UNION BANKSHARES INC
Form 10-K/A
May 10, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934
( ) TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016 Commission file number 001-15985
UNION BANKSHARES, INC.
VERMONT 03-0283552
P.O. BOX 667
20 LOWER MAIN STREET
MORRISVILLE, VT 05661-0667
Registrant's telephone number: 802-888-6600
Former name, former address and former fiscal year, if changed since last report: Not applicable
Securities registered pursuant to section 12(b) of the Act:

Common Stock, $2.00 par value	The NASDAQ Stock Market LLC
(Title of class)	(Exchanges registered on)

Securities registered pursuant to Sections 12(g) of the Act:
None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [ ] No [X]
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 [X]
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES [X] NO [ ]
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]
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 definitions of “large accelerated filer,” ”accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes [ ] No [X]
The aggregate market value of the common stock held by non-affiliates of the registrant on June 30, 2016 was $139,942,259 based on the closing price on the NASDAQ Stock Market LLC on such date of $36.36 per share. For

purposes of this calculation, all directors, executive officers, and named executives of the Registrant are assumed to be affiliates. Such assumption, however, shall not be deemed to be an admission of such status as to any such individual.

DOCUMENTS INCORPORATED BY REFERENCE

Specifically designated portions of the following documents are incorporated by reference in the indicated Part of this Annual Report on Form 10-K:

Document	Part
Proxy Statement for the 2017 Annual Meeting of Shareholders	III

Explanatory Note: The primary purpose of this Amendment is to correct the regulatory capital ratio information previously disclosed in Note 21 to the audited consolidated financial statements of Union Bankshares, Inc. included in Part II, Item 8 of the Report and to correct the related narrative disclosures in Part I, Item 1, Part II, Item 6 and Part II, Item 7. The capital ratios as previously disclosed were understated due to a calculation error. In addition, Exhibit 21.1 is being filed with this amendment as it was inadvertently omitted from the Form 10-K.

PART I

Item 1. Description of Business

Certain Definitions: Capitalized terms used in the following discussion and not otherwise defined below have the meanings assigned to them in Note 1 to the Company's audited consolidated financial statements contained in Part II, item 8, page 51 of this Annual Report.

General: Union Bankshares, Inc. (“Company”) is a one-bank holding company whose sole subsidiary is Union Bank (“Union”). It was incorporated in the State of Vermont in 1982. The Company's common stock is traded on the NASDAQ Global Select Market under the symbol "UNB". Union Bank was organized and chartered as a State bank in 1891 and became a wholly owned subsidiary of the Company in 1982 upon its formation. Both Union Bankshares, Inc. and Union Bank are headquartered in Morrisville, Vermont.

The Company's business is that of a community bank in the financial services industry. The Company has one definable business segment, Union Bank, which provides full retail, commercial, municipal banking, and asset management and trust services throughout its 17 banking offices, three loan centers, and several ATMs covering northern Vermont and New Hampshire. Also, many of Union's services are provided via the telephone, mobile devices, and through its website, www.ublocal.com. Union seeks to make a profit for the Company while providing quality retail banking services to individuals and commercial banking services to small and medium sized corporations, partnerships, and sole proprietorships, as well as nonprofit organizations, local municipalities and school districts within its market area.

The Company's income is derived principally from interest and fees on loans and earnings on other investments. Its primary expenses arise from interest paid on deposits and borrowings, salaries and wages, health insurance and other employee benefits and other general overhead expenses. Our profitability depends primarily on net interest income, which is the difference between interest and dividend income on interest-earning assets and interest expense on interest-bearing liabilities. Interest-earning assets include loans, investment securities, and interest-earning deposits in banks. Interest-bearing liabilities primarily include customer deposit accounts and borrowings. Net interest income is dependent upon the level of interest rates and the extent to which such rates change, as well as changes in the volume of various categories of assets and liabilities. Our profitability is also dependent on the level of noninterest income (primarily gains on sale of real estate loans, loan servicing income, and service fees), provision for loan losses, noninterest expenses and income taxes. Our operations and profitability are subject to changes in interest rates, applicable statutes and regulations, general economic conditions, the competitive environment, as well as other factors beyond our control.

Employees: The Company itself does not have any paid employees. As of December 31, 2016, Union employed 191 full time equivalent employees. Union employees are not represented by any collective bargaining group. Union maintains comprehensive employee benefit programs for its employees, including medical and dental insurance, long-term and short-term disability insurance, life insurance, and a 401(k) plan. Management considers its employee relations to be good.

Description of Services: Services or products offered to our customers include, but are not limited to, the following:

- Commercial loans for business purposes to business owners and investors for plant and equipment, working capital, real estate renovation and other sound business purposes;
- Commercial real estate loans on income producing properties, including commercial construction loans;
- SBA guaranteed loans;
- Residential construction and mortgage loans;

- Online cash management services, including account reconciliation, credit card depository, Automated Clearing House origination, wire transfers and night depository;
- Merchant credit card services for the deposit and immediate credit of sales drafts,
- Remote deposit capture for merchants;
- Online mortgage applications;
- Business checking accounts;
- Standby letters of credit, bank checks or money orders, and safe deposit boxes;
- ATM services;
- Debit MasterCard and ATM cards;
- Telephone, Internet, and mobile banking services, including bill pay;
- Home improvement loans and overdraft checking privileges against preauthorized lines of credit;
- Retail depository services including personal checking accounts, checking accounts with interest, savings accounts, money market accounts, certificates of deposit, IRA/SEP/KEOGH accounts and Health Savings accounts;

- Customer repurchase agreement sweeps; and
- Asset management and trust services to individuals and organizations.

Consistent with the objective of the Company to serve the needs of individuals, businesses and others within the communities served, the Company seeks to concentrate its assets in loans. For the year ended December 31, 2016, the Company's rate of average loans to average deposits was 92.3%. To be consistent with the requirements of prudent banking practices, adequate levels of assets are invested in high-grade securities, FDIC insured certificates of deposits, or other prudent investment alternatives such as company-owned life insurance or investments in real estate limited partnerships for affordable housing. Deposits are the primary source of funds for use in lending, investing and for other general operating purposes. In addition we obtain funds from principal repayments, sales and prepayments of loans, securities and FDIC insured certificates of deposit. Other funding sources may include brokered deposits purchased through CDARS, ICS or through other deposit brokers, borrowings from the FHLB, correspondent banks or the Federal Reserve discount window.

Competition: The Company and Union face substantial competition for loans and deposits in northern Vermont and New Hampshire from local and regional commercial banks, savings banks, tax exempt credit unions, mortgage brokers, and financial services affiliates of bank holding companies, as well as from national financial service providers such as mutual funds, brokerage houses, insurance companies, consumer finance companies and internet banks. Within the Company's market area are branches of several commercial and savings banks that are substantially larger than Union. Union focuses on its community banking niche and on providing convenient locations, hours and modes of delivery to provide superior customer service. We have seen over the last few years, a trend by customers to turn to local community banks to fulfill their financial needs with organizations and people they know and trust. We are hopeful that this trend will continue. The Company seeks to capitalize upon the extensive business and personal contacts and relationships of its directors, advisory board members and officers to continue to develop the Company's customer base, as well as relying on director and advisory board referrals, officer-originated calling programs and customer and shareholder referrals.

In order to compete with the larger financial institutions in its service area, Union capitalizes on the flexibility and local autonomy which is accorded by its independent status. This includes an emphasis on personal service, timely decision making, local promotional activity, and personal contacts and community service by Union's officers, directors and employees. The Company strives to inform the public about the strength of the Company, the variety and flexibility of services offered, as well as the strength of the local economy relative to the national economy and global problems in the real estate market and provides information on financial topics of interest. The Company also strives to educate future generations by helping them to cultivate sound personal financial habits through its "Save for Success" program for children.

The Company competes for deposit accounts by offering customers competitive products and rates, personal service, local area expertise, convenient locations and access, and an array of financial services and products. Higher interest rates and deposit “specials” offered by competitors as well as the variety of nonbanking investment avenues open to our customers and the public make deposit growth challenging.

The competition in originating real estate and other loans comes principally from commercial banks, savings banks, mortgage banking companies and tax exempt credit unions. The Company competes for loan originations primarily through the interest rates and loan fees it charges, the types of loans it offers, and the efficiency and quality of services it provides. In addition to residential mortgage lending and municipal loans, the Company also emphasizes commercial real estate, construction, and both conventional and SBA guaranteed commercial lending. Factors that affect the Company's ability to compete for loans include general and local economic conditions, prevailing interest rates including the “prime” rate, and pricing volatility of the secondary loan markets. The Company promotes an increased level of personal service and expertise within the community to position itself as a lender to small to middle market business and residential customers, which tend to be under-served by larger institutions.

