F&M BANK CORP
Form 10-K
March 26, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For fiscal year ended December 31, 2008
Commission file number: 0-13273
F & M BANK CORP.
(Exact name of registrant as specified in its charter)

Virginia	**54-1280811**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

P. O. Box 1111, Timberville, Virginia 22853
(Address of principal executive offices) (Zip Code)
(540) 896-8941
(Registrant s telephone number including area code)
Securities registered pursuant to Section 12(b) of the Act: **None**
Securities registered pursuant to Section 12(g) of the Act:
Common Stock $5 Par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Sarbanes Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes o No þ

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

The registrant s Common Stock is traded Over-the-Counter under the symbol FMBM. The aggregate market value of the 2,113,716 shares of Common Stock of the registrant issued and outstanding held by non-affiliates on June 30, 2008 was approximately $68,188,478 based on the closing sales price of $32.26 per share on that date. For purposes of this calculation, the term affiliate refers to all directors and executive officers of the registrant.

As of the close of business on March 1, 2009, there were 2,287,897 shares of the registrant s Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Proxy Statement for the Annual Meeting of Shareholders to be held on May 9, 2009 (the Proxy Statement).

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PART I

Item 1. Business

General

F & M Bank Corp. (the Company or we), incorporated in Virginia in 1983, is a one-bank holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, and owns 100% of the outstanding stock of its two affiliates, Farmers & Merchants Bank (Bank) and TEB Life Insurance Company (TEB). Farmers & Merchants Financial Services, Inc. (FMFS) is a wholly owned subsidiary of Farmers & Merchants Bank. Farmers & Merchants Bank also holds a majority ownership in VBS Mortgage LLC. (VBS).

Farmers & Merchants Bank was chartered on April 15, 1908, as a state chartered bank under the laws of the Commonwealth of Virginia. TEB was incorporated on January 27, 1988, as a captive life insurance company under the laws of the State of Arizona. FMFS is a Virginia chartered corporation and was incorporated on February 25, 1993. VBS (formerly Valley Broker Services, Inc.) was incorporated on May 11, 1999. The Bank purchased a majority interest in VBS on November 3, 2008.

The Bank offers all services normally offered by a full-service commercial bank, including commercial and individual demand and time deposit accounts, repurchase agreements for commercial customers, commercial and individual loans, and drive-in banking services. TEB was organized to re-insure credit life and accident and health insurance currently being sold by the Bank in connection with its lending activities. FMFS was organized to write title insurance but now provides brokerage and other financial services to customers of Farmers & Merchants Bank. VBS originates conventional and government sponsored mortgages through two offices in Harrisonburg and Roanoke, VA.

The Bank makes various types of commercial and consumer loans and has a heavy concentration of residential and agricultural real estate loans. The local economy is relatively diverse with strong employment in the agricultural, manufacturing, service and governmental sectors.

The Company s and the Bank s principal executive office is at 205 South Main Street, Timberville, VA 22853, and its phone number is (540) 896-8941.

Filings with the SEC

The Company files annual, quarterly and other reports under the Securities Exchange Act of 1934 with the Securities and Exchange Commission (SEC). These reports are posted and are available at no cost on the Company s website, *www.farmersandmerchants.biz*, as soon as reasonably practicable after the Company files such documents with the SEC. The Company s filings are also available through the SEC s website at *www.sec.gov*.

Employees

On December 31, 2008, the Bank had 134 full-time and part-time employees; including executive officers, loan and other banking officers, branch personnel, operations personnel and other support personnel. None of the Company s employees is represented by a union or covered under a collective bargaining agreement. Management of the Company considers their employee relations to be excellent. No one employee devotes full-time services to F&M Bank Corp.

Competition

The Bank s offices face strong competition from numerous other financial institutions. These other institutions include large national and regional banks, other community banks, nationally chartered savings banks, credit unions, consumer finance companies, mortgage companies, loan production offices, mutual funds and life insurance companies. Competition for loans and deposits is affected by a variety of factors including interest rates, types of products offered, the number and location of branch offices, marketing strategies and the reputation of the Bank within the communities served.

Regulation and Supervision

General. The operations of F & M Bank Corp. and the Bank are subject to federal and state statutes, which apply to state member banks of the Federal Reserve System.

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The stock of F & M Bank Corp. is subject to the registration requirements of the Securities Act of 1934. F & M Bank Corp. is subject to the periodic reporting requirements of the Securities Exchange Act of 1934. These include, but are not limited to, the filing of annual, quarterly and other current reports with the Securities and Exchange Commission. As an Exchange Act reporting company, the Corporation is directly affected by the Sarbanes-Oxley Act of 2002, which is aimed at improving corporate governance and reporting procedures. The Corporation is complying with SEC and other rules and regulations implemented pursuant to Sarbanes-Oxley and intends to comply with any applicable rules and regulations implemented in the future.

F & M Bank Corp., as a bank holding company, is subject to the provisions of the Bank Holding Company Act of 1956, as amended (the Act). It is registered as such and is supervised by the Federal Reserve Board. The Act requires F & M Bank Corp. to secure the prior approval of the Federal Reserve Board before F & M Bank Corp. acquires ownership or control of more than 5% of the voting shares or substantially all of the assets of any institution, including another bank.

As a bank holding company, F & M Bank Corp. is required to file with the Federal Reserve Board an annual report and such additional information as it may require pursuant to the Act. The Federal Reserve Board may also conduct examinations of F & M Bank Corp. and any or all of its subsidiaries. Under Section 106 of the 1970 Amendments to the Act and the regulations of the Federal Reserve Board, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with an extension of credit, provision of credit, sale or lease of property or furnishing of services.

Federal Reserve Board regulations permit bank holding companies to engage in non-banking activities closely related to banking or to managing or controlling banks. These activities include the making or servicing of loans, performing certain data processing services, and certain leasing and insurance agency activities. Since 1994, the Company has entered into agreements with the Virginia Community Development Corporation to purchase equity positions in the Housing Equity Fund of Virginia II, III, IV, V, VII, VIII, IX, X, Historic Equity Fund I and Local & Historic Fund II. These funds provide housing for low-income individuals throughout Virginia. Approval of the Federal Reserve Board is necessary to engage in any of the activities described above or to acquire interests engaging in these activities.

