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 the Fiscal Year Ended December 31, 2008

BANK OF THE JAMES FINANCIAL GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

Commission file number 000-50548

Virginia **(State or Other Jurisdiction of Incorporation or Organization)**	**20-0500300** **(I.R.S. Employer Identification No.)**
828 Main Street, Lynchburg, VA **(Address of Principal Executive Offices)**	**24504** **(Zip Code)**

(434) 846-2000
(Issuer's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: Common Stock, $2.14 par value

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

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 ☒ No

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

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K (§ 229.405) 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. ☒

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 definition 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	☐	Smaller reporting company	☒

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

The aggregate value of the voting common equity held by nonaffiliates as of June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $34,027,000 based on the price at which the common stock last sold on such day. This price reflects inter-dealer prices without retail mark up, mark down, or commissions, and may not represent actual transactions.

The number of shares outstanding of Common Stock, $2.14 par value as of March 19, 2009 was approximately 2,810,255.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2009 Proxy Statement for the Annual Meeting of Shareholders, scheduled to be held on May 19, 2009, are incorporated by reference into Part III of this Form 10-K

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PART I

Item 1. Business

Overview and History

Bank of the James Financial Group, Inc. ("Financial") is a bank holding company with its headquarters in Lynchburg, Virginia. Financial was incorporated at the direction of Bank of the James (the "Bank") on October 3, 2003 to serve as a bank holding company of the Bank. Financial acquired all of the shares of the Bank in a statutory share exchange on a one-for-one basis on January 1, 2004. In addition to the Bank, Financial wholly-owns BOTJ Investment Group, Inc. ("Investment Group") through which we offer brokerage, fixed and variable annuity products, and related services to the public through a third party broker-dealer. The Bank also wholly-owns BOTJ Insurance, Inc. ("BOTJ Insurance") through which we act as an agent for insurance and annuity products. The Bank, BOTJ Insurance, and the Investment Group are our only subsidiaries and primary assets. Financial conducts its business through the following lines: community banking through the Bank, insurance agency services through the BOTJ Insurance, mortgage origination through the Mortgage Division of the Bank, and securities brokerage services through Investment Group.

The Bank is a Virginia banking corporation headquartered in Lynchburg, Virginia. The Bank was incorporated under the laws of the Commonwealth of Virginia as a state chartered bank in 1998 and began banking operations in July 1999. The Bank was organized to engage in general retail and commercial banking business.

The Bank was organized in part as a response to the loss of many of the Central Virginia, Region 2000 area's (as defined in below) local financial institutions through mergers with larger, non-local banks and bank holding companies. The organizers perceived that local customers who once relied on experienced personal attention were being forced to use 800 numbers, computerized menus, and persons in other localities who were not familiar with their needs.

The Bank opened for business on July 22, 1999 to fill this void left in the Region 2000 market. The Bank's organizers recognized that an opportunity existed to create a banking institution designed exclusively for a market that expected personalized service. The idea was to build a financial institution staffed with experienced professionals who would place a high value on knowing their customers and serving their distinctive banking needs.

The Bank was capitalized by more than 2,400 shareholders that wanted a new local bank. These investors provided the initial customer base and are integral to the success of the Bank. Management believes that the key to the Bank's success lies in providing Bank customers with personalized service while providing products and services that meet their banking needs.

The Bank's principal office is located at 828 Main Street, Lynchburg, Virginia 24504 and its telephone number is (434) 846-2000. The Bank also maintains a website at www.bankofthejames.com.

Location and Market Area

The Bank's market area primarily consists of Region 2000, which encompasses the seven jurisdictions of the Town of Altavista, Amherst County, Appomattox County, the City of Bedford, Bedford County, Campbell County, and the City of Lynchburg. Region 2000 supports a diverse, well-rounded economy. U.S. Routes 29, 60, 221, 460 and 501 and State Routes 24 and 40 all pass through the trade area and provide efficient access to other regions of the state. Regional airport service and rail service provide additional transportation channels.

Total population in the market area equals approximately 230,000. According to U.S. Census estimates, in 2005 the populations of the localities in the Region 2000 market area were approximately as follows: City of Lynchburg – 65,113; Amherst County – 31,894; Appomattox County – 13,967; Bedford County (including the City of Bedford) – 65,286; Campbell County (including the Town of Altavista) – 52,339. The area is serviced by one daily newspaper and a number of radio and television stations providing diverse media outlets. Median family income has continued to increase in Region 2000 during the past ten years.

Region 2000 has a broad range of services, light industry, and manufacturing plants. Principal service, industrial, research and development employers include: BWX Technologies, Inc. (nuclear fuel); AREVA (nuclear services); Centra Health, Inc. (health care services); C.B. Fleet, Inc. (medical supplies); Genworth Financial (life insurance and other financial products); Frito-Lay, Inc. (snack foods); Lynchburg Foundry Company (castings); R.R. Donnelley Printing Inc. (printed products); as well as six colleges including Randolph College, Sweet Briar College, Liberty University, and Lynchburg College.

Competition

The banking business is highly competitive. We compete with other commercial banks, savings institutions, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions operating in the Region 2000 market area and elsewhere. Many of our nonbank competitors are not subject to the same extensive federal regulations that govern federally-insured banks and state regulations governing state chartered banks. As a result, such nonbank competitors may have certain advantages over the Bank in providing certain services.

Virginia law permits statewide branching by banks. Consequently, the Bank’s market area is a highly competitive, highly branched banking market. Competition in the market area for loans to individuals, small businesses, and professional concerns, the Bank’s target market, is keen, and pricing is important. Most of the Bank’s competitors have substantially greater resources and lending limits than the Bank and offer certain services, such as extensive and established branch networks and trust services, that the Bank is not currently providing. Moreover, larger institutions operating in the Region 2000 market area have access to borrowed funds at a lower cost than presently available to the Bank. Deposit competition is strong and comes from institutions in the market, U.S. Government securities, private issuers of debt obligations and suppliers of other investment alternatives for depositors, among other sources. As a result, the Bank has paid, and may in the future pay, above-market rates to attract deposits.

The adoption of legislation permitting nationwide interstate banking and branching and the use of financial holding companies may also increase competition in the Bank’s market area. See “Supervision and Regulation of Financial” below.

Supervision and Regulation of Financial

General . As a bank holding company registered under the Bank Holding Company Act of 1956 (the “BHCA”), Financial is subject to regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). Financial is required to file with the Federal Reserve Board an annual report and such other additional information as the Federal Reserve Board may require pursuant to the BHCA. Financial must also provide the Virginia Bureau of Financial Institutions (the “Commission”) with information regarding Financial and the Bank. The Federal Reserve Board and the Commission may also examine Financial and the Bank.

The Federal Reserve Board has jurisdiction under the BHCA to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. The BHCA generally limits the

activities of a bank holding company and its subsidiaries to that of banking, managing or controlling banks, or any other activity that is so closely related to banking or to managing or controlling banks as to be a proper incident thereto.

Since September 1995, the BHCA has permitted bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to certain conditions, including nationwide and state imposed concentration limits. Banks are also able to branch across state lines, provided certain conditions are met, including that applicable state laws expressly permit such interstate branching. Virginia has adopted legislation that permits branching across state lines, provided there is reciprocity with the state in which the out-of-state bank is based.

Financial is also subject to the periodic reporting requirements of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), including the filing with the Securities and Exchange Commission (the "SEC") of annual, quarterly and other reports on the financial condition and performance of the organization. As a reporting company under the Exchange Act, Financial is directly affected by the Sarbanes-Oxley Act of 2002 (the "SOx"), which is aimed at improving corporate governance and reporting procedures and requires expanded disclosure of Financial's corporate operations and internal controls. Financial intends to be in compliance with any applicable rules and regulations as they become effective. Management anticipates that compliance with SOx will be costly. The new legislation and its implementing regulations will potentially lead to an increase in certain outside professional costs.

The Federal Reserve Board requires a bank holding company to act as a source of financial strength and to take measures to preserve and protect its bank subsidiaries. Financial would be compelled by the Federal Reserve Board to invest additional capital in the event the Bank experiences either significant loan losses or rapid growth of loans or deposits.

Capital Requirements . The Federal Reserve Board ("FRB") had adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the BHCA. The FRB's capital adequacy guidelines are similar to those imposed on the Bank by the FRB. See "Regulation of the Bank – Capital Requirements."

Limits on the Payment of Dividends . Financial is a legal entity, separate and distinct from the Bank. A significant portion of Financial's revenues will be from dividends paid to it by the Bank. Both Financial and the Bank are subject to laws and regulations that limit the payment of dividends, including requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and only (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In particular, under the current supervisory practices of the Federal Reserve Board, prior approval from the Federal Reserve Board and a supermajority of the Bank's shareholders is required if cash dividends declared in any given year exceed net income for that year plus retained earnings of the two preceding years. In addition, under the FDIA, insured depository institutions such as the Bank are prohibited from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become "undercapitalized" (as such term is used in the statute).

Recent Regulatory Developments . The following is a summary of recently enacted laws and regulations that could materially impact the Company's results of operations or financial condition.

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "EESA") enacted by the U.S. Congress in response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions. Pursuant to the EESA, the U.S. Department of Treasury ("U.S. Treasury") has the authority to, among other

things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. The EESA also included a provision to increase the amount of deposits insured by the Federal Deposit Insurance Corporation ("FDIC") to $250,000.

On October 14, 2008, the U.S Treasury announced the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program"). This program would made $250 billion of capital available to U.S. financial institutions from the $700 billion authorized by the EESA in the form of preferred stock investments by the U.S. Treasury under the following general terms:

- the preferred stock issued to the U.S. Treasury ("Treasury Preferred Stock") would pay 5% dividends for the first five years, and then 9% dividends thereafter;
- in connection with the purchase of preferred stock, the U.S. Treasury will receive warrants entitling the U.S. Treasury to buy the participating institution's common stock with a market price equal to 15% of the Treasury Preferred Stock;
- the Treasury Preferred Stock may not be redeemed for a period of three years, except with proceeds from high-quality private capital;
- the consent of the U.S. Treasury will be required to increase common dividends per share or any share repurchases, with limited exceptions, during the first three years, unless the Treasury Preferred Stock has been redeemed or transferred to third parties; and
- participating companies must adopt the U.S Treasury's standards for executive compensation and corporate governance for the period during which the U.S. Treasury holds the equity issued under the TARP Capital Purchase Program.

Although Financial received preliminary approval from the U.S. Treasury to participate in the TARP Capital Purchase Program, Financial decided not to participate in the program.

Also on October 14, 2008, the FDIC announced a new program – the Temporary Liquidity Guarantee Program – that provides unlimited deposit insurance on funds in non-interest-bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of $250,000, as well as a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies. All eligible institutions were covered under the program for the first 30 days without incurring any costs. After the initial period, participating institutions will be assessed a charge of 10 basis points per annum for the additional insured deposits and a charge of 75 basis points per annum for guaranteed senior unsecured debt. The Bank is participating in the Temporary Liquidity Guarantee program and as a result is able to offer its customers unlimited deposit insurance on its non-interest bearing accounts.

Regulation of the Bank

The Bank is subject to various state and federal banking laws and regulations that impose specific requirements or restrictions on and provide for general regulatory oversight with respect to virtually all aspects of its operations. The following is a brief summary of the material provisions of certain statutes, rules and regulations that will affect the Bank. This summary is qualified in its entirety by reference to the particular statutory and regulatory provisions referred to below.

General . The Bank is under the supervision of, and subject to regulation and examination by, the Federal Reserve Board and the State Corporation Commission of Virginia Bureau of Financial Institutions (the “Commission”). As such, the Bank is subject to various statutes and regulations administered by these agencies that govern, among other things, required reserves, investments, loans, lending limits, acquisitions of fixed assets, interest rates payable on deposits, transactions among affiliates and the Bank, the payment of dividends, mergers and consolidations, and establishment of branch offices.

The earnings of the Bank are affected by general economic conditions, management policies and the legislative and governmental actions of the various regulatory authorities, including those referred to above.

Insurance of Accounts, Assessments and Regulation by the FDIC . The Bank is a Virginia chartered commercial bank and a member of the Federal Reserve System. Its deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation up to the maximum legal limits of the FDIC and it is subject to regulation, supervision and regular examination by the Virginia Bureau of Financial Institutions and the Federal Reserve. The regulations of these various agencies govern most aspects of the Bank’s business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends and location and number of branch offices. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds, and not for the purpose of protecting shareholders.

The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. The system assesses higher rates on those institutions that pose greater risks to the Deposit Insurance Fund (the “DIF”). The FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Within the lower risk category, Risk Category I, rates will vary based on each institution’s CAMELS component ratings, certain financial ratios, and long-term debt issuer ratings.

Capital group assignments are made quarterly and an institution is assigned to one of three capital categories: (1) well capitalized; (2) adequately capitalized; and (3) undercapitalized. These three categories are substantially similar to the prompt corrective action categories described above, with the “undercapitalized” category including institutions that are undercapitalized, significantly undercapitalized and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution’s primary federal banking regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution’s financial condition and the risk posed to the deposit insurance funds. Assessments range from 5 to 43 cents per $100 of deposits, depending on the institution’s capital group and supervisory subgroup. Institutions that are well capitalized will be charged a rate between 5 and 7 cents per $100 of deposits.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

The Bank is a member of the DIF and pays its deposit insurance assessments to the DIF.

Capital Requirements . The various federal bank regulatory agencies, including the Federal Reserve Board, have adopted risk-based capital requirements for assessing bank capital adequacy. In addition, Virginia chartered banks must also satisfy the capital requirements adopted by the Commission. The federal capital standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, as adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank

holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, with each multiplied by one of several risk adjustment percentages. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The minimum requirement for the ratio of total capital to risk-weighted assets (including certain off-balance sheet obligations, such as stand-by letters of credit) for a bank to be "adequately capitalized" is 8.0%. At least half of the risk-based capital must consist of stockholders' equity (including retained earnings) and qualifying noncumulative preferred stock, less deductions for goodwill and various other intangibles ("Tier 1 capital"). The remainder ("Tier 2 capital") generally consists of a limited amount of subordinated debt, certain hybrid capital instruments and other debt securities, preferred stock and a limited amount of the general valuation allowance for loan losses. No element of Tier 1 or Tier 2 capital may contain covenants, terms, or restrictions that are inconsistent with sound banking practices. The sum of Tier 1 capital and Tier 2 capital is "total risk-based capital." The total risk-based capital ratio of the Bank as of December 31, 2008 and December 31, 2007 was 10.03% and 11.94, respectively, exceeding the minimums required.

The Federal Reserve Board also has adopted regulations that supplement the risk-based guidelines to include a minimum leverage ratio of Tier 1 capital to quarterly average assets ("Leverage ratio") of 3.0%. The Federal Reserve Board has emphasized that the foregoing standards are supervisory minimums and that a banking organization will be permitted to maintain such minimum levels of capital only if it receives the highest rating under the regulatory rating system and the banking organization is not experiencing or anticipating significant growth. Such banks are expected to maintain capital ratios well above minimum levels. All other banking organizations are required to maintain a Leverage ratio of at least 4.0% to 5.0% of Tier 1 capital. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets. The tangible Tier 1 Leverage ratio is the ratio of a banking organization's Tier 1 capital, less deductions for intangibles otherwise includable in Tier 1 capital to total tangible assets. The Leverage ratio of the Bank as of December 31, 2008 and December 21, 2007 was 7.48% and 8.96%, respectively, exceeding the minimums required.

Further, the Federal Reserve Board and other federal banking agencies have adopted regulations to ensure that banks with significant exposure to market risk maintain adequate capital to support that exposure. Under these rules, the Federal Reserve Board must explicitly include a bank's exposure to declines in the economic value of its capital due to changes in interest rates as a factor in evaluating a bank's capital adequacy.

Mergers and Acquisitions . The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 authorizes the Federal Reserve Board to permit adequately capitalized and adequately managed bank holding companies to acquire all or substantially all of the assets of an out-of-state bank or bank holding company, subject to certain conditions, including nationwide and state concentration limits. Banks also are able to branch across state lines, provided certain conditions are met, including that applicable state law must expressly permit such interstate branching. Virginia law permits branching across state lines, provided there is reciprocity with the state in which the out-of-state bank is based.

Financial Modernization . On November 12, 1999, financial modernization legislation known as the Gramm-Leach-Bliley Act (the "Act") was signed into law. The Act, which was effective March 11, 2000, permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. A bank holding company may become a financial holding company by filing a declaration that the bank holding company wishes to become a financial holding company if each of its subsidiary banks (i) is well capitalized under

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regulatory prompt corrective action provisions, (ii) is well managed, and (iii) has at least a satisfactory rating under the Community Reinvestment Act ("CRA"). No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

The Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Board has determined to be closely related to banking. Subsidiary banks of a financial holding company must continue to be well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has a CRA rating of satisfactory or better.

Although the above laws may have a significant impact on the banking industry by promoting, among other things, competition, it is not possible for the management of the Bank to determine, with any degree of certainty, the impact of such laws on the Bank.

Community Reinvestment Act . The Bank is also subject to the requirements of the CRA. The CRA 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. Each financial institution's efforts in meeting community credit needs currently is evaluated as part of the examination process pursuant to a number of assessment factors. These factors also are considered in evaluating mergers, acquisitions and applications to open branches.

Safety and Soundness . The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institutions in question are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," all such terms are defined under uniform regulations defining such capital levels issued by each of the federal banking agencies.

On December 19, 1991, the FDICIA was enacted into law. FDICIA requires each federal banking regulatory agency to prescribe, by regulation or guideline, standards for all insured depository institutions and depository institution holding companies relating to (i) internal controls, information systems and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; (v) asset growth; (vi) compensation, fees and benefits; and (vii) such other operational and managerial standards as the agency determines to be appropriate. The compensation standards would prohibit employment contracts or other compensatory arrangements that provide excess compensation, fees or benefits or could lead to material financial loss. In addition, each federal banking regulatory agency must prescribe, by regulation or guideline, standards relating to asset quality, earnings and stock valuation as the agency determines to be appropriate. The federal banking agencies, including the Federal Reserve Board, have adopted regulations concerning standards for safety and soundness required to be prescribed by regulation pursuant to Section 39 of the FDIA. In general, the standards relate to (1) operational and managerial matters; (2) asset quality and earnings; and (3) compensation. The operational and managerial standards cover (a) internal controls and information systems, (b) internal audit systems, (c) loan documentation, (d) credit underwriting, (e) interest rate exposure, (f) asset growth, and (g) compensation, fees and benefits.