The Company, through Union's Asset Management Group division, competes for personal and institutional asset management and trust business with trust companies, commercial banks having trust departments, investment advisory firms, brokerage firms, mutual funds and insurance companies.

Regulation and Supervision

General

As a bank holding company registered under the BHCA, the Company is subject to regulation and supervision by the Board of Governors of the FRB. As a state chartered commercial bank, Union Bank is subject to the regulation and supervision by the FDIC and the DFR. The regulatory framework is intended primarily for the protection of depositors, federal deposit insurance funds and the banking system as a whole, and not for the protection of security holders. This regulation and supervision establishes a comprehensive framework of activities in which a bank holding company or a bank can engage. The prior approval of the FDIC and DFR is required, among other things, for Union to establish or relocate a branch office, assume deposits or engage in any merger, consolidation, purchase or sale of all or substantially all of the assets of any bank. This regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to classification of assets and establishment of adequate credit loss reserves for regulatory purposes. To the extent that this information describes statutory and regulatory provisions, it is qualified in its entirety by reference to those provisions.

The Company is also under the jurisdiction of the SEC for matters relating to the offer and sale of its securities as well as investor reporting requirements. The Company is subject to restrictions, reporting requirements, and review procedures under federal securities laws and regulations. The Company's common stock is listed on the NASDAQ Global Select Market under the trading symbol “UNB” and accordingly, the Company is subject to the rules of NASDAQ for listed companies.

Financial Regulatory Reform Legislation

The Dodd-Frank Act. The Dodd-Frank Act comprehensively reformed the regulation of financial institutions and the products and services they offer. Among other things, the Dodd-Frank Act:

- granted the FRB increased supervisory authority and codified the source of strength doctrine,
- provided new capital standards applicable to the Company,
- modified the scope and costs associated with deposit insurance coverage,
- permitted well capitalized and well managed banks to acquire other banks in any state subject to certain deposit concentration limits and other conditions,
- permitted the payment of interest on business demand deposit accounts,
- established the CFPB,
- established new minimum mortgage underwriting standards for residential mortgages,
- barred banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain circumstances, and
- established the Financial Stability Oversight Council to designate certain activities as posing a risk to the United States financial systems and recommended new or heightened standards and safeguards for financial institutions engaging in such activities.

While this legislation is focused principally on changes to the financial regulatory system, several corporate governance, disclosure and compensation provisions of the Dodd-Frank Act target public companies. The corporate governance, disclosure and compensation provisions include:

- A requirement that public companies solicit an advisory vote on executive compensation ("Say-on-Pay"), an advisory vote on the frequency of Say-on-Pay votes and, in the event of a merger or other extraordinary transaction, an advisory vote on certain "golden parachute" payments. At the 2016 annual meeting, the shareholders approved a Say-on-Pay advisory vote,
- Requirements that the SEC adopt rules directing the securities exchanges to adopt listing standards with respect to compensation committee independence and the use of consultants,
- Provisions calling for the SEC to adopt expanded disclosure in the annual proxy statement and other filings, particularly in the area of executive compensation, such as disclosure of pay versus performance, the ratio of CEO pay to the pay of a median employee and policies with regard to hedging transactions conducted by employees and directors,
- Provisions that will require the adoption or revision of certain other policies, such as compensation recovery policies providing for the recovery of executive compensation in the event of a financial restatement, and
- A provision clarifying the SEC's authority to adopt rules requiring issuers to include in the proxy solicitations for shareholder nominations for directors.

Bank Holding Company Regulation

Source of Strength. Under long-standing FRB policy and now codified in the Dodd-Frank Act, bank holding companies, such as Union Bankshares, are required to act as a source of financial and management strength to their subsidiary banks, such as Union, and to commit resources to support them. This support may be called for at times when a bank holding company may not have the required resources to do so.

Acquisitions and Activities. Under the BHCA, the activities of bank holding companies, such as Union Bankshares Inc., and those of companies that they control, such as Union, or in which they hold more than 5% of the voting stock, are limited to banking, managing or controlling banks, furnishing services to or performing services for their subsidiaries, or certain activities that the FRB has determined to be so closely related to banking, managing or controlling banks as to be a proper incident thereto. Satisfactory capital ratios, CRA ratings and anti-money laundering policies are generally prerequisites to obtaining Federal regulatory approval to make acquisitions. Union Bankshares Inc. has not elected to become a financial holding company.

Enforcement Powers. The FRB has the authority to issue cease and desist orders against bank holding companies to prevent or terminate unsafe or unsound banking practices, violations of law and regulations, or conditions imposed by, or violations of agreements with, or commitments to, the FRB. The FRB is also empowered to assess civil money penalties against companies or individuals who violate the BHCA or orders or regulations thereunder, to order termination of nonbanking activities of nonbanking subsidiaries of bank holding companies, and to order termination of ownership and control of a nonbanking subsidiary by a bank holding company. There are no enforcement actions currently in place against the Company.

The FRB has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and rate of earnings retention that is consistent with the company's capital needs, asset quality and overall financial condition.

Regulation of Union Bank

Deposit Insurance. As a member of the FDIC, the deposits of Union are permanently insured under the Deposit Insurance Fund (“DIF”) maintained by the FDIC up to $250,000 per ownership category. Under applicable federal laws and regulations, deposit insurance premium assessments to the DIF are based on a supervisory risk rating system, with the most favorably rated institutions paying the lowest premiums. Under this assessment system, risk is defined and measured using an institution's supervisory ratings, combined with certain other risk measures, including certain financial ratios and long-term debt issuer ratings. For the year ended December 31, 2016, the Bank's total FDIC insurance assessment expense was $307 thousand.

Brokered Deposits. The FDICIA restricts the ability of an FDIC insured bank to accept brokered deposits unless it is a well capitalized institution under FDICIA's prompt corrective action guidelines. Union accepts brokered time and money market deposits primarily through its membership with the Promontory Interfinancial Network in CDARS and ICS, respectively. Additionally, Union has established an account with one of its approved investment brokers to accept brokered deposits as an approved liquidity source.

Community Reinvestment Act ("CRA"). Union is subject to the federal CRA, which requires banks to demonstrate their commitment to serving the credit needs of low and moderate income residents of their communities. Union participates in a variety of direct and indirect lending programs and other investments for the benefit of low and moderate income residents in its local communities. The FDIC conducts examinations of insured banks' compliance with CRA requirements and rates institutions as "Outstanding," "Satisfactory," "Needs to Improve," and "Substantial NonCompliance." Failure of an institution to receive at least a "Satisfactory" CRA rating could adversely affect its ability to undertake certain activities, such as branching and acquisitions of other financial institutions, which require regulatory approval based, in part, on the institution's record of CRA compliance. In addition, failure of a bank subsidiary to receive at least a "Satisfactory" rating would disqualify a bank holding company from eligibility to become or remain a financial holding company under the GLBA. Union has received at least a "Satisfactory" rating from all CRA compliance examinations by the FDIC.

Federal Reserve Board Policies and Reserve Requirements. The monetary policies and regulations of the FRB have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. FRB policies affect the levels of bank earnings on loans and investments and the levels of interest paid on bank deposits and borrowings through the Federal Reserve System's open-market operations in United States government securities, regulation of the discount rate and terms on bank borrowings from Federal Reserve Banks and regulation of nonearning reserve requirements. Regulation D promulgated by the FRB requires all depository institutions to maintain reserves against their transaction accounts (generally, demand deposits, NOW accounts and certain other types of accounts that permit payments or transfers to third parties) and nonpersonal nontime deposits (generally, money market deposit accounts or other savings deposits held by corporations or other depositors that are not natural persons, and certain types of time deposits), subject to certain exemptions. As of December 31, 2016, Union's reserve requirement was approximately $891 thousand, which was satisfied by vault cash.

Enforcement Powers. The FDIC and the DFR have the authority to issue orders to banks under their supervision to cease and desist from unsafe or unsound banking practices, violations of law and regulation, or conditions imposed by, or violations of agreements with, or commitments to, the FDIC or DFR. The FDIC and the DFR are also empowered to assess civil money penalties against companies or individuals who violate banking laws, orders or regulations. There are no enforcement actions currently in place against Union.