The Bank as a state member bank is supervised and regularly examined by the Virginia Bureau of Financial Institutions and the Federal Reserve Board. Such supervision and examination by the Virginia Bureau of Financial Institutions and the Federal Reserve Board is intended primarily for the protection of depositors and not for the stockholders of F & M Bank Corp.

Payment of Dividends. The Company is a legal entity, separate and distinct from its subsidiaries. A significant portion of the revenues of the Company result from dividends paid to it by the Bank. There are various legal limitations applicable to the payment of dividends by the Bank to the Company. Under the current regulatory guidelines, prior approval from the Board of Governors of the Federal Reserve System is required if cash dividends declared in any given year exceed net income for that year, plus retained net profits of the two preceding years. The payment of dividends by the Bank or the Company may also be limited by other factors, such as requirements to maintain capital above regulatory guidelines.

Bank regulatory agencies have the authority to prohibit the Bank or the Company from engaging in an unsafe or unsound practice in conducting their businesses. The payment of dividends, depending on the financial condition of the Bank, or the Company, could be deemed to constitute such an unsafe or unsound practice. Based on the Bank s current financial condition, the Company does not expect that any of these laws will have any impact on its ability to obtain dividends from the Bank.

Capital Requirements. The Federal Reserve has issued risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, regulatory agencies may from time to time require that a banking organization maintain capital above the minimum levels because of its financial condition or actual or anticipated growth. Under the risk-based capital requirements, the Company and Bank are required to maintain a minimum ratio of total capital to risk-weighted assets of at least 8%. At least half of the total capital is required to be Tier 1 capital , which consists principally of common and certain qualifying preferred shareholders equity (including Trust Preferred Securities), less certain intangibles and other adjustments. The remainder (Tier 2 capital) consists of a limited amount of subordinated and other qualifying debt (including certain hybrid capital instruments) and a limited amount of the

general loan loss allowance. The Tier 1 and total capital to risk-weighted asset ratios of the Company as of December 31, 2008 were 9.44% and 10.04%, respectively, exceeding the minimum requirements.

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In addition, each of the federal regulatory agencies has established a minimum leverage capital ratio (Tier 1 capital to average adjusted assets) (Tier 1 leverage ratio). These guidelines provide for a minimum Tier 1 leverage ratio of 4% for banks and bank holding companies that meet certain specified criteria, including that they have the highest regulatory examination rating and are not contemplating significant growth or expansion. The Tier 1 leverage ratio of the Company as of December 31, 2008, was 7.64%, which is above the minimum requirements. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

The Gramm-Leach-Bliley Act. Effective on March 11, 2001, the Gramm-Leach-Bliley Act (the GLB Act) allows a bank holding company or other company to certify status as a financial holding company, which will allow such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker; underwriting; dealing in or making markets in securities; and engaging in merchant banking under certain restrictions. It also authorizes the Federal Reserve to determine by regulation what other activities are financial in nature, or incidental or complementary thereto.

USA Patriot Act of 2001. In October, 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Northern Virginia which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcements and the intelligence communities abilities to work cohesively to combat terrorism on a variety of fronts. The continuing and potential impact of the Patriot Act and related regulations and policies on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws, and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Community Reinvestment The requirements of the Community Reinvestment Act are also applicable to the Bank. The act imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution s efforts in meeting community needs currently are evaluated as part of the examination process pursuant to twelve assessment factors. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or facility.

Forward-Looking Statements

F & M Bank Corp. makes forward-looking statements in the Management s Discussion and Analysis of Financial Condition and Results of Operations and in other portions of this Annual Report on Form 10-K that are subject to risks and uncertainties. These forward-looking statements include: estimates of risks and of future costs and benefits; assessments of probable loan losses and statements of goals and expectations. These forward-looking statements are subject to significant uncertainties because they are based upon management s estimates and projections of future interest rates and other economic conditions; future laws and regulations; and a variety of other matters. As a result of these uncertainties, actual results may be materially different from the results indicated by these forward-looking statements. In addition, the Company s past results of operations do not necessarily indicate its future results.

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Item 1A. Risk Factors

General economic conditions, either national or within the Company s local markets.

The Company is affected by general economic conditions in the United States and the local markets within which it operates. An economic downturn within the Company s markets, or the nation as a whole; a significant decline in general economic conditions caused by inflation, recession, unemployment or other factors beyond the Company s control could negatively impact the growth rate of loans and deposits, the quality of the loan portfolio, loan and deposit pricing and other key factors of the Company s business. Such negative developments could adversely impact the Company s financial condition and performance.

Changes in interest rates could affect the Company s income and cash flows.

The direction and speed of interest rate changes affects our net interest margin and net interest income. Typically, in a period of declining interest rates our net interest income is negatively affected in the short term as our interest earning assets (primarily loans and investment securities) reprice more quickly than our interest bearing liabilities (deposits and borrowings).

We attempt to mitigate this risk by maintaining a neutral position regarding the volume of assets and liabilities that mature or reprice during any period; however, interest rate fluctuations, loan prepayments, loan production and deposit flows constantly change and influence the ability to maintain a neutral position. Generally speaking, the Company s earnings will be more sensitive to fluctuations in interest rates the greater the variance in volume of assets and liabilities that mature and reprice in any period. Accordingly, the Company may not be successful in maintaining a neutral position and, as a result, the Company s net interest margin may be impacted.

The Company faces substantial competition that could adversely affect the Company s growth and/or operating results.

The Company operates in a competitive market for financial services and faces intense competition from other financial institutions both in making loans and in attracting deposits. Many of these financial institutions have been in business for many years, are significantly larger, have established customer bases, and have greater financial resources and lending limits.

There could be an adverse effects on the way in which we do business if we do not maintain our capital requirements and our status as a well-capitalized bank.