Activities and Investments of Insured State-Chartered Banks . The activities and equity investments of FDIC-insured, state-chartered banks are generally limited to those that are permissible for national banks.

Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a limited partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met. In addition, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements. Any insured state-chartered bank directly or indirectly engaged in any activity that is not permitted for a national bank must cease the impermissible activity.

Regulatory Enforcement Authority . Applicable banking laws include substantial enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions, including the filing of misleading or untimely reports with regulatory authorities, may provide the basis for enforcement action.

USA Patriot Act . The USA Patriot Act became effective on October 26, 2001 and provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Among other provisions, the USA Patriot Act permits financial institutions, upon providing notice to the United States Treasury, to share information with one another in order to better identify and report to the federal government concerning activities that may involve money laundering or terrorists' activities. The USA Patriot Act is considered a significant banking law in terms of information disclosure regarding certain customer transactions. Although it does create a reporting obligation, the Bank does not expect the USA Patriot Act to materially affect its products, services or other business activities.

Reporting Terrorist Activities . The Federal Bureau of Investigation ("FBI") has sent, and will send, our banking regulatory agencies lists of the names of persons suspected of involvement in the September 11, 2001, terrorist attacks on New York City and Washington, DC. The Bank has been asked, and may be asked again, to search its records for any relationships or transactions with persons on those lists. If the Bank finds any relationships or transactions, it must file a suspicious activity report and contact the FBI. The Office of Foreign Assets Control ("OFAC"), which is a division of the Department of the Treasury is responsible for helping to ensure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Bank actively checks high-risk OFAC areas such as new accounts, wire transfers and customer files. The Bank performs these checks utilizing software, which is updated each time a modification is made to the lists provided by OFAC and other agencies of Specially Designated Nationals and Blocked Persons.

Mortgage Banking Regulation . The Bank's mortgage banking division is subject to the rules and regulations of, and examination by the Department of Housing and Urban Development ("HUD"), the Federal Housing Administration (the "FHA"), the Department of Veteran Affairs and state regulatory authorities with respect to originating, processing, servicing and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers and, in some cases, restrict certain loan features, and fix maximum interest rates and fees. In addition to other federal laws, mortgage origination activities are subject to the Equal Credit Opportunity Act, Truth-in-Lending Act, Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Home Ownership Equity Protection Act, and the regulations promulgated thereunder. These laws prohibit discrimination, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level.

Banking Products and Services

The Bank currently conducts business from eight full-service offices and one limited services office. Four of the full-service offices are located in Lynchburg, Virginia, one full-service location is located in Madison Heights, Virginia, one is located in the Town of Amherst, Virginia and one is located in Forest, Virginia. The Bank operates a limited service office in a temporary location in the Town of Altavista, Virginia. The Bank anticipates relocating this office to a permanent, full service office in the third quarter of 2009. The Bank established a mortgage loan origination division that conducts business under the name “Bank of the James Mortgage, a Division of Bank of the James.” The mortgage division conducts business primarily from the division’s main office located in the Forest branch of the Bank and an office located in Moneta, Virginia. For a more detailed description of these facilities, see “Item 2. Properties” below.

Deposit Services . Deposits are a major source of our funding. The Bank offers a full range of deposit services that are typically available in most banks and savings and loan associations including checking accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to the Bank’s market area at rates competitive to those offered in the area. In addition, the Bank offers its customers Individual Retirement Accounts (IRAs). All deposit accounts are insured by the Federal Deposit Insurance Corporation (the “FDIC”) up to the maximum amount allowed by law (generally, $250,000 per depositor, subject to aggregation rules). The Bank solicits such accounts from individuals, businesses, associations and organizations, and governmental authorities.

Lending Services . The Bank offers a full range of short- to medium-term commercial and consumer loans. Our primary focus is on making loans to small businesses and consumers in the Region 2000 market area. In addition, we also provide a wide range of real estate finance services. Our primary lending activities are principally directed to our primary market area in the Region 2000 area. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. Additionally, the Bank originates fixed and floating-rate mortgage loans and real estate construction and acquisition loans. Where appropriate, the Bank attempts to limit interest rate risk through the use of variable interest rates and terms of less than five years.

In general, the Bank offers the following lending services:

Commercial Business Lending. We make loans to small- and medium-sized businesses in Region 2000 for purposes such as purchases of equipment, facilities upgrades, inventory acquisition and various working capital purposes.

Real Estate Construction . We make commercial and residential construction and development loans to customers in our market area.

Commercial Real Estate Mortgage . We grant loans to borrowers secured by commercial real estate. In underwriting these types of loans we consider the historic and projected future cash flows of the real estate.

Consumer . We offer various types of secured and unsecured consumer loans, including personal loans, lines of credit, overdraft lines of credit, automobile loans, installment loans, demand loans, and home equity loans. We make consumer loans primarily for personal, family or household purposes.

Loan Participations . We sell loan participations in the ordinary course of business when a loan originated by us exceeds our legal lending limit or we otherwise want to share risk with another bank. We also purchase loan participations from time to time from other banks in the ordinary course of business, usually without recourse against that bank. Purchased loan participations are underwritten in accordance with our loan policy and represent a source of loan growth.

Consumer Residential Mortgage Origination . The Bank, through Bank of the James Mortgage, a Division of Bank of the James (the "Mortgage Division") originates consumer residential mortgage loans. Through the Mortgage Division, the Bank originates conforming and non-conforming home mortgages primarily in the Region 2000 area. As part of the Bank's overall risk management strategy, the loans originated and closed by the Mortgage Division are pre-sold to major mortgage banking or other financial institutions and at no time are such loans carried on the Bank's balance sheet.

Other Services . Other services offered by the Bank include safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, automatic drafts for various accounts, and credit card merchant services. The Bank also has become associated with a shared network of automated teller machines (ATMs) that may be used by Bank customers throughout Virginia, the United States, and internationally.

The Bank intends to introduce new products and services desired by the public and as permitted by the regulatory authorities or desired by the public. The Bank remains committed to meeting the challenges that require technology. The Bank provides its customers with access to the latest technological products, such as telephone banking and internet banking, including on-line bill pay. This service allow customers to handle routine transactions using a standard touch tone telephone and via the internet at the Bank's website.

Brokerage and Investment Services

We provide brokerage and investment services through our Investment Group subsidiary. Investment Group provides securities brokerage services to Bank customers and others through an agreement with Community Bankers' Securities, LLC ("CB Securities"), a registered broker-dealer. We began providing these services on April 4, 2006. Under our agreement, CB Securities will operate service centers in one or more branches of the Bank. Currently, the only center is located in the Church Street branch. Given the relatively short operating history of Investment Group, to date the results of Investment Group have not had a material impact on our financial performance.

Insurance Services

We provide insurance and annuity products through BOTJ Insurance as an agent for national insurance companies. As of the date hereof, we offer the following insurance products: credit life, life insurance, fixed annuities, and disability insurance. We began providing these services in September 2008. Given the relatively short operating history of BOTJ Insurance, to date the results of BOTJ Insurance have not had a material impact on our financial performance.

Employees

As of March 14, 2009, we had approximately 118 full-time and 2 part time employees. None of our employees are represented by any collective bargaining agreements, and relations with employees are considered excellent. We maintain employee benefit programs that include health insurance, a flexible spending account, and a 401(k) plan.

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Item 1A. Risk Factors

In addition to other information set forth in this report, the following factors should be considered carefully in evaluating our business.

Risks Related to Our Business

The Company's Business May Be Adversely Affected by Conditions in the Financial Markets and Economic Conditions Generally . Since December 2007, the United States economy has been in a recession. Business activity across a wide range of industries and regions is greatly reduced and local governments and many businesses are experiencing difficulty due to the lack of consumer spending and the lack of liquidity in the credit markets. Unemployment has increased.

Since mid-2007, and particularly during the second half of 2008, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes which resulted in a serious lack of liquidity. This was initially triggered by declines in home prices and the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities. The global markets have been characterized by substantially increased volatility and short-selling and an overall loss of investor confidence, initially in financial institutions, but more recently in companies in a number of other industries and in the broader markets.

Market conditions have also led to the failure or merger of a number of prominent financial institutions. Financial institution failures or near-failures have resulted in further losses as a consequence of defaults on securities issued by them and defaults under contracts entered into with such entities as counterparties. Furthermore, declining asset values, defaults on mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to put pressure on rating agencies to lower credit ratings, and to increase the cost and decrease the availability of credit and liquidity, despite very significant declines in Federal Reserve borrowing rates and other government actions. Some banks and other lenders have suffered significant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of collateral. The foregoing has significantly weakened the strength and liquidity of some financial institutions worldwide. In 2008, the U.S. government, the Federal Reserve, the Treasury and other regulators took numerous steps to increase liquidity and to restore investor confidence, including investing approximately $350 billion in the equity of other banking organizations, but asset value in most categories have continued to decline and access to liquidity continues to be more limited.

The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, is highly dependent upon the business environment in the markets where the Company operates (the Region 2000 area of Virginia) and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; natural disasters; or a combination of these or other factors.

Overall, during 2008, households and business in the United States have been adversely effected by the deteriorating business environment. Although the business environment in Virginia generally has declined, the impact has been less severe in Region 2000 than in many other areas in Virginia and in the United States. It is expected that the business growth in Region 2000 may be limited for the foreseeable future. There can be no assurance that these conditions will improve in the near term. Such conditions could adversely affect the credit quality of the Company's loans, results of operations and financial condition.

The markets for our services are highly competitive and we face substantial competition . The banking business is highly competitive. We compete as a financial intermediary with other commercial banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies and brokerage and investment banking firms soliciting business from residents of and businesses located in Lynchburg, Virginia and surrounding areas and elsewhere. Many of these competing institutions have greater resources than we have. Specifically, many of our competitors enjoy competitive advantages, including greater financial resources, a wider geographic presence or more accessible branch office locations, the ability to offer additional services, greater marketing resources, more favorable pricing alternatives, and lower origination and operating costs. We are also subject to lower lending limits than our larger competitors. Increased competitive pressures have been one effect of the Gramm-Leach-Bliley Act. This competition could result in a decrease in loans we originate and could negatively affect our results of operations.

In attracting deposits, we compete with insured depository institutions such as banks, savings institutions, and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds . Traditional banking institutions, as well as entities intending to transact business solely online, are increasingly using the Internet to attract deposits without geographic or physical limitations. In addition, many non-bank competitors are not subject to the same extensive regulations that govern us. These competitors may offer higher interest rates than we offer, which could result in either attracting fewer deposits or increasing our interest rates in order to attract deposits. Increased deposit competition could increase our cost of funds and could adversely affect our ability to generate the funds necessary for our lending operations, which would negatively affect our results of operations.

We have a limited operating history upon which to base any estimate of our future success . We and our subsidiaries have limited operating histories. As a consequence, there is limited historical financial information on which to base any estimate of our future performance. The financial statements presented in this report may not be as meaningful as those of a company which has a longer history of operations. Because of our limited operating history, you may not have access to the type and amount of information that would be available to a shareholder of a financial institution with a more extended operating history.

Opening new branches may not result in increased assets or revenues for us . As set forth below, we are considering opening additional branches over the next 18 months (see "Management's Discussion and Analysis – Expansion Plans"). The investment necessary for these branch expansions may negatively impact our earnings and efficiency ratio. There is a risk that we will be unable to manage our growth, as the process of opening new branches may divert our time and resources. There is a risk that, if we do open these branches, they may not be profitable, which would negatively impact our results of operations. There is also risk that we may fail to open any additional branches.

Our plans for future expansion depend, in some instances, on factors beyond our control, and an unsuccessful attempt to achieve growth could have a material adverse effect on our business, financial condition, results of operations and future prospects . We expect to continue to engage in new branch expansion in the future. We may also seek to acquire other financial institutions, or parts of those institutions, though we have no present plans in that regard. Expansion involves a number of risks, including:

- the time and costs of evaluating new markets, hiring experienced local management and opening new offices;
- the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- our entrance into new markets where we lack experience; and

- the introduction of new products and services with which we have no prior experience into our business.

We could suffer loan losses from a decline in credit quality . We could sustain losses if borrowers, guarantors, and related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for loan losses that we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance, and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations.

Additional growth may require us to raise additional capital in the future, and capital may not be available when it is needed, which could adversely affect our financial condition, and results of operations . We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate our capital resources are sufficient to satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations could be materially impaired.

If the value of real estate in our core market were to decline materially, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on our business, financial condition and results of operations . With most of our loans concentrated in the Region 2000 areas surrounding Lynchburg, Virginia, a decline in local economic conditions could adversely affect the values of our real estate collateral. Consequently, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are more geographically diverse.

In addition to considering the financial strength and cash flow characteristics of borrowers, we often secure loans with real estate collateral . At December 31, 2008, approximately 83% of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the teamwork and increased productivity fostered by our culture, which could harm our business . We believe that a critical contributor to our success has been our corporate culture, which we believe fosters teamwork and increased productivity. As our organization grows and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

If we fail to retain our key employees, our growth and profitability could be adversely affected . Our success is, and is expected to remain, highly dependent on our executive management team, consisting of Robert R. Chapman III, J. Todd Scruggs, and Harry P. Umberger. This is particularly true because, as a community bank, we depend on our management team’s ties to the community to generate business for us. Our growth will continue to place significant demands on our management, and the loss of any such person’s services may have an adverse effect upon our growth and profitability.

As a community bank, the Bank has different lending risks than larger banks. We provide services to our local communities . Our ability to diversify our economic risks is limited by our own local markets and economies. We lend primarily to small to medium-sized businesses, professionals, and individuals which may expose us to greater lending risks than those of banks lending to larger, better-capitalized businesses with longer operating histories.

We manage our credit exposure through careful monitoring of loan applicants and loan concentrations in particular industries, and through loan approval and review procedures . We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimate based on experience, judgment, and expectations regarding our borrowers, the economies in which we and our borrowers operate, as well as the judgment of our regulators. We cannot assure you that our loan loss reserves will be sufficient to absorb future loan losses or prevent a material adverse effect on our business, financial condition, or results of operations.

Risks Related to Our Industry

Our profitability is vulnerable to interest rate fluctuations . Our profitability depends substantially upon our net interest income. Net interest income is the difference between the interest earned on assets, such as loans and investment securities, and the interest paid on liabilities, such as NOW accounts, savings accounts, time deposits and other borrowings. Market interest rates for loans, investments and deposits are highly sensitive to many factors beyond our control. Recently, interest rate spreads have generally narrowed due to changing market conditions, policies of various government and regulatory authorities and competitive pricing pressures, and we cannot predict whether these rate spreads will narrow further. This narrowing of interest rate spreads could adversely affect our financial condition and results of operations. In addition, we cannot predict whether interest rates will continue to remain at present levels. Changes in interest rates may cause significant changes, up or down, in our net interest income. Depending on our portfolio of loans and investments, our results of operations may be adversely affected by changes in interest rates.

We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business, which limitations or restrictions could adversely affect our profitability . As a bank holding company, we are primarily regulated by the Board of Governors of the Federal Reserve System (“Federal Reserve”). The Bank is primarily regulated by the Federal Reserve and the Virginia Bureau of Financial Institutions (“BFI”). Our compliance with Federal Reserve and the BFI regulations is costly and may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capital requirements by our regulators.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability . Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.

The costs of being a public company are proportionately higher for small companies like us due to the requirements of the Sarbanes-Oxley Act . The Sarbanes-Oxley Act of 2002 and the related rules and regulations promulgated by the Securities and Exchange Commission have increased the scope, complexity, and cost of corporate governance, reporting, and disclosure practices. Many of these regulations are applicable to our company. We expect to experience increasing compliance costs, including costs related to internal controls and the requirement that our auditors attest to and report on management’s assessment of our internal controls, as a result of the Sarbanes-Oxley Act. These necessary costs are proportionately higher for a company of our size and will affect our profitability more than that of some of our larger competitors.

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Changes in monetary policies may have an adverse effect on our business, financial condition and results of operations . Our financial condition and results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve Board. Actions by monetary and fiscal authorities, including the Federal Reserve Board, could have an adverse effect on our deposit levels, loan demand or business and earnings.

Item 1B. Unresolved Staff Comments

Not applicable

Item 2. Properties

Current Locations and Property

As of December 31, 2008 the Bank conducted its banking business from nine locations, its mortgage origination services business primarily from two locations, and its investment services business primarily from one location.

Depending on such factors as cost, availability, and location, we may either lease or purchase our facilities. The existing facilities that we have purchased typically have been former branches of other financial institutions. We own 5 of our locations and lease 5 of our locations. The following table describes the location and general character of our facilities:

Address	Type of Facility	Year Opened	Owned/Leased
5204 Fort Avenue Lynchburg, Virginia	Full service branch with drive thru and ATM	2000	Owned
4698 South Amherst Highway Madison Heights, Virginia	Full service branch with drive thru and ATM	2002	Owned
17000 Forest Road Forest, Virginia	Full service branch with drive thru and ATM Headquarters for Mortgage Division	2005	Owned
164 South Main Street Amherst, Virginia	Full service branch with drive thru and ATM	2007	Owned
1405 Ole Dominion Blvd. Bedford, Virginia	Full service branch with drive thru and ATM	2008	Owned
828 Main Street Lynchburg, Virginia	Corporate Headquarters; Full service branch with ATM	2004	Leased (1)
615 Church Street Lynchburg, Virginia	Full service branch with drive thru and ATM Headquarters for Investment Group	1999	Leased (2)
4935 Boonsboro Road, Suites C and D Lynchburg, Virginia	Full service branch with drive thru and ATM	2006	Leased (3)
14662 Moneta Road, Suite A Moneta, Virginia	Mortgage Banking Office	2005	Leased (4)
815 Main St Altavista, Virginia	Temporary limited service branch with no ATM or drive thru.	2008	Leased (5)

(1) Base lease expires July 31, 2014. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.
(2) Base lease expires August 31, 2009. The Company intends to enter into a new lease agreement for this property.
(3) Base lease expires December 31, 2010. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.
(4) Base lease expires September 30, 2009. We have one or more renewal options that we may exercise at our discretion subject to the terms and conditions outlined in the lease.
(5) The Bank is operating a temporary branch in the Town of Altavista, Virginia pursuant to a month-to-month lease, renewable at the Bank's sole option through August 31, 2009. The Bank has purchased certain real property and improvements thereto located at 1110 Main Street in the Town of Altavista, Virginia. The Bank presently is constructing a permanent bank branch at this location and anticipates that the branch will open in the third quarter of 2009.