Capital Adequacy and Safety and Soundness

Capital Adequacy Guidelines. The FDIC and other federal bank regulatory agencies adopted a final rule for leverage and risk-based capital requirements and the method for calculating risk-weighted assets which is consistent with agreements that were reached by the Basel Committee on Banking Supervision under the so-called Basel III framework and certain provisions of the Dodd-Frank Act. Among other things, the rule established a common equity Tier 1 capital ratio with a minimum requirement of 4.5%, increased the minimum Tier 1 risk based ratio from 4.0% to 6.0%, and assigned a higher risk weight of 150% to exposures that are more than 90 days past due or in nonaccrual status as well as certain commercial real estate loans that finance the acquisition, development or construction of real property. The final rule also required accumulated OCI be included for purposes of calculating regulatory capital unless a one time opt-out election was made during the first quarter of 2015. The Company and Union both made the election. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" of 2.5% above the minimum capital ratio requirements. The 2.5% capital conservation buffer requirement will be phased in over a four-year period ending January 1, 2019. Please refer to Note 21(Regulatory Capital Requirements) to the Company's audited consolidated financial statements contained in Item 8 of this annual report on Form 10-K for the capital ratios for the Company and Union as of December 31, 2016 and December 31, 2015.

A financial institution's failure to meet minimum regulatory capital standards can lead to other penalties, including termination of deposit insurance or appointment of a conservator or receiver for the financial institution. Risk based capital ratios are the primary measure of regulatory capital presently applicable to bank holding companies. Risk based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure and to minimize disincentives for holding liquid assets.

Federal bank regulatory agencies require banking organizations that engage in significant trading activity to calculate a capital charge for market risk. Significant trading activity means trading activity of at least 10% of total assets or $1 billion, whichever is smaller, calculated on a consolidated basis for bank holding companies. Federal bank regulators may apply the market risk measure to other bank holding companies, as the agency deems necessary or appropriate for safe and sound banking practices. Each agency may exclude organizations that it supervises that otherwise meet the criteria under certain circumstances. The market risk charge will be included in the calculation of an organization's risk based capital ratio. Neither the Company nor Union is currently subject to this special capital charge.

Prompt Corrective Action. FDICIA, among other things, identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the respective federal banking agencies to implement systems for “prompt corrective action” for insured depository institutions that do not meet minimum capital requirements. FDICIA imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An “undercapitalized” bank must develop a capital restoration plan and its parent holding company must guarantee that bank's compliance with the plan. The liability of the parent holding company under any such guarantee is limited to the lesser of 5% of the bank's assets at the time it became undercapitalized or the amount needed to comply with the plan. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent's general unsecured creditors. In addition, FDICIA requires the various federal banking agencies to prescribe certain noncapital standards for safety and soundness related generally to operations and management, asset quality and executive compensation, and permits regulatory action against a financial institution that does not meet such standards.

Consistent with the revisions to the capital adequacy rules of the federal banking regulators, effective January 1, 2015, the FDIC adopted conforming changes to its prompt corrective action regulations. These changes include a new common equity Tier 1 ratio requirement, with a required minimum ratio of 6.5% for well-capitalized status. The new regulations also increase the minimum ratio of Tier 1 capital to risk weighted assets for well-capitalized status to 8.0%, from the previous 6.0%.

The various federal banking agencies have adopted substantially similar regulations that define the five capital categories identified by FDICIA, using the Tier 1 Capital, Common Equity Tier 1 Capital, Total Capital and Leverage Ratios as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations as in effect during 2016, a “well capitalized” institution must have a Tier 1 capital ratio of at least 8.0%, a Common Equity Tier 1 ratio of 6.5%, a total capital ratio of at least 10% and a leverage ratio of at least 5% and not be subject to a capital directive order.

At December 31, 2016, Union's Tier I and Total Risk Based Capital Ratios were 12.2% and 13.3% respectively, and its Leverage Capital Ratio was 8.4%, and it is considered well capitalized under applicable regulatory guidelines in effect as of such date. However, an increase in the amount of capital that the Company or Union must maintain in order to support a given level of assets would reduce the amount of leverage that our capital could support and increased volatility could be problematic. Our ability to increase our level of interest earning assets or to allocate those assets in the best manner to generate interest income may be adversely affected.

Safety and Soundness Standard. FDICIA, as amended, directs each Federal banking agency to prescribe safety and soundness standards for depository institutions relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, asset quality, earnings and stock valuation. The Community Development and Regulatory Improvement Act of 1994 amended FDICIA by allowing Federal banking regulators to publish guidelines rather than regulations concerning safety and soundness.

FDICIA also contains a variety of other provisions that may affect Union's operations, including reporting requirements, regulatory guidelines for real estate lending, "truth in savings" disclosure provisions, and the requirement that a depository institution give 90 days prior notice to customers and regulatory authorities before closing any branch. Union is subject to §112 of FDICIA, which requires an additional annual reporting to the FDIC, FRB, and DFR regarding preparation of the annual financial statements, the maintenance of an internal control structure for financial reporting and compliance with certain designated banking laws, as well as imposition of increased responsibilities on the Company's external auditor and audit committee.

Dividend Restrictions

As a bank holding company, the Company's ability to pay dividends to its stockholders is largely dependent on the ability of its subsidiary to pay dividends to it. Payment of dividends by Vermont-chartered banks, such as Union, is subject to applicable state and federal laws. Under Vermont banking laws, a Vermont-chartered bank may not authorize dividends or other distributions that would reduce the bank's capital below the amount of capital required in the bank's Certificate of General Good or under any capital or surplus standards established by the Commissioner of the DFR. Union does not have any capital restrictions in its Certificate of General Good and, to date, the Commissioner of the DFR has not adopted capital or surplus standards. Nevertheless, the capital standards established by the FDIC, described above under "Prompt Corrective Action" apply to Union, and the capital standards of the FRB apply to the Company on a consolidated basis. In addition, the FRB, the FDIC and the Commissioner of the DFR are authorized under applicable federal and state laws to prohibit payment of dividends that are determined to be an unsafe or unsound practice. Payment of dividends that significantly deplete the capital of a bank or a bank holding company, or render it illiquid, could be found to be an unsafe or unsound practice. Further, the Basel III capital standards limit a financial institution's ability to pay dividends if it does not maintain a required capital conservation buffer.

Consumer Protection Regulation

We are subject to a number of federal and state laws designed to protect consumers and prohibit unfair or deceptive business practices, including the Equal Credit Opportunity Act, the Fair Housing Act, Home Ownership Protection Act, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act"), GLBA, the Truth in Lending Act, CRA, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the National Flood Insurance Act and various state law counterparts. Union is also subject to laws and regulations to protect consumers in connection with their deposit or electronic transactions. These laws include the Truth in Savings Act, the Electronic Funds Transfer Act and the Expedited Funds Availability Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must interact with customers when taking deposits, making loans, collecting loans and providing other services. Further, the Dodd-Frank Act established the CFPB, which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services. The CFPB also has a broad mandate to prohibit unfair or deceptive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. The CFPB is charged with examining banks with assets in excess of $10 billion, while community banks continue to be examined by their primary regulator. This supervisory structure may lead to conflicting regulatory guidance for community banks versus larger banks and increase regulatory costs and burdens. Failure to comply with consumer protection laws and regulations can subject financial institutions to enforcement actions, fines and other penalties.

Mortgage Reform. The Dodd-Frank Act prescribes certain standards that mortgage lenders must consider before making a residential mortgage loan, including verifying a borrower's ability to repay such mortgage loan, and allows borrowers to assert violations of certain provisions of the Truth-in-Lending Act as a defense to foreclosure proceedings. Under the Dodd-Frank Act, prepayment penalties are prohibited for certain mortgage transactions and creditors are prohibited from financing credit life/disability insurance policies in connection with a residential mortgage loan or home equity line of credit. In addition, the Dodd-Frank Act prohibits mortgage originators from receiving compensation based on the terms of residential mortgage loans and generally limits the ability of a mortgage originator to be compensated by others if compensation is received from a consumer. The Dodd-Frank Act requires mortgage lenders to make additional disclosures prior to the extension of credit, in each billing statement, and for negative amortization loans and hybrid adjustable rate mortgages. Additionally, the CFPB published rules and forms that combined certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under the Truth in Lending Act (Regulation Z) and the Real Estate Settlement Procedures Act (Regulation X), also known as the TILA and RESPA Integrated Disclosures, or TRID. TRID established new disclosure timing requirements and applies to most closed-end consumer credit transactions secured by real property.

Privacy and Customer Information Security. The GLBA requires financial institutions to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to nonaffiliated third parties. In general, we must provide our customers with an annual disclosure that explains our policies and procedures regarding the disclosure of such nonpublic personal information or provide notice as to where our policies and procedures may be accessed. Except as otherwise required or permitted by law, we are prohibited from disclosing nonpublic personal information except as provided in such policies and procedures. The GLBA also requires that we develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information (as defined under the GLBA), to protect against anticipated threats or hazards to the security or integrity of such information; and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. We are also required to send a notice to customers whose “sensitive information” has been compromised if unauthorized use of this information is “reasonably possible.” Most of the states, including the states where we operate, have enacted legislation concerning breaches of data security and our duties in response to a data breach. Congress continues to consider federal legislation that would require consumer notice of data security breaches. Pursuant to the FACT Act, we have developed and implemented a written identity theft prevention program to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts.