The Bank is subject to regulatory capital adequacy guidelines. If the Bank fails to meet the capital adequacy guidelines for a well-capitalized bank, it could increase the regulatory scrutiny for the Bank and the Company; increase our FDIC insurance premiums, and could lead to a decline in the confidence that our customers have in us and a reduction in the demand for our products and services.

The inability of the Company to successfully manage its growth or implement its growth strategy may adversely affect the result of operations and financial conditions.

The Company may not be able to successfully implement its growth strategy if unable to identify attractive markets, locations or opportunities to expand in the future. The ability to manage growth successfully also depends on whether the Company can maintain capital levels adequate to support its growth, maintain cost controls, asset quality and successfully integrate any businesses acquired into the organization.

As the Company continues to implement its growth strategy by opening new branches it expects to incur increased personnel, occupancy and other operating expenses. The Company must absorb those higher expenses while it begins to generate new deposits, and there is a further time lag involved in redeploying new deposits into attractively priced loans and other higher yielding earning assets. Thus, the Company s plans to branch could depress earnings in the short run, even if it efficiently executes a branching strategy leading to long-term financial benefits.

The Company s exposure to operational risk may adversely affect the Company.

Similar to other financial institutions, the Company is exposed to many types of operational risk, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems.

The Company s concentration in loans secured by real estate may adversely impact earnings due to changes in the real estate markets.

The Company offers a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, home equity, consumer and other loans. Many of the Company s loans are secured by real estate (both residential and commercial) in the Company s market area. A major change in the real estate market, resulting in deterioration in the value of this collateral, or in the local or national economy, could adversely affect the customers ability to pay these loans, which in turn could impact the Company. Risk of loan defaults and foreclosures are unavoidable in the banking industry, and the Company tries to limit its exposure to this risk by monitoring extensions of credit carefully. The Company cannot fully eliminate credit risk, and as a result credit losses may occur in the future.

Legislative or regulatory changes or actions, or significant litigation, could adversely impact the Company or the businesses in which the Company is engaged.

The Company is subject to extensive state and federal regulation, supervision and legislation that govern almost all aspects of its operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact the Company or its ability to increase the value of its business. Additionally, actions by regulatory agencies or significant litigation against the Company could cause it to devote significant time and resources to defending itself and may lead to penalties that materially affect the Company and its shareholders. Future changes in the laws or regulations or their interpretations or enforcement could be materially adverse to the Company and its shareholders.

Changes in accounting standards could impact reported earnings.

The accounting standard setters, including the FASB, SEC and other regulatory bodies, periodically change the financial accounting and reporting standards that govern the preparation of the Company s consolidated financial statements. These changes can be hard to predict and can materially impact how it records and reports its financial condition and results of operations. In some cases, the Company could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements.

Item 1B. Unresolved Staff Comments

The Company does not have any unresolved staff comments to report for the year ended December 31, 2008.

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Item 2 Description of Properties

The locations of F & M Bank Corp., Inc. and its subsidiaries are shown below.

Timberville Main Office
205 South Main Street
Timberville, VA 22853

Elkton Branch
127 West Rockingham Street
Elkton, VA 22827

Broadway Branch
126 Timberway
Broadway, VA 22815

Port Road Branch
1085 Port Republic Road
Harrisonburg, VA 22801

Bridgewater Branch
100 Plaza Drive
Bridgewater, VA 22812

Edinburg Branch
120 South Main Street
Edinburg, VA 22824

Woodstock Branch
161 South Main Street
Woodstock, VA 22664

Crossroads Branch
80 Cross Keys Road
Harrisonburg, VA 22801

Luray Branch
700 East Main Street
Luray, VA 22835

With the exception of the Edinburg Branch, Port Road Branch and the Luray Branch, all facilities are owned by Farmers & Merchants Bank. ATMs are available at all locations, with the exception of Edinburg.

Through an agreement with Nationwide Money ATM Services, the Bank also operates cash only ATMs at five Food Lion grocery stores, one in Mt. Jackson, VA and four in Harrisonburg, VA.

VBS has two offices located at:

Harrisonburg Office
2040 Deyerle Avenue
Suite 102
Harrisonburg, VA 22801

Roanoke Office
4519 Brambleton Avenue
Suite 210
Roanoke, VA 24018

Item 3. Legal Proceedings

In the normal course of business, the Company may become involved in litigation arising from banking, financial, or other activities of the Company. Management after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Company s financial condition, operating results or liquidity.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders of the Company during the fourth quarter of the period covered by this report.

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Stock Listing

The Company s Common Stock trades under the symbol FMBM on the OTC Bulletin Board. The bid and asked price of the Company s stock is not published in any newspaper. Although several firms in both Harrisonburg and Richmond, Virginia occasionally take positions in the Company stock, they typically only match buyers and sellers.

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Transfer Agent and Registrar
Farmers & Merchants Bank
205 South Main Street
P.O. Box 1111
Timberville, VA 22853

Stock Performance

The following graph compares the cumulative total return to the shareholders of the Company for the last five fiscal years with the total return of the Russell 2000 Index and the SNL Bank Index, as reported by SNL Financial, LC, assuming an investment of $100 in the Company s common stock on December 31, 2003, and the reinvestment of dividends.

	Period Ending December 31,					
Index	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
F & M Corp	100.00	120.35	123.78	138.00	156.38	156.74
Russell 2000	100.00	118.33	123.72	146.44	144.15	95.44
SNL Bank Index	100.00	112.06	113.59	132.87	103.25	58.91

Recent Stock Prices and Dividends

Dividends to shareholders totaled $2,083,000 and $2,031,000 in 2008 and 2007, respectively. Regular quarterly dividends have been declared for fifty six consecutive quarters. Dividends per share increased 4.65% in 2008.
The ratio of dividends per share to net income per share was 65.01% in 2008, compared to 45.60% in 2007. The decision as to timing, amount and payment of dividends is at the discretion of the Company s Board of Directors. The payment of dividends depends on the earnings of the Company and its subsidiaries, the financial condition of the Company and other factors including capital adequacy, regulatory requirements, general economic conditions and shareholder returns.

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Stock Repurchases

As previously reported, on September 18, 2008, the Company s Board of Directors approved an increase in the number of shares of common stock that the Company can repurchase under the share repurchase program from 150,000 to 200,000 shares. Shares repurchased through the end of 2008 totaled 162,010 shares; of this amount, 58,344 shares were repurchased in 2008, at an average cost of $30.52 per share.

The number of common shareholders of record was approximately 1,665 as of March 1, 2009. This amount includes all shareholders, whether titled individually or held by a brokerage firm or custodian in street name.

Quarterly Stock Information

These quotes include the terms of trades transacted through a broker. The terms of exchanges occurring between individual parties may not be known to the Company.

	2008			**2007**		
	Per Share Range		**Per Share**	**Stock Price Range**		**Per Share**
Quarter	**Low**	**High**	**Dividend**	**Low**	**High**	**Dividend**
1st	29.50	32.05	$ .22	28.15	33.00	$ 0.21
2nd	31.75	32.50	.22	30.00	33.75	0.21
3rd	30.10	33.00	.23	30.00	33.00	0.22
4th	28.80	31.50	.23	31.00	33.25	0.22
Total			$ .90			$ 0.86

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Item 6. Selected Financial Data
Five Year Summary of Selected Financial Data

(Dollars in thousands, except per share data)	**2008**	**2007**	**2006**	**2005**	**2004**
Income Statement Data:					
Interest and Dividend Income	$ 25,544	$ 24,635	$ 22,526	$ 19,878	$ 16,804
Interest Expense	10,498	11,043	9,091	6,998	5,396
Net Interest Income	15,046	13,592	13,435	12,880	11,408
Provision for Loan Losses	815	270	240	360	240
Net Interest Income after Provision for Loan Losses	14,231	13,322	13,195	12,520	11,168
Noninterest Income	3,169	3,215	2,754	2,643	2,254
Securities Gains (Losses)	(1,680)	101	193	71	532
Noninterest Expenses	11,097	10,532	9,688	8,608	7,741
Income before Income Taxes	4,623	6,106	6,454	6,626	6,213
Income Tax Expense	1,419	1,653	1,925	1,846	1,863
Net Income	$ 3,204	$ 4,453	$ 4,529	$ 4,780	$ 4,350
Per Share Data:					
Net Income	$ 1.38	$ 1.89	$ 1.90	$ 1.99	$ 1.80
Dividends Declared	.90	.86	.82	.78	.74
Book Value	15.64	16.71	16.05	15.22	14.21
Balance Sheet Data:					
Assets	$ 472,058	$ 386,727	$ 375,924	$ 346,328	$ 369,957
Loans Held for Investment	399,233	317,180	309,461	277,398	248,972
Loans Held for Sale	3,780			3,528	47,150
Securities	30,785	36,614	37,373	34,921	38,800
Deposits	342,225	298,560	289,522	267,310	246,505
Short-Term Debt	20,510	12,743	11,717	14,345	57,362
Long-Term Debt	65,331	29,714	29,247	22,808	26,462
Shareholders Equity	36,258	39,165	38,105	36,567	34,260
Average Shares Outstanding	2,319	2,360	2,386	2,404	2,414
Financial Ratios:					
Return on Average Assets[1]	.75%	1.17%	1.26%	1.34%	1.31%
Return on Average Equity[1]	8.50%	11.53%	12.13%	13.56%	13.11%
Net Interest Margin	3.89%	3.94%	4.17%	4.01%	3.82%
Efficiency Ratio [2]	58.60%	60.31%	57.45%	53.07%	54.02%
Dividend Payout Ratio	65.01%	45.60%	43.12%	38.70%	41.06%

Capital and Credit Quality Ratios:					
Average Equity to Average Assets[1]	8.85%	10.05%	10.36%	9.86%	10.00%
Allowance for Loan Losses to Loans[3]	.55%	.54%	.58%	.60%	.61%
Nonperforming Assets to Total Assets	1.01%	1.11%	.58%	.20%	.63%
Net Charge-offs to Total Loans[3]	.08%	.11%	.04%	.07%	.09%

[1] Ratios are primarily based on daily average balances.

[2] The Efficiency Ratio equals noninterest expenses divided by the sum of tax equivalent net interest income and noninterest income. Noninterest expenses exclude intangible asset amortization. Noninterest income excludes gains (losses) on securities transactions.

[3] Calculated based on Loans Held for Investment, excludes Loans Held for Sale.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides information about the major components of the results of operations and financial condition, liquidity and capital resources of F & M Bank Corp. and its subsidiaries. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements presented in Item 8, Financial Statements and Supplementary Information, of this Form 10-K.

Critical Accounting Policies

General

The Company s financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within the statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. The Company s financial position and results of operations are affected by management s application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company s consolidated financial position and/or results of operations. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of these transactions would be the same, the timing of events that would impact these transactions could change. Following is a summary of the Company s significant accounting policies that are highly dependent on estimates, assumptions and judgments.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) Statement of Financial Accounting Standard (SFAS) No. 5, Accounting for Contingencies , which requires that losses be accrued when they are probable of occurring and estimable and (ii) SFAS No. 114, Accounting by Creditors for Impairment of a Loan , which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The Company s allowance for loan losses is the accumulation of various components that are calculated based on independent methodologies. All components of the allowance represent an estimation performed pursuant to either SFAS No. 5 or SFAS No. 114. Management s estimate of each SFAS No. 5 component is based on certain observable data that management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; loan volumes; geographic, borrower and industry concentrations; seasoning of the loan portfolio; the findings of internal credit quality assessments and results from external bank regulatory examinations. These factors, as well as historical losses and current economic and business conditions, are used in developing estimated loss factors used in the calculations.

Allowances for commercial loans are determined by applying estimated loss factors to the portfolio based on management s evaluation and risk grading of the commercial loan portfolio. Allowances are provided for noncommercial loan categories using estimated loss factors applied to the total outstanding loan balance of each loan category. Specific allowances are typically provided on all impaired commercial loans in excess of a defined threshold that are classified in the Special Mention, Substandard or Doubtful risk grades. The specific reserves are determined on a loan-by-loan basis based on management s evaluation the Company s exposure for each credit, given the current payment status of the loan and the value of any underlying collateral.

While management uses the best information available to establish the allowance for loan and lease losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or, if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

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Goodwill and Intangibles

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Additionally, it further clarifies the criteria for the initial recognition and measurement of intangible assets separate from goodwill. SFAS No. 142 was effective for fiscal years beginning after December 15, 2001 and prescribes the accounting for goodwill and intangible assets subsequent to initial recognition. The provisions of SFAS No. 142 discontinue the amortization of goodwill and intangible assets with indefinite lives. Instead, these assets are subject to an annual impairment review and more frequently if certain impairment indicators are in evidence. SFAS No. 142 also requires that reporting units be identified for the purpose of assessing potential future impairments of goodwill.

The Company adopted SFAS No. 142 on January 1, 2002. Goodwill totaled $2,639,000 at January 1, 2002. The goodwill is not amortized but is tested for impairment at least annually. Based on this testing, there were no impairment charges for 2008 or 2007. Application of the non-amortization provisions of the Statement resulted in additional net income of $120,000 for each of the years ended December 31, 2008, 2007 and 2006.

Core deposit intangibles are amortized on a straight-line basis over a ten year life. Core deposit intangible, net of amortization, amounted to $598,000 and $874,000 at December 31, 2008 and 2007, respectively. The Company adopted SFAS 147 on January 1, 2002 and determined that the core deposit intangible will continue to be amortized over its estimated useful life.

Securities Impairment

The Company evaluates each of its investments in securities, debt and equity, under guidelines contained in SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities.* These guidelines require the Company to determine whether a decline in value below original cost is other than temporary. In making its determination, management considers current market conditions, historical trends in the individual securities, and historical trends in the overall markets. Expectations are developed regarding potential returns from dividend reinvestment and price appreciation over a reasonable holding period (five years) and current carrying values are compared to these expected values. Declines determined to be other than temporary are charged to operations and included in the gain (loss) on security sales. Such charges were $1,759,000 for 2008, $171,000 for 2007 and $40,000 for 2006.

Overview

The Company s net income for 2008 totaled $3,204,000 or $1.38 per share, down 28.05% from $4,453,000 or $1.89 a share in 2007. Return on average equity decreased in 2008 to 8.50% versus 11.53% in 2007, while the return on average assets decreased from 1.17% to.75%. The Company s operating earnings, which are net earnings excluding gains (losses) on the sale of investments, non-recurring tax entries and other non-recurring income was $4,399,000 in 2008 versus $4,125,000 in 2007, an increase of 6.64%. Core profitability increased as a result of the growth in net interest income, which was driven by the significant loan portfolio growth of the Bank.

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See page 10 for a five-year summary of selected financial data.

Changes in Net Income per Common Share

	2008 to 2007	2007 to 2006
Prior Year Net Income Per Share	$ 1.89	$ 1.90
Change from differences in:		
Net interest income	.73	.13
Provision for credit losses	(.24)	(.01)
Noninterest income, excluding securities gains	(.01)	.21
Securities gains	(.76)	(.04)
Noninterest expenses	(.32)	(.41)
Income taxes	.09	.11
Total Change	(.51)	(.01)
Net Income Per Share	$ 1.38	$ 1.89

Net Interest Income

The largest source of operating revenue for the Company is net interest income, which is calculated as the difference between the interest earned on earning assets and the interest expense paid on interest bearing liabilities. The net interest margin is the net interest income expressed as a percentage of interest earning assets. Changes in the volume and mix of interest earning assets and interest bearing liabilities, along with their yields and rates, have a significant impact on the level of net interest income.

Net interest income for 2008 was $15,046,000 representing an increase of $1,454,000 or10.70%. A 1.17% increase in 2007 versus 2006 resulted in total net interest income of $13,592,000. In this discussion and in the tabular analysis of net interest income performance, entitled Consolidated Average Balances, Yields and Rates, (found on page 14), the interest earned on tax exempt loans and investment securities has been adjusted to reflect the amount that would have been earned had these investments been subject to normal income taxation. This is referred to as tax equivalent net interest income.

Loans held for investment, expressed as a percentage of total earning assets, increased slightly in 2008 to 90.44% as compared to 89.37% in 2007. Tax equivalent income on earning assets increased $961,000, supported by the increase in loan income of $1,338,000.

During 2008, yields on earning assets decreased .53%, primarily due to a.56% decrease in the yield on loans held for investment. This decrease is consistent with declining market rates resulting from Federal Reserve interest rate cuts and a slowing economy.

The average cost of interest bearing liabilities decreased .66% in 2008, following an increase of .47% in 2007. The decrease in average cost resulted following action by the Federal Reserve s Federal Open Market Committee (FOMC), which cut the Federal Funds rate on seven occasions in 2008. These rate cuts were in response to the aforementioned slowing in the national economy following the subprime mortgage crisis and resulting capital markets crisis.

The analysis on the next page reveals a slight decrease in net interest margin to 3.89% in 2008 primarily due to changes in balance sheet leverage as loan growth was funded primarily by increasing long-term debt rather than through core deposits.

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Consolidated Average Balances, Yields and Rates[1]

	2008			2007			2006		
	Balance	Interest	Rate	Balance	Interest	Rate	Balance	Interest	Rate
ASSETS									
Loans:[2]									
Commercial	$ 128,815	7,976	6.19%	$ 98,027	7,629	7.78%	$ 87,343	$ 6,755	7.73%
Real estate	195,743	13,061	6.67%	185,383	12,415	6.70%	181,022	12,143	6.71%
Installment	31,239	2,735	8.76%	29,516	2,606	8.83%	25,867	2,147	8.30%
Loans held for investment	355,797	23,772	6.68%	312,926	22,650	7.24%	294,232	21,045	7.15%
Loans held for sale	5,816	238	4.09%	296	22	7.43%	140	9	6.43%
Investment securities:[3]									
Fully taxable	19,813	1,101	5.56%	23,743	1,341	5.65%	22,045	1,004	4.55%
Partially taxable	6,583	509	7.73%	7,116	488	6.86%	7,012	459	6.55%
Tax exempt	169	8	4.73%	287	14	4.88%	375	17	4.53%
Total investment securities	26,565	1,618	6.09%	31,146	1,843	5.92%	29,432	1,480	5.03%
Interest bearing deposits in banks	2,426	117	4.82%	1,821	123	6.75%	1,859	120	6.46%
Federal funds sold	2,821	50	1.77%	3,960	196	4.95%	1,298	64	4.93%
Total Earning Assets	393,425	25,795	6.56%	350,149	24,834	7.09%	326,961	22,718	6.95%
Allowance for loan losses	(1,946)			(1,747)			(1,737)		
Nonearning assets	34,748			32,972			35,246		
Total Assets	$ 426,227			$ 381,374			$ 360,470		

LIABILITIES AND STOCKHOLDERS EQUITY

Deposits:

Demand interest bearing	$ 58,682	$ 798	1.36%	$ 52,857	$ 1,172	2.22%	$ 40,833	581	1.42%
Savings	30,073	293	.97%	30,457	331	1.09%	37,954	446	1.18%
Time deposits	169,978	6,955	4.09%	168,005	7,819	4.65%	152,691	6,229	4.08%
Total interest bearing deposits	258,733	8,046	3.11%	251,319	9,322	4.00%	231,478	7,256	3.13%
Short-term debt	23,622	456	1.93%	11,040	502	4.55%	16,425	784	4.77%
Long-term debt	50,135	1,996	3.98%	26,940	1,219	4.52%	23,191	1,051	4.53%
Total interest bearing liabilities	332,490	10,498	3.16%	289,299	11,043	3.82%	271,094	9,091	3.35%
Noninterest bearing deposits	49,557			46,465			44,395		
Other liabilities	6,469			6,975			7,645		
Total liabilities	388,516			342,739			323,134		
Stockholders equity	37,711			38,635			37,336		
Total liabilities and stockholders equity	$ 426,227			$ 381,374			$ 360,470		
Net interest earnings		$ 15,297			$ 13,791			$ 13,627	
Net yield on interest earning assets (NIM)			3.89%			3.94%			4.17%

1 Income and yields are presented on a tax-equivalent basis using the applicable federal income tax rate.

2 Interest income on loans

includes loan fees.

[3] Average balance information is reflective of historical cost and has not been adjusted for changes in market value.

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The following table illustrates the effect of changes in volumes and rates.

	2008 Compared to 2007 Increase (Decrease)			2007 Compared to 2006 Increase (Decrease)		
	Due to Change in Average: Volume	Rate	Increase or (Decrease)	Due to Change in Average Volume	Rate	Increase or (Decrease)
Interest income:						
Loans held for investment	$ 3,104	$ (1,982)	$ 1,122	$ 1,337	$ 268	$ 1,605
Loans held for sale	410	(194)	216	10	3	13
Investment securities:						
Taxable	(222)	(18)	(240)	77	260	337
Partially taxable	(37)	58	21	7	22	29
Tax exempt	(6)		(6)	(4)	1	(3)
Interest bearing deposits in banks	41	(47)	(6)	(2)	5	3
Federal funds sold	(56)	(90)	(146)	131	1	132
Total Interest Income	3,234	(2,273)	961	1,556	560	2,116
Interest expense:						
Deposits:						
Demand	129	(503)	(374)	171	420	591
Savings	(4)	(34)	(38)	(88)	(27)	(115)
Time deposits	92	(956)	(864)	625	965	1,590
Short-term debt	572	(618)	(46)	(257)	(25)	(282)
Long-term debt	1,048	(271)	777	170	(2)	168
Total Interest Expense	1,837	(2,382)	(545)	621	1,331	1,952
Net Interest Income	$ 1,397	$ 109	$ 1,506	$ 935	$ (771)	$ 164

Note: Volume changes have been determined by multiplying the prior years average rate by the change in average balances outstanding. The rate change is the difference between the total change and the volume change.

Interest Income

Tax equivalent interest income increased $961,000 or 3.87% in 2008, after increasing 9.31% or $2,116,000 in 2007. Overall, the yield on earning assets decreased .53 %, from 7.09% to 6.56%. Loans grew at a record pace during 2008, with average loans outstanding increasing $42,871,000 to $355,797,000. Real estate loans increased 5.59% and commercial loans increased 31.41%. Combined these categories accounted for 95.98% of the total increase in year ending loans. The increase in both residential real estate and commercial loans is primarily the result of market conditions and recent additions to the lending staff. Market conditions contributed as other banks began to pull back on lending due to their rising loan losses or exposure to subprime lending. Our lending personnel contributed to our growth as we have recently added several business development officers that have experience with other institutions.

These officers continue to be successful in bringing former and new customers to the Bank.
Average total securities, yielding 6.09%, decreased $4,581,000 during 2008. Proceeds from the sale and maturity of investment securities were used to fund (in part) the growth in the loan portfolio. Income on loans held for sale totaled $238,000, as compared to the $22,000 during 2007. The bank entered into this participation arrangement as a higher yielding alternative to federal funds sold. Due to the slowdown in secondary market lending, there was very little activity on this participation commitment during 2006 or 2007. However, as market rates began to fall in the early part of 2008 the originating bank had an increased need for participating banks to fund a portion of these loans. The Bank purchases a 95% participation interest in these loans. These participations are short-term, real estate loan participations that have an average life of approximately ten days. The Bank holds its participation interest in these loans during the period of time between loan closing and when the loan is paid off by the secondary market purchaser.

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Interest Expense

Interest expense decreased $545,000 or 4.94% during 2008, which followed a 21.47% increase $1,952,000 in 2007. The average cost of funds of 3.16% decreased .66% compared to 2007. Average interest bearing liabilities increased $43,191,000 in 2008 following an increase of $18,205,000 in 2007. Due to competition within the local market for deposits, the Bank experienced very little deposit growth during 2008. The increase in interest bearing liabilities was primarily the result of an increase in short and long term debt, which supported the growth of the loan portfolio. Expense of long-term debt increased $777,000 in 2008 after an increase of $168,000 in 2007. The average cost of long term debt declined from 4.52% in 2007 to 3.98% in 2008, with the increase in interest expense resulting from an increase of $23,195,000 in average long term debt outstanding for the year. The Company borrowed $39,747,000 in 2008 and $10,000,000 in 2007. Changes in the cost of funds attributable to rate and volume variances can be found in the table at the top of page 14.

Noninterest Income

Noninterest income continues to be an increasingly important factor in maintaining and growing profitability. Management is conscious of the need to constantly review fee income and develop additional sources of complementary revenue. The Bank continues to enjoy significant revenue from its subsidiary Farmers & Merchants Financial Services (FMFS). However, gross revenue for FMFS decreased $68,000 in 2008. This decrease resulted primarily from a reduction in brokerage income as sales of investment products declined due to concerns over stock market volatility and the slowing of the national economy.

Exclusive of losses, non-interest income decreased 1.43% ($46,000) in 2008 following an increase of 16.75% in 2007. Investments in bank owned life insurance (BOLI) on officers of the Company resulted in tax-free income of $336,000 and $293,000 in 2008 and 2007. Investments in low income housing projects resulted in non-interest income of $102,000 in 2008 and $227,000 in 2007, a decrease of $125,000. This decrease is primarily the result of a decline in non-recurring state tax credits received on the Company s investment in one of its low income housing projects. Securities transactions in 2008 resulted in losses of $1,681,000 after recognition of impairment write-downs totaling $1,759,000 on several holdings within the equities portfolio. This followed a gain of $101,000 in 2007. The losses within the securities portfolio were not the result of securities actually sold, but due to the recognition of Other Than Temporary Impairment (OTTI) losses on securities that declined significantly in value. Typically securities are considered impaired when their value has been significantly below cost for over a year. With the continued decline in the stock market, there will likely be more OTTI losses in 2009 unless the markets experience a rapid and significant recovery.

Noninterest Expense

Noninterest expenses increased from $10,532,000 in 2007 to $11,097,000 in 2008, a 5.36% increase. Salary and benefits increased 5.77% to $6,623,000 in 2008 and 9.32% in 2007. The 2008 increase resulted from additions to staff to support Bank growth and expansion, normal salary adjustments and increases in insurance costs.. Occupancy and equipment expense decreased 5.85% ($71,000) in 2008, following a 13.18% increase in 2007. The decrease in 2008 was primarily the result in reduced depreciation expense as a result of equipment that became fully depreciated in late 2007 and remained in service during 2008. The increase in 2007 was due to ATM upgrades, new vehicles, computer equipment and full year costs associated with three branch offices that were opened at various dates during 2006. Other operating expense increased $274,000 in 2008, following a $170,000 increase in 2007. Much of the increase was due to an increase in FDIC assessments, data processing and legal fees. During 2008, noninterest expenses dropped as a percentage of total assets due to the rapid growth in total assets. Noninterest expenses continue to be substantially lower than peer group averages. Total noninterest expense as a percentage of average assets totaled 2.60%, 2.76%, and 2.69%, in 2008, 2007 and 2006, respectively. Peer group averages have ranged between 3.23% and 3.44% over the same time period.

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Provision for Loan Losses

Management evaluates the loan portfolio in light of national and local economic trends, changes in the nature and volume of the portfolio and industry standards. Specific factors considered by management in determining the adequacy of the level of the allowance for loan losses include internally generated loan review reports, past due reports and historical loan loss experience. This review also considers concentrations of loans in terms of geography, business type and level of risk. Management evaluates nonperforming loans relative to their collateral value and makes the appropriate adjustments to the allowance for loan losses when needed. Based on the factors outlined above, the current year provision for loan losses increased from $270,000 in 2007 to $815,000 in 2008. The increase in the provision was due primarily to the rapid portfolio growth and its impact on the calculation of the reserves needed based on historic loss rates and allocations for environmental factors that are driven in part by portfolio size.

Actual net loan charge-offs were $329,000 in 2008 and $358,000 in 2007. Loan losses as a percentage of average loans held for investment totaled .09 % and .12% in 2008 and 2007, respectively. This loss rate is significantly better than peer group averages which were .84% in 2008 and .25% in 2007.

Of the $329,000 in net charge-offs during 2008, $286,000 resulted from one commercial loan relationship that was charged off during the year. This loan resulted from a restructuring, during 2007, of several loans to several service related businesses that were non-performing. The restructured loan performed as agreed for approximately six months before deteriorating and becoming a non-performing asset. While there were deficiencies in collateral perfection, the principal reason for the impairment was poor management which resulted in a decline in the business (closure of two of the businesses) and a decrease in resale value.

During 2007, this loan was written down due to impairment and accounted for $293,000 of the Bank s $358,000 in net charge-offs. The loan was not charged off in full during 2007, because as of yearend there were ongoing negotiations for the possible sale of the business or possible reaffirmation of a part of the debt. At the end of 2007 the remaining loan balance which was still carried was listed as a non-accrual asset and was fully reserved in the allowance for loan loss calculation as an impaired asset, pending the outcome of asset sales and bankruptcy proceedings. The aforementioned sale of the business and/or reaffirmation did not occur. Following receipt of proceeds from asset sales and bankruptcy liquidation, the remainder of the loan was charged off in 2008.Funding of the allowance for loan losses was increased in 2008 in part to account for the remaining loss that was anticipated on this relationship.

Balance Sheet

Total assets increased 22.06% during the year to $472,058,000, an increase of $85,331,000 from $386,727,000 in 2007. Earning assets increased 24.20% or $84,866,000 to $435,501,000 at December 31, 2008. Much of the increase in earning assets resulted from growth in the portfolio of loans held for investment which totaled $399,233,000 at year end 2008. Deposit growth for 2008 totaled $43,666,000 or 14.63%; however local deposits increased only $16 million, with non-local, brokered deposits and Federal Home Loan Bank debt providing the bulk of the funding for loan growth. The Company continues to utilize its assets well with 92.27% of year-end assets consisting of earning assets.

Investment Securities

Average balances in investment securities decreased 14.71% in 2008 to $26,565,000. Proceeds from the sale or maturity of investments were used in part to support loan growth and for debt repayment. At year end, 5.13% of earning assets of the Company were held as investment securities to provide liquidity, as security for public deposits and to secure repurchase agreements. Management strives to match the types and maturities of securities owned to balance projected liquidity needs, interest rate sensitivity and to maximize earnings through a portfolio bearing low credit risk. Portfolio yields averaged 6.09% for 2008, up from 5.92% in 2007. Average yields on the investment portfolio now exceed peer group averages primarily due to a lengthening of asset maturities within the bond portfolio of the Bank and additional investments in dividend yielding investments held by the Company. It is anticipated that these yields will fall in 2009 as maturing debt securities reprice at lower yields and as some of the issuers of equity securities have recently cut dividends due to the weakening economy.

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The Company recognized losses totaling $1,681,000 on its equities portfolio. Of this amount, $1,759,000 in losses resulted from Other Than Temporary Impairment (OTTI) write-downs on several of its holdings. Management considers a number of factors in determining whether to recognize OTTI on any of its securities, including current market conditions, historical trends in individual securities, historical trends in the overall market and length of time that a security has been below cost. Additional information on the securities impairment write-downs can be found on page 12 under the caption Securities Impairment and page 16 under the caption Noninterest Income .

The composition of securities at December 31 was:

(Dollars in thousands)	**2008**	**2007**	**2006**
Available for Sale:[1]			
U.S. Treasury and Agency	$ 10,194	$ 16,459	$ 18,945
Municipal	125	250	369
Mortgage-backed[2]	8,574	5,411	2,506
Corporate bonds	281	2,426	2,437
Marketable equity securities	3,063	5,668	6,508
Total	22,237	30,214	30,765
Held to Maturity:			
U.S. Treasury and Agency	110	109	110
Total	110	109	110
Other Equity Investments	8,439	6,291	6,498
Total Securities	$ 30,786	$ 36,614	$ 37,373

[1] At estimated fair value.

[2] Issued by a U.S. Government Agency or secured by U.S. Government Agency collateral.

Maturities and weighted average yields of debt securities at December 31, 2008 are presented in the table below. Amounts are shown by contractual maturity; expected maturities will differ as issuers may have the right to call or prepay obligations.

	Years to Maturity							
	Less than one		One to Five		Over Five			
(Dollars in thousands)	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Total**	**Yield**

Debt Securities Available for Sale:								
U.S. Treasury & Agency	$ 4,095	5.32%	$ 6,099	4.70%	$		$ 10,194	4.95%
Municipal	125	4.95%					125	4.95%
Mortgage-backed					8,574	5.14%	8,574	5.14%
Corporate bonds					281	17.07%	281	17.07%
Total	$ 4,220	5.31%	$ 6,099	4.70%	$ 8,855	5.52%	$ 19,174	5.50%
Debt Securities Held to Maturity:								
U.S. Treasury & Agency	$ 110	4.78%					110	4.78%
Total	$ 110	4.78%					$ 110	4.78%

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Analysis of Loan Portfolio

The Company s portfolio of loans held for investment totaled $399,233,000 at December 31, 2008 compared with $317,180,000 at the beginning of the year. The Company s policy has been to make conservative loans that are held for future interest income. Collateral required by the Company is determined on an individual basis depending on the purpose of the loan and the financial condition of the borrower. Commercial loans, including agricultural and multi family loans, increased 37.56% during 2008 to $141,906,000. Real estate mortgages increased $19,388,000 (13.67%). Growth has included a variety of loan and collateral types including residential real estate, real estate development and commercial real estate loans to finance warehouse and storefront properties. In 2007 and 2008, the Bank added to its business development lending staff an experienced commercial lender and an agri-business lender. The experienced commercial lender was hired from another local bank that had been merged into a larger institution. The agri-business had retired from a position with the Federal government in the local Farm Services Agency. Both of these officers have a loyal customer following and have contributed to the loan growth described above. Management anticipates that these customers will continue to convert over to the Bank over the next several years as borrowing needs arise. Construction loans increased $19,958,000 or 38.90%, this increase resulted primarily from several large real estate development loans. The growth in construction loans within our portfolio was broadly diversified with loans to a variety of developers, including large multi-unit single family developments, single lot spec homes; and multifamily properties in various locations throughout our market area. The Bank also has loan participation arrangements with several other banks within the region to aid in diversification of the loan portfolio geographically, by collateral type and by borrower.

Consumer installment loans increased $4,020,000. This category includes personal loans, auto loans and other loans to individuals. While this category continues to suffer from strong competition by other providers of automobile financing, growth was achieved due to increases in home equity lines of credit and amortizing second mortgages. Throughout most of the year, the Bank offered special financing terms that included covering borrower closing costs or discounts on the initial interest rate for a period of time. Credit card balances increased $140,000 to $1,940,000 but are a minor component of the loan portfolio. The following table presents the changes in the loan portfolio over the previous five years.

	December 31				
(Dollars in thousands)	**2008**	**2007**	**2006**	**2005**	**2004**
Real estate mortgage	$ 161,224	$ 141,836	$ 137,595	$ 133,826	$ 147,281
Real estate construction	71,259	51,301	46,669	33,540	17,365
Consumer installment	22,792	18,772	15,990	16,435	20,006
Commercial	115,297	86,048	89,347	73,896	43,973
Agricultural	18,711	15,701	14,587	14,759	