We believe that each of these operating facilities are maintained in good operating condition and are suitable for our operational needs.

In addition, the Bank may evaluate the feasibility of entering into sale/leaseback agreements for certain branches.

Interest in Additional Properties

As discussed in "Management's Discussion and Analysis—Expansion Plans" in addition to the facilities set forth above, the Bank owns real property and improvements thereto located in the Timberlake Road area of Campbell County (Lynchburg), Virginia. We anticipate using this property for future expansion. The Timberlake property is not suitable for its intended use as a branch bank. Management anticipates that it will be necessary to raze the current structures and replace it with appropriate new construction.

Management of the Bank continues to look for and evaluate additional locations for future branch growth and will consider opening an additional branch in the next 12 months if a suitable location is available on acceptable terms. The opening of all additional branches is contingent on the receipt of regulatory approval.

We will use the internet, consistent with applicable regulatory guidelines, to augment our growth plans. We currently offer online account access, bill payment, and account management functions through our website.

Item 3. Legal Proceedings

There are no material pending legal proceedings to which the Company is a party or to which the property of the Company is subject.

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

No matters were submitted to vote to the security holders of Financial during the quarter ended December 31, 2008.

PART II

Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities

Market Prices and Dividends

The Common Stock of Financial is quoted on the Over the Counter Bulletin Board (OTCBB) under the symbol "BOJF ("BOJF.OB" on some systems). The volume of trading of shares of Common Stock has not been extensive. Prior to January 2, 2004, the common stock of the Bank was traded on the OTCBB under the symbol BOTJ. The following table sets forth the quarterly high and low bid prices for each quarter in fiscal 2008 and 2007 for Financial and was obtained from the OTC Bulletin Board (www.otcbb.com — "Trading Activity Reports").

	Market Prices and Dividends (1)		
	Sales Price ($)		
	High	Low	Dividends ($)
Fiscal 2008			
Fourth Quarter	12.25	7.15	0.00
Third Quarter	14.50	9.00	0.00
Second Quarter	18.50	11.50	0.00
First Quarter	15.00	11.05	0.00
Fiscal 2007			
Fourth Quarter	19.00	17.51	0.00
Third Quarter	20.75	16.50	0.00
Second Quarter	18.10	14.04	0.00
First Quarter	15.65	12.05	0.00

The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

As of March 19, 2009 (the most recent date available), the Common Stock traded for $8.50 per share. As of March 19, 2009, there were approximately 2,810,255 shares of Common Stock outstanding, which shares are held by approximately 2,985 shareholders of record. Neither Financial nor the Bank prior to the formation of Financial has declared or paid a cash dividend on its Common Stock.

Dividend Policy

The Company's future dividend policy is subject to the discretion of its Board of Directors and will depend upon a number of factors, including future earnings, financial condition, liquidity and capital requirements of both the Company and the Bank, applicable governmental regulations and policies and other factors deemed relevant by its Board of Directors.

The Company is organized under the Virginia Stock Corporation Act, which prohibits the payment of a dividend if, after giving it effect, the corporation would not be able to pay its debts as they become due in the usual course of business or if the corporation's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the corporation were to be dissolved, to satisfy the preferential rights upon dissolution of any preferred shareholders.

The Company is a legal entity separate and distinct from its subsidiaries. Its ability to distribute cash dividends will depend primarily on the ability of the Bank to pay dividends to it, and the Bank is subject to laws and regulations that limit the amount of dividends that it can pay. As a state member bank, the Bank is subject to certain restrictions imposed by the reserve and capital requirements of federal and Virginia banking statutes and regulations. For a discussion of these restrictions, see "Supervision and Regulation of Financial – Limits on the Payment of Dividends."

The Bank generated start-up losses in its beginning years; as such the organization had negative retained earnings and was not able to pay cash dividends until recently. Although Financial's retained earnings are now positive, cash dividends are not planned at this time. Financial intends to follow a policy of keeping retained earnings, if any, for the purpose of increasing net worth and reserves of the Bank during its initial years of operation in order to promote the Bank's growth and ability to compete in its market area. As a result, Financial does not anticipate paying a cash dividend on its Common Stock in 2009.

Stock Repurchases

On October 1, 2007 the Board of Directors of Financial authorized a stock repurchase program which calls for the repurchase of up to 25,000 shares of its common stock on or before September 30, 2008. The Plan expired on September 30, 2008 and as a result no shares were repurchased during the quarter ended December 31, 2008.

Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information concerning Financial's equity compensation plans at December 31, 2008. All figures have been adjusted to reflect the 10% stock dividend declared on May 20, 2008 and paid on July 22, 2008 as well as all prior stock dividends declared by Financial. All outstanding stock options have been issued under plans approved by shareholders.

Plan Category	Number of Shares to be Issued Upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Shares Reflected in First Column)
Equity compensation plans approved by shareholders - 1999 Stock Option Plan of Bank of the James Financial Group, Inc.	318,021	$ 8.61	21,180
Equity compensation plans not approved by shareholders	N/A	N/A	N/A
Total	318,021	8.61	21,180

Recent Sales of Unregistered Securities

None.

Item 6. Selected Financial Data

Not applicable.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations

YEARS ENDED DECEMBER 31, 2008 AND DECEMBER 31, 2007

The following discussion is intended to assist readers in understanding and evaluating our financial condition and results of operations. You should read this discussion in conjunction with our financial statements and accompanying notes included elsewhere in this report. Because Bank of the James Financial Group, Inc. ("Financial") has no material operations and conducts no business other than the ownership of its two subsidiaries, Bank of the James and BOTJ Investment Group, Inc., the discussion primarily concerns the business of these two subsidiaries. However, for ease of reading and because our financial statements are presented on a consolidated basis, references to "we," "us," or "our" refer to Financial, Bank of the James, and BOTJ Investment Group, Inc. as appropriate. The comparison of operating results for Financial between the years ended December 31, 2008 and 2007 should be read in the context of both the size and the relatively short operating history of the Bank.

Overview

Financial is a bank holding company headquartered in Lynchburg, Virginia. We conduct our primary operations through two wholly-owned subsidiaries, Bank of the James (which we refer to as the "Bank") and BOTJ Investment Group, Inc. (which we refer to as the "Investment Group") as well as a subsidiary of the Bank, BOTJ Insurance, Inc. (which we refer to as "BOTJ Insurance.")

The Bank is a Virginia banking corporation headquartered in Lynchburg, Virginia. The Bank was incorporated under the laws of the Commonwealth of Virginia as a state chartered bank in 1998 and began banking operations in July 1999. Investment Group was incorporated under the laws of the Commonwealth of Virginia in 2006 and began providing securities brokerage services to the public in April 2006. It conducts its business primarily from one office located in the City of Lynchburg. BOTJ Insurance was incorporated under the laws of the Commonwealth of Virginia in 2008 and began offering insurance and annuity products to the public in September 2008.

Although we intend to increase other sources of revenue, our operating results depend primarily upon the Bank's net interest income, which is determined by the difference between (i) interest and dividend income on earning assets, which consist primarily of loans, investment securities and other investments, and (ii) interest expense on interest-bearing liabilities, which consist principally of deposits

and other borrowings. The Bank's net income also is affected by its provision for loan losses, as well as the level of its non-interest income, including loan fees and service charges, and its non-interest expenses, including salaries and employee benefits, occupancy expense, data processing expenses, miscellaneous other expenses, franchise taxes, and income taxes.

For the year ended December 31, 2008, net income was $224,000, a decrease of $1,860,000 from $2,084,000 for year ended December 31, 2007. The decrease in earnings resulted in large part from a loss realized on the sale of preferred stock of Federal National Mortgage Association in the amount $1,210,000 (net of tax benefit realized on the sale). For the year ended December 31, 2008, net income per share decreased to $0.08 per basic share ($0.08 diluted) from $0.74 per basic share ($0.71 diluted) for the year ended December 31, 2007.

Net interest income increased in large part as a result of the growth in average interest-earning assets, specifically loans. The increase is attributable to fees derived from increased mortgage origination volume, revenue from the Bank's investment in a title insurance company, as well as commissions on investments offered through Investment Group. Non-interest expense increased in 2008 as compared to 2007 because of increases in personnel expense, outside expense, and other operating expenses resulting from the growth of the Bank's branch network.

Total assets as of December 31, 2008 were $328,605,000 compared to $270,060,000 at the end of 2007, an increase of $58,545,000 or 21.7%. Loans, net of unearned income and loan loss provision, increased from $224,022,000 as of December 31, 2007 to $274,890,000 as of the end of December 31, 2008, an increase of 22.7%. Management expects that the current level of equity capital will allow the Bank, among other things, to continue to grow its loan portfolio.

Financial experienced net interest margin compression during 2008 as a result of increased competition for deposits and price sensitive deposit customers. The combination of these factors created a shift in the funding mix and an decrease in the net interest margin. The net interest margin decreased 47 basis points to 3.71% for 2008, compared to 4.18% for 2007. For the fourth quarter of 2008, the net interest margin was 3.48%. Management expects the net interest margin to remain under pressure during the first and second quarters of 2009 because of the rates we currently are paying on deposits and because the limited amount of prime borrowers (for which financial institutions are competing) are able to demand low rates on their loans from the Bank. However, the ability to attract lower cost funds, including non interest-bearing deposits, and the shape of the yield curve will have a significant impact on future increases or decreases in net interest income.

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements that constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. The words "believe," "estimate," "expect," "intend," "anticipate," "plan" and similar expressions and variations thereof identify certain of such forward-looking statements which speak only as of the dates on which they were made. Financial undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those indicated in the forward-looking statements as a result of various factors. Such factors include, but are not limited to competition, general economic conditions, potential changes in interest rates, and changes in the value of real estate securing loans made by the Bank.

Stock Dividends

On May 20, 2008, Financial declared a 10% stock dividend, which was paid on July, 22, 2008 to shareholders of record on June 17, 2008. On May 15, 2007, Financial declared a 10% stock dividend, which was paid on July 24, 2007 to shareholders of record on June 19, 2007. Except as otherwise described in this report, all share amounts and dollar amounts per share in this report with regard to the common stock have been adjusted to reflect these and all prior stock dividends.

Critical Accounting Policies

Financial's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within our statements is, to a significant extent, based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. The Bank uses historical loss factors as one factor in determining the inherent loss that may be present in the loan portfolio. Actual losses could differ significantly from the historical factors that the Bank uses in estimating risk. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of Financial's transactions would be the same, the timing of events that would impact the transactions could change.

The allowance for loan losses is management's estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) SFAS No. 5, "Accounting for Contingencies," which requires that losses be accrued when they are probable of occurring and are reasonably estimable and (ii) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," which requires that losses on impaired loans 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. Guidelines for determining allowances for loan losses are also provided in the SEC Staff Accounting Bulletin No. 102 – "Selected Loan Loss Allowance Methodology and Documentation Issues" and the Federal Financial Institutions Examination Council's interagency guidance, "Interagency Policy Statement on the Allowance for Loan and Lease Losses" (the "FFIEC Policy Statement"). See "Management Discussion and Analysis Results of Operations – Allowance for Loan Losses and Loan Loss Reserve" below for further discussion of the allowance for loan losses.

Because Financial has a relatively short operating history, historical trends alone do not provide sufficient information to judge the adequacy of the allowance for loan losses. Therefore, management considers industry trends, peer comparisons, as well as individual classified impaired loans, in addition to historical experience to evaluate the allowance for loan losses. Our method for determining the allowance for loan losses is discussed more fully under "Provision and Allowance for Loan Losses for the Bank" below.

Results of Operations

Year ended December 31, 2008 compared to year ended December 31, 2007

Net Income

The net income for Financial for the year ended December 31, 2008 was $224,000 or $0.08 per basic and diluted share compared with net income of $2,084,000 or $074 per basic and $0.71 per diluted share for the year ended December 31, 2007. Note 10 of the Audited Financial Statements provides additional information with respect to the calculation of Financial's earnings per share.

The decrease of $1,860,000 in 2008 net income compared to 2007 net income was due in large part to a loss on the sale of preferred stock of Federal National Mortgage Association (the "GSE") in the amount

$1,833,000 ($0.65 per share). The value of this stock decreased sharply in September 2008 after the announcement that the GSE was suspending dividend payments and was being placed into conservatorship of the Federal Housing Finance Agency. On December 29, 2008, the Bank sold its preferred stock and realized this loss. A provision of the Emergency Economic Stabilization Act enabled the Company to realize a tax benefit of approximately $623,000. This economic benefit had the result of lowering the total charge taken on the preferred stock to $1,210,000.

Exclusive of the loss realized loss on the sale the GSE preferred stock the Company would have had net income of approximately $1,434,000, or $0.51 per basic share ($0.49 diluted) for the year ended December 31, 2008.

Our earnings benefited from the following factors: i) additional interest earned as a result of an increase in the size of the loan portfolio, Financial's primary method of investment; and ii) a slight increase in non-interest income, exclusive of the realized loss on the sale of the GSE preferred stock. In addition, our earnings were negatively impacted by i) a decrease in net interest margin, ii) an increase in personnel expenses and occupancy expenses related to our expansion as well as an increase in outside expenses.

Our loan loss provision was $1,355,000 for the year ended December 31, 2008 as compared with a loan loss provision of $451,000 for the year ended December 31, 2007. This increase resulted from application of the Bank's impairment review, as required by SFAS 114, and an analysis of historical loss percentages, as required by SFAS 5, both of which are discussed in more detail below, performed in accordance with FFIEC Policy Statement discussed under "Critical Accounting Policies," above. Although as of December 31, 2008 the Bank had non-performing assets, inclusive of other real estate owned, in excess of $3,940,000, management believes that the allowance for loan losses was adequate.

These operating results represent a return on average shareholders' equity of 0.93% for the year ended December 31, 2008 compared to 9.10% for the year ended December 31, 2007. Return on average assets for the year ended December 31, 2008 was 0.07% compared to 0.84% in 2007.

Net Interest Income

The fundamental source of Financial's earnings, net interest income, is defined as the difference between income on earning assets and the cost of funds supporting those assets. The significant categories of earning assets are loans, federal funds sold, and investment securities, while deposits, fed funds purchased, and other borrowings represent interest-bearing liabilities. The level of net interest income is impacted primarily by variations in the volume and mix of these assets and liabilities, as well as changes in interest rates when compared to previous periods of operation.

Net interest income for 2008 increased $696,000 to $10,576,000 or 7.04% from net interest income of $9,880,000 in 2007. The growth in net interest income was due to an increase in average interest-earning assets which was the result of growth in the loan portfolio funded by the growth in deposits. The net interest margin decreased to 3.71% in 2008 from 4.18% in 2007. The average rate on earning assets decreased 97 basis points from 7.49% in 2007 to 6.52% in 2008 and the average rate on interest-bearing liabilities decreased from 4.06% in 2007 to 3.33% in 2008. Although management cannot predict with certainty future interest rate decisions by the FOMC, management believes that the rates being offered on both loans and deposits can be adjusted to maintain an acceptable spread between the average rate the Bank receives on assets and the average rate that the Bank pays on liabilities.

Interest income increased to $18,594,000 for the year ended December 31, 2008 from $17,715,000 for the year ended December 31, 2007. This increase was due to an increase in the amount of interest earning assets, including loans and investment securities.

Interest expense increased to $8,018,000 for the year ended December 31, 2008 from $7,835,000 for the year ended December 31, 2007. This increase in interest expense was primarily due to both an increase in the aggregate balance in interest bearing deposit accounts and an increase in interest rates paid in response to competition for deposits in our market area. In addition, interest expense increased in part because of a growth in certificates of deposit, which paid increased interest rates in response to competition. The Bank expects its interest expense to begin to decrease slightly throughout the first and second quarters of 2009 as maturing certificates of deposit renew and reprice at lower rates.

The following table illustrates average balances of total interest earning assets and total interest bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, stockholders' equity and related revenue, expense and corresponding weighted average yields and rates. The average balances used in this table and other statistical data were calculated using average daily balances.