Additionally, the FACT Act amends the Fair Credit Reporting Act to generally prohibit a person from using information received from an affiliate to make a solicitation for marketing purposes to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations.

Home Mortgage Disclosure Act (“HMDA”). HMDA makes information available to the public that helps to show whether financial institutions are serving the housing credit needs of their neighborhoods and communities. The Act requires institutions to gather and compile data about loan applications for home purchase, home improvement and refinances where both the old loan and new loan are secured by a dwelling. In accordance with the Dodd-Frank Act the CFPB has adopted regulations that require additional information be gathered and compiled about loan terms, underwriting practices and loan pricing. The information must be compiled each calendar year on a Loan/Application Register, sent to the FDIC by March 1st of the following year and made available to the public no later than March 31st. The Federal Financial Institutions Examinations Council prepares a series of tables that comprise the disclosure statement for each reporting institution. HMDA applies to financial institutions that have their main office or any branch in a Metropolitan Statistical Area ("MSA"). Union is subject to HMDA as it has branch offices within the Burlington, Vermont MSA.

Regulation of Other Activities

Transactions with Related Parties. The Company's and Union's authority to extend credit, purchase or sell an asset from or to their directors, executive officers and 10% or more stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of the Federal Reserve Act and Regulation O of the FRB thereunder. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based in part, on the amount of the bank's capital. Under guidelines, any related party transaction, including a loan, must be reviewed by the Company's Audit Committee. In addition, under the federal SOX Act (discussed below), the Company, itself, may not extend or arrange for any personal loans to its directors and executive officers. The Company has a Related Persons Transactions Approval Policy administered by the Company's Audit Committee which incorporates applicable regulatory guidelines and requirements.

Interstate Banking. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 authorized an adequately capitalized and managed bank holding company to acquire banks based outside its home state, generally without regard to whether the state's law would permit the acquisition, and also authorized banks to merge across state lines thereby creating interstate branches. In addition, this Act authorized banks to acquire existing interstate branches (short of merger) or to establish new interstate branches. States were given the right, exercisable before June 1, 1997, to prohibit altogether or impose certain limitations on interstate mergers and the acquisition or establishment of interstate branches. The Dodd-Frank Act removed remaining state law impediments to de novo interstate branching. Although interstate banking and branching may result in increased competitive pressures in the markets in which the Company operates, interstate branching may also present competitive opportunities for locally-owned and managed banks, such as Union, that are familiar with the local markets and that emphasize personal service and prompt, local decision-making. The ability to branch interstate has also benefited Union, as it permitted the expansion of its banking operations into New Hampshire, with the conversion of its loan production office in Littleton to a full service branch in March of 2006, the May 2011 acquisition of three New Hampshire branches, and the opening of a full service branch in Lincoln, New Hampshire in 2014.

Affiliate Restrictions. Bank holding companies and their affiliates are subject to certain restrictions under the Federal Reserve Act in their dealings with each other, such as in connection with extensions of credit, transfers of assets, and purchase of services among affiliated parties. The Dodd-Frank Act further tightened these restrictions. Generally, loans or extensions of credit, issuances of guarantees or letters of credit, investments or purchases of assets by a subsidiary bank from a bank holding company or its affiliates are limited to 10% of the bank's capital and surplus (as defined by federal regulations) with respect to each affiliate and to 20% in the aggregate for all affiliates, and borrowings are also subject to certain collateral requirements. These transactions, as well as other transactions between a subsidiary bank and its holding company or other affiliates must generally be on arms-length terms, that is, on terms comparable to those involving nonaffiliated companies. Further, under the Federal Reserve Act and FRB regulations, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in-arrangements in connection with extensions of credit or lease or sale of property, furnishing of property or services to third parties. The Company and Union are subject to these restrictions in their intercompany transactions.

Bank Secrecy Act. Union is subject to federal laws establishing record keeping, customer identification and reporting requirements pertaining to large or suspicious cash transactions, purchases of other monetary instruments and the international transfer of cash or monetary instruments that may signify money laundering. Provisions designed to help combat international terrorism, were added to the Bank Secrecy Act by the 2001 USA Patriot Act. These provisions require banks to avoid establishing or maintaining correspondent accounts of foreign off-shore banks and banks in jurisdictions that have been found to fall significantly below international anti-money laundering standards. U.S. banks are also prohibited from opening correspondent accounts for off-shore shell banks, defined as banks that have no physical presence and that are not part of a regulated and recognized banking company. The USA Patriot Act requires all financial institutions to adopt an anti-money laundering program and to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-U.S. persons or their representatives.

The due diligence requirements issued by the Department of Treasury require minimum standards to verify customer identity and maintain accurate records, encourage information sharing cooperation among financial institutions, federal banking agencies and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of “concentration accounts” and require all covered financial institutions to have in place an anti-money laundering compliance program. In addition, the USA Patriot Act amended certain provisions of the federal Right to Financial Privacy Act to facilitate the access of law enforcement to bank customer records in connection with investigating international terrorism.

The USA Patriot Act also amends the BHC Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering program when reviewing an application under these acts.

SOX Act. This far reaching federal legislation was generally intended to protect investors by strengthening corporate governance and improving the accuracy and reliability of corporate disclosures made pursuant to federal securities laws. The SOX Act includes provisions addressing, among other matters, the duties, functions and qualifications of audit committees for all public companies; certification of financial statements by the chief executive officer and the chief financial officer; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; disclosure of off-balance sheet transactions; a prohibition on personal loans to directors and officers, except (in the case of banking companies) loans in the normal course of business; expedited filing requirements for reports of beneficial ownership of company stock by insiders; disclosure of a code of ethics for senior officers, and of any change or waiver of such code; the formation of a public accounting oversight board; auditor independence; disclosure of fees paid to the company's auditors for non-audit services and limitations on the provision of such services; attestation requirements for company management and external auditors, relating to internal controls and procedures; and various increased criminal penalties for violations of federal securities laws.

NASDAQ. In response to the SOX Act, the NASDAQ Exchange on which the Company's common stock is listed, implemented new corporate governance listing standards, including rules strengthening director independence requirements for boards and committees of the board, the director nomination process and shareholder communication avenues. These rules require the Company to annually certify to the NASDAQ, after each annual meeting, that the Company is in compliance and will continue to comply with the NASDAQ corporate governance requirements.

Taxing Authorities. The Company and Union are subject to income taxes at the Federal level and are individually subject to state taxation based on the laws of each state in which they operate. The Company and Union file a consolidated federal tax return with a calendar year end. The Company and Union have filed separate tax returns for each state jurisdiction affected for 2015 and will do the same for 2016. No tax return is currently being examined or audited by any taxing authority that the Company is aware of. The taxing authorities also regulate the information reporting requirements that Union is subject to which continue to increase and require resources to comply with.

Available Information

The Company files annual, quarterly, and current reports, proxy statements, and other documents with the SEC under the Securities Exchange Act of 1934 (the “Exchange Act”). The public may read and copy any materials that Union Bankshares, Inc. has filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549-0213. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, including Union Bankshares, that file electronically with the SEC. The public can obtain any documents that the Company has filed with the SEC at www.sec.gov.

Our Internet website address is www.ublocal.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, including any amendments to those reports filed or furnished pursuant to section 13(a) or 15(d), proxy statements filed pursuant to Section 14(a) and reports filed pursuant to Section 16, 13(d) and 13(g) of the Exchange Act are available free of charge through the Investor Relations page of our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC. The information on our website is not incorporated by reference into this report.

The Company will also provide copies of its 2016 Annual Report on Form 10-K, free of charge, upon written request to its Treasurer at the Company's main address, PO Box 667, Morrisville, VT 05661-0667. Shareholder meeting materials for our 2017 annual meeting are available at www.materials.proxyvote.com/905400 no later than the date on which they are mailed to shareholders.

PART II

Item 6. Selected Financial Data

The selected financial data presented in the table below depicts several measurements of performance or financial condition over a period of time. The following information should be read in conjunction with the consolidated financial statements and related notes and with other financial data in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

	At or For The Years Ended December 31,				
	2016	2015	2014	2013	2012
Financial Condition Data:	(Dollars in thousands, except per share data)				
Investment securities	$66,555	$59,327	$52,964	$45,492	$26,126
Loans and loans held for sale	541,093	506,141	490,721	464,953	455,159
Allowance for loan losses	5,247	5,201	4,694	4,647	4,657
Total assets	691,381	628,879	624,063	585,443	577,256
Deposits	597,660	560,408	552,064	518,354	509,993
Borrowed funds	31,595	9,564	15,118	13,216	15,747
Stockholders' equity	56,279	53,568	51,434	49,820	45,046
Operating Data:					
Interest and dividend income	$26,836	$25,144	$24,852	$24,481	$25,028
Interest expense	2,061	2,025	2,155	2,459	3,351
Net interest income	24,775	23,119	22,697	22,022	21,677
Provision for loan losses	150	550	345	305	660
Net interest income after provision for loan losses	24,625	22,569	22,352	21,717	21,017
Noninterest income	10,140	9,792	8,909	8,509	10,525
Noninterest expenses	24,221	22,304	21,594	21,229	23,035
Income before provision for income taxes	10,544	10,057	9,667	8,997	8,507
Provision for income taxes	2,033	2,179	1,973	1,862	1,663
Net income	$8,511	$7,878	$7,694	$7,135	$6,844
Ratios:					
Return on average assets	1.30%	1.27%	1.30%	1.25%	1.22%
Return on average equity	15.25%	14.80%	14.88%	15.46%	16.35%
Net interest margin (1)	4.17%	4.10%	4.17%	4.21%	4.27%
Efficiency ratio (2)	67.97%	66.25%	67.40%	68.04%	71.51%
Net interest spread (3)	4.09%	4.02%	4.08%	4.10%	4.14%
Total loans to deposits ratio	90.54%	90.32%	88.89%	89.70%	89.25%
Net loan charge-offs to average loans not held for sale	0.02%	0.01%	0.06%	0.07%	0.05%
Allowance for loan losses to loans not held for sale (4)	0.98%	1.04%	0.98%	1.01%	1.05%
Nonperforming assets to total assets (5)	0.63%	0.53%	0.78%	0.39%	0.73%
Equity to assets	8.14%	8.52%	8.24%	8.51%	7.80%
Total capital to risk weighted assets (6)	13.32%	13.42%	13.60%	13.28%	12.95%
Per common share data:					
Book value per common share	$12.61	$12.02	$11.54	$11.17	$10.11
Earnings per common share	$1.91	$1.77	$1.73	$1.60	$1.54
Dividends paid per common share	$1.11	$1.08	$1.04	$1.01	$1.00
Dividend payout ratio (7)	58.12%	61.02%	60.12%	63.13%	64.94%

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(1) The ratio of tax equivalent net interest income to average earning assets. See page 17 for more information.

(2) The ratio of noninterest expense to tax equivalent net interest income and noninterest income, excluding securities gains (losses).

(3) The difference between the average rate earned on earning assets and the average rate paid on interest bearing liabilities. See page 17 for more information.

(4) Calculation includes the net carrying amount of acquired loans recorded at fair value from the 2011 Branch Acquisition as of December 31, 2014 ($9.1 million), December 31, 2013 ($17.0 million) and December 31, 2012 ($22.9 million). Excluding such loans, the ALL to loans not purchased and not held for sale was 1.00% at December 31, 2014, 1.05% at December 31, 2013, and 1.11% at December 31, 2012. The acquired loan portfolios were transferred to the Company's existing loan portfolios during the fourth quarter of 2015.

(5) Nonperforming assets are loans or investment securities that are in nonaccrual or 90 or more days past due as well as OREO or OAO.

(6) The December 31, 2016 and December 31, 2015 ratios are calculated under the Basel III capital rules that became effective for the Company and Union on January 1, 2015.

(7) Cash dividends declared and paid per common share divided by consolidated net income per share.

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

GENERAL

The following discussion and analysis by management focuses on those factors that, in management's view, had a material effect on the consolidated financial position of Union Bankshares, Inc. ("the Company," "our," "we," "us") and its subsidiary, Union Bank ("Union"), as of December 31, 2016 and 2015, and its results of operations for the years ended December 31, 2016, 2015 and 2014. This discussion is being presented to provide a narrative explanation of the consolidated financial statements and should be read in conjunction with the consolidated financial statements and related notes and with other financial data in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. The purpose of this presentation is to enhance overall financial disclosures and to provide information about historical financial performance and developing trends as a means to assess to what extent past performance can be used to evaluate the prospects for future performance. Management is not aware of the occurrence of any events after December 31, 2016 which would materially affect the information presented.

CERTAIN DEFINITIONS

Capitalized terms used in the following discussion and not otherwise defined below have the meanings assigned to them in Note 1 to the Company's audited consolidated financial statements contained in Part II, item 8, page 51 of this Annual Report.

NON-GAAP FINANCIAL MEASURES

Under SEC Regulation G, public companies making disclosures containing financial measures that are not in accordance with GAAP must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure, as well as a statement of the company’s reasons for utilizing the non-GAAP financial measure. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. However, two non-GAAP financial measures commonly used by financial institutions, namely tax-equivalent net interest income and tax-equivalent net interest margin (as presented in the tables in the section labeled Yields Earned and Rates Paid), have not been specifically exempted by the SEC, and may therefore constitute non-GAAP financial measures under Regulation G. We are unable to state with certainty whether the SEC would regard those measures as subject to Regulation G. Management believes that these non-GAAP financial measures are useful in evaluating the Company’s financial performance and facilitate comparisons with the performance of other financial institutions. However, that information should be considered supplemental in nature and not as a substitute for related financial

information prepared in
accordance with GAAP.

CRITICAL ACCOUNTING POLICIES

The Company has established various accounting policies which govern the application of GAAP in the preparation of the Company's financial statements. Certain accounting policies involve significant judgments and assumptions by management which have a material impact on the reported amount of assets, liabilities, capital, revenues and expenses and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require management to make its most difficult and subjective judgments, often as a result of the need to make estimates on matters that are inherently uncertain. Based on this definition, management has identified the accounting policies and judgments most critical to the Company. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Nevertheless, because the nature of the judgments and assumptions made by management are inherently subject to a degree of uncertainty, actual results could differ from estimates and have a material impact on the carrying value of assets, liabilities, capital, or the results of operations of the Company.

Allowance for loan losses

The Company believes the ALL is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. The amount of the ALL is based on management's periodic evaluation of the collectability of the loan portfolio, including the nature, volume and risk characteristics of the portfolio, credit concentrations, trends in historical loss experience, estimated value of any underlying collateral, specific impaired loans and economic conditions. Changes in these qualitative factors may cause management's estimate of the ALL to increase or decrease and result in adjustments to the Company's provision for loan losses in future periods. For additional information, see FINANCIAL CONDITION- Allowance for Loan Losses and Credit Quality below.

Other than temporary impairment of securities

The OTTI decision is a critical accounting policy for the Company. Accounting guidance requires a company to perform periodic reviews of individual securities in its investment portfolio to determine whether a decline in the value of a security is OTT. A review of OTTI requires management to make certain judgments regarding the cause and materiality of the decline, its effect on the financial statements and the probability, extent and timing of a valuation recovery, the company's intent and ability to continue to hold the security, and, with respect to debt securities, the likelihood that the company will have to sell the security before its value recovers. Pursuant to these requirements, management assesses valuation declines to determine the extent to which such changes are attributable to (1) fundamental factors specific to the issuer, such as the nature of the issuer and its financial condition, business prospects or other factors or (2) market-related factors, such as interest rates or equity market declines. Declines in the fair value of securities below their costs that are deemed by management to be OTT are (1) if equity securities, recorded in earnings as realized losses and (2) if debt securities, recorded in earnings as realized losses to the extent they are deemed credit losses, with noncredit losses recorded in OCI (loss). Once an OTT loss on a debt or equity security is realized, subsequent gains in the value of the security may not be recognized in income until the security is sold.

Intangible assets

The Company's intangible assets include goodwill, which represents the excess of the purchase price over the fair value of net assets acquired in the 2011 Branch Acquisition, as well as a core deposit intangible related to the deposits acquired. The core deposit intangible is amortized on a straight line basis over the estimated average life of the acquired core deposit base of 10 years. The Company evaluates the valuation and amortization of the core deposit intangible if events occur that could result in possible impairment. With respect to goodwill, in accordance with current authoritative guidance, the Company assesses qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the Company is less than its carrying amount, which could result in goodwill impairment.

Pension liabilities

The Union Bank Pension Plan ("Plan") was closed to new participants on October 5, 2012. The accrual of retirement benefits for current participants was frozen as of that date. The benefit of the Plan, based on actuarial computations of current benefits for plan participants, is credited to Pension and other employee benefits.

The Company's defined benefit pension obligation and net periodic benefit costs are actuarially determined based on the following assumptions: discount rate, current and expected future return on plan assets, anticipated mortality rates, and Consumer Price Index rate. The determination of the defined benefit pension obligation and net periodic benefit cost is a critical accounting estimate as it requires the use of estimates and judgments related to the amount and timing of expected future cash outflows for benefit payments and cash inflows for maturities and returns on plan assets as well as Company contributions. Changes in estimates, assumptions and actual results could have a material impact on the Company's financial condition and/or results of operations.

Other

The Company also has other key accounting policies, which involve the use of estimates, judgments and assumptions, that are significant to understanding the Company's financial condition and results of operations, including the valuation of deferred tax assets, investment securities and OREO. The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements and in the section below under the caption “FINANCIAL CONDITION” and the subcaptions “Allowance for Loan Losses and Credit Quality”, ”Investment Activities” and “Liability for Pension Benefits”. Although management believes that its estimates, assumptions and judgments are reasonable, they are based upon information presently available and can be impacted by events outside the control of the Company. Actual results may differ significantly from these estimates under different assumptions, judgments or conditions.

OVERVIEW

The Company's net income was $8.5 million for 2016 compared to $7.9 million for 2015, an increase of $633 thousand, or 8.0%. These results reflected the effect of an increase in net interest income of $1.7 million or 7.2%, an increase in noninterest income of $348 thousand, or 3.6%, a decrease in the provision for loan losses of $400 thousand, or 72.7%, and a decrease in the provision for income taxes of $146 thousand, or 6.7%, partially offset by an increase in noninterest expenses of $1.9 million, or 8.6%.

As of December 31, 2016, the Company had total consolidated assets of $691.4 million, an increase of 9.9% compared to December 31, 2015. The growth year over year is attributable to strong loan demand funded primarily with customer deposits and low rate funding options from the FHLB.

Net loans and loans held for sale increased $35.0 million or 7.0%, to $536.5 million, or 77.6% of total assets, at December 31, 2016, compared to $501.5 million, or 79.7% of total assets, at December 31, 2015. The Company experienced growth in real estate secured loans, primarily commercial real estate and residential real estate loans.

The Company's primary source of funding, customer deposits, increased $37.3 million, or 6.6%, to reach $597.7 million at December 31, 2016. During 2016, management successfully focused on growing deposits by expanding its products and services to meet the needs of customers. Additionally, borrowed funds increased $22.0 million during 2016 as lower rate advances were drawn to fund loan demand and purchase investment securities.

The Company's total capital increased from $53.6 million at December 31, 2015 to $56.3 million at December 31, 2016. This increase primarily reflects net income of $8.5 million for 2016, less regular cash dividends paid of $4.9 million. (See Capital Resources on page 33.)

Management anticipated a 25 bp increase in interest rates in July 2016, however, an increase did not occur until December 2016. This movement in interest rates did not have a significant impact on the Company's 2016 results of operations. However, based on results of the Company's recent asset liability management reports, the Company is considered asset sensitive and is positioned to benefit in 2017 from this and potential future increases in interest rates.

On June 24, 2016 Union Bankshares, Inc. became part of the Russell 2000 index, a subset of the Russell 3000 index which is comprised of the 3000 U.S. publicly traded companies with the largest market capitalization. The Russell 2000 index is a widely used proxy for small capitalization U.S. publicly traded companies.

RESULTS OF OPERATIONS

For the year ended December 31, 2016, we reported net income of $8.5 million compared to $7.9 million for the year ended December 31, 2015 and $7.7 million for the year ended December 31, 2014. The primary components of these results, which include net interest income, provision for loan losses, noninterest income, noninterest expenses, and provision for income taxes are discussed below:

Net Interest Income. The largest component of the Company’s operating income is net interest income, which is the difference between interest and dividend income received from interest earning assets and the interest paid on interest bearing liabilities. Net interest income is affected by various factors, including but not limited to: changes in interest rates, loan and deposit pricing strategies, the volume and mix of interest earning assets and interest bearing liabilities, and the level of nonperforming assets. The net interest margin is calculated as net interest income on a fully tax equivalent basis as a percentage of average interest earning assets. The net interest margin for the year ended December 31, 2016, 2015 and 2014 was 4.17%, 4.10%, and 4.17%, respectively. Short term interest rates have increased with the 25 bp increases in the federal funds target rate initiated by the FRB in December 2015 and December 2016.

2016 compared with 2015. Net interest income was $24.8 million on a fully tax equivalent basis for 2016, compared to $23.1 million for 2015, an increase of $1.7 million, or 7.2%. The increase in net interest income is reflective of a 5.0% growth in average earning assets during 2016 coupled with a 6 bp increase in the average yield on average earning assets, partially offset by a 4.2% increase in average interest bearing liabilities. The net interest margin increased 7 bp to 4.17% in 2016 compared to 4.10% in 2015. The increase in average interest earning assets was primarily driven by growth in average loans of $22.8 million, or 4.6%, compared to 2015 and to a lesser extent the increases in interest rates mentioned above.

The average cost of funding, which is tied primarily to our customer deposits, decreased 1 bp to 0.42% for the year ended December 31, 2016, compared to 0.43% for the year ended December 31, 2015. During 2016, Union began offering a fully FDIC insured money market account through Promontory, the Insured Cash Sweep account, to its municipal and commercial customers. Several municipal customers began utilizing this new deposit product and as monies in time deposits matured they were transferred to ICS money market accounts. As a result, an increase in the average balance and average rate paid on savings and money market accounts occurred for the year ended December 31, 2016, with corresponding decreases in time deposits. See the following tables for details.

2015 compared with 2014. Net interest income was $23.1 million on a fully tax equivalent basis for 2015, compared to $22.7 million for 2014, an increase of $422 thousand, or 1.9%. The increase in net interest income is reflective of 3.7% growth in average earning assets during 2015, partially offset by a 7 bp decline in the net interest margin to 4.10% in 2015 compared to 4.17% in 2014. The increase in average interest earning assets was driven by growth in average loans of $20.1 million, or 4.2%, compared to 2014. Customer deposits were primarily used to fund loan demand with an increase in average total deposits of $20.7 million, or 4.0%, during 2015.

The average yield on average interest earning assets decreased 10 bps during 2015 compared to a 4 bp decrease on the average cost of funds. Yield on interest earning assets averaged 4.45% in 2015 compared to 4.55% in 2014 as the loan portfolio yield continued to be impacted by the low interest rate environment. The cost of funds averaged 0.43% in 2015 compared to 0.47% in 2014 as we continued to fund asset growth through customer deposits and short term borrowings at low interest rates. Our average cost of deposits, which continued to be our primary funding source, was 0.37% for 2015, representing a decrease of 3 bps compared to 2014.

The following table shows for the periods indicated the total amount of income recorded from average interest earning assets, the related average tax equivalent yields, the interest expense associated with average interest bearing liabilities, the related average rates paid, and the resulting tax equivalent net interest spread and margin:

	Years Ended December 31,								
	2016			2015			2014		
	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Average Assets:									
Federal funds sold and overnight deposits	$16,953	$51	0.30 %	$11,530	$15	0.13 %	$16,033	$24	0.15 %
Interest bearing deposits in banks	10,816	160	1.48 %	12,749	169	1.32 %	14,216	160	1.13 %
Investment securities (1), (2)	61,111	1,496	2.88 %	58,284	1,379	2.70 %	51,630	1,222	2.69 %
Loans, net (1), (3)	521,435	25,056	4.91 %	498,644	23,531	4.84 %	478,556	23,416	5.01 %
Nonmarketable equity securities	2,215	73	3.30 %	2,014	50	2.51 %	2,053	30	1.45 %
Total interest earning assets (1)	612,530	26,836	4.51 %	583,221	25,144	4.45 %	562,488	24,852	4.55 %
Cash and due from banks	4,565			4,600			4,513		
Premises and equipment	13,189			12,657			11,047		
Other assets	22,795			20,961			15,957		
Total assets	$653,079			$621,439			$594,005		
Average Liabilities and Stockholders' Equity:									
Interest bearing checking accounts	$128,977	$120	0.09 %	$118,344	$94	0.08 %	$109,944	$86	0.08 %
Savings/money market accounts	204,056	524	0.26 %	187,679	324	0.17 %	180,515	316	0.18 %
Time deposits	126,248	978	0.77 %	141,581	1,264	0.89 %	145,650	1,344	0.92 %
Borrowed funds	27,616	439	1.57 %	19,830	343	1.71 %	16,778	409	2.41 %
Total interest bearing liabilities	486,897	2,061	0.42 %	467,434	2,025	0.43 %	452,887	2,155	0.47 %
Noninterest bearing deposits	105,596			96,994			87,777		
Other liabilities	4,761			3,765			1,644		
Total liabilities	597,254			568,193			542,308		
Stockholders' equity	55,825			53,246			51,697		
Total liabilities and stockholders' equity	$653,079			$621,439			$594,005		
Net interest income		$24,775			$23,119			$22,697	
Net interest spread (1)			4.09 %			4.02 %			4.08 %
Net interest margin (1)			4.17 %			4.10 %			4.17 %

(1) Average yields reported on a tax equivalent basis using a marginal tax rate of 34%.

(2) Average balances of investment securities are calculated on the amortized cost basis and include nonaccrual securities, if applicable.

(3) Includes loans held for sale as well as nonaccrual loans, unamortized costs and premiums and is net of the ALL.

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Tax exempt interest income amounted to $1.8 million for the years ended December 31, 2016 and 2015, and $1.6 million for the year ended December 31, 2014. The following table presents the effect of tax exempt income on the calculation of net interest income, using a marginal tax rate of 34% for all years:

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Net interest income as presented	$24,775	$23,119	$22,697
Effect of tax-exempt interest			
Investment securities	265	196	170
Loans	524	615	576
Net interest income, tax equivalent	$25,564	$23,930	$23,443

Rate/Volume Analysis. The following table describes the extent to which changes in average interest rates (on a fully tax equivalent basis) and changes in volume of average interest earning assets and interest bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. For each category of interest earning assets and interest bearing liabilities, information is provided on changes attributable to:

- changes in volume (change in volume multiplied by prior rate);
- changes in rate (change in rate multiplied by prior volume); and
- total change in rate and volume.

Changes attributable to both rate and volume have been allocated proportionately to the change due to volume and the change due to rate.

	Year Ended December 31, 2016 Compared to Year Ended December 31, 2015 Increase/(Decrease) Due to Change In			Year Ended December 31, 2015 Compared to Year Ended December 31, 2014 Increase/(Decrease) Due to Change In		
	Volume	Rate	Net	Volume	Rate	Net
	(Dollars in thousands)					
Interest earning assets:						
Federal funds sold and overnight deposits	$9	$27	$36	$(6)	$(3)	$(9)
Interest bearing deposits in banks	(28)	19	(9)	(17)	26	9
Investment securities	44	73	117	153	4	157
Loans, net	1,160	365	1,525	969	(854)	115
Nonmarketable equity securities	5	18	23	(2)	22	20
Total interest earning assets	$1,190	$502	$1,692	$1,097	$(805)	$292
Interest bearing liabilities:						
Interest bearing checking accounts	$8	$18	$26	$7	$1	$8
Savings/money market accounts	30	170	200	13	(5)	8
Time deposits	(129)	(157)	(286)	(38)	(42)	(80)
Borrowed funds	126	(30)	96	64	(130)	(66)
Total interest bearing liabilities	$35	$1	$36	$46	$(176)	$(130)
Net change in net interest income	$1,155	$501	$1,656	$1,051	$(629)	$422

Provision for Loan Losses. The provision for loan losses was $150 thousand, $550 thousand, and $345 thousand for the years ended December 31, 2016, 2015 and 2014, respectively. The provision for 2016 was deemed appropriate by management based on the size and mix of the loan portfolio, the level of nonperforming loans, the results of the qualitative factor review and the outlook for future economic conditions. For further details, see FINANCIAL CONDITION Asset Quality and Allowance for Loan Losses below.

Noninterest Income. The following table sets forth the components of noninterest income for the years ended December 31, 2016, 2015 and 2014:

	For The Years Ended December 31,						
			Variance from 2016 to 2015			Variance from 2015 to 2014	
	2016	2015	$	%	2014	$	%
	(Dollars in thousands)						
Trust income	$737	$719	$18	2.5	$726	$(7)	(1.0)
Service fees	5,871	5,568	303	5.4	5,354	214	4.0
Net gains on sales of loans held for sale	2,898	2,871	27	0.9	2,097	774	36.9
Gain on sale of OREO	—	29	(29)	(100.0)	134	(105)	(78.4)
Income from Company-owned life insurance	339	282	57	20.2	124	158	127.4
Other income	224	270	(46)	(17.0)	159	111	69.8
Subtotal	10,069	9,739	330	3.4	8,594	1,145	13.3
Net gains on sales of investment securities AFS	71	53	18	34.0	315	(262)	(83.2)
Total noninterest income	$10,140	$9,792	$348	3.6	$8,909	$883	9.9

The significant changes in noninterest income for the year ended December 31, 2016 compared to the year ended December 31, 2015 are described below:

- Service fees. There was a $303 thousand increase in service fees for 2016 compared to 2015. Loan servicing fees increased $158 thousand due to the increase in our serviced loan portfolio from $422.3 million at December 31, 2015 to $452.0 million at December 31, 2016, or an increase of 7.0%. Additionally, overdraft fees and ATM network income increased $101 thousand and $34 thousand, respectively.
- Net gains on sales of loans held for sale. Continuing the Company's strategy to mitigate long-term interest rate risk, residential and commercial loans totaling $135.5 million were sold to the secondary market during 2016, versus residential loan sales of $131.7 million during 2015, resulting in an increase in the net gains on sales of loans held for sale of $27 thousand, or 0.9%.
- Income from Company-owned life insurance. During the second quarter of 2016, the administration of the Company's life insurance policies was moved to a single service provider. As a result, the earnings on the older policies are calculated evenly throughout a calendar year rather than as of the June 30th anniversary date of the policies, which was the practice in prior years. Additionally, during the second quarter of 2016, the Company received proceeds from the death benefit on an insurance policy on the life of a former director, resulting in $73 thousand of additional income. This increase was partially offset by the administrative change mentioned previously.
- Other income. Other income decreased $46 thousand for 2016 compared to 2015 primarily due to the decrease in income from MSR, net of amortization.

The significant changes in noninterest income for the year ended December 31, 2015 compared to the year ended December 31, 2014 are described below:

- Service fees. There was a $214 thousand increase in service fees for 2015 compared to 2014. Loan servicing fees increased $144 thousand due to the increased level of residential mortgage loans serviced. The implementation of a new fee structure on deposit accounts during the third quarter of 2015 increased service charges on deposit accounts approximately $140 thousand for 2015. These increases were partially offset by decreases in ATM fees of $56 thousand and overdraft fee income of $20 thousand.
- Net gains on sales of loans held for sale. Continuing the Company's strategy to mitigate long-term interest rate risk, residential loans totaling $131.7 million were sold to the secondary market during 2015, versus residential loan sales of $94.9 million during 2014, resulting in an increase in the net gains on sales of loans held for sale of $774 thousand, or 36.9%.
- Gain on sale of OREO. During the third quarter of 2014, the Company sold a commercial OREO property resulting in a gain on the sale of $127 thousand, with no similar gain in 2015.

- Income from Company-owned life insurance. The Company purchased $5.0 million of company-owned life insurance covering certain officers of Union during the first quarter of 2015. Income from the new policies was recorded starting in the first quarter of 2015, resulting in increased income for the year ended December 31, 2015 compared to the year ended December 31, 2014.

- Other income. Other income increased $111 thousand for 2015 compared to 2014 primarily due to the increase in income from MSR, net of amortization.

Noninterest Expense. The following table sets forth the components of noninterest expenses for the years ended December 31, 2016, 2015 and 2014:

	For The Years Ended December 31,						
			Variance from 2016 to 2015			Variance from 2015 to 2014	
	2016	2015	$	%	2014	$	%
	(Dollars in thousands)						
Salaries and wages	$10,203	$9,517	$686	7.2	$8,916	$601	6.7
Pension and employee benefits	3,525	2,977	548	18.4	2,725	252	9.2
Occupancy expense, net	1,263	1,279	(16)	(1.3)	1,199	80	6.7
Equipment expense	2,115	1,875	240	12.8	1,674	201	12.0
ATM and debit card expense	639	783	(144)	(18.4)	695	88	12.7
FDIC insurance assessment	307	345	(38)	(11.0)	348	(3)	(0.9)
Prepayment penalties on borrowings	21	—	21	100.0	256	(256)	(100.0)
Equity in losses of limited partnerships	565	484	81	16.7	800	(316)	(39.5)
Trust expenses	409	379	30	7.9	377	2	0.5
Professional fees	731	641	90	14.0	617	24	3.9
Supplies and printing	298	305	(7)	(2.3)	480	(175)	(36.5)
Other expenses	4,145	3,719	426	11.5	3,507	212	6.0
Total noninterest expense	$24,221	$22,304	$1,917	8.6	$21,594	$710	3.3

The significant changes in noninterest expense for the year ended December 31, 2016 compared to the year ended December 31, 2015 are described below:

- Salaries and wages. The $686 thousand increase reflects normal annual salary increases, an increase of $226 thousand for short term and long term incentive compensation for certain officers of Union and a $59 thousand increase in the amount of commissions paid to mortgage loan originators.
- Pension and employee benefits. The actuarial calculation for the fiscal year ended December 31, 2016 decreased the pension benefit by $238 thousand compared to December 31, 2015. Additionally, the cost of the Company's medical and dental plans increased $165 thousand, or 8.8%, due to increases in premium rates and higher dental claims. Also, as a result of higher salaries and wages, payroll related taxes increased $50 thousand and 401k employer contribution expense increased $77 thousand between years.
- Equipment expense. Equipment depreciation increased $147 thousand year over year as a result of new technology equipment installed throughout the branch network as well as other infrastructure replacements. Additionally, increases in maintenance contracts of $140 thousand occurred as a result of the installation of the new equipment.
- ATM and debit card expense. The $144 thousand decrease between 2015 and 2016 reflects $98 thousand in expenses related to the issuance of EMV chip debit cards that did not recur in 2016 and $34 thousand of incentives received as a result of negotiation of a vendor contract utilized to offset expenses incurred in 2016.
- Equity in losses of limited partnerships. The increase is attributable to an additional investment in a limited partnership resulting in an increase in equity in losses of $91 thousand, partially offset by one limited partnership investment reaching the end of the compliance period.
- Professional fees. Professional fee expenses increased $90 thousand year over year as a result of engaging consultants for advisory services related to a review of the Company's core operating system, review the Company's branch network and facilities, and additional outsourced internal audit services.

The significant changes in noninterest expense for the year ended December 31, 2015 compared to the year ended December 31, 2014 are described below:

- Salaries and wages. The $601 thousand increase reflects normal annual salary increases, an increase of $174 thousand in the amount of commissions paid to mortgage loan originators and a decrease in the deferral of salary expense due to accounting methods utilized to account for loan origination costs.

- Pension and employee benefits. The cost of the Company's medical and dental plans increased $134 thousand, or 8.3%, due to increases in premium rates and dental claims between years. In addition, payroll related taxes increased $48 thousand and 401k employer contribution expense increased $45 thousand between years.
- ATM and debit card expense. The $88 thousand increase between 2014 and 2015 reflects expenses related to the issuance of EMV chip debit cards, partially offset by a reduction in vendor fees as a result of negotiation of vendor contracts.
- Equity in losses of limited partnerships. In the fourth quarter of 2014, the Company exited three limited partnerships that had reached the final year of tax credits and were near or at the end of the limited partnership federal tax credit program compliance period. This resulted in a decrease in the provision for undistributed net losses recognized between years.
- Supplies and Printing. The increase in 2014 is primarily attributable to costs associated with rebranding of the Company and Union. These costs represent expenditures for new printed materials such as brochures, business cards, letterhead etc.

Provision for Income Taxes. The Company has provided for current and deferred federal income taxes for the current and all prior periods presented. The Company's net provision for income taxes was $2.0 million for 2016, $2.2 million for 2015, and $2.0 million for 2015. The Company’s effective tax rate for 2016 decreased to 19.3% compared to 21.7% for 2015 and 20.4% for 2014. The decrease in the effective tax rate related to an increase in tax credits recorded from investments in affordable housing projects to $881 thousand for 2016 versus $564 thousand for 2015 and $735 thousand for 2014.

FINANCIAL CONDITION

At December 31, 2016, the Company had total consolidated assets of $691.4 million, including gross loans and loans held for sale (total loans) of $541.1 million, deposits of $597.7 million and stockholders' equity of $56.3 million. The Company’s total assets increased $62.5 million, or 9.9%, from $628.9 million at December 31, 2015.

Net loans and loans held for sale increased $35.0 million, or 7.0%, to $536.5 million, or 77.6% of total assets, at December 31, 2016, compared to $501.5 million, or 79.7% of total assets, at December 31, 2015. (See Loan Portfolio below.)

Total deposits increased $37.3 million, or 6.6% to $597.7 million at December 31, 2016, from $560.4 million at December 31, 2015. Noninterest bearing deposits increased $12.6 million, or 12.6%, from $99.8 million at December 31, 2015 to $112.4 million at December 31, 2016 and interest bearing deposits increased $71.9 million, or 23.2%, from $310.2 million at December 31, 2015 to $382.1 million at December 31, 2016, while time deposits decreased $47.2 million, or 31.4%, from $150.4 million at December 31, 2015, to $103.2 million at December 31, 2016. (See average balances and rates in the Yields Earned and Rates Paid table on page 17.)

Total borrowed funds increased $22.0 million, or 230.4%, from $9.6 million at December 31, 2015 to $31.6 million at December 31, 2016. There was an increase in FHLB advances of $22.6 million, to fund loan demand, while customer overnight collateralized repurchase sweeps decreased $523 thousand between December 31, 2015 and December 31, 2016. (See Borrowings on page 29.)

Total stockholders’ equity increased $2.7 million, or 5.06%, from $53.6 million at December 31, 2015 to $56.3 million at December 31, 2016. (See Capital Resources on page 33.)

Loan Portfolio. The Company's gross loan portfolio (including loans held for sale) increased $35.0 million, or 6.9%, to $541.1 million, representing 78.3% of assets at December 31, 2016, from $506.1 million, representing 80.5% of assets at December 31, 2015. The Company's loans consist primarily of adjustable-rate and fixed-rate mortgage loans secured by one-to-four family, multi-family residential or commercial real estate. Real estate secured loans represented $463.8 million, or 85.7%, of total loans at December 31, 2016 compared to $444.4 million, or 87.8%, of total loans at December 31, 2015. Although competition for good loans is strong, especially in the commercial sector, the Company has been able to originate loans to both current and new customers while maintaining credit quality. The composition of the Company's loan portfolio remained relatively unchanged from December 31, 2015, and there was no material change in the Company's lending programs or terms during 2016.

The composition of the Company's loan portfolio at year-end for each of the last five years was as follows:

	2016		2015		2014		2013		2012	
	$	%	$	%	$	%	$	%	$	%
	(Dollars in thousands)									
Residential real estate	$172,727	31.9	$165,396	32.7	$165,475	33.7	$159,441	34.3	$154,938	34.0
Construction real estate	34,189	6.3	42,889	8.5	37,258	7.6	30,898	6.7	36,018	7.9
Commercial real estate	249,063	46.0	230,442	45.5	211,710	43.1	210,718	45.3	197,240	43.3
Commercial	41,999	7.8	21,397	4.2	20,620	4.2	20,569	4.4	21,463	4.7
Consumer	3,962	0.7	3,963	0.8	4,435	0.9	5,396	1.2	6,065	1.3
Municipal	31,350	5.8	36,419	7.2	40,480	8.3	34,091	7.3	28,421	6.3
Loans held for sale	7,803	1.5	5,635	1.1	10,743	2.2	3,840	0.8	11,014	2.5
Total loans	$541,093	100.0	$506,141	100.0	$490,721	100.0	$464,953	100.0	$455,159	100.0

The Company originates and sells qualified residential mortgage loans in various secondary market avenues, with a majority of sales made to the FHLMC/Freddie Mac. At December 31, 2016, the Company serviced a $616.1 million residential real estate mortgage portfolio, of which $7.8 million was held for sale and approximately $435.6 million was serviced for unaffiliated third parties. This compares to a residential real estate mortgage serviced portfolio of $561.1 million at December 31, 2015, of which $5.6 million was held for sale and approximately $390.1 million was serviced for unaffiliated third parties. Loans held for sale are accounted for at the lower of cost or fair value and are reviewed by management at least quarterly based on current market pricing.

The Company sold $135.3 million of qualified residential real estate loans originated during 2016 to the secondary market to mitigate long-term interest rate risk and to generate fee income, compared to sales of $131.7 million during 2015. The Company generally retains the servicing rights on sold residential mortgage loans. The Company originates and sells FHA, VA, and RD residential mortgage loans, and also has an Unconditional Direct Endorsement Approval from HUD which allows the Company to approve FHA loans originated in any of its Vermont or New Hampshire locations without needing prior HUD approval. The Company sells VA and FHA loans as originated with servicing released. Some of the government backed loans qualify for zero down payments without geographic or income restrictions. These loan products increase the Company's ability to serve the borrowing needs of residents in the communities we serve, including low and moderate income borrowers, while the government guaranty mitigates our exposure to credit risