993,355

* Certain December 31, 2009 amounts have been revised. See Note 2 to the condensed consolidated financial statements.

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Income
For the Three and Nine Months Ended September 30, 2010 and 2009
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Interest income				
Loans	$ 7,409,474	$ 7,954,250	$ 21,713,276	$ 24,100,108
Investment securities	237,059	373,158	879,976	996,135
Federal funds sold	13,747	6,798	43,983	19,207
Total interest income	7,660,280	8,334,206	22,637,235	25,115,450
Interest expense				
Deposits	2,168,903	3,474,837	6,958,389	11,302,645
Borrowed funds	450,301	534,507	1,520,365	1,413,381
Total interest expense	2,619,204	4,009,344	8,478,754	12,716,026
Net interest income	5,041,076	4,324,862	14,158,481	12,399,424
Provision for loan losses	1,410,000	6,000,000	3,150,000	10,200,000
Net interest income (loss) after provision for loan losses	3,631,076	(1,675,138)	11,008,481	2,199,424
Noninterest income				
Service charges and fees	484,981	404,723	1,375,554	1,230,478
Gain on sale of loans	1,922,868	1,842,129	4,761,092	4,295,216
Gain (loss) on sale of assets	-	(5,764)	840,941	(43,637)
Rental income	118,515	54,834	387,457	128,141
Other	136,111	98,020	494,196	267,161
Total noninterest income	2,662,475	2,393,942	7,859,240	5,877,359
Noninterest expense				
Salaries and benefits	3,180,292	2,718,326	8,934,796	7,741,216
Occupancy	492,012	466,187	1,529,597	1,318,975
Equipment	192,505	210,882	631,619	668,806
Supplies	111,941	126,407	363,127	377,005
Professional and outside services	460,308	402,952	1,476,927	1,294,701
Advertising and marketing	109,584	75,191	335,244	233,361
Other real estate owned expenses	327,261	111,543	1,008,597	1,057,059
Other operating expenses	913,419	805,143	2,645,798	2,397,223
Total noninterest expense	5,787,322	4,916,631	16,925,705	15,088,346
Net income (loss) before income taxes	506,229	(4,197,827)	1,942,016	(7,011,563)
Income tax expense (benefit)	172,117	(1,427,260)	660,285	(2,383,932)
Net income (loss)	334,112	(2,770,567)	1,281,731	(4,627,631)

Preferred stock dividends and amortization of discount		221,910		221,544		659,399		368,516
Net income (loss) available to common shareholders	$	112,202	$	(2,992,111)	$	622,332	$	(4,996,147)
Earnings (loss) per share, basic	$	0.03	$	(0.71)	$	0.15	$	(1.18)
Earnings (loss) per share, diluted	$	0.03	$	(0.71)	$	0.15	$	(1.18)

See accompanying notes to consolidated financial statements

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Stockholders' Equity
For the Nine Months Ended September 30, 2010 and 2009
(Unaudited)

	Prefered Stock	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Warrant	Discount on Preferred Stock	Accumulated Other Comprehensive Income (loss)
Balance, December 31, 2009 *	$ 58,952	$ 16,922,512	$ 40,568,771	$ (9,741,459)	$ 732,479	$ (636,959)	$ (56,205)
Amortization of preferred stock discount	-	-	-	(108,239)	-	108,239	-
Preferred stock dividend	-	-	-	(551,160)	-	-	-
Issuance of common stock	-	31,152	(31,152)	-	-	-	-
Stock based compensation	-	-	73,072	-	-	-	-
Minimum pension adjustment (net of income taxes of 2,188)	-	-	-	-			6,435
Net income	-	-	-	1,281,731	-	-	-
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $101,130)	-	-	-	-	-	-	297,440
Total comprehensive income	-	-	-	-	-	-	-
Balance, September 30, 2010	$ 58,952	$ 16,953,664	$ 40,610,691	$ (9,119,127)	$ 732,479	$ (528,720)	$ 247,670
Balance, December 31, 2008	$ -	$ 16,917,488	$ 25,737,048	$ 3,453,788	$ -	$ -	$ 54,250
	58,952	-	14,679,048	-	732,479	(732,479)	-

Issuance of preferred stock													
Amortization of preferred stock discount		-		-		-		(59,624)		-		59,624		-
Preferred stock dividend		-		-		-		(308,892)		-				-
Issuance of common stock		-		5,024		(5,024)		-		-				-
Stock based compensation		-		-		123,129		-		-				-
Minimum pension adjustment (net of income taxes of $2,188)														6,435
Net loss		-		-		-		(4,627,631)		-		-		-
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $91,256)		-		-		-		-		-		-		268,401
Total comprehensive loss		-		-		-		-		-		-		-
Balance, September 30, 2009	$	58,952	$	16,922,512	$	40,534,201	$	(1,542,359)	$	732,479	$	(672,855)	$	329,086

* Certain December 31, 2009 amounts have been revised. See Note 2 to the condensed consolidated financial statements.

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2010 and 2009
(Unaudited)

	2010	2009
Cash Flows from Operating Activities		
Net income (loss)	$ 1,281,731	$ (4,627,631)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	976,201	907,351
Provision for loan losses	3,150,000	10,200,000
Write-down of other real estate owned	184,000	-
Gain on securities	(597,375)	(8,061)
Gain on loans sold	(4,761,092)	(4,295,216)
Gain on sale of premises and equipment	(242,936)	37,589
Gain on sale of other real estate owned	(17,546)	(29,340)
Stock compensation expense	73,072	123,129
Proceeds from sale of mortgage loans	192,149,659	190,689,712
Origination of mortgage loans for sale	(206,404,127)	(189,155,344)
Amortization of premiums and accrection of discounts on securities, net	367,149	148,794
(Increase) decrease in interest receivable	775,417	(57,626)
Increase in bank owned life insurance	(392,312)	(4,075,234)
(Increase) decrease in other assets	1,485,722	(9,772,443)
Decrease in interest payable	(69,225)	(393,934)
Decrease in other liabilities	(625,450)	(305,806)
Net cash used in operating activities	(12,667,112)	(10,614,060)
Cash Flows from Investing Activities		
Purchases of available for sale securities	(15,138,493)	(33,331,406)
Proceeds from sales and calls of available for sale securities	40,670,661	11,850,002
Proceeds from maturities and principal payments of available for sale securities	1,694,167	-
Proceeds from sale of other real estate owned	4,032,682	1,271,482
Net increase in loans	(775,672)	(8,901,961)
Purchases of premises and equipment	(863,782)	(1,232,306)
Proceeds from sale of premises and equipment	377,321	681,741
Net cash provided by (used in) investing activities	29,996,884	(29,662,448)
Cash Flows from Financing Activities		
Issuance of preferred stock	-	14,738,000
Net increase (decrease) in deposits	(8,232,051)	41,586,630
Net increase (decrease) in federal home loan bank advances	(250,000)	4,000,000
Net decrease in other borrowings	(10,045,070)	(7,488,317)
Dividends on preferred stock	(551,160)	(308,892)
Net cash provided by (used in) financing activities	(19,078,281)	52,527,421

Net increase (decrease) in cash and cash equivalents		(1,748,509)		12,250,913
Cash and cash equivalents, beginning of period		20,661,820		26,600,829
Cash and cash equivalents, end of period	$	18,913,311	$	38,851,742
Supplemental Schedule of Non Cash Activities				
Real estate owned assets acquired in settlement of loans	$	5,861,491	$	8,941,954

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements (Unaudited)

Note 1 - Principles of presentation

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

The Company’s financial statements are prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) which, effective for all interim and annual periods ending after September 15, 2009, principally consist of the Financial Accounting Standards Board Accounting Standards Codification (“FASB Codification”). FASB Codification Topic 105: Generally Accepted Accounting Principles establishes the FASB codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the Securities and Exchange Commission (“SEC”) under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the FASB Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the FASB Codification is superseded and deemed non-authoritative.

In the opinion of management, the accompanying condensed consolidated financial statements of the Company have been prepared on the accrual basis in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, all adjustments that are, in the opinion of management, necessary for a fair presentation have been included. The results of operations for the three and nine month periods ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year ending December 31, 2010. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009 as filed with the Securities and Exchange Commission.

Note 2 – Correction of an immaterial error

During the second quarter of 2010, the Company identified an error related to the calculation of its income tax benefit for the fourth quarter of the year ended December 31, 2009. The Company evaluated the error in accordance with Accounting Standards Codification 250-10-45-27 Materiality Determination for Correction of an Error and Staff Accounting Bulletin No. 99, Materiality. Although the error was considered to be immaterial to the fourth quarter and year ended December 31, 2009, because of the significance of the out-of-period error to the second quarter of 2010, the Company applied the guidance of SAB No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements, and revised its 2009 financial statements for the immaterial error.

The following is a reconciliation of the effects of the adjustments made to the Company’s previously reported December 31, 2009 consolidated balance sheet to the revised consolidated balance sheet appearing in the Form 10-Q:

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	December 31, 2009		
	As Reported	Adjustment	As Revised
Other assets	$ 15,015,708	$ (969,588)	$ 14,046,120
Other liabilities	2,641,410	124,140	2,765,550
Retained earnings deficit	(8,647,731)	(1,093,728)	(9,741,459)

The effect of the correction on retained earnings was a result of decreasing the income tax benefit for 2009 by approximately $1,094,000 which increased the net loss by the same amount, representing an increase in the loss per basic and diluted share of $0.26.

The effect of the adjustments on the Company's capital ratios was immaterial and did not change the "well capitalized" classification of the Company or the Bank.

Note 3 - Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheets and statements of income for the period. Actual results could differ significantly from those estimates.

Note 4 - Earnings per common share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator				
Net income (loss) - basic and diluted	$ 334,112	$ (2,770,567)	$ 1,281,731	$ (4,627,631)
Less:				
Preferred stock dividend	(185,739)	(185,739)	(551,160)	(308,892)
Amortization of discount	(36,171)	(35,805)	(108,239)	(59,624)
Net income (loss) available to common shareholders	$ 112,202	$ (2,992,111)	$ 622,332	$ (4,996,147)
Denominator				
Weighted average shares outstanding - basic	4,238,416	4,230,875	4,237,505	4,230,516
Dilutive effect of common stock options and restricted stock awards	-	-	-	-

Weighted average shares outstanding - diluted	4,238,416	4,230,875	4,237,505	4,230,516
Earnings (loss) per share - basic and diluted				
Earnings (loss) per share - basic	$ 0.03	$ (0.71)	$ 0.15	$ (1.18)
Effect of dilutive common stock options	-	-	-	-

Outstanding options and warrants to purchase common stock were considered in the computation of diluted earnings per share for the periods presented. Stock options and warrants to acquire 310,205 shares of common stock were not included in computing diluted earnings per share for the three and nine months ended September 30, 2010 because their effects were anti-dilutive. Options and warrants to acquire 336,255 shares of common stock were anti-dilutive for the three and nine month periods ended September 30, 2009 and thus excluded from the computation of fully diluted earnings per share.

Note 5 – Investment securities available for sale

At September 30, 2010 and December 31, 2009, all of our securities were classified as available-for-sale. The following table 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
September 30, 2010					
US Government Agencies					
Within one year	$ 2,000	$ 2,007	$ 8	$ 2,015	2.33%
One to five years	5,000	5,245	155	5,400	2.10%
Five to ten years	1,440	1,440	(1)	1,439	0.70%
Total	8,440	8,692	162	8,854	1.92%
Mortgage-backed securities					
Within one year	151	165	(10)	155	6.52%
One to five years	6,301	6,366	185	6,551	3.33%
Five to ten years	4,993	5,155	27	5,182	3.00%
More than ten years	232	241	(4)	237	1.93%
Total	11,677	11,927	198	12,125	3.20%
Municipals					
Five to ten years	5,000	5,168	117	5,285	5.15%
Other investments					
More than five years	2,000	1,975	73	2,048	5.65%
Total investment securities	$ 27,117	$ 27,762	$ 550	$ 28,312	3.34%
December 31, 2009					
US Government Agencies					
One to five years	$ 9,000	$ 9,315	$ (66)	$ 9,249	2.32%
Five to ten years	3,000	3,029	32	3,061	4.50%
More than ten years	34,250	35,284	75	35,359	5.73%
Total	46,250	47,628	41	47,669	5.70%
Mortgage-backed securities					
One to five years	389	435	(37)	$ 398	4.40%

Five to ten years	471	471	29	500	5.24%
More than ten years	3,141	3,227	53	3,280	5.42%
	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 years	2,000	1,973	10	1,983	5.65%
Total investment securities	$ 53,251	$ 54,760	$ 97	$ 54,857	4.72%

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Investment securities available for sale that have an unrealized loss position at September 30, 2010 and December 31, 2009 are detailed below.

	Securities in a loss Position for less than 12 Months		Securities in a loss Position for more than 12 Months		Total	
September 30, 2010	Fair Value	Unrealized Losses	Fair Value (Loss)	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Investment Securities available for sale						
US Government Agencies	$ 1,439	$ (16)	$ -	$ -	$ 1,439	$ (16)
Mortgage-backed securities	483	(2)	-	-	483	(2)
Total	$ 1,922	$ (18)	$ -	$ -	$ 1,922	$ (18)
December 31, 2009						
Investment securities available for sale						
US Government Agencies	$ 19,542	$ (264)	$ -	$ -	$ 19,542	$ (264)
Total	$ 19,542	$ (264)	$ -	$ -	$ 19,542	$ (264)

Management does not believe that any individual unrealized loss as of September 30, 2010 and December 31, 2009 is other than a temporary impairment. These unrealized losses are primarily attributable to changes in interest rates. The Company has the ability to hold these securities for a time necessary to recover the amortized cost or until maturity when full repayment would be received.

Note 6 – Deposits

Deposits as of September 30, 2010 and December 31, 2009 were as follows:

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%
Noninterest bearing demand	$ 40,790,586	8.32%	$ 38,520,878	7.73%
Now	32,013,417	6.53%	36,441,259	7.31%
Money market	92,663,141	18.91%	115,166,477	23.11%
Savings	10,463,651	2.14%	8,901,299	1.79%
Time deposits of $100,000 and over	129,121,578	26.35%	119,352,471	23.95%

Other time deposits	185,000,700	37.75%	179,902,740	36.10%
Total	$ 490,053,073	100.00%	$ 498,285,124	100.00%

Note 7 – Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate at September 30, 2010 was 2.44%. The securities were redeemable par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. No amounts have been redeemed at September 30, 2010 and there are no plans to do so. The principal asset of the Trust is $5.2 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

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

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

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust's obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends.

Note 8 – Stock incentive plans

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

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

	Nine Months Ended September 30,							
	2010				2009			
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	336,005	$ 9.58	$ 4.75		333,955	$ 9.63	$ 4.77	
Granted	-	-	-		3,000	4.45	2.86	
Forfeited	(25,800)	10.77	5.02		(700)	10.42	6.12	
Exercised	-	-	-		-	-	-	
Options outstanding, end of period	310,205	$ 9.48	$ 4.73	$ -	336,255	$ 9.63	$ 4.75	$ -
Options exercisable, end of period	291,350				300,900			

During the first quarter of 2009, we granted to certain officers 26,592 restricted shares of common stock with a weighted average fair market value of $4.60 per share at the date of grant. These restricted stock awards have three-year graded vesting. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock and performance share awards was 13,537 and 22,238 at September 30, 2010 and 2009, respectively.

Stock-based compensation expense was $73,072 and $123,129 for the nine months ended September 30, 2010 and 2009, respectively. Unamortized stock-based compensation related to nonvested share based compensation arrangements granted under the Incentive Plan as of September 30, 2010 and 2009 was $147,678 and $360,247, respectively. The time based unamortized compensation of $147,678 is expected to be recognized over a weighted average period of 1.31 years.

Note 9 — Fair value

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

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

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

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

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

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

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

Investment securities: The fair values for investment securities are determined by quoted prices for similar assets or liabilities (Level 2).

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

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

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

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

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

(1) Excludes restricted stock.

	Fair Value Measurement at December 31, 2009 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Financial Assets-Recurring				
	$	$	$	$
US Government Agencies	47,669	-	47,669	-
MBS	4,178	-	4,178	-
Municipals	1,027	-	1,027	-
Other available for sale (1)	1,983	-	1,983	-
Financial Assets-Non-Recurring				
	$	$	$	$
Impaired loans	25,913	-	-	25,913
Real estate owned	11,279	-	-	11,279
Residential loans held for sale	7,506	-	7,506	-

(1) Excludes restricted stock.

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

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

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

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

remaining maturities.

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

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

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

Off-balance-sheet instruments –The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of commitments to extend credit, including letters of credit, is estimated to approximate their aggregate book balance and is not considered material and therefore not included in the following table.

	September 30, 2010		December 31, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
	$	$	$	$
Cash and cash equivalents	18,913,311	18,913,311	20,661,820	20,661,820
Investment securities available for sale	28,311,767	28,311,767	54,857,211	54,857,211
Loans held for sale	26,521,812	26,521,812	7,506,252	7,506,252
Loans	448,810,797	448,629,947	457,046,616	466,271,730
Accrued interest receivable	2,591,301	2,591,301	3,366,718	3,366,718
Financial liabilities				
Deposits	490,053,073	492,103,799	498,285,124	500,979,984
FHLB borrowings	28,750,000	29,050,023	29,000,000	29,011,904
Trust preferred securities	8,764,000	8,764,000	8,764,000	8,764,000
Other borrowings	4,784,451	4,784,451	14,829,521	14,783,055
Accrued interest payable	431,844	431,844	501,069	501,069
Off-balance-sheet instruments				
Undisbursed credit lines		49,200,742		49,621,000
Commitments to extend or originate credit		25,182,542		19,078,000
Standby letters of credit		3,428,258		4,177,000

Note 10 – Capital Purchase Program

On May 1, 2009, as part of the Capital Purchase Program established by the U.S. Department of the Treasury (the "Treasury") under the Emergency Economic Stabilization Act of 2008 ("EESA"), the Company entered into a Letter Agreement and Securities Purchase Agreement—Standard Terms (collectively, the "Purchase Agreement") with the Treasury, pursuant to which the Company sold (i) 14,738 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value $4.00 per share, having a liquidation preference of $1,000 per share (the "Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 499,029 shares of the Company's common stock at an initial exercise price of $4.43 per share, subject to certain anti-dilution and other adjustments, for an aggregate purchase price of $14,738,000 in cash. The fair value of the preferred stock was estimated using discounted cash flow methodology at an assumed market equivalent rate of 13%, with 20 quarterly payments over a five year period. The fair value of the warrant was estimated using the Black-Scholes option pricing model, with assumptions of 25% volatility, a risk-free rate of 2.03%, a yield of 6.162% and an estimated life of 5 years. The value attributed to the warrant is being accreted as a discount on the preferred stock using the effective interest rate method over five years.

The Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum for the first five years, and thereafter at a rate of 9% per annum. The Preferred Stock is generally non-voting, other than on certain matters that could adversely affect the Preferred Stock.

The Warrant is immediately exercisable. The Warrant provides for the adjustment of the exercise price and the number of shares of common stock issuable upon exercise pursuant to customary anti-dilution provisions, such as upon stock splits or distributions of securities or other assets to holders of common stock, and upon certain issuances of common stock at or below a specified price relative to the then-current market price of common stock. The Warrant expires ten years from the issuance date. Pursuant to the Purchase Agreement, the Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrant.

Note 11 – Recent accounting pronouncements

In January 2010, the FASB issued ASU No. 2010-06- Fair Value Measurements and Disclosures amending Topic 820. The ASU provides for additional disclosures of transfers between assets and liabilities valued under Level 1 and 2 inputs as well as additional disclosures regarding those assets and liabilities valued under Level 3 inputs. The new disclosures are effective for interim and annual reporting periods beginning after December 15, 2009 except for those provisions addressing Level 3 fair value measurements which provisions are effective for fiscal years, and periods therein, beginning after December 15, 2010. The adoption of this Statement did not have a material impact on the Company's consolidated financial statements.

In March 2010, the FASB issued ASU No. 2010-09 amending FASB ASC Topic 855 to exclude SEC reporting entities from the requirement to disclose the date on which subsequent events have been evaluated. It further modifies the requirement to disclose the date on which subsequent events have been evaluated in reissued financial statements to apply only to such statements that have been restated to correct an error or to apply U.S. GAAP retrospectively. The Company has complied with ASU No. 2010-09.

New authoritative accounting guidance under ASC Topic 860, "Transfers and Servicing," amended prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC Topic 860 became effective January 1, 2010 and did not have a significant impact on the Company's consolidated financial statements.

In July 2010, The FASB issued ASU No. 2010-20, Receivables - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, Topic 830. This ASU requires entities to provide disclosures designed to facilitate financial statement users' evaluation of(i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 will be effective for the Company's consolidated financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period will be required for the Company's consolidated financial statements that include periods beginning on or after January 1, 2011. This ASU requires additional disclosures only and will not have an impact on the Company's consolidated financial statements.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Caution about forward-looking statements

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

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to, changes in interest rates, general economic conditions, the quality or composition of the loan or investment portfolios, the level of nonperforming assets and charge-offs, the local real estate market, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, changes in regulations applicable to the Company, demand for loan products, deposit flows, competition, accounting principles, policies and guidelines, and any other risks discussed in this report or in "Item 1A Risk Factors" in the Annual Report on Form 10-K for the year ended December 31, 2009. Monetary and fiscal policies of the U.S. Government could also adversely effect the Company; such policies include the impact of any regulations or programs implemented pursuant to the Emergency Economic Stabilization Act of 2008 (EESA), the American Recovery and Reinvestment Act of 2009 (ARRA), the Dodd-Frank Wall Street Reform and Consumer Protection Act and other policies of the U.S. Treasury and the Federal Reserve Board.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

General

The Company was organized under the laws of the Commonwealth of Virginia as a bank holding company whose activities consist of investment in its wholly-owned subsidiary, the Bank. The Bank is engaged in commercial and retail banking. We opened to the public on December 13, 1999. We place special emphasis on serving the financial needs of individuals, small and medium sized businesses, entrepreneurs, and professional concerns.

The Bank has one subsidiary, Village Bank Mortgage Corporation. We offer a wide range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans. In addition we provide investment services through a separate division of the Bank, Village Investment Services. We are a community-oriented and locally owned and managed financial institution focusing on providing a high level of responsive and personalized services to our customers, delivered in the context of a strong direct relationship with the customer. We conduct our operations from our main office/corporate headquarters location and fourteen branch offices.

The Company's primary source of earnings is net interest income, and its principal market risk exposure is interest rate risk. The Company is not able to predict market interest rate fluctuations and its asset/liability management strategy may not prevent interest rate changes from having a material adverse effect on the Company's results of operations and financial condition. In addition, revenues are generated from fees charged on deposit accounts and gains from sale of mortgage loans to third-party investors.

Although management endeavors to minimize the credit risk inherent in the Company's loan portfolio, it must necessarily make various assumptions and judgments about the collectability of the loan portfolio based on its experience and evaluation of economic conditions. If such assumptions or judgments prove to be incorrect, the current allowance for loan losses may not be sufficient to cover loan losses and additions to the allowance may be necessary, which would have a negative impact on net income.

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

The Company experienced significant losses during the prior year primarily as a result of the economic climate. Although we were profitable for the first, second and third quarters of 2010, a continuation of the turbulence in significant portions of the global financial markets, or worsening, could further impact the Company's performance, both directly, by affecting both revenues and the value of the Company's assets and liabilities, and indirectly, by affecting the Company's counterparties. Dramatic declines in the housing market in the past year have resulted in significant write-downs of asset values by financial institutions in the United States. Concerns about the stability of the U.S. financial markets generally have reduced the availability of funding to certain financial institutions, leading to a tightening of credit, reduction of business activity, and increased market volatility. It is not clear at this time what impact liquidity and funding initiatives of the Treasury and other bank regulatory agencies that have been announced or any additional programs that may be initiated in the future will have on the financial markets and the financial services industry. The extreme levels of volatility and limited credit availability currently being experienced could continue to affect the U.S. banking industry and the broader U.S. and global economies, which could have an effect on all financial institutions, including the Company.

For the three months ended September 30, 2010, the Company had net income totaling $334,000 and net income available to common shareholders of $112,000, or $0.03 per fully diluted share, compared to a net loss of $(2,771,000) and a net loss available to common shareholders of $(2,992,000), or $(.71) per fully diluted basis, for the same period in 2009. The most significant factors in our improving earnings were a decline in the provision for loan losses of $4,590,000, from $6,000,000 in 2009 to $1,410,000 in 2010, and a larger decline in our cost of deposits relative to the decline in our yield on loans resulting from an increase in net interest income of $716,000.

Our total assets decreased to $583,879,000 at September 30, 2010 from $601,993,000 at December 31, 2009, a decrease of $(18,114,000), or 3%. Liquid assets (cash and due from banks, federal funds sold and investment securities available for sale) decreased by $(28,294,000), loans held for sale increased by $19,016,000, net portfolio loans decreased by $(8,236,000), accrued interest receivable decreased by $(775,000), and other real estate owned increased by $1,662,000.

The net decrease in assets of $18,114,000 resulted primarily from a decrease in deposits of $8,232,000 and the reduction of other borrowings of $10,045,000. The decline in borrowings is primarily a result of the pay off of a loan on our headquarters building at the Watkins Centre on September 30, 2010

The following presents management's discussion and analysis of the financial condition of the Company at September 30, 2010 and December 31, 2009, and results of operations for the Company for the three and nine month periods ended September 30, 2010 and 2009. This discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2009 as filed with the Securities and Exchange Commission as well as the third quarter 2010 financial statements and notes thereto appearing elsewhere in this report.

Results of operations

For the three months ended September 30, 2010, the Company had income totaling $334,000, and income available to common shareholders of $112,000, or $0.03 per fully diluted share, compared to net a loss of $(2,271,000) and a net loss available to common shareholders of $(2,992,000) or $(0.71) per fully diluted share, for the same period in 2009. For the nine months ended September 30, 2010, the Company had income totaling $1,282,000, and net income available to common shareholders of $622,000, or $0.15 per share on a fully diluted basis, compared to a loss totaling $(4,628,000), and a net loss available to common shareholders of $(4,996,000) or $(1.18) per share on a fully diluted basis, for the same period in 2009.

The increase in net earnings during the three and nine months ended September 30, 2010 compared to the same periods in 2009 is primarily a result of:

	Third Quarter 2010 Compared to Third Quarter 2009	Nine Months Ended Sept 30, 2010 Compared to Nine Months Ended Sept 30, 2009
Increase in net interest income	$ 716,000	$ 1,759,000
Decrease in provision for loan losses	4,590,000	7,050,000
Increase in gain on sale of loans	81,000	466,000
Gain on sale of securities	-	489,000
Gain on sale of land	-	243,000
Increase in rental income	64,000	259,000
Increase in noninterest expenses	(871,000)	(1,837,000)

The increase in net interest income is primarily attributable to the significant decline in the cost of deposits. Our cost of deposits declined from 3.39%for the first nine months of 2009 to 2.01%for the first nine months of 2010. The decrease in the provision for loan losses reflects management's recognition of higher provisions in previous periods attributable to the Bank's current level of nonperforming assets and slowing of the deterioration of asset quality and is discussed in more detail under Asset Quality and Provision for Loan Losses. The increase in gain on sale of loans is

attributable to increased loan production by the mortgage banking subsidiary of the Bank. The mortgage subsidiary closed $77,620,000 in mortgage loans in the third quarter of 2010 compared to $61,795,000 in the third quarter of 2009, and $206,404,000 for the nine months ended September 30, 2010 compared to $189,155,000 for the same period in 2009. The increase in rental income is a result of an increase in rented square feet in our headquarters building at the Watkins Centre as well as the expiration of rental concessions on previous rental agreements.

At September 30, 2010, the headquarters building has leases and letters of intent for greater than 90% of its leasable square footage. The increase in noninterest expenses in comparing the nine month periods is primarily attributable to increases in salaries and benefits of $1,194,000, and occupancy costs of $211,000 resulting from the addition of the mortgage company's loan production office in Northern Virginia as well as the startup of a financial services division of the Bank. The quarter to quarter comparison reflects similar increases in salaries and benefits and occupancy costs of $462,000 and $26,000, respectively, as well as and increase of $216,000 in expenses related to foreclosed real estate.

Net interest income

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

Net interest income for the third quarter of $5,042,000 represents an increase of $716,000, or 17%, compared to the third quarter of 2009, and an increase of $339,000, or 7%, compared to the second quarter of 2010. These increases are a result of a decline in our Company's cost of funds that was greater than a decline in the yield on earning assets. Our cost of funds declined from 3.03% for the third quarter of 2009 to 1.90% for the third quarter of 2010, a decline of 1.13%. The yield on earning assets declined from 6.05% for the third quarter of 2009 to 5.69% for the third quarter of 2010, a decline of .36%

The Company's net interest margin is not a measurement under accounting principles generally accepted in the United States, but it is a common measure used by the financial services industry to determine how profitably earning assets are funded. Net interest margin is calculated by dividing net interest income by average earning assets. Our net interest margin over the last several quarters is provided in the following table:

Quarter Ended	Actual
June 30, 2009	3.17%
September 30, 2009	3.17%
December 31, 2009	3.22%
March 31, 2010	3.26%
June 30, 2010	3.46%
September 30, 2010	3.74%

As interest rates were reduced by the Federal Reserve during 2007 and 2008 in reaction to the declining economy, our margin was compressed as our deposits generally do not reprice as quickly as our loans. Because our deposits continue to reprice downward and the yield on interest earning assets appears to be stabilizing, we expect the upward trend in out net interest margin to continue. However, given the continued depressed economy and the potential impact on interest income from new nonaccrual loans, no assurance can be provided that this will occur.

Average interest-earning assets for the first nine months of 2010 increased by $11,607,000, or 2.2%, compared to the first nine months of 2009. The increase in interest-earning assets was due primarily to an increase in investment

securities of $12,232,000 and federal funds sold of $10,178,000, offset by a decline in loans of $13,519,000. The average yield on interest-earning assets decreased to 5.57% for the first nine months of 2010 compared to 6.31% for the first nine months of 2009.

Many of our loans are indexed to short-term rates affected by the Federal Reserve's decisions about short-term interest rates, and, accordingly, as the Federal Reserve increases or decreases short-term rates, the yield on interest-earning assets is affected. As the Federal Reserve decreased interest rates starting in 2007 and into 2008, decreasing short-term interest rates by 5% over twelve months, the average yield on our interest-earning assets decreased. Additionally, while many of our indexed rate loans have interest rate floors included in their terms, we have decreased rates to loan customers to better reflect the current interest rate environment and in some limited cases to facilitate workouts on nonperforming loans.

Our average interest-bearing liabilities increased by $17,484,000, or 4%, for the first nine months of 2010 compared to the first nine months of 2009. The increase in interest-bearing liabilities was primarily due to growth in average deposits of $15,953,000. The average cost of interest-bearing liabilities decreased to 2.21% for the first nine months of 2010 from 3.42% for the first nine months of 2009. The principal reason for the decrease in liability costs was the reduction in short-term interest rates by the Federal Reserve and our efforts to reduce rates for repricing liabilities. See our discussion of interest rate sensitivity below for more information.

The following tables illustrate average balances of total interest-earning assets and total interest-bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted-average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances. We had no tax exempt assets for the periods presented.

Average Balance Sheets
(in thousands)

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Average Balance	Interest Income/ Expense	Annualized Yield Rate	Average Balance	Interest Income/ Expense	Annualized Yield Rate
Loans net of deferred fees	$ 461,442	$ 7,190	6.18%	$ 483,613	$ 7,777	6.38%
Investment securities	29,844	237	3.15%	31,563	373	4.69%
Loans held for sale	18,752	219	4.63%	12,993	177	5.40%
Federal funds and other	24,297	14	0.23%	18,240	7	0.15%
Total interest earning assets	534,335	7,660	5.69%	546,409	8,334	6.05%
Allowance for loan losses and deferred fees	(9,384)			(9,697)		
Cash and due from banks	14,751			18,066		
Premises and equipment, net	27,665			27,722		
Other assets	34,235			27,103		
Total assets	$ 601,602			$ 609,603		
Interest bearing deposits						
Interest checking	$ 32,704	$58	0.70%	$29,465	$ 137	1.84%
Money market	97,384	236	0.96%	96,455	468	1.92%
Savings	10,323	18	0.69%	6,916	21	1.20%
Certificates	312,707	1,857	2.36%	321,579	2,849	3.51%
Total	453,118	2,169	1.90%	454,415	3,475	3.03%
Borrowings	51,412	450	3.47%	51,382	534	4.12%
Total interest bearing liabilities	504,530	2,619	2.06%	505,797	4,009	3.14%
Noninterest bearing deposits	44,189			41,913		
Other liabilities	2,910			2,631		
Total liabilities	551,629			550,341		
Equity capital	49,973			59,262		
Total liabilities and capital	$ 601,602			$ 609,603		
Net interest income before provision					$ 4,325	

for loan losses	$ 5,041	
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities	3.63%	2.91%
Annualized net interest margin (net interest income expressed as percentage of average earning assets)	3.74%	3.17%

Average Balance Sheets
(In thousands)

	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Average Balance	Interest Income/ Expense	Annualized Yield Rate	Average Balance	Interest Income/ Expense	Annualized Yield Rate
Loans net of deferred fees	$ 465,087	$ 21,225	6.10%	$ 478,606	$ 23,682	6.62%
Investment securities	39,099	$880	3.01%	$ 26,867	$996	4.96%
Loans held for sale	13,491	488	4.84%	10,775	418	5.19%
Federal funds and other	25,882	44	0.23%	15,704	19	0.16%
Total interest earning assets	543,559	22,637	5.57%	531,952	25,115	6.31%
Allowance for loan losses and deferred fees	(9,665)			(7,679)		
Cash and due from banks	12,565			14,372		
Premises and equipment, net	27,718			27,898		
Other assets	33,952			25,855		
Total assets	$ 608,129			$ 592,398		
Interest bearing deposits						
Interest checking	$ 35,512	$ 274	1.03%	$ 23,562	$ 282	1.60%
Money market	104,034	863	1.11%	54,419	759	1.86%
Savings	10,018	62	0.83%	6,730	60	1.19%
Certificates	312,244	5,759	2.47%	361,144	10,202	3.78%
Total	461,808	6,958	2.01%	445,855	11,303	3.39%
Borrowings	52,247	1,520	3.89%	50,716	1,413	3.73%
Total interest bearing liabilities	514,055	8,478	2.21%	496,571	12,716	3.42%
Noninterest bearing deposits	41,332			39,563		
Other liabilities	2,760			2,108		
Total liabilities	558,147			538,242		
Equity capital	49,982			54,156		
Total liabilities and capital	$ 608,129			$ 592,398		
					$ 12,399	

Net interest income before provision for loan losses	$ 14,159		
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities		3.36%	2.89%
Annualized net interest margin (net interest income expressed as percentage of average earning assets)		3.48%	3.12%

Asset quality and provision for loan losses

Provisions for loan losses for the three months ended September 30, 2010 was $1,410,000 compared to $6,000,000 for the three months ended September 30, 2009. The provision for loan losses for the nine months ended September 30, 2010 was $3,150,000 compared to $10,200,000 for the nine months ended September 30, 2009. The decreases in the provision for loan losses in 2010 when compared to 2009 reflects management's recognition of higher provisions in previous periods attributable to the Bank's current level of nonperforming assets. However, overall asset quality continues to be a concern as there continues to be uncertainty in the economy and the level of nonperforming assets remains significant. We believe there is reason for optimism regarding our current asset quality, however, as the amount of nonperforming assets declined by 14% in the third quarter.

Nonperforming assets consisting of nonaccrual loans and other real estate owned for the indicated periods is as follows (dollars in thousands):

	Sept. 30, 2010	June 30, 2010	March 31, 2010	Dec. 31, 2009	Sept. 30, 2009
Nonaccrual loans					
Number	117	132	130	123	117
Amount	$ 23,943	$ 31,106	$ 33,255	$ 25,193	$ 21,916
Other real estate owned	12,941	11,816	10,715	11,279	11,249
	$ 36,884	$ 42,922	$ 43,970	$ 36,472	$ 33,165
Percentage of total assets	6.32%	7.08%	7.14%	6.18%	5.35%

The decrease in nonperforming assets in the third quarter of 2010 reflects some larger loans returning to accrual status, primarily as a result of payments received from the borrowers. Loans may be placed back on accrual status when, in the opinion of management, the circumstances warrant such action such as a history of timely payments, additional collateral is obtained or the borrowers cash flows improve. Our approach to troubled lending relationships is to work with the borrower to the extent possible and still adhere to strong credit management guidelines. If the economy continues to be depressed at the levels we have experienced from the latter part of 2008 through 2010, nonperforming assets could continue to increase. See our discussion of the allowance for loan losses under Allowance for loan losses and Critical accounting policies below.

In addition to the nonperforming assets at September 30, 2010, there were nine loans past due 90 days or more and still accruing interest totaling $738,000, compared to twelve loans totaling $4,787,000 at December 31, 2009. We believe that these assets are adequately collateralized and are currently recorded at realistically recoverable values. However, economic circumstances related to specific credit relationships are changing, which may impact our assessments of collectability. In addition, the amount of loans 90 days or more and still accruing interest is at the lowest level it has been since June 30, 2009 and is down significantly from the $4,787,000 at December 31, 2009.

The following table reflects details related to asset quality and allowance for loan losses of Village Bank (dollars in thousands):

	Sept 30, 2010	June 30, 2010	Mar 31, 2010	Dec 31, 2009	Sept 30, 2009
Loans 90 days past due and still accruing	$ 738	$ 959	$ 2,535	$ 4,787	$ 1,661
Nonaccrual loans	23,943	31,106	33,255	25,913	21,916
Other real estate owned	12,941	11,816	10,715	11,279	11,249
Allowance for loan losses					
Beginning balance	$ 9,500	$ 9,091	$ 10,522	$ 9,527	$ 9,618
Provision for loan losses	1,410	1,240	500	3,020	6,000
Charge-offs	(1,091)	(954)	(2,114)	(2,026)	(6,091)
Recoveries	-	123	183	1	-
Ending balance	$ 9,819	$ 9,500	$ 9,091	$ 10,522	$ 9,527
Ratios					
Allowance for loan losses to					
Loans, net of unearned income	2.14%	2.05%	1.96%	2.25%	2.02%
Nonaccrual loans	41.01%	30.54%	27.34%	40.61%	43.47%
Nonperforming assets to total assets	6.32%	7.06%	7.14%	6.17%	5.35%

Noninterest income

Noninterest income increased from $2,394,000 for the three months ended September 30, 2009 to $2,662,000 for the three months ended September 30, 2010, an increase of $268,000 or 11%. Noninterest income also increased from $5,877,000 for the first nine months of 2009 to $7,859,000 for the first nine months of 2010, an increase of $1,982,000 or 34%. These increases in noninterest income are primarily a result of higher gain on loan sales and fees from increased loan production by our mortgage banking subsidiary, the gain on the sale of land behind one of our branches, gains on the sales and calls of several securities, and an increase of rental income from the leasing of additional space in the Company's headquarters building. Our mortgage banking subsidiary has experienced a significant increase in loan production as a result of the addition of a loan production office in Northern Virginia as well as improved performance from some of our existing loan originators.

Noninterest expense

Noninterest expense for the three months ended September 30, 2010 was $5,787,000 compared to $4,917,000 for the three months ended September 30, 2009, an increase of $870,000 or 18%. Salaries and benefits increased by $462,000 and expenses related to real estate owned increased by $216,000. The increase in salaries and benefits is attributable to the addition of the mortgage company's loan production office in Northern Virginia as well as the

startup of a financial services division of the Bank. We believe that expense associated with foreclosed real estate will continue to be significant as we work through the disposition of nonperforming assets.

Noninterest expense for the nine months ended September 30, 2010 totaled $16,926,000, an increase of $1,837,000, or 12% from $15,088,000 for the nine months ended September 30, 2009. Salaries and benefits increased by $1,194,000 or 15% from $7,741,000 for the nine months ended September 30, 2009 to $8,935,000 for the nine months ended September 30, 2010. Occupancy costs increased by $211,000, from $1,319,000 for the nine months ended September 30, 2009 to $1,530,000 for the nine months ended September 30, 2010. These two increases are related to the addition of the mortgage company's loan production office in Northern Virginia as well as the startup of a financial services division of the Bank. Other large increases included increases in advertising and marketing of $102,000 and the FDIC insurance premium of $145,000.

Income taxes

The provision for income taxes of $660,000 for the nine months ended September 30, 2010 is based upon the results of operations. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

The Company must also evaluate the likelihood that deferred tax assets will be recovered from future taxable income. If any such assets are not likely to be recovered, a valuation allowance must be recognized. We determined that a valuation allowance was not required for deferred tax assets as of September 30, 2010. The assessment of the carrying value of deferred tax assets is based on certain assumptions, changes in which could have a material impact on the Company's financial statements.

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded a franchise tax expense of $274,000 and $260,000 for the nine months ended September 30, 2010 and 2009, respectively.

Loan portfolio

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

Loan Portfolio, Net
(In thousands)

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%
Commercial	$ 32,133	7.0%	$ 39,576	8.5%
Real estate - residential	99,456	21.7%	93,657	20.0%
Real estate - commercial	258,055	56.3%	240,830	51.5%
Real estate - construction	57,988	12.7%	81,688	17.5%
Consumer	10,494	2.3%	11,609	2.5%
Total loans	458,126	100.0%	467,360	100.0%
Less: deferred costs, net	504		209	
Less: allowance for loan losses	(9,819)		(10,522)	
Total loans, net	$ 448,811		$ 457,047	

Allowance for loan losses

The allowance for loan losses at September 30, 2010 was $9,819,000, compared to $10,522,000 at December 31, 2009. The ratio of the allowance for loan losses to gross portfolio loans (net of unearned income and excluding mortgage loans held for sale) at September 30, 2010 and December 31, 2009 was 2.14% and 2.25%, respectively. The reduction in this ratio is attributable to the significant charge-offs of $4,159,000 we recognized in the first nine months of 2010. The amount of the loan loss provision is determined by an evaluation of the level of loans outstanding, the level of non-performing loans, historical loan loss experience, delinquency trends, underlying collateral values, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions. See our discussion of the allowance for loan losses under Critical accounting policies below.

The following table presents an analysis of the changes in the allowance for loan losses for the periods indicated.

Analysis of Allowance for Loan Losses
(In thousands)

	Nine Months Ended September 30, 2010	2009
Beginning balance	$ 10,522	$ 6,059
Provision for loan losses	3,150	10,200
Charge-offs		
Commercial and industrial	$ (804)	$ (5,201)
Real estate - residential	(957)	(226)
Real estate - commercial	(1,228)	-
Real estate - construction	(1,017)	(460)
Consumer	(153)	(855)
	(4,159)	(6,742)
Recoveries		
Commercial and industrial	203	-
Real estate - residential	1	-
Real estate - commercial	-	-
Real estate - construction	101	3
Consumer	1	7
	306	10
Net charge-offs	(3,853)	(6,732)
Ending balance	$ 9,819	$ 9,527
Loans outstanding at end of period (1)	$ 458,126	$ 471,621
Ratio of allowance for loan losses as a percent of loans outstanding at end of period	2.14%	2.02%
Average loans outstanding for the period (1)	$ 465,087	$ 478,607
Ratio of net charge-offs to average loans outstanding for the period	0.83%	1.41%

(1) Loans are net of deferred costs.

Deposits

Total deposits decreased by $8,232,000, or 2%, during the first nine months of 2010 as compared to an increase of $41,587,000, or 9%, during the first nine months of 2009. Checking and savings accounts decreased by $596,000, money market accounts decreased by $22,503,000 and time deposits increased by $14,867,000. Our strategy has been to adjust our interest rates on deposit accounts to encourage movement from money market accounts to longer term certificates of deposit to lengthen the maturities of our liabilities with the expectation that interest rates will increase over the long-term. The cost of our interest bearing deposits declined to 2.01% for the first nine months of 2010 compared to 3.39% for the first nine months of 2009.

While the mix of our deposits continues to be weighted toward time deposits, such deposits represent 64% of total deposits at September 30, 2010 as compared to 60% at December 31, 2009. As our branch network has increased and is more convenient to a larger segment of our targeted customer base, we have experienced a move to a higher percentage of our deposits in checking accounts. We are emphasizing checking account deposit growth at our existing branches.

The variety of deposit accounts that we offer has allowed us to be competitive in obtaining funds and has allowed us to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of funds away from depository institutions such as banking institutions into direct investment vehicles such as government and corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, and is expected to continue to be, significantly affected by money market conditions.

Borrowings

We use borrowings to supplement deposits when they are available at a lower overall cost to us or they can be invested at a positive rate of return.

Other borrowings decreased by $10,295,000 or 20% during the nine months ended September 30, 2010, from $52,593,000 at December 31, 2009 to $42,298,000 at September 30, 2010. This decline is primarily a result of the pay off of a loan of $9,889,000 on our headquarters building at the Watkins Centre on September 30, 2010. This loan had an interest rate of 6.6% and federal funds sold was used to fund the pay off. The liquidity used to make this pay off was replaced with wholesale funding (brokered deposits) at an average interest rate of 1.57% thereby reducing our annual interest expense by $497,000.

As a member of the Federal Home Loan Bank of Atlanta (“FHLB”), the Bank is required to own capital stock in the FHLB and is authorized to apply for borrowings from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. Borrowings from the FHLB were $28,750,000 and $29,000,000 at September 30, 2010 December 31, 2009 respectively. The FHLB advances are secured by the pledge of first mortgage loans, home equity loans and our FHLB stock. During the second and third quarters of 2010, $15,000,000 of the FHLB advances with an average interest rate of 4.19% matured of which we refinanced $14,750,000 with an average interest rate of 2.01% thereby reducing our annual interest expense by approximately $332,000. The cost of borrowings declined to 3.47% for the third quarter of 2010 compared to 4.12% for the fourth quarter of 2009 primarily as a result of this refinance of advances from the Federal Home Loan Bank.

Capital resources

Stockholders’ equity at September 30, 2010 was $48,956,000, compared to $47,848,000 at December 31, 2009. On May 1, 2009, the Company received a $14,738,000 investment by the United States Department of the Treasury under its Capital Purchase Program (the TARP Program). The TARP Program is a voluntary program designed to provide capital for healthy banks to improve the flow of funds from banks to their customers. Under the TARP Program, the Company issued to the Treasury $14,738,000 of preferred stock and warrants to purchase 499,030 shares of the Company’s common stock at a purchase price of $4.43 per share. The preferred stock issued by the Company under the TARP Capital Purchase Program carries a 5% dividend for each of the first 5 years of the investment, and 9% thereafter, unless the shares are redeemed by the Company. The $1,108,000 increase in equity during the first nine months of 2010 was primarily due to net income of $1,282,000 which was reduced by dividends paid to the U.S. Treasury on the TARP investment of $659,000, and an increase of $297,000, net of tax, in the value of our securities available for sale.

During the first quarter of 2005 and the third quarter of 2007, the Company issued $5.2 and $3.6 million, respectively in Trust Preferred Capital Notes. The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion.

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, under capitalized, significantly under capitalized, and critically under capitalized. The Bank meets the criteria to be categorized as a "well capitalized" institution as of September 30, 2010.

The following table presents the composition of regulatory capital and the capital ratios of the Company at the dates indicated.

Analysis of Capital
(In thousands)

	September 30, 2010	December 31, 2009 *
Tier 1 capital		
Preferred stock	$ 59	$ 59
Common stock	16,954	16,922
Additional paid-in capital	40,611	40,569
Retained earnings (deficit)	(9,119)	(9,741)
Warrant Surplus	732	732
Discount on preferred stock	(529)	(636)
Qualifying trust preferred securities	8,764	8,764
Total equity	57,472	56,669
Total Tier 1 capital	57,472	56,669
Tier 2 capital		
Allowance for loan losses (1)	6,082	6,310
Total Tier 2 capital	6,082	6,310
Total risk-based capital	63,554	62,979
Risk-weighted assets	$ 482,798	$ 500,602
Capital ratios		
Tier 1 capital to risk-weighted assets	11.9%	11.3%
Total capital to risk-weighted assets	13.2%	12.6%

Leverage ratio (Tier 1 capital to average assets)	9.6%	9.4%
Equity to total assets	9.8%	8.1%

(1) Amount is limited to 1.25 percent of the Company's gross risk weighted assets

* Certain December 31, 2009 amounts have been revised. See Note 2 to the condensed consolidated financial statements.

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Liquidity

Liquidity is identified as the ability to generate or acquire sufficient amounts of cash when needed at a reasonable cost to accommodate withdrawals, payments of debt, and increased loan demand. These events may occur daily or other short-term intervals in the normal operation of the business. Experience helps management predict time cycles in the amount of cash required. In assessing liquidity, management gives consideration to relevant factors including stability of deposits, quality of assets, economy of markets served, concentrations of business and industry, competition, and the Company's overall financial condition. The Bank's primary sources of liquidity are cash and the securities in our available for sale portfolio. In addition, the Bank has substantial lines of credit from its correspondent banks and access to advances from the Federal Home Loan Bank of Atlanta to support liquidity as conditions dictate.

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

At September 30, 2010, cash, cash equivalents and investment securities available for sale totaled $47,225,000, or 8.0% of total assets, which we believe is adequate to meet short-term liquidity needs.

At September 30, 2010, we had commitments to originate $77,810,000 of loans as compared to $72,876,000 at December 31, 2009. The increase is primarily attributable to commitments to make mortgage loans by our mortgage company which will be sold in the secondary market. Fixed commitments to incur capital expenditures were less than $25,000 at September 30, 2010. Time deposits scheduled to mature in the 12-month period ending September 30, 2011 totaled $213,613,000 at September 30, 2010. Based on past experience, we believe that a significant portion of such deposits will remain with us. We further believe that loan repayments and other sources of funds such as deposit growth will be adequate to meet our foreseeable short-term and long-term liquidity needs.

Interest rate sensitivity

An important element of asset/liability management is the monitoring of our sensitivity to interest rate movements. In order to measure the effects of interest rates on our net interest income, management takes into consideration the expected cash flows from the securities and loan portfolios and the expected magnitude of the repricing of specific asset and liability categories. We evaluate interest sensitivity risk and then formulate guidelines to manage this risk based on management's outlook regarding the economy, forecasted interest rate movements and other business factors. Our goal is to maximize and stabilize the net interest margin by limiting exposure to interest rate changes.

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

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

The data in the following table reflects repricing or expected maturities of various assets and liabilities at September 30, 2010. The gap analysis represents the difference between interest-sensitive assets and liabilities in a specific time interval. Interest sensitivity gap analysis presents a position that existed at one particular point in time, and assumes that assets and liabilities with similar repricing characteristics will reprice at the same time and to the same degree.

Village Bank and Trust Financial Corp.
Interest Rate Sensitivity GAP Analysis
September 30, 2010
(In thousands)

	Within 3 Months	3 to 6 Months	6 to 12 Months	13 to 36 Months	More than 36 Months	Total
Interest Rate Sensitive Assets						
Loans (1)						
Fixed rate	$ 32,184	$ 11,192	$ 21,379	$ 40,629	$ 145,049	$ 250,433
Variable rate	114,515	2,912	9,897	14,721	65,648	207,693
Investment securities	2,107	-	-	5,400	20,805	28,312
Loans held for sale	26,522	-	-	-	-	26,522
Federal funds sold	6,652	-	-	-	-	6,652
Total rate sensitive assets	181,980	14,104	31,276	60,750	231,502	519,612
Cumulative rate sensitive assets	181,980	196,084	227,360	288,110	519,612	
Interest Rate Sensitive Liabilities						
Interest checking (2)	-	-	-	32,013	-	32,013
Money market accounts	92,663	-	-	-	-	92,663
Savings (2)	-	-	-	10,464	-	10,464
Certificates of deposit	46,912	75,487	91,214	77,599	22,909	314,121
FHLB advances	-		5,000	15,750	8,000	28,750
	-	-	-		8,764	8,764

Trust Preferred Securities						
Federal funds purchased	-	-	-	-	-	-
Other borrowings	4,784	-	-	-	-	4,784
Total rate sensitive liabilities	144,359	75,487	96,214	135,826	39,673	491,559
Cumulative rate sensitive liabilities	144,359	219,846	316,060	451,886	491,559	
Rate sensitivity gap for period	$ 37,621	$ (61,383)	$ (64,938)	$ (75,076)	$ 191,829	$ 28,053
Cumulative rate sensitivity gap	$ 37,621	$ (23,762)	$ (88,700)	$ (163,776)	$ 28,053	
Ratio of cumulative gap to total assets	6.4%	(4.0)%	(15.1)%	(27.9)%	4.8%	
Ratio of cumulative rate sensitive assets to cumulative rate sensitive liabilities	126.1%	89.2%	71.9%	63.8%	105.7%	
Ratio of cumulative gap to cumulative rate sensitive assets	20.7%	(12.1)%	(39.0)%	(56.8)%	5.4%	

(1) Includes nonaccrual loans of approximately $23,943,000, which are spread throughout the categories.
(2) Management believes that interest checking and savings accounts are generally not sensitive to changes in interest rates and therefore has placed such deposits in the "13 to 36 months" category.

At September 30, 2010, our balance sheet is asset sensitive for the first three months, meaning that our assets reprice more quickly than our liabilities during that period, and liability sensitive for the next thirty-three months, meaning that our liabilities will reprice more quickly than our assets during that period, with a ratio of cumulative gap to total assets ranging from a positive gap of 6.4% for the first three months to a negative gap of (27.9)% for the thirteen to thirty-six month period. A negative gap can adversely affect earnings in periods of increasing interest rates. This negative position is due primarily to the short maturity of certificates of deposit and the significant increase in money market accounts.

Critical accounting policies

The accounting and reporting policies followed by the Company conform, in all material respects, to U.S. generally accepted accounting principles ("U.S. GAAP") which, effective for all interim and annual periods ending after September 15, 2009, principally consist of the Financial Standards Board Accounting Standards Codification ("FASB Codification"). FASB Codification Topic 105: Generally Accepted Accounting Principles establishes the FASB codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the FASB Codification carries an equal level of authority. All non-grandfathered, non SEC accounting literature not included in the FASB Codification is superseded and deemed non-authoritative. In preparing the consolidated financial statements, management has made estimates, assumptions and judgments based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements may reflect different estimates, assumptions and judgments. Certain policies inherently have greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation allowance to be established, or when an asset or liability must be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when readily available. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. The Company adjusts such estimates and assumptions when the Company believes facts and circumstances dictate. Illiquid credit markets, volatile equity, foreign currency and energy markets and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in the future periods.

The financial condition and results of operations presented in the financial statements, accompanying notes to the financial statements and management's discussion and analysis are, to a large degree, dependent upon the Company's accounting policies. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change. Presented below is discussion of those accounting policies that management believes are the most important accounting policies to the portrayal and understanding of our financial condition and results of operations.

These critical accounting policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood. See also Note 1 of the Notes to Consolidated Financial Statements filed with the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Allowance for loan losses

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

The allowance reflects management's best estimate of probable losses within the existing loan portfolio and of the risk inherent in various components of the loan portfolio, including loans identified as impaired as required by FASB Codification Topic 310: Receivables. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment. Loans may be placed back on accrual status when, in the opinion of management, the circumstances warrant such action such as a history of timely payments subsequent to being placed on nonaccrual status, additional collateral is obtained or the borrowers cash flows improve.

Loans are grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon estimates of default rates for a given loan grade, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

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

Loans held for sale

The Company, through the Bank's mortgage banking subsidiary, Village Bank Mortgage, originates residential mortgage loans for sale in the secondary market. Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value on an aggregate basis as determined by outstanding commitments from investors. Upon entering into a commitment to originate a loan, the Company locks in the loan and rate with an investor and commits to deliver the loan if settlement occurs on a best efforts basis, thus limiting interest rate risk. Certain additional risks exists that the investor fails to meet its purchase obligation, however, based on historical performance and the size and nature of the investors the company does not expect them to fail to meet their obligation. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Residential mortgage loans held for sale are sold to the permanent investor with the mortgage servicing rights released. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. This difference arises primarily as a result of the value of the mortgage servicing rights.

Once a residential mortgage loan is sold to a permanent investor, the Company has no further involvement or retained interest in the loan. There are limited circumstances in which the permanent investor can contractually require the Company to repurchase the loan. The Company makes no provision for any such recourse related to loans sold as history has shown repurchase of loans under these circumstances has been remote.

Income taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Deferred taxes are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management is also required to identify, estimate and disclose positions they have taken where the income tax treatment of the position taken is not 100% certain. Our evaluation of the deductibility or taxability of items included in the Company's tax returns has not resulted in the identification of any material, uncertain tax positions.

Impact of inflation and changing prices and seasonality

The Company's financial statements included herein have been prepared in accordance with generally accepted accounting principles in the United States, which require the Company to measure financial position and operating results primarily in terms of historical dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4 – CONTROLS AND PROCEDURES

Based upon an evaluation as of September 30, 2010 under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of the Company's disclosure controls and procedures, they have concluded that our disclosure controls and procedures, as defined in Rule 13a-15 and Rule 15d-15 under the Securities Exchange Act of 1934, as amended, are effective in ensuring that all material information required to be disclosed in reports that it files or submits under such Act is recorded, processed, summarized and is made known to management in a timely fashion.

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

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

Not applicable.

ITEM 1a. – RISK FACTORS

There have been no material changes to our risk factors as previously disclosed in Part I, Item IA of our Annual Report on Form 10K for the fiscal year ended December 31, 2009 other than the following:

The Dodd-Frank Wall Street Reform and Consumer Protection Act may affect our business activities, financial position and profitability by increasing our regulatory compliance burden and associated costs, placing restrictions on certain products and services, and limiting our future capital raising strategies.

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), which implements significant changes in the financial regulatory landscape and will impact all financial institutions, including Village Bank and Trust Financial Corp. and Village Bank. The Act is likely to increase our regulatory compliance burden. However, it is too early for us to fully assess the full impact of the Act on our business, financial condition or results of operations in part because many of the Act's provisions require subsequent regulatory rulemaking.

Among the Act's significant regulatory changes, it creates a new financial consumer protection agency, known as the Bureau of Consumer Financial Protection (the "Bureau"), that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer compliance, which will increase our regulatory compliance burden and costs and may restrict the financial products and services we offer to our customers. Moreover, the Act permits states to adopt stricter consumer protection laws and state attorney generals may enforce consumer protection rules issued by the Bureau. The Act also imposes more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred issuances from counting as Tier 1 capital. These restrictions will limit our future capital strategies. The Act also increases regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate and other hedging transactions.

Although certain provisions of the Act, such as direct supervision by the Bureau, will not apply to banking organizations with less than $10 billion of assets, such as Village Bank and Trust Financial Corp. and Village Bank, the changes resulting from the legislation will impact our business. These changes will require us to invest significant management attention and resources to evaluate and make necessary changes.

Effective July 6, 2010, regulatory changes in overdraft and interchange fee restrictions may reduce our non-interest income. We are currently in the process of evaluating this regulatory change, but have not fully quantified the full impact.

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 – REMOVED AND RESERVED

ITEM 5 – OTHER INFORMATION

Not applicable.

ITEM 6 – EXHIBITS

31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

VILLAGE BANK AND TRUST FINANCIAL CORP.
(Registrant)

Date: November 12, 2010 By: /s/Thomas W. Winfree
President and Chief Executive Officer

Date: November 12, 2010 By: /s/C. Harril Whitehurst, Jr.
Senior Vice President and Chief Financial Officer

Exhibit Index

Exhibit Number	Document
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350