Net Interest Margin Analysis
Average Balance Sheets
For the Twelve Months Ended December 31, 2008 and 2007
(dollars in thousands)

	2008			2007		
	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/Paid	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/Paid
ASSETS						
Loans, including fees	$248,193	$16,656	6.71%	$207,772	$16,259	7.83%
Federal funds sold	763	19	2.49%	973	49	5.04%
Securities	34,508	1,846	5.35%	27,015	1,357	5.02%
Federal agency equities	1,742	73	4.19%	810	50	6.17%
CBB equity	68	—	0.00%	56	—	0.00%
Total earning assets	285,274	18,594	6.52%	236,626	17,715	7.49%
Allowance for loan losses	(2,348)			(2,162)		
Non-earning assets	17,649			14,901		
Total assets	$300,575			$249,365		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Deposits						
Demand interest bearing	$ 39,256	$ 636	1.62%	$ 42,964	$ 1,123	2.61%
Savings	43,886	1,143	2.60%	12,572	193	1.54%
Time deposits	122,684	5,304	4.32%	124,886	6,083	4.87%
Total interest bearing deposits	205,826	7,083	3.44%	180,422	7,399	4.10%
Other borrowed funds						
Fed funds purchased	3,596	99	2.75%	2,035	114	5.60%
Repurchase agreements	13,925	359	2.58%	10,737	322	3.00%
Other borrowings	17,158	477	2.78%	—	—	0.00%
Total interest-bearing liabilities	240,505	8,018	3.33%	193,194	7,835	4.06%
Non-interest bearing deposits	35,235			33,237		
Other liabilities	646			631		
Total liabilities	276,386			227,062		
Stockholders' equity	24,189			22,303		
Total liabilities and Stockholders equity	$300,575			$249,365		
Net interest earnings		$10,576			$ 9,880	
Net interest margin			3.71%			4.18%
Interest spread			3.19%			3.43%

	Volume and Rate (in thousands) Years Ending December 31,					
	2008			2007		
	Volume Effect	Rate Effect	Change in Income/ Expense	Volume Effect	Rate Effect	Change in Income/ Expense
Loans	$1,500	$(1,103)	$ 397	$3,111	$(132)	$ 2,979
Federal funds sold	(9)	(21)	(30)	(65)	1	(64)
Securities	395	94	489	61	56	117
Federal agency equities	31	(9)	23	5	(2)	3
Total earning assets	1,917	(1,039)	879	3,112	(77)	3,035
Liabilities:						
Demand interest bearing	(90)	(397)	(487)	293	16	309
Savings	744	206	950	(161)	(66)	(227)
Time deposits	(105)	(674)	(779)	1,068	791	1,859
Fed funds purchased	(45)	30	(15)	74	1	75
FHLB borrowings	477	—	477	—	—	—
Repurchase agreements	62	(34)	37	85	50	135
Total interest-bearing liabilities	$1,053	$ (870)	$ 183	$1,359	$ 792	$ 2,151
Change in net interest income	$ 864	$ (169)	$ 696	$1,753	$(869)	$ 884

Non-Interest Income of Financial

Non-interest income has been and will continue to be an important factor for increasing our profitability. We recognize this and our management continues to review and consider areas where non-interest income can be increased. Non-interest income (excluding securities gains and losses) consists primarily of fees and charges on transactional deposit accounts, mortgage loan origination fees, distributions from a title insurance agency in which we have an ownership interest, and fees generated by the investment services of Investment Group.

The Bank, through Bank of the James Mortgage, a Division of Bank of the James (the “Mortgage Division”) originates both conforming and non-conforming consumer residential mortgage loans primarily in the Region 2000 area. As part of the Bank’s overall risk management strategy, all of the loans originated and closed by the Mortgage Division are presold to mortgage banking or other financial institutions. The Mortgage Division assumes no credit or interest rate risk on these mortgages.

Effective April 4, 2006, Investment Group began providing securities brokerage services to Bank customers and others. Investment Group provides the services through an agreement with Community Bankers’ Securities, LLC (“CB Securities”), a registered broker-dealer. Under this agreement, CB Securities will operate service centers in one or more branches of the Bank. The centers will be staffed by dual employees of Investment Group and CB Securities. Investment Group receives commissions on transactions generated and in some cases ongoing management fees such as mutual fund 12b-1 fees. Due to the relatively short operating history of Investment Group, its financial impact on the consolidated financials of Financial has been immaterial. Although management cannot predict the financial impact of Investment Group with certainty, management anticipates it will continue to be a growing component of non-interest income in 2009.

Effective September 2008, BOTJ Insurance began providing insurance and annuity products to Bank customers and others. Due to the relatively short operating history of Investment Group, its financial impact on the consolidated financials of Financial has been immaterial. Although management cannot predict the financial impact of BOTJ Insurance with certainty, management anticipates its impact on non-interest income will not be material in 2009.

Non-interest income, exclusive of gains and losses on sale of securities, decreased to $2,624,000 in 2008 from 2,710,000 in 2007. Inclusive of gains and losses on sale of securities, non-interest income decreased to $954,000 in 2008 from $2,751,000 in 2007. The following table summarizes our non-interest income for the periods indicated.

	Non-Interest Income (dollars in thousands) At December 31,	
	2008	**2007**
Service charges and fees	$ 465	$ 504
Mortgage loan origination fees, net of commission	1,183	1,345
Investment service fees	571	520
Equity earnings from title insurance	61	68
Other	344	273
Non-interest income	2,624	2,710
Gain (loss) on sales of available-for-sale securities	(1,670)	41
Total non-interest income	$ 954	$ 2,751

The decrease in non-interest income for 2008 was due to i) the loss on the sale of the GSE stock; and ii) a decrease in fees generated by the Mortgage Division. The decrease was offset in part by increased revenue from the Investment Group. 2008 was Investment Group's second full year of operation. In 2008, Investment Group increased its revenue as a direct result of increased transactions for its customers. For the year ended December 31, 2008, Investment Group accounted for 2.92% of Financial's total income as compared with 2.54% of Financial's total income for the year ended December 31, 2007. During 2008, despite the fact the mortgage loan market was suppressed as a result of declining real estate values and a difficult credit market, mortgage loan volume remained relatively strong and the Mortgage Division improved its market share. In addition, the Mortgage Division provides opportunities to establish many new banking relationships by providing more bank services and products to new customers. The Mortgage Division originated 371 mortgage loans, totaling $56,379,000 in 2008 as compared with 416 mortgage loans, totaling $71,278,000 during the year ended December 31, 2007. For the year ended December 31, 2008, the Mortgage Division accounted for 6.05% of Financial's total income as compared with 6.57% of Financial's total income for the year ended December 31, 2007.

Non-Interest Expense of Financial

Non-interest expenses increased from $9,019,000 for the year ended December 31, 2007 to $10,813,000 for the year ended December 31, 2008. The following table summarizes our non-interest expense for the periods indicated.

	Non-Interest Expense (dollars in thousands) At December 31,	
	2008	2007
Salaries and employee benefits	$ 5,290	$ 4,756
Occupancy	747	700
Equipment	983	840
Supplies	382	326
Professional, data processing and other outside expenses	1,295	1,135
Marketing	387	375
Credit expense	234	210
Loss (gain) on sale of assets	(5)	51
Amortization of tax credit investment	785	—
Other	715	626
Total non-interest expense	$ 10,813	$ 9,019

The increase in non-interest expense was due in large part to an increase in personnel expenses as well as increases in occupancy and outside expenses, all of which directly relate to our expansion into the City of Bedford and the Town of Altavista. Our total personnel expense, net of fees collected from borrowers to cover direct salary costs incurred in originating certain loans (in accordance with SFAS 91), increased to $5,290,000 for the year ended December 31, 2008, from $4,756,000 for the twelve months ended December 31, 2007. Compensation for some employees of the Mortgage Division and Investment Group is commission-based and therefore subject to fluctuation. Because of increased volume of business at both the Mortgage Division and Investment Group, commission compensation and the corresponding employee benefits increased in 2008. The Bank also had increases in depreciation expense, data processing fees, and other operating expenses, all of which are related to the growth of the Bank.

Because of the costs associated with increased staffing at the newest branches, Financial's efficiency ratio (that is, the cost of producing each dollar of revenue) increased from 71.40% in 2007 to 93.97% in 2008. Management intends that additional interest earning assets will help lower the efficiency ratio.

Analysis of Financial Condition

General

Our total assets were $328,605,000 at December 31, 2008, an increase of $58,545,000 or 21.68% from $270,060,000 at December 31, 2007, primarily due to growth in the loan portfolio. Loans, net of unearned income and allowance, increased to $274,890,000 on December 31, 2008 from $224,022,000 on December 31, 2007. The increase in loans was funded by growth in deposits from $228,723,000 on December 31, 2007 to $268,111,000 on December 31, 2008.

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Loans

Our loan portfolio is the largest and most profitable component of our earning assets. The Bank has comprehensive policies and procedures which cover both commercial and consumer loan origination and management of credit risk. Loans are underwritten in a manner that focuses on the borrower's ability to repay. Management's goal is not to avoid risk, but to manage it and to include credit risk as part of the pricing decision for each product.

The Bank's loan portfolio consists of commercial short-term lines of credit, term loans, mortgage financing and construction loans that are used by the borrower to build or develop real estate properties, and consumer loans. The consumer portfolio includes residential real estate mortgages, home equity lines and installment loans.

Loans, net of unearned income and allowance, increased to $274,890,000 on December 31, 2008 from $224,022,000 on December 31, 2007. Total loans increased to $277,749,000 on December 31, 2008 from $226,168,000 on December 31, 2007. These increases can be attributed in part to an interest rate environment that made borrowing attractive to the Bank's customers, the Bank's increased presence in the market, and the Bank's reputation for service.

As of December 31, 2008, the Bank had $3,859,000 in non-accrual loans compared with $1,246,000 at December 31, 2007. The Bank continues to pursue an aggressive charge off policy that also yields loan recoveries. This increase is due in large part to loans with two customers that are non-performing. Since December 31, 2008, the Bank purchased the real estate collateral securing the loans associated with one of these relationships at a foreclosure sale. See "Asset Quality" below.

The following table summarizes the composition of the Bank's loan portfolio for the periods indicated by dollar amount:

	Loan Portfolio (in thousands) December 31,				
	2008	2007	2006	2005	2004
Commercial loans	$ 52,842	$ 43,877	$ 36,082	$ 30,853	$ 35,163
Real estate - construction	43,507	36,296	32,087	27,303	22,251
Real estate - residential	136,850	114,278	98,151	78,058	63,215
Installment and other	44,550	31,717	23,240	21,043	21,062
Total loans	277,749	226,168	189,560	157,257	141,691
Less allowance for loan losses	2,859	2,146	2,091	1,777	1,419
Net loans	$274,890	$224,022	$187,469	$155,480	$140,272

(1) From 2003 to 2004, certain loans previously classified as commercial were reclassified because real estate served as the primary collateral for such loans.

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The following table sets forth the maturities of the loan portfolio at December 31, 2008.

	Remaining Maturities of Selected Loans (dollars in thousands) At December 31, 2008			
	Less than One Year	One to Five Years	Greater than Five Years	Total
Commercial, financial, and agricultural	$ 30,582	$14,407	$ 8,262	$ 53,251
Real estate - construction	39,487	2,668	1,880	44,035
Real estate - mortgage	21,983	16,019	99,142	137,144
Installment and other	7,340	10,860	25,118	43,318
Total	$ 99,393	$43,954	$ 134,402	$277,749
For maturities over one year:				
Fixed Rates	$ 83,614			
Variable Rates	94,742			
Total	$178,356			

Deposits

We experienced strong deposit growth from $228,723,000 for the period ended December 31, 2007 to $268,111,000 at the end of the same period in 2008, for an increase of 17.22%. Non-interest-bearing deposits increased $805,000 or 2.30% from $34,973,000 at December 31, 2007 to $35,778,000 at December 31, 2008. Interest-bearing deposits increased $35,583,000 or 18.37% from $193,750,000 at December 31, 2007 to $232,333,000 at December 31, 2008. Additionally, the Bank's effort to increase non-FDIC insured sweep accounts (repurchase agreements) resulted in an increased balance in these accounts to $14,339,000 on December 31, 2008 from $10,542,000 on December 31, 2007.

	Average Deposits and Rates Paid (dollars in thousands) Year Ended December 31,					
	2008		2007		2006	
	Amount	Rate	Amount	Rate	Amount	Rate
Non interest- bearing deposits	$ 35,235		$ 33,237		$ 27,316	
Interest -bearing deposits						
Interest checking	$ 12,709	1.06%	$ 11,879	1.45%	$ 10,510	1.45%
Money market	26,368	1.88%	30,988	3.06%	21,284	3.11%
Savings	44,065	2.60%	12,669	1.55%	22,401	1.88%
Time deposits						
Less than $100,000	82,188	4.28%	86,428	4.82%	73,189	4.08%
Greater than $100,000	40,496	4.41%	38,458	4.99%	28,297	4.37%
Total interest-bearing deposits	$205,826	3.44%	$180,422	4.10%	$155,681	3.51%
Total deposits	$241,061		$213,659		$182,997	

The following table includes a summary of average deposits and average rates paid and maturities of CDs greater than $100,000.

	Maturities of CD's Greater than $ 100,000 (in thousands)				
	Less than Three Months	Three to Six Months	Six to Twelve Months	Greater than One Year	Total
At December 31, 2008	$ 8,034	$5,273	$12,055	$10,079	$35,441

Cash and Cash Equivalents

Cash and cash equivalents increased from $4,314,000 on December 31, 2007 to $15,825,000 on December 31, 2008. This increase was due primarily to routine fluctuations in deposits and federal funds sold. These routine fluctuations in deposits, including fluctuations in transactional accounts and professional settlement accounts, contribute to variations in cash and cash equivalents. Federal funds sold increased from $0 on December 31, 2007 to $5,241,000 on December 31, 2008. Management considers the amount of the increase in federal funds sold to be part of the normal course of business.

Investment Securities

The investment securities portfolio of the Bank is used as a source of income and liquidity.

The following table summarizes the fair value of the Bank's securities portfolio for the periods indicated:

	Securities Portfolio (in thousands) December 31,		
	2008	2007	2006
Held to Maturity			
U.S. agency obligations	$ 6,039	$ 6,523	$ 7,343
Available-for-sale			
U.S. agency obligations	7,237	15,083	15,714
Mortgage - backed securities	5,030	4,734	2,144
Municipals	694	2,523	840
Corporates	3,176	3,393	—
Total available-for-sale	$16,137	$25,733	$18,698

Deposited funds are generally invested in overnight vehicles, including Federal funds sold, until approved loans are funded. The decision to purchase investment securities is based on several factors or a combination thereof, including:

a) The fact that yields on acceptably rated investment securities (S&P "A" rated or better) are significantly better than the overnight Federal funds rate;

b) Whether demand for loan funding exceeds the rate at which deposits are growing, which leads to higher or lower levels of surplus cash;

c) Management's target of maintaining a minimum of 6% of the Bank's total assets in a combination of Federal funds sold and investment securities (aggregate of available–for-sale and held-to-maturity portfolios); and

d) Whether the maturity or call schedule meets management's asset/liability plan.

Available-for-sale securities (as opposed to held-to-maturity securities) may be liquidated at any time as funds are needed to fund loans. Liquidation of securities may result in a net loss or net gain depending on current bond yields available in the primary and secondary markets and the shape of the U.S. Treasury yield curve. Management is cognizant of its credit standards policy and does not feel pressure to maintain loan growth at the same levels as deposit growth and thus sacrifice credit quality in order to avoid security purchases.

Management has made the decision to maintain a significant portion of its available funds in liquid assets so that funds are available to fund future growth of the loan portfolio. Management believes that this strategy will allow us to maximize interest margins while maintaining appropriate levels of liquidity.

Securities held-to-maturity decreased from $6,494,000 as of December 31, 2007 to $5,994,000 as of December 31, 2008. This immaterial decrease resulted primarily from the call of one position. The decision to invest in securities held-to-maturity is based on the same factors as the decision to invest in securities available-for-sale except that management invests surplus funds in securities held-to-maturity only after concluding that such funds will not be necessary for liquidity purposes during the term of such security. However, the held-to-maturity securities may be pledged for such purposes as short term borrowings and as collateral for public deposits.

The portfolio of securities available-for-sale decreased to $16,136,000 as of December 31, 2008 from $25,733,000 as of December 31, 2007. During 2008, the Bank sold available-for-sale securities to provide liquidity to pay down short term borrowings and to position the Bank to be able to fund future loan growth.

The following table shows the maturities of held-to-maturity and available-for-sale securities at amortized cost and market value at December 31, 2008 and approximate weighted average yields of such securities. Yields on state and political subdivision securities are not shown on a tax equivalent basis. Financial attempts to maintain diversity in its portfolio and maintain credit quality and repricing terms that are consistent with its asset/liability management and investment practices and policies. For further information on Financial's securities, see Note 4 to the consolidated financial statements included in Item 8 of this Form 10-K.

Securities Portfolio Maturity Distribution / Yield Analysis
(dollars in thousands)
At December 31, 2008

	Less than One Year	One to Five Years	Five to Ten Years	Greater than Ten Years and Other Securities	Total
Held to Maturity					
U.S. agency					
Amortized cost	$—	$2,000	$ 995	$ 2,999	$ 5,994
Market value	$—	$2,005	$1,000	$ 3,034	$ 6,039
Weighted average yield		4.00%	5.69%	6.16%	
Available for sale securities					
U.S. agency					
Amortized cost	$—	$ —	$1,000	$ 5,994	$ 6,994
Market value	$—	$ —	$1,054	$ 6,183	$ 7,237
Weighted average yield			4.95%	5.70%	
Mortgage Backed Securities					
Amortized cost	$—	$1,032	$ 453	$ 3,572	$ 5,057
Market value	$—	$1,038	$ 460	$ 3,532	$ 5,030
Weighted average yield		4.25%	4.84%	5.09%	
Municipals					
Amortized cost	$—	$ —	$ 479	$ 239	$ 718
Market value	$—	$ —	$ 480	$ 214	$ 694
Weighted average yield			8.49%	6.53%	
Corporate					
Amortized cost	$—	$ —	$2,448	$ 1,035	$ 3,483
Market value	$—	$ —	$2,316	$ 860	$ 3,175
Weighted average yield			5.75%	7.38%	
Total portfolio					
Amortized cost	$—	$3,032	$5,375	$ 13,839	$22,246
Market value	$—	$3,043	$5,310	$ 13,823	$22,175
Weighted average yield		4.08%	5.50%	5.74%	

Liquidity

The liquidity of Financial depends primarily on the dividends paid to it by the Bank. Payment of cash dividends by the Bank is limited by regulations of the Federal Reserve Board and is tied to the regulatory capital requirements.

The objective of liquidity management for the Bank is to ensure the continuous availability of funds to meet the demands of depositors, investors and borrowers. Stable core deposits and a strong capital position are the components of a solid foundation for the Bank's liquidity position.

Funding sources for the Bank primarily include paid-in capital and customer-based deposits but also include borrowed funds and cash flow from operations. The Bank has in place several agreements that will provide alternative sources of funding, including, but not limited to, lines of credit, sale of investment securities, purchase of federal funds, advances through the Federal Home Loan Bank of Atlanta ("FHLBA") and correspondents, and brokered certificate of deposit arrangements. Management believes that the Bank has the ability to meet its liquidity needs.

At December 31, 2008, cash, interest-bearing and non interest-bearing deposits with banks, federal funds sold, securities and loans maturing within one year was $115,218,000. At the end of 2008, approximately 39.94%, or $110,723,000 of the loan portfolio would mature or reprice within a one-year period. At December 31, 2008 non-deposit sources of available funds totaled $83,230,000, which included $63,980,000 available from the FHLBA.

Capital Resources

Capital adequacy is an important measure of financial stability and performance. Management's objectives are to maintain a level of capitalization that is sufficient to sustain asset growth and promote depositor and investor confidence.

Regulatory agencies measure capital adequacy utilizing a formula that takes into account the individual risk profiles of financial institutions. The guidelines define capital as Tier 1 (primarily common stockholders' equity, defined to include certain debt obligations) and Tier 2 (remaining capital generally consisting of a limited amount of subordinated debt, certain hybrid capital instruments and other debt securities, preferred stock and a limited amount of the general valuation allowance for loan losses). The Bank's regulatory capital levels exceed those established for well-capitalized institutions. The following table (along with Note 14 of the Audited Financial Statements) shows the minimum capital requirements and the Bank's capital position as of December 31, 2008 and 2007.

Analysis of Capital for Bank of the James

	2008	2007
Tier 1 Capital:		
Common Stock	$ 3,743	$ 3,743
Additional paid in capital	13,317	13,311
Retained earnings	7,195	6,981
Total Tier 1 Capital	$ 24,255	$ 24,035
Tier 2 Capital:		
Allowance for loan losses	2,859	2,146
Total Tier 2 Capital	$ 2,859	$ 2,146
Total risk-based capital	$ 27,114	$ 26,181
Risk weighted assets	$270,451	$219,180
Average total assets	$324,386	$268,187

	December 31,		Regulatory Minimums	
	2008	2007	Capital Adequacy	Well Capitalized
Capital Ratios				
Tier 1 capital to average total assets	7.48%	8.96%	4.00%	5.00%
Tier 1 risk-based capital ratio	8.97%	10.97%	4.00%	6.00%
Total risk-based capital ratio	10.03%	11.94%	8.00%	10.00%

The Bank was initially capitalized through a public offering of its common stock, $4.00 (split adjusted to $2.14) par value per share (“Common Stock”), at $10.00 per share, which concluded in February, 1999 and resulted in a capitalization of the Bank of $9,356,300. On December 22, 2006, Financial completed a follow-on offering pursuant to which it raised $5,147,000 (net of costs and expenses of $106,000). As a result of these two offerings and funds generated from operations, Financial currently has sufficient liquidity and capital with which to operate.

Financial is in the process of completing a private placement of unregistered debt securities pursuant to which it will issue notes to accredited investors in an amount between $6,200,000 and $7,000,000. Management anticipates that this transaction will close on March 30, 2009 in the full amount of the offering. The debt issued pursuant to this offering will bear interest at the rate of 6% per year with interest payable quarterly in arrears. The first interest payment is due on July 1, 2009. No principal payments are due until the debt matures on April 1, 2012 (the “Maturity Date”). On the Maturity Date the principal and all accrued but unpaid interest on the debt will be due and payable. Financial intends to use between $5,500,000 and $6,000,000 of the proceeds to provide additional capital to the Bank. We expect to retain the balance of the proceeds at Financial to service interest payments on the debt.

As of the date hereof, the capital ratios for the Company on a consolidated basis are comparable to the capital ratios of the Bank.

Stockholder’s Equity

Stockholders’ equity increased a non-material amount of $111,000 from $24,524,000 on December 31, 2007 to $24,635,000 on December 31, 2008.

Asset Quality

We perform monthly reviews of all delinquent loans and loan officers are charged with working with customers to resolve potential payment issues. We generally classify a loan as nonaccrual when it is deemed uncollectible or when the borrower has not made a payment in 90 days. We generally restore a loan if i) a borrower is no longer 90 days past due on the loan; and ii) management determines that a borrower has the capacity to repay the loan. We also classify other real estate owned (OREO) as a non performing asset. OREO, which is accounted for in the “other assets” section of the Statement of Financial Condition, represents real property owned by the Bank either through purchase at foreclosure or received from the borrower through a deed in lieu of foreclosure.

Asset quality remained strong in 2008. Non-accrual loans increased to $3,859,000 on December 31, 2008 from $1,246,000 on December 31, 2007. Management has provided for the anticipated losses on these loans in the loan loss reserve. OREO increased to $81,000 on December 31, 2008 from $0 on December 31, 2007. As of the date hereof, OREO has increased to $1,938,000. $1,609,000 of the OREO balance is due to the purchase of a partially-developed commercial property, which the Bank purchased at foreclosure.

The amount allocated during the year to the provision for loan losses represents management's analysis of the existing loan portfolio and credit risks. Management's policy is to maintain the allowance for loan losses at a level sufficient to absorb the estimated losses inherent in the loan portfolio. Both the amount of the provision and the level of the allowance for loan losses are impacted by many factors, including general economic conditions, actual and expected credit losses, loan performance measures, historical trends and specific conditions of the individual borrower.

In performing its loan loss analysis, the Bank assigns one of the following risk categories to each commercial loan in the Bank's portfolio:

Risk Category	Classification
Risk 1	Excellent
Risk 2	Above Average
Risk 3	Satisfactory
Risk 4	Acceptable/Low Satisfactory
Risk 5	Special Mention
Risk 6	Sub-Standard
Risk 7	Doubtful
Risk 8	Loss

Management considers the following four components when calculating its loan loss reserve requirement:

- In accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan," the Bank performs an individual impairment analysis on all loans with a Risk Rating of 5 through 8.
- In accordance with SFAS 5, "Accounting for Contingencies," the Bank examines historical charge-off data by classification code in order to determine a portion of the reserve related to homogeneous pools. The Bank updates its historical charge-off data twice a year and adjusts the reserve accordingly. The Bank also adjusts the historical charge-off data based on the risk rated tiering system set forth above to more accurately reflect the Bank's actual losses.
- The Bank applies various risk factors, including, for example, levels of trends in delinquencies, current and expected economic conditions, and levels of and trends in recoveries of prior charge-offs.
- The Bank applies factors to determine the method by which to allocate the unallocated reserve for inherent losses related to the loan pool, including, for example, loan concentrations, policy and procedure changes, national and local economic trends and conditions, and overall portfolio quality.

The Bank's allowance for loan losses increased 33.22% from $2,146,000 on December 31, 2007 to $2,859,000 on December 31, 2008. This increase is reflective of the growth in the loan portfolio and current economic conditions. The increase resulted from application of the Bank's commercial loan rating system and individual impairment calculations, as discussed above, as applied to the larger total loan portfolio. As of December 31, 2008 the allowance for loan losses was equal to 1.03% of the total loan portfolio as compared with 0.95% at December 31, 2007.

The following tables set forth information regarding impaired and non-accrual loans as of December 31, 2008 and 2007:

	Impaired & Non-Accrual Loans (in thousands) At December 31,	
	2008	2007
Impaired loans without a valuation allowance	$ 8,006	$10,355
Impaired loans with a valuation allowance	10,375	4,503
Total impaired loans	$18,381	$14,858
Valuation allowance related to impaired loans	$ 1,441	$ 1,389
Total non-accrual loans	$ 3,859	$ 1,246
Total loans past due ninety days or more and still accruing	$ —	$ —

No non-accrual loans were excluded from impaired loan disclosure for both 2008 and 2007.

	Average Investment in Impaired Loans (in thousands) Years Ended December 31,	
	2008	2007
Average investment in impaired loans	$ 15,703	$ 13,891
Interest income recognized on impaired loans	$ 860	$ 988
Interest income recognized on a cash basis on impaired loans	$ 786	$ 988

No nonaccrual loans were excluded from impaired loan disclosure under SFAS No. 114 at December 31, 2008 and 2007. If interest on these loans had been accrued, such income would have approximated $242,000 and $88,000 for 2008 and 2007, respectively. Loan payments received on nonaccrual loans are applied to principal. When a loan is placed on non-accrual status there are several negative implications. First, all interest accrued but unpaid at the time of the classification is deducted from the interest income totals for the Bank. Second, accruals of interest are discontinued until it becomes certain that both principal and interest can be repaid. Third, there may be actual losses that necessitate additional provisions for credit losses charged against earnings. These loans were included in the nonperforming loan totals listed above.

An external loan review firm examined the Bank's loan portfolio in March, 2009. After examination of approximately 62 customer relationships comprising 147 loans totaling $73,524,000 in exposure, or approximately 23% of the Bank's total outstanding loan balances as of March 31, 2009, the results of the external loan review showed the Bank's loan portfolio to be sound and the credit underwriting practices to be fully satisfactory as compared to peer group institutions.

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The following table shows sets forth the detail of loan charged-off, recovered, and the changes in the allowance for loan losses as of the dates indicated:

	Allowance for Loan Losses (dollars in thousands) At December 31,				
	2008	2007	2006	2005	2004
Balance, beginning of period	$2,146	$2,091	$1,777	$1,419	$1,451
Loans charged-off:					
Commercial, financial and agricultural	379	165	143	224	641
Real estate-construction	31	25	101	—	15
Real estate-mortgage	82	125	76	86	67
Installment and other	197	127	83	175	166
Total loans charged off	$ 689	$ 442	$ 403	$ 485	$ 889
Recoveries:					
Commercial, financial and agricultural	$ 17	$ 22	$ 63	$ 5	$ 76
Real estate-construction	—	—	—	12	—
Real estate-mortgage	—	—	3	—	—
Installment and other	30	24	21	23	27
Total recoveries	$ 47	$ 46	$ 87	$ 40	$ 103
Net charge-offs	$ 642	$ 396	$ 316	$ 445	$ 786
Provision for loan losses	1,355	451	630	803	754
Balance, end of period	$2,859	$2,146	$2,091	$1,777	$1,419

The following table shows the balance and percentage of the Bank's allowance for loan losses allocated to each major category of loans:

	Allocation of Allowance for Loan Losses (dollars in thousands) At December 31,									
	2008	Percent of Loans to Total Loans	2007	Percent of Loans to Total Loans	2006	Percent of Loans to Total Loans	2005	Percent of Loans to Total Loans	2004	Percent of Loans to Total Loans
Commercial, financial, and agricultural	$ 536	18.75%	$ 523	24.37%	$ 565	27.02%	$ 499	28.08%	$ 493	34.84%
Real estate - construction	154	5.39%	105	4.89%	390	18.65%	143	8.05%	123	8.67%
Real estate - mortgage	1,864	65.19%	1,226	57.13%	712	34.05%	657	36.97%	411	28.96%
Installment and other	305	10.67%	292	13.61%	424	20.28%	478	26.90%	392	27.63%
	$2,859	100.00%	$2,146	100.00%	$2,091	100.00%	$1,777	100.00%	$1,419	100.00%

The following table provides information on the Bank's nonperforming assets as of the dates indicated:

	Nonperforming Assets (dollars in thousands) At December 31,				
	2008	2007	2006	2005	2004
Nonaccrual loans	$3,859	$1,246	$ 646	$ 261	$ 380
Restructured loans	—	—	—	—	—
Foreclosed property	81	—	535	—	85
Loans past due 90 days accruing interest	—	—	—	—	—
Total nonperforming assets	$3,940	$1,246	$1,181	$ 261	$ 465
Allowance for loan losses to period end loans	1.03%	0.95%	1.10%	1.13%	1.00%
Nonperforming assets to period end loans	1.42%	0.55%	0.34%	0.17%	0.27%
Net charge-offs (recoveries) to average loans	0.26%	0.19%	0.19%	0.30%	0.62%

Income Tax Expense

For the year ended December 31, 2008, Financial had a federal income tax benefit of $862,000 as a result of a tax credit investment. Note 9 of the Audited Financial Statements provides additional information with respect to our 2008 federal income tax expense and the deferred tax accounts.

Interest Rate Sensitivity

The most important element of asset/liability management is the monitoring of Financial's sensitivity to interest rate movements. The income stream of Financial is subject to risk resulting from interest rate fluctuations to the extent there is a difference between the amount of Financial's interest earning assets and the amount of interest bearing liabilities that prepay, mature or reprice in specified periods. Management's goal is to maximize net interest income with acceptable levels of risk to changes in interest rates. Management seeks to meet this goal by influencing the maturity and re-pricing characteristics of the various lending and deposit taking lines of business and by managing discretionary balance sheet asset and liability portfolios.

Management also is attempting to mitigate interest rate risk by limiting the dollar amount of loans carried on its balance sheet that have fixed rates in excess of five years. To reduce our exposure to interest rate risks inherent with longer term fixed rate loans, we generally do not hold such mortgages on our books. The Bank established the Mortgage Division to serve potential customers that desired fixed rate loans in excess of five years.

Management believes that Financial has been successful in managing its net interest margin despite numerous adjustments by the FOMC since 2001. During 2008, the Bank's prime rate decreased from 7.25% to 3.25% and as of March 12, 2009 remained at 3.25%. Our net interest margin was under pressure in part because of higher rates paid on deposit accounts, primarily certificates of deposit. Financial's spread on earning assets to interest bearing liabilities decreased from 3.43% in 2007 to 3.19% in 2008. Management attempts to mitigate this pressure by constantly monitoring and repricing deposits.

Management monitors interest rate levels on a daily basis and meets in the form of the Asset/Liability Committee ("ALCO") at least weekly or when a special situation arises (e.g., FOMC unscheduled rate change). The following reports and/or tools are used to assess the current interest rate environment and its impact on Financial's earnings and liquidity: monthly and year-to-date net interest margin and spread calculations, monthly and year-to-date balance sheet and income statements versus budget (including quarterly interest rate shock analysis), quarterly net portfolio value analysis, a weekly survey of rates offered by other local competitive institutions, and gap analysis which matches maturities or repricing dates of interest sensitive assets to those of interest sensitive liabilities.

Financial currently subscribes to computer simulated modeling tools made available through its consultant, FinPro, Inc., to aid in asset/liability analysis. In addition to monitoring by the ALCO and Investment Committee, the board is informed of the current asset/liability position and its potential effect on earnings at least quarterly.

Current Trends

A variety and wide scope of economic factors affect Financial's success and earnings. Although interest rate trends are one of the most important of these factors, Financial believes that interest rates cannot be predicted with a reasonable level of confidence and therefore does not attempt to do so with complicated economic models. Management believes that the best defense against wide swings in interest rate levels is to minimize vulnerability at all potential interest rate levels. Rather than concentrate on any one interest rate scenario, Financial prepares for the opposite as well, in order to safeguard margins against the unexpected.

The downward trend in short term interest rates beginning in the last quarter of 2007 was due to the actions of the FOMC resulting from a weakening economy. As a result, the yield curve continued to steepen through the first three quarters of 2008. As liquidity increased as a result of open market operations and other government actions, longer-term interest rates decreased. Although it cannot be certain, management believes that short term interest rates will trend downward or remain stable for at during 2009. It also cannot be predicted what effect a change in short term rates will have on the long term interest rates and the resulting shape of the yield curve. An increase in long-term interest rates is likely to have an adverse impact on the Mortgage Division, primarily due to reduced refinancing opportunities.

Off-Balance Sheet Arrangements

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. A summary of the Bank's commitments is as follows:

	Contract Amounts at December 31,	
	2008	2007
Commitments to extend credit	$44,248	$50,725
Standby letters of credit	3,282	2,069
Total	$47,530	$52,794

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on its credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral is required in instances which the Bank deems necessary.

Management does not anticipate any material losses as a result of these transactions.

The Bank rents, under non-cancelable leases, three of its banking facilities and one mortgage production office. The Bank has liability in the form of minimum annual rental commitments under these leases as follows:

Year Ending	Amount (in thousands)
2009	$ 252
2010	250
2011	290
2012	295
2013	296
Thereafter	170
	$ 1,553

Expansion Plans

Subject to regulatory approval, the Bank anticipates opening additional branches during the next two fiscal years. Although numerous factors could influence the Bank’s expansion plans, the following discussion provides a general overview of the of the additional branch location that the Bank currently is considering.

Timberlake Road Area, Campbell County (Lynchburg), Virginia. As previously disclosed, the Bank has purchased certain real property located at the intersection of Turnpike and Timberlake Roads, Campbell County, Virginia. The Bank does not anticipate opening a branch at this location until the latter part of 2009, at the earliest. The Bank has determined that the existing structure is not suitable for use as a bank branch.

The Bank estimates that the cost of improvements, furniture, fixtures, and equipment necessary to upfit the property will be between $900,000 and $1,500,000 per location.

Although the Bank cannot predict with certainty the financial impact of each new branch, management generally anticipates that each new branch will become profitable within 12 to 18 months of operation.

Recent Accounting Pronouncements

For information regarding recent accounting pronouncements and their effect on us, see "Recent Accounting Pronouncements" in Note 19 to the consolidated financial statements included in Item 8 of this Form 10-K.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Not applicable

Item 8. Financial Statements and Supplementary Data

The following financial statements are filed as a part of this report:

Report of Independent Registered Public Accounting Firm	46
Management's Annual Report on Internal Control Over Financial Reporting	45
Consolidated Financial Statements	
Balance Sheets, December 31, 2008 and 2007	47
Statements of Income, Years Ended December 31, 2008 and December 31, 2007	48
Statements of Changes in Stockholders' Equity and Comprehensive Income, Years Ended December 31, 2008 and December 31, 2007	49
Statements of Cash Flows, Years Ended December 31, 2008 and December 31, 2007	50
Notes to Financial Statements	51

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MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for the preparation and fair presentation of the financial statements included in this annual report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning effects of events and transactions that are accounted for or disclosed.

Management is also responsible for establishing and maintaining adequate internal control over financial reporting. Financial's internal control over financial reporting includes those policies and procedures that pertain to Financial's ability to record, process, summarize and report reliable financial data. Management recognizes that there are inherent limitations in the effectiveness of any internal control over financial reporting, including the possibility of human error and the circumvention or overriding of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

In order to ensure that Financial's internal control over financial reporting is effective, management regularly assesses such controls and did so most recently for its financial reporting as of December 31, 2008. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management has concluded that the internal control over financial reporting was effective as of December 31, 2008.

This annual report does not include an attestation report of Financial's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by Financial's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit Financial to provide only management's report in the annual report.

The Board of Directors, acting through its Audit Committee, is responsible for the oversight of Financial's accounting policies, financial reporting and internal control. The Audit Committee of the Board of Directors is comprised entirely of outside directors who are independent of management. The Audit Committee is responsible for the appointment and compensation of the independent auditor and approves decisions regarding the appointment or removal of Financial's Internal Auditor. It meets periodically with management, the independent auditors and the internal auditors to ensure that they are carrying out their responsibilities. The Audit Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting and auditing procedures of Financial in addition to reviewing Financial's financial reports. The independent auditors and the internal auditors have full and unlimited access to the Audit Committee, with or without management, to discuss the adequacy of internal control over financial reporting, and any other matter which they believe should be brought to the attention of the Audit Committee.

/S/ Robert R. Chapman III	/S/ J. Todd Scruggs
Robert R. Chapman III	J. Todd Scruggs
Chief Executive Officer & President	Secretary-Treasurer (Principal Financial Officer)
March 26, 2009	March 26, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Bank of the James Financial Group, Inc. and Subsidiaries
Lynchburg, Virginia

We have audited the accompanying consolidated balance sheets of Bank of the James Financial Group, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bank of the James Financial Group, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assessment of the effectiveness of Bank of the James Financial Group, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2008 included in the accompanying *Management's Annual Report on Internal Control Over Financial Reporting* and, accordingly, we do not express an opinion thereon.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 24, 2009

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share and per share data)

	December 31, 2008	December 31, 2007
Assets		
Cash and due from banks	$ 10,584	$ 4,314
Federal funds sold	5,241	—
Total cash and cash equivalents	15,825	4,314
Securities held-to-maturity (fair value of $6,039 in 2008 and $6,523 in 2007)	5,994	6,494
Securities available-for-sale, at fair value	16,136	25,733
Restricted stock, at cost	2,059	986
Loans, net of allowance for loan losses of $2,859 in 2008 and $2,146 in 2007	274,890	224,022
Premises and equipment, net	7,672	6,002
Interest receivable	1,624	1,515
Other assets	4,405	994
Total Assets	$328,605	$270,060
Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing demand	$ 35,778	$ 34,973
NOW, money market and savings	127,341	56,995
Time	104,992	136,755
Total deposits	268,111	228,723
Federal funds purchased	—	5,587
Repurchase agreements	14,339	10,542
Federal Home Loan Bank borrowings	21,000	—
Interest payable	302	405
Other liabilities	218	279
Total liabilities	$303,970	$245,536
Commitments and contingencies		
Stockholders' equity		
Common stock $2.14 par value; authorized 10,000,000 shares, issued and outstanding 2,810,255 shares in 2008 and 2,556,898 shares in 2007	$ 6,014	$ 5,472
Additional paid-in-capital	19,473	15,995
Retained earnings (deficit)	(776)	3,064
Accumulated other comprehensive (loss)	(76)	(7)
Total stockholders' equity	$ 24,635	$ 24,524
Total liabilities and stockholders' equity	$328,605	$270,060

See notes to the consolidated financial statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except share and per share amounts)

	Years Ended December 31, 2008	2007
Interest and Dividend Income		
Loans	$ 16,656	$ 16,259
Securities		
US agency obligations	805	1,138
Mortgage backed	705	120
Tax-exempt municipals	42	57
Dividends	73	50
Corporates	294	42
Federal funds sold	19	49
Total interest income	$ 18,594	$ 17,715
Interest Expense		
Deposits		
NOW, money market and savings	$ 1,779	$ 1,316
Time Deposits	5,304	6,083
Federal funds purchased	99	114
Federal Home Loan Bank borrowings	477	—
Repurchase agreements	359	322
Total interest expense	$ 8,018	$ 7,835
Net interest income	$ 10,576	$ 9,880
Provision for loan losses	1,355	451
Net interest income after provision for loan losses	$ 9,221	$ 9,429
Other operating income		
Mortgage fee income	$ 1,183	$ 1,345
Service charges and fees	1,347	1,255
Other	94	110
Gain (loss) on sale of available-for-sale securities	(1,670)	41
Total other operating income	$ 954	$ 2,751
Other operating expenses		
Salaries and employee benefits	$ 5,290	$ 4,756
Occupancy	747	700
Equipment	983	840
Supplies	382	326
Professional, data processing and other outside expenses	1,295	1,135
Marketing	387	375
Credit expense	234	210
Loss (gain) on sale of assets	(5)	51
Amortization of tax credit investment	785	—
Other	715	626
Total other operating expenses	$ 10,813	$ 9,019
Income (loss) before income taxes	$ (638)	$ 3,161
Income tax expense (benefit)	(862)	1,077
Net Income	$ 224	$ 2,084
Income per common share - basic	$ 0.08	$ 0.74
Income per common share - diluted	$ 0.08	$ 0.71

See notes to the consolidated financial statements

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BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(dollars in thousands)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Gain (Loss)	Total
Balance at December 31, 2006	2,296,424	$ 4,914	$ 12,261	$ 4,989	$ (233)	$21,931
Net Income	—	—	—	2,084	—	2,084
Changes in unrealized gains on securities available for sale net of deferred taxes of $130	—	—	—	—	253	253
Reclassification adjustment for gains included in net income, net of income tax expense of $14	—	—	—	—	(27)	(27)
Comprehensive Income						2,310
10% Stock dividend	229,790	497	3,511	(4,009)	—	(1)
Exercise of stock options	32,364	65	217	—	—	282
Stock compensation expense	—	—	12	—	—	12
Disqualifying disposition 123R recapture	—	—	13	—	—	13
Acquisition of common stock	(1,680)	(4)	(19)	—	—	(23)
Balance at December 31, 2007	2,556,898	$ 5,472	$ 15,995	$ 3,064	$ (7)	$24,524
Net Income	—	—	—	224	—	224
Changes in unrealized losses on securities available for sale net of deferred taxes of $605	—	—	—	—	(1,171)	(1,171)
Reclassification adjustment for losses included in net income, net of income tax benefit $568	—	—	—	—	1,102	1,102
Comprehensive Income						155
10% Stock dividend	255,196	546	3,518	(4,064)	—	—
Exercise of stock options	2,496	5	5	—	—	10
Stock compensation expense	—	—	7	—	—	7
Acquisition of common stock	(4,335)	(9)	(52)	—	—	(61)
Balance at December 31, 2008	2,810,255	$ 6,014	$ 19,473	$ (776)	$ (76)	$24,635

See notes to the consolidated financial statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES OF CASH FLOWS

(dollars in thousands)

	Years Ended December 31, 2008	2007
Cash flows from operating activities		
Net Income	$ 224	$ 2,084
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	757	663
Net amortization and accretion of premiums and discounts on securities	9	37
(Gain) loss on sale of available for sale securities	1,670	(41)
Provision for loan losses	1,355	451
Loss (gain) on sale of other assets	(5)	51
Stock compensation expense	7	12
Provision for deferred income taxes	(487)	3
Amortization of tax credit investment	785	—
(Increase) in interest receivable	(109)	(205)
(Increase) in other assets	(625)	(757)
(Increase) in income taxes receivable	(1,171)	—
(Decrease) in income taxes payable	—	(104)
Increase (decrease) in interest payable	(103)	98
Increase (decrease) in other liabilities	(58)	151
Net cash provided by operating activities	$ 2,249	$ 2,443
Cash flows from investing activities		
Proceeds from maturities and calls of securities held to maturity	$ 500	$ 1,000
Purchases of securities available for sale	(20,904)	(14,616)
Proceeds from maturities and calls of securities available for sale	9,046	3,442
Proceeds from sale of securities available for sale	19,671	4,487
Purchase of Community Banker's Bank stock	(60)	—
Purchases of Federal Home Loan Bank stock	(1,012)	(27)
Purchases of Federal Reserve Bank stock	(1)	(160)
Origination of loans, net of principal collected	(52,223)	(37,004)
Purchases of premises and equipment	(2,425)	(1,022)
Purchase of historic and new market tax credits	(2,280)	—
Proceeds from sale of other assets	403	1,011
Net cash used in investing activities	$(49,285)	$(42,889)
Cash flows from financing activities		
Net increase in deposits	$ 39,388	$ 26,934
Net increase (decrease) in federal funds purchased	(5,587)	2,092
Net increase in repurchase agreements	3,797	5,587
Net increase in Federal Home Loan Bank advances	21,000	—
Acquisition of common stock	(61)	(23)
Proceeds from exercise of stock options	10	295
Net cash provided by financing activities	$ 58,547	$ 34,884
Increase (decrease) in cash and cash equivalents	11,511	(5,562)
Cash and cash equivalents at beginning of period	$ 4,314	$ 9,876
Cash and cash equivalents at end of period	$ 15,825	$ 4,314
Non cash transactions		
Transfer of loans to foreclosed assets	$ 506	$ 527
Fair value adjustment for securities	$ (106)	$ 342
Cash transactions		
Cash paid for interest	$ 8,121	$ 7,737
Cash paid for taxes	$ 809	$ 1,164

See notes to the consolidated financial statements

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
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Note 1 - Organization

Bank of the James Financial Group, Inc. ("Financial" or the "Company"), a Virginia corporation, was organized in 2003 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Financial is headquartered in Lynchburg, Virginia. Financial conducts its business activities through the branch offices of its wholly owned subsidiary bank, Bank of the James (the "Bank") and through BOTJ Investment Group, Inc. ("BOTJIG"), a wholly-owned investment services firm operating from an office within the Bank branch located at 615 Church Street in Lynchburg. Financial exists primarily for the purpose of holding the stock of its subsidiaries, the Bank and BOTJIG, and of such other subsidiaries as it may acquire or establish. The Bank also operates a wholly-owned subsidiary, BOTJ Insurance, Inc, ("BOTJ-Ins") also located at 615 Church Street.

Bank of the James was incorporated on October 23, 1998, and began banking operations on July 22, 1999. The Bank is a Virginia chartered bank and is engaged in lending and deposit gathering activities in Region 2000, which includes the counties of Amherst, Appomattox, Bedford and Campbell (which includes the Town of Altavista) and the cities of Bedford and Lynchburg, Virginia. It operates under the laws of Virginia and the Rules and Regulations of the Federal Reserve System and the Federal Deposit Insurance Corporation. The Bank's ten locations consist of four in Lynchburg, Virginia, one in Forest, Virginia which includes the Mortgage Division, one in Madison Heights, Virginia, one in the Town of Amherst, Virginia, one in the City of Bedford, Virginia, one in the Town of Altavista, Virginia, and a mortgage origination office in Moneta, Virginia.

Note 2 - Summary of significant accounting policies

Consolidation

The consolidated financial statements include the accounts of Bank of the James Financial Group, Inc. and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

Basis of presentation and use of estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, as well as the amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

Cash and cash equivalents

Cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within ninety days. Generally, federal funds are purchased and sold for one-day periods.

Securities

The Bank classifies its securities in three categories: (1) debt securities that the Bank has the positive intent and ability to hold to maturity are classified as "held-to-maturity securities" and reported at amortized cost;

Note 2 - Summary of significant accounting policies (continued)

(2) debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as “trading securities” and reported at fair value, with unrealized gains and losses included in net income; and (3) debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as “available-for-sale securities” and reported at fair value, with unrealized gains and losses excluded from net income and reported in a separate component of stockholders’ equity, net of applicable deferred taxes. The Bank does not engage in trading securities.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of Financial to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Restricted investments

As members of the Federal Reserve Bank (FRB) and the Federal Home Loan Bank of Atlanta (FHLB), the Bank is required to maintain certain minimum investments in the common stock of the FRB and FHLB, which are carried at cost. Required levels of investment are based upon the Bank’s capital and a percentage of qualifying assets. The Bank also maintains stock ownership in Community Bankers’ Bank (CBB) which is carried at cost. The investment in CBB is minimal and is not mandated but qualifies the Bank for preferred pricing on services offered by CBB.

Mortgage Fee Income

The Bank, through Bank of the James Mortgage, a Division of Bank of the James (the “Mortgage Division”) originates consumer residential mortgage loans for fee income. Through the Mortgage Division, the Bank originates conforming and non-conforming home mortgages primarily in the Region 2000 area. As part of the Bank’s overall risk management strategy, the loans originated and closed by the Mortgage Division are pre-sold to major mortgage banking or other financial institutions and at no time are such loans carried on the Bank’s balance sheet. Upon loan closing the Bank receives a fee for its loan origination service.

Loans

Financial grants real estate, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by real estate loans collateralized by real estate within Region 2000. The ability of Financial’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in the area.

Note 2 - Summary of significant accounting policies (continued)

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on real estate and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer term loans are typically charged-off no later than 120 days whereas consumer revolving credit loans are typically charged-off no later than 180 days. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current (within 90 days past due) and future payments are reasonably assured.

Allowance for loan loss

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the collateral value of the impaired loan or discounted cash flows is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that Financial will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment

Note 2 - Summary of significant accounting policies (continued)

include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by evaluating the fair value of the underlying collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, Financial does not separately identify individual consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Property, equipment and depreciation

Property and equipment, including leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is provided over the estimated useful lives of the respective assets on the straight-line basis, which range from 3 to 7 years for equipment and 10 to 39.5 years for buildings and improvements. Leasehold improvements are amortized over a term which includes the remaining lease term and probable renewal periods. Land is carried at cost and is not depreciable. Expenditures for major renewals and betterments are capitalized and those for maintenance and repairs are charged to operating expenses as incurred.

Foreclosed properties

Foreclosed properties consist of properties acquired through foreclosure or deed in lieu of foreclosure. These properties are carried at the lower of cost or fair market value less estimated costs to sell at the date of foreclosure. Losses from the acquisition of property in full or partial satisfaction of loans are charged against the allowance for loan losses. Subsequent write-downs, if any, are charged against expense. Gains and losses on the sales of foreclosed properties are included in determining net income in the year of the sale.

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.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon

Note 2 - Summary of significant accounting policies (continued)

settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income.

Stock options

Stock-based compensation is estimated at the date of grant, using the Black-Scholes option valuation model for determining fair value. The model employs the following assumptions:

1. Dividend yield – calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant;
2. Expected life (term of the option) – based on the average of the contractual life and vesting schedule for the respective option;
3. Expected volatility – based on the monthly historical volatility of Financial's stock price over the expected life of the options;
4. Risk-free interest rate – based on the 10 year U.S. Treasury yield on the day of grant.

For the years ended December 31, 2008 and 2007, Financial recognized stock-based compensation expense of $7 and $12 respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for the year ended December 31, 2007; dividend yield of 0%, expected volatility of 40%, a risk-free interest rate of 4.75%, and expected lives of 7 years. The following weighted average assumptions were used for the year ended December 31, 2008; dividend yield of 0%, expected volatility of 40%, a risk-free interest rate of 3.95%, and expected lives of 7 years. During 2008, the company took into consideration guidance under SFAS 123R and SEC Staff Accounting Bulletin No. 107 ("SAB 107") when reviewing and updating assumptions.

Financial estimates forfeitures when recognizing compensation expense and this estimate of forfeitures is adjusted over the requisite service period or vesting schedule based on the extent to which actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment, which is recognized in the period of change, and also will impact the amount of estimated unamortized compensation expense to be recognized in future periods.

Reclassification

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

Note 2 - Summary of significant accounting policies (continued)

Earnings per share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, a well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options, and are determined using the treasury stock method.

Comprehensive income

Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" (SFAS 130), establishes standards for reporting and presentation of comprehensive income and its components in a full set of general purpose financial statements. SFAS 130 was issued to address concerns over the practice of reporting elements of comprehensive income directly in equity.

The Company is required to classify items of other comprehensive income (such as net unrealized gains (losses) on securities available-for-sale) by their nature in a financial statement and present the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. It does not require per share amounts of comprehensive income to be disclosed.

In accordance with the provisions of the SFAS 130, the Company has included in the accompanying financial statements, comprehensive income resulting from such activities. Comprehensive income consists of the net income or loss and net unrealized income or losses on securities available-for-sale. These amounts are reported net of the income tax effect less any related allowance for realization. Also, accumulated other comprehensive income is included as a separate disclosure within the statements of changes in stockholders' equity in the accompanying financial statements.

Marketing

The Company expenses advertising costs as incurred. Advertising expenses were $279 and $337 for 2008 and 2007, respectively.

Note 3 - Restrictions on cash

To comply with Federal Reserve regulations, the Bank is required to maintain certain average cash reserve balances. The daily average cash reserve requirements were approximately $1,572 and $1,096 for the weeks including December 31, 2008 and 2007, respectively.

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Note 4 - Securities

A summary of the amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
U.S. agency obligations	$ 5,994	$ 45	$ —	$ 6,039
Available-for-sale				
U.S. agency obligations	$ 6,994	$ 243	$ —	$ 7,237
Mortgage-backed securities	5,057	27	(54)	5,030
Municipals	718	2	(26)	694
Corporates	3,483	25	(333)	3,175
	$ 16,252	$ 297	$ (413)	$16,136

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
U.S. agency obligations	$ 6,494	$ 32	$ (3)	$ 6,523
Available-for-sale				
U.S. agency obligations	$ 14,954	$ 129	$ —	$15,083
Mortgage-backed securities	4,764	19	(49)	4,734
Municipals	2,547	1	(25)	2,523
Corporates	3,478	—	(85)	3,393
	$ 25,743	$ 149	$ (159)	$25,733

Note 4 - Securities (continued)

The following tables show the gross unrealized losses and fair value of the Bank's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008 and 2007:

December 31, 2008	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$2,681	$ 42	$ 298	$ 12	$ 2,979	$ 54
Corporates	—	—	1,690	333	1,690	333
Municipals	—	—	214	26	214	26
Total temporarily impaired securities	$2,681	$ 42	$2,202	$ 371	$ 4,883	$ 413

December 31, 2007	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. agency obligations	$ —	$ —	$1,992	$ 3	$ 1,992	$ 3
Mortgage-backed securities	1,001	18	1,569	31	2,570	49
Corporates	3,393	85	—	—	3,393	85
Municipals	1,684	24	497	1	2,181	25
Total temporarily impaired securities	$6,078	$ 127	$4,058	$ 35	$10,136	$ 162

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and may do so more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of Financial to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2008, the Company does not consider the unrealized losses as other-than-temporary losses due to the nature of the securities involved. The securities consist of 23 bonds, all of which have an S&P rating of A or higher or are indirectly backed by the U.S. Government. For these reasons, management believes the default risk to be minimal. The $4,883 in securities in which there is an unrealized loss of $413 includes unrealized losses ranging from $1 to $175 or from 0.01% to 16.91% of the original cost of the investment. As management has the ability to hold securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

The amortized costs and fair values of securities at December 31, 2008, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Note 4 - Securities (continued)

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Values	Amortized Cost	Fair Values
Due in one year or less	$ 2,000	$2,005	$ —	$ —
Due after one year through five years	—	—	1,031	1,038
Due after five years through ten years	995	1,000	4,380	4,310
Due after ten years	2,999	3,034	10,841	10,788
	$ 5,994	$6,039	$ 16,252	$16,136

The Bank sold $19,671 of securities available-for-sale in 2008 with realized losses totaling $1,670. Gross realized gains amounted to $163. The Bank realized a loss in 2008 of $1,833, on the sale of preferred stock of Federal National Mortgage Association. The Bank sold $4,487 of securities available-for-sale in 2007 with realized gains on the sales totaling $41.

The amortized costs of securities pledged as collateral for public deposits and other short term borrowings were approximately $16,706 and $19,447 (fair value of $16,931 and $19,592) at December 31, 2008 and 2007, respectively.

Note 5 - Loans and allowance for loan losses

A summary of loans, net is as follows:

	December 31, 2008	December 31, 2007
Commercial loans	$ 52,842	$ 43,877
Real estate – construction	43,507	36,296
Real estate – residential	136,850	114,278
Installment and other	44,550	31,717
Total loans	277,749	226,168
Less allowance for loan losses	2,859	2,146
Net loans	$274,890	$224,022

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Note 5 - Loans and allowance for loan losses (continued)

The activity in the allowance for loan losses for 2008 and 2007 is summarized as follows:

	2008	2007
Balance at beginning of period	$2,146	$2,091
Provision charged to operations	1,355	451
Loan charge-offs	(689)	(442)
Loan recoveries	47	46
Balance at end of period	$2,859	$2,146

The following tables set forth information regarding impaired and non-accrual loans as of December 31, 2008 and 2007:

	Impaired & Non-Accrual Loans At December 31,	
	2008	2007
Impaired loans without a valuation allowance	$ 8,006	$10,355
Impaired loans with a valuation allowance	10,375	4,503
Total impaired loans	$18,381	$14,858
Valuation allowance related to impaired loans	$ 1,441	$ 1,389
Total non-accrual loans	$ 3,859	$ 1,246
Total loans past due ninety days or more and still accruing	$ —	$ —

All non-accrual loans were included in the impaired loan disclosure for both 2008 and 2007.

	Average Investment in Impaired Loans Years Ended December 31,	
	2008	2007
Average investment in impaired loans	$ 15,703	$ 13,891
Interest income recognized on impaired loans	$ 860	$ 988
Interest income recognized on a cash basis on impaired loans	$ 786	$ 988

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Note 5 - Loans and allowance for loan losses (continued)

The Bank grants primarily commercial, real estate, and installment loans to customers throughout its market area, which consists primarily of Region 2000 which includes the counties of Amherst, Appomattox, Bedford and Campbell and the cities of Bedford and Lynchburg, Virginia. The real estate portfolio can be affected by the condition of the local real estate market. The commercial and installment loan portfolio can be affected by the local economic conditions.

The Company's officers, directors and their related interests have various types of loan relationships with the Bank. The total outstanding balances of these related party loans at December 31, 2008 and 2007 were $2,579 and $2,830 respectively. During 2008, new loans and advances amounted to $650 and repayments amounted to $901. The terms and interest rates of these loans are similar to those for comparable loans with other borrowers of the Bank.

Note 6 - Premises and equipment

Property and equipment at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Land	$ 542	$ 542
Building and improvements	3,113	3,038
Construction in progress	1,803	487
Furniture and equipment	5,179	4,202
Leasehold improvements	1,450	1,391
	12,087	9,660
Less accumulated depreciation	4,415	3,658
Net property and equipment	$ 7,672	$6,002

Total depreciation expense for the years ended December 31, 2008 and 2007 was $757 and $663, respectively.

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Note 7 - Deposits

A summary of deposit accounts is as follows:

	December 31,	
	2008	2007
Demand		
Non-interest bearing	$ 35,778	$ 34,973
Interest bearing	41,699	46,595
Savings	85,642	10,400
Time, $100,000 or more	69,422	43,484
Other time	35,570	93,271
	$268,111	$228,723

At December 31, 2008, maturities of time deposits are scheduled as follows:

Year Ending December 31,	Amount
2009	$ 74,489
2010	20,505
2011	3,567
2012	5,588
2013	843
	$104,992

The Bank held related party deposits of $5,824 and $5,074 at December 31, 2008 and 2007, respectively.

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Note 8 - Other borrowings

Short-term borrowings consist of the following at December 31, 2008 and 2007:

	2008	2007
Federal funds purchased	$ —	$ 5,587
Securities sold under agreements to repurchase	14,339	10,542
Total short term borrowings	$14,339	$16,129
Weighted interest rate	2.56%	3.41%

Short-term borrowings consist of securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the date sold. Short-term borrowings may also include federal funds purchased, which are unsecured overnight borrowings from other financial institutions.

Unsecured federal fund lines and their respective limits are maintained with the following institutions: Community Bankers' Bank, $11,000; Suntrust Bank, $3,000; and Compass Bank, $2,250. In addition, the Bank maintains a $3,000 reverse repurchase agreement with Suntrust whereby securities may be pledged as collateral in exchange for funds for a minimum of 30 days with a maximum of 90 days. The Bank also maintains a secured federal funds line with Community Bankers' Bank whereby it may pledge securities as collateral with no specified minimum or maximum amount or term. Federal funds purchased totaling $5,587 were outstanding as of December 31, 2007. There were no federal funds purchased outstanding as of December 31, 2008.

The Bank is also a member of the Federal Home Loan Bank of Atlanta ("FHLBA"). The Bank's available credit through the FHLBA is $63,980 as of September 30, 2008, the most recent calculation. Of this amount the Bank has borrowed $21,000 under the following terms:

Amount	Type	Rate	Ultimate Maturity Date
$ 1,000	Fixed rate credit	2.445%	4/15/2009
10,000	Fixed rate hybrid	2.700%	2/5/2010
3,000	Fixed rate credit	3.410%	4/15/2013
2,000	Fixed rate credit	3.785%	4/15/2015
5,000	Convertible 4/15/2010	2.360%	4/15/2013
$21,000	Total	2.810%	

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Note 9 - Income taxes

The Company files income tax returns in the U.S. federal jurisdiction and the state of Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2005.

Income tax expense attributable to income before income tax expense is summarized as follows:

	December 31,	
	2008	**2007**
Current federal income tax expense (benefit)	$ 259	$1,074
Deferred federal income tax (benefit)	(487)	3
Tax credits	(634)	—
Income tax expense (benefit)	$(862)	$1,077

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Note 9 - Income taxes (continued)

Income tax expense differed from amounts computed by applying the U.S. Federal income tax rate of 34% to income before income tax expense as a result of the following:

	2008	2007
Computed "expected" income tax expense (benefit)	$(217)	$1,075
Increase (reduction) in income tax resulting from:		
Non-taxable income	(13)	(16)
Non-deductible expenses	2	18
Tax credits	(634)	—
Income tax expense (benefit)	$(862)	$1,077

The tax effects of temporary differences result in deferred tax assets and liabilities as presented below:

	2008	2007
Deferred tax assets		
Allowance for loan losses	$ 736	$527
Unrealized loss on available-for-sale securities	39	3
Charitable contributions	9	—
Carryover of tax credits	436	—
Gross deferred tax assets	1,220	530
Deferred tax liability		
Depreciation	238	71
Prepaid expenses	16	16
Gross deferred tax liability	254	87
Net deferred tax asset	$ 966	$443

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BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
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Note 10 - Earnings per share

Basic EPS excludes dilution and is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, or resulted in the issuance of common stock that then shared in the earnings of the entity. All amounts have been restated for the stock dividend in 2008 and 2007.

The basic and diluted earnings per share calculations are as follows:

	2008	2007
Numerator:		
Net income available to stockholders	$ 224	$ 2,084
Basic EPS weighted average shares outstanding	2,809,437	2,808,042
Effect of dilutive securities:		
Incremental shares attributable to Stock Option Plan	95,032	138,349
Diluted EPS weighted-average shares outstanding	2,904,469	2,946,391
Basic earnings per share	$ 0.08	$ 0.74
Diluted earnings per share	$ 0.08	$ 0.71

There were 80,080 shares excluded from the 2008 earnings per share calculation and 2,783 shares excluded from the 2007 earnings per share calculation because their effects were anti-dilutive.

Note 11 - Defined contribution benefit plan

The Company has a 401(k) defined contribution plan, which is administered by the Virginia Bankers' Association. Participants have the right to contribute up to a maximum of 19% of pretax annual compensation or the maximum allowed under Section 401(g) of the Internal Revenue Code, whichever is less. In 2008 and 2007, the Company made a matching contribution to the plan in the amount of 50% of the first 6% of the elective contributions made by the participants. The Company's expense for the plan totaled $99 and $91 for 2008 and 2007, respectively.

Note 12 - Stock option plan

On October 21, 1999, the Board of Directors adopted the "1999 Stock Option Plan" for officers and employees. In 2007 and 2008, stock dividends of 10% and 10% were declared affecting the aforementioned grants retroactively (See Note 13). There are 21,180 remaining shares available for grant as of December 31, 2008.

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
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Note 12 - Stock option plan (continued)

Stock option plan activity for the twelve months ended December 31, 2008 is summarized below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Value of in-the-money options (Aggregate Intrinsic Value)
Options outstanding, January 1, 2008	327,991	$ 8.58		
Granted	1,600	14.69		
Exercised	(2,494)	4.21		
Forfeited	(9,076)	11.02		
Options outstanding, December 31, 2008	318,021	$ 8.61	4.64	$421,837
Options exercisable, December 31, 2008	316,421	$ 8.58	4.62	$421,837
Weighted average fair value of options granted during the year		$ 7.15		

The total approximate value of in-the-money options exercised during 2008 was $9. As of December 31, 2008, there was approximately $8 of total unrecognized compensation expense related to non-vested option awards which will be recognized over the remaining service period.

The Company has not issued any non-vested stock.

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Note 12 - Stock option plan (continued)

The following is summarized information concerning currently outstanding and exercisable options as adjusted for all stock dividends previously declared and paid:

Options Outstanding and Exercisable			
Range of Exercise Prices	Number of Options	Remaining Contractual Life	Weighted Average Exercise Price
$4.01 to $4.50	91,343	1.8 years	$ 4.28
$6.01 to $8.92	101,087	4.8 years	$ 7.69
$11.02 to $13.23	121,208	6.5 years	$ 12.39
$14.50 to $16.53	4,383	8.1 years	$ 15.76
$4.01 to $16.53	318,021	4.6 years	$ 8.61

Note 13 - Stockholders' equity

The Company was initially capitalized through a public offering of its common stock, $4.00 (split adjusted to $2.14) par value per share ("Common Stock"), at $10.00 per share, which concluded in February, 1999 and resulted in a capitalization of the Company of $9,356,300. On December 22, 2006, Financial completed a follow-on offering pursuant to which it raised $5,147,000 (net of costs and expenses of $106,000). As a result of these two offerings and funds generated from operations, Financial currently has sufficient liquidity and capital with which to operate.

The Bank is subject to certain legal and regulatory restrictions on the amount of cash dividends it may declare. As of December 31, 2008, the aggregate amount of unrestricted funds which could be transferred from Financial's subsidiaries to Financial without regulatory approval, totaled $6,878 or 28% of total consolidated stockholders' equity.

On May 15, 2007, the Board of Directors of the Company declared a 10% stock dividend. The stock dividend was paid on July 24, 2007 to shareholders of record June 19, 2007. Following the stock dividend, the number of outstanding shares increased by 229,790. The dividend required a reclassification of retained earnings effective May 15, 2007 in the amount of $4,009. Of this amount, $497 was reclassified as common stock and $3,512 was reclassified as additional paid-in-capital. The reclassification did not change total stockholders' equity. All per share amounts have been retroactively adjusted to reflect this dividend.

On May 20, 2008, the Board of Directors of the Company declared a 10% stock dividend. The stock dividend was paid on July 22, 2008 to shareholders of record June 17, 2008. Following the stock dividend, the number of outstanding shares increased by 255,196. The dividend required a reclassification of retained earnings effective May 20, 2008 in the amount of $4,064. Of this amount, $546 was reclassified as common stock and $3,518 was reclassified as additional paid-in-capital. The reclassification did not change total stockholders' equity. All per share amounts have been retroactively adjusted to reflect this dividend.

Note 14 - Regulatory matters (all amounts in thousands)

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2008 that the Bank meets all capital adequacy requirements to which it is subject. The Bank's actual regulatory capital amounts and ratios for December 31, 2008 and 2007 are also presented in the table below, dollars are in thousands.

As of December 31, 2008, the most recent notification from the Federal Reserve Bank of Richmond categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

Note 14 - Regulatory matters (all amounts in thousands) (continued)

On February 1, 2007, $5,000,000 of additional capital from Financial's recent common stock offering was transferred to the Bank level in the form of a capital contribution. The capital ratios for the Company on a consolidated basis are comparable to the capital ratios of the Bank for 2008 and 2007 as set forth below:

	December 31, 2008 (dollars in thousands)					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$27,114	10.03%	$ 21,636	>8.00%	$27,045	>10.00%
Tier I capital (to risk-weighted assets)	$24,255	8.97%	$ 10,818	>4.00%	$16,227	>6.00%
Tier I capital (leverage) (to average assets)	$24,255	7.48%	$ 12,975	>4.00%	$16,219	>5.00%

	December 31, 2007 (dollars in thousands)					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$26,180	11.94%	$ 17,534	>8.00%	$21,918	>10.00%
Tier I capital (to risk-weighted assets)	$24,035	10.97%	$ 8,767	>4.00%	$13,151	>6.00%
Tier I capital (leverage) (to average assets)	$24,035	8.96%	$ 10,727	>4.00%	$13,409	>5.00%

Note 15 - Contingent liabilities

The Bank rents, under non-cancelable leases, three of its banking facilities and one mortgage production office. The initial term of the lease for 615 Church Street is for five years with an additional renewal term of five years. The Bank chose to accept the additional renewal period of 5 years and has 0.5 years remaining on this lease.

Note 15 - Contingent liabilities (continued)

The Bank entered into a lease agreement for 828 Main Street with Jamesview Investments, LLC of which a Board member is a 33% owner. The initial term of the lease is 10 years with two five year renewal options for a total of 20 years. The Bank has 16.5 years remaining on this lease including option periods. The total expense to be incurred by the Bank over the course of the lease, including options to extend, is $1,837.

In December 2005, the Bank entered into a lease agreement for 4935 Boonsboro Road with Forehand Family Limited Partnership. The initial term of the lease is 5 years with two five year renewal options for a total of 15 years. The Bank has 12 years remaining on this lease including option periods.

In September 2006, the Bank entered into a lease agreement for a mortgage origination office at 14662 Moneta Road, Moneta, Virginia with Lakeland Development Corporation. The initial term of the lease is 3 years with 1 year renewal periods thereafter. The Bank has 0.8 years remaining on the initial 3 year term of the lease.

In September 2008, the Bank entered into a short-term lease agreement to lease a store front facility located at 815 Main Street, Altavista, Virginia with Finch Properties, LLC. The initial term of the lease is 6 months at which time the lease shall convert to a month to month lease for 6 additional months. The Bank will enter the month to month phase on March 1, 2009 and intends to continue the lease until July 2009 or until the Bank’s permanent facility currently under construction in Altavista has been completed and is able to be occupied.

Also in September 2008, the Bank entered into a lease agreement for a potential future branch facility located at 1152 Hendricks Store Road, Moneta, Virginia. The initial term of the lease is five years with one five year renewal option for a total of 10 years. The Bank has 4.6 years remaining on the initial five year term of the lease.

Rental expenses under operating leases were $276 and $265 for the years ended December 31, 2008 and 2007, respectively.

The current minimum annual rental commitments under the non-cancelable leases in effect at December 31, 2008 are as follows:

Year Ending	Amount
2009	$ 252
2010	250
2011	290
2012	295
2013	296
Thereafter	170
	$1,553

Note 16 - Financial instruments with off-balance-sheet risk

The Bank is not a party to derivative financial instruments with off-balance-sheet risks such as futures, forwards, swaps and options. The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These instruments may involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Credit risk is defined as the possibility of sustaining a loss because the other party to a financial instrument fails to perform in accordance with the terms of the contract. The Bank's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Bank requires collateral or other security to support financial instruments when it is deemed necessary. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Types of collateral vary but may include marketable securities, accounts receivable, inventory, and property, plant and equipment.

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Note 16 - Financial instruments with off-balance-sheet risk (continued)

Financial instruments whose contract amounts represent credit risk are as follows:

	Contract Amounts at December 31,	
	2008	2007
Commitments to extend credit	$44,248	$50,725
Standby letters of credit	$ 3,282	$ 2,069

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

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is generally less than that involved in extending loans to customers because the Bank generally holds deposits equal to the commitment. Management does not anticipate any material losses as a result of these transactions.

Note 17 - Concentration of credit risk

The Bank has a diversified loan portfolio consisting of commercial, real estate and consumer (installment) loans. Substantially all of the Bank's customers are residents or operate business ventures in its market area consisting primarily of the Lynchburg metropolitan area. Therefore, a substantial portion of its debtors' ability to honor their contracts and the Bank's ability to realize the value of any underlying collateral, if needed, is influenced by the economic conditions in this market area.

The Bank maintains a significant portion of its cash balances with one financial institution. At December 31, 2008 accounts at this institution were 100% secured by the Federal Deposit Insurance Corporation as a result of the temporary FDIC insurance limit increases promulgated by the Emergency Economic Stabilization Act of 2008. Uninsured balances were approximately $1,835, which consisted of the total balances in two accounts at the Federal Home Loan Bank of Atlanta, and $1,705 at December 31, 2008 and 2007, respectively.

Note 18 - Fair value measurements

The Company adopted SFAS No. 157, "Fair Value Measurements" (SFAS 157), on January 1, 2008 to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. SFAS 157 clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

Note 18 - Fair value measurements (continued)

In February of 2008, the FASB issued Staff Position No. 157-2 (FSP 157-2) which delayed the effective date of SFAS 157 for certain nonfinancial assets and nonfinancial liabilities except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 defers the effective date of SFAS 157 for such nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Thus, the Company has only partially applied SFAS 157. Those items affected by FSP 157-2 include other real estate owned (OREO), goodwill and core deposit intangibles.

In October of 2008, the FASB issued Staff Position No. 157-3 (FSP 157-3) to clarify the application of SFAS 157 in a market that is not active and to provide key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements were not issued.

SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy under SFAS 157 based on these two types of inputs are as follows:

- Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.
- Level 2 –Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.
- Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available for sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that considers observable market data (Level 2).

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Note 18 - Fair value measurements (continued)

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2008:

		Fair Value Measurements at December 31, 2008 Using		
Description	Balance as of December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$ 16,136	$ —	$ 16,136	$ —

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Note 18 - Fair value measurements (continued)

The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis during the period.

		Carrying Value at December 31, 2008		
Description	Balance as of December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans, net of valuation analysis	$ 8,934	$ —	$ 8,247	$ 687

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances there are no quoted market prices for Financial's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS No. 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of Financial.

The following methods and assumptions were used in estimating fair value disclosures for financial instruments:

Cash and cash equivalents

The carrying amounts of cash and short-term instruments approximate fair values.

Securities

Fair values of securities, excluding Federal Reserve Bank stock, Federal Home Loan Bank stock, and Community Bankers' Bank stock are based on quoted market prices.

Loans

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain fixed rate loans are based on quoted market prices of similar loans adjusted for differences in loan characteristics. Fair values for other loans such as commercial real estate and commercial and industrial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values of non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Note 18 - Fair value measurements (continued)

Deposits

Fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed rate certificates of deposit are estimated using discounted cash flow analyses that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings

The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days approximate fair value.

Accrued interest

The carrying amounts of accrued interest approximate fair value.

Off-balance sheet credit-related instruments

Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Fair value of off-balance sheet credit-related instruments were deemed to be immaterial at December 31, 2008 and 2007 and therefore are not included in the table below.

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Note 18 - Fair value measurements (continued)

The estimated fair values, and related carrying or notional amounts, of Financial's financial instruments are as follows:

	December 31, 2008		December 31, 2007	
	Carrying Amounts	Approximate Fair Values	Carrying Amounts	Approximate Fair Values
Financial assets				
Cash and due from banks	$ 10,584	$ 10,584	$ 4,314	$ 4,314
Federal funds sold	5,241	5,241	—	—
Securities				
Available-for-sale	16,136	16,136	25,733	25,733
Held-to-maturity	5,994	6,039	6,494	6,523
Loans, net	274,890	279,151	224,022	227,777
Interest receivable	1,624	1,624	1,515	1,515
Financial liabilities				
Deposits	$268,111	$ 266,216	$228,723	$ 224,023
Federal funds purchased	—	—	5,587	5,587
FHLB borrowings	21,000	21,090	—	—
Repurchase agreements	14,339	14,339	10,542	10,542
Interest payable	302	302	405	405

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on-balance-sheet and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets that are not considered financial assets include deferred income taxes and bank premises and equipment; a significant liability that is not considered a financial liability is accrued post-retirement benefits. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

Note 18 - Fair value measurements (continued)

Financial assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of Financial's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment.

Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Note 19 - Impact of Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) reached a consensus on Emerging Issues Task Force ("EITF") Issue 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements," ("EITF Issue 06-4"). In March 2007, the FASB reached a consensus on EITF Issue 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements," ("EITF Issue 06-10"). Both of these standards require a company to recognize an obligation over an employee's service period based upon the substantive agreement with the employee such as the promise to maintain a life insurance policy or provide a death benefit postretirement. The Company adopted the provisions of these standards effective January 1, 2008. The adoption of these standards was not material to the consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather, provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The FASB has approved a one-year deferral for the implementation of the Statement for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company adopted SFAS 157 effective January 1, 2008. The adoption of SFAS 157 was not material to the consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of this Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at

Note 19 - Impact of Recently Issued Accounting Standards (continued)

each subsequent reporting date. The fair value option may be applied instrument by instrument and is irrevocable. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, with early adoption available in certain circumstances. The Company adopted SFAS 159 effective January 1, 2008. The Company decided not to report any existing financial assets or liabilities at fair value that are not already reported, thus the adoption of this statement did not have a material impact on the consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), "Business Combinations" (SFAS 141(R)). The Standard will significantly change the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisition dates on or after the beginning of an entity's first year that begins after December 15, 2008. The Company does not expect the implementation of SFAS 141(R) to have a material impact on its consolidated financial statements, at this time.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51" (SFAS 160). The Standard will significantly change the financial accounting and reporting of noncontrolling (or minority) interests in consolidated financial statements. SFAS 160 is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2008, with early adoption prohibited. The Company does not expect the implementation of SFAS 160 to have a material impact on its consolidated financial statements, at this time.

In November 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" (SAB 109). SAB 109 expresses the current view of the staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply the views in Question 1 of SAB 109 on a prospective basis to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. Implementation of SAB 109 did not have a material impact on its consolidated financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110, "Use of a Simplified Method in Developing Expected Term of Share Options" (SAB 110). SAB 110 expresses the current view of the staff that it will accept a company's election to use the simplified method discussed in SAB 107 for estimating the expected term of "plain vanilla" share options regardless of whether the company has sufficient information to make more refined estimates. The staff noted that it understands that detailed information about employee exercise patterns may not be widely available by December 31, 2007. Accordingly, the staff will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. Implementation of SAB 110 did not have a material impact on its consolidated financial statements.

Note 19 - Impact of Recently Issued Accounting Standards (continued)

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of SFAS No. 133," ("SFAS No. 161"). SFAS No. 161 requires that an entity provide enhanced disclosures related to derivative and hedging activities. SFAS No. 161 is effective for the Company on January 1, 2009. The adoption of SFAS No. 161 is not expected to have a material impact on the Company's consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP No. 142-3"). FSP No. 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). The intent of FSP No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the assets under SFAS No. 141(R). FSP No. 142-3 is effective for the Company on January 1, 2009, and applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. The adoption of FSP No. 142-3 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles," ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." Management does not expect the adoption of the provision of SFAS No. 162 to have any impact on the consolidated financial statements.

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161," ("FSP 133-1 and FIN 45-4"). FSP 133-1 and FIN 45-4 require a seller of credit derivatives to disclose information about its credit derivatives and hybrid instruments that have embedded credit derivatives to enable users of financial statements to assess their potential effect on its financial position, financial performance and cash flows. The disclosures required by FSP 133-1 and FIN 45-4 will be effective for the Company on December 31, 2008 and are not expected to have a material impact on the consolidated financial statements.

In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS No. 157 in determining the fair value of a financial asset during periods of inactive markets. FSP 157-3 was effective as of September 30, 2008 and did not have material impact on the Company's consolidated financial statements.

In December 2008, the FASB issued FSP No. FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities." FSP No. FAS 140-4 and FIN 46(R)-8 requires enhanced disclosures about transfers of financial assets and interests in

Note 19 - Impact of Recently Issued Accounting Standards (continued)

variable interest entities. The FSP is effective for interim and annual periods ending after December 15, 2008. Since the FSP requires only additional disclosures concerning transfers of financial assets and interest in variable interest entities, adoption of the FSP will not affect the Company's financial condition, results of operations or cash flows.

In January 2009, the FASB reached a consensus on EITF Issue 99-20-1. This FSP amends the impairment guidance in EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets," to achieve more consistent determination of whether an other-than-temporary impairment has occurred. The FSP also retains and emphasizes the objective of an other-than-temporary impairment assessment and the related disclosure requirements in FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and other related guidance. The FSP is effective for interim and annual reporting periods ending after December 15, 2008 and shall be applied prospectively. The FSP was effective as of December 31, 2008 and did not have a material impact on the consolidated financial statements.

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BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008 and 2007
(dollars in thousands, except share and per share data)

Note 20 - Condensed Financial Statements of Parent Company

Financial information pertaining only to Bank of the James Financial Group, Inc. is as follows:

Balance Sheet

	December 31,	
	2008	2007
Assets		
Cash	$ 16	$ 153
Taxes receivable	81	53
Investment in subsidiaries		
Bank of the James	24,179	24,028
BOTJ Investment Group, Inc.	359	290
Total investment in subsidiaries	24,538	24,318
Total assets	$24,635	$24,524
Liabilities and stockholders' equity		
Total liabilities	$ —	$ —
Common stock	$ 6,014	$ 5,472
Additional paid-in-capital	19,473	15,995
Retained earnings (deficit)	(776)	3,064
Accumulated other comprehensive (loss)	(76)	(7)
Total stockholders' equity	$24,635	$24,524
Total liabilities and stockholders' equity	$24,635	$24,524

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008 and 2007
(dollars in thousands, except share and per share data)

Note 20 - Condensed Financial Statements of Parent Company (continued)

Statements of Income

	Year Ended December 31,	
	2008	2007
Income	$ 1	$ —
Operating expenses		
Legal and professional fees	$ 89	$ 152
Net expenses	$ (88)	$ (152)
Allocated income tax benefits	$ 30	$ 52
(Loss) before equity in undistributed income of subsidiaries	$ (58)	$ (100)
Equity in undistributed income – Bank of the James	$214	$2,067
Equity in undistributed income – BOTJ Investment Group, Inc.	68	117
Net Income	$224	$2,084

BANK OF THE JAMES FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008 and 2007
(dollars in thousands, except share and per share data)

Note 20 - Condensed Financial Statements of Parent Company (continued)

Statements of Cash Flows

	Years Ended December 31,	
	2008	2007
Cash flows from operating activities		
Net Income	$ 224	$ 2,084
Adjustments to reconcile net income to net cash used in operating activities:		
Increase in income taxes receivable	(28)	(53)
Stock compensation expense	(7)	(12)
Equity in undistributed net (income) of Bank of the James	(214)	(2,067)
Equity in undistributed net (income) loss of BOTJ Investment Group, Inc.	(68)	(117)
Net cash used in operating activities	$ (86)	$ (165)
Cash flows from investing activities		
Capital contribution to subsidiary Bank of the James	$ —	$(5,000)
Capital contribution to subsidiary BOTJ Investment Group, Inc.	—	(100)
Net cash used in investing activities	$ —	$(5,100)
Cash flows from financing activities		
Acquisition of common stock	$ (61)	$ (23)
Proceeds from issuance of stock under stock option plan	10	295
Net cash (used in) provided by financing activities	$ (51)	$ 271
(Decrease) in cash and cash equivalents	(137)	(4,994)
Cash and cash equivalents at beginning of period	$ 153	$ 5,147
Cash and cash equivalents at end of period	$ 16	$ 153

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

There has been no change in the independent accountants engaged to audit the financial statements of the Company and its subsidiaries during the last two fiscal years ended December 31, 2008. There have been no disagreements with such independent accountants during the last two fiscal years ended December 31, 2008, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Item 9A(T). Controls and Procedures

Financial's management, including Financial's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, Financial's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that Financial files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Management's annual report on internal control over financial reporting is incorporated herein by reference to Financial's audited Consolidated Financial Statements set forth in Item 8 of this Annual Report on Form 10-K.

There have been no significant changes during the quarter ended December 31, 2008, in the Company's internal controls over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) or in other factors that could have significantly affected those controls subsequent to the date of our most recent evaluation of internal controls over financial reporting, including any corrective actions with regard to significant deficiencies and material weaknesses.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Part of the response to this Item will be included in the information set forth under the headings "Information Concerning Nominees and Directors Continuing in Office," "Corporate Governance and the Board of Directors Matters," and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Bank's definitive Proxy Statement for its 2009 Annual Meeting of Shareholders, which Proxy Statement will be filed with the SEC within 120 days of the end of the Bank's 2007 fiscal year (the "2009 Proxy Statement"), and such information is hereby incorporated by reference.

Financial has adopted a code of ethics that applies to Financial's directors, executive officers (including the principal financial officer, principal accounting officer or controller, or persons performing similar functions), and senior officers. The code of ethics has been posted under the "Investor Relations" section on Financial's website: www.bankofthejames.com.

Item 11. Executive Compensation

The response to this Item will be included in the information set forth under the headings "Compensation of Directors and Executive Officers," "Outstanding Equity Awards at Fiscal Year End," "Corporate Governance and the Board of Directors Matters," and "Committees of the Board of Directors of Financial" in the 2009 Proxy Statement and such information is hereby incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Certain information required by this Item 12 is included under "Securities Authorized for Issuance Under Equity Compensation Plans" in Part II, Item 5 of this annual report on Form 10-K. The information required by this Item will be included in the information set forth under the heading "Corporate Governance and the Board of Directors Matters – Independence of Directors" and "Security Ownership of Management" in the 2009 Proxy Statement and is hereby incorporated by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The response to this Item will be included in the information set forth under the heading "Transactions with Management" in the 2008 Proxy Statement and is hereby incorporated by reference.

Item 14. Principal Accounting Fees and Services

The response to this Item will be included in the information set forth under the heading "Independent Public Accountants" in the 2008 Proxy Statement and is hereby incorporated by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements. Listed and included in Part II, Item 8.

(2) Financial Statement Schedules. Not applicable.

(3) Exhibits. The following exhibits are filed as a part of this Form 10-K

No.	Description
2.1	Agreement and Plan of Share Exchange dated October 9, 2003 between Bank of the James Financial Group, Inc. and Bank of the James, dated as of October 9, 2003 (incorporated by reference to Exhibit 2.1 to Form 8-K12g-3 filed on January 13, 2004)
3.1	Articles of Incorporation of Bank of the James Financial Group, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K12g-3 filed on January 13, 2004)
3.2	Bylaws of Bank of the James (incorporated by reference to Exhibit 3.2 to Form 8-K filed August 18, 2006)
4.1	Specimen Common Stock Certificate of Bank of the James Financial Group, Inc. (incorporated by reference to Exhibit 4.1 to Form 10-KSB filed on March 26, 2004)
10.2	Amended and Restated Stock Option Plan (incorporated by reference to Form S-8 filed on August 14, 2004)
10.3	Lease Agreement Between W.C. English, Inc. and Bank of the James (incorporated by reference to Exhibit 10.3 to Form 10-SB Registration Statement of Bank of the James filed with the Federal Reserve Board on April 18, 2000)
10.6	Lease between Jamesview Investments LLC and Bank of the James dated October 9, 2003 (incorporated by reference to Exhibit 10.6 to Form 10-KSB filed on March 26, 2004)

21.1	List of subsidiaries (filed herewith)
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a) (filed herewith)
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a) (filed herewith)
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act Of 2002 (filed herewith)

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SIGNATURES

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities as of March 26, 2009.

Signature	Capacity
/S/ Robert R. Chapman III Robert R. Chapman III	President (Principal Executive Officer) and Director
/S/ J. Todd Scruggs J. Todd Scruggs	Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer) and Director
/S/ Kenneth S. White Kenneth S. White	Director, Chairman
/S/ Lewis C. Addison Lewis C. Addison	Director
/S/ William C. Bryant III William C. Bryant III	Director
/S/ Donna Schewel Clark Donna Schewel Clark	Director
/S/ James F. Daly James F. Daly	Director
/S/ Watt R. Foster, Jr. Watt R. Foster, Jr.	Director
/S/ Donald M. Giles Donald M. Giles	Director
/S/ Augustus A. Petticolas, Jr. Augustus A. Petticolas, Jr.	Director
/S/ Thomas W. Pettyjohn, Jr. Thomas W. Pettyjohn, Jr.	Director
/S/ Richard R. Zechini Richard R. Zechini	Director

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Exhibit 21.1

List of Subsidiaries

Subsidiary	Jurisdiction or State of Incorporation	Names Under Which Subsidiary Does Business
Bank of the James	Virginia	Bank of the James Bank of the James Mortgage Bank of the James Mortgage, a Division of Bank of the James
BOTJ Investment Group, Inc.	Virginia	BOTJ Investment Group, Inc.
BOTJ Insurance, Inc.	Virginia	BOTJ Insurance, Inc.

Exhibit 31.1

Certification—Principal Executive Officer

I, Robert R. Chapman III, President of Bank of the James Financial Group, Inc. certify that:

(1) I have reviewed this Form 10-K of Bank of the James Financial Group, Inc.;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 26, 2009

By /S/ Robert R. Chapman III
Robert R. Chapman III
President (Principal Executive Officer) and Director

Exhibit 31.2

Certification—Principal Financial Officer and Principal Accounting Officer

I, J. Todd Scruggs, Secretary and Treasurer of Bank of the James Financial Group, Inc., certify that:

(1) I have reviewed this Form 10-K of Bank of the James Financial Group, Inc.;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 26, 2009

By /S/ J. Todd Scruggs

J. Todd Scruggs
Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer) and Director

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Robert R. Chapman III, Chief Executive Officer of Bank of the James Financial Group, Inc., a Virginia corporation (the “Company”) and J. Todd Scruggs , Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer), each certify in his capacity as an officer of the Company that he has reviewed the annual report on Form 10-K for the year ended December 31, 2008 (the “Report”) and to the best of his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of the Company as of the dates and for the periods covered by the Report.

BANK OF THE JAMES FINANCIAL GROUP, INC.

Date: March 26, 2009

By /S/ Robert R. Chapman III
Robert R. Chapman III
President and Director (Principal Executive Officer)

Date: March 26, 2009

By /S/ J. Todd Scruggs
J. Todd Scruggs
Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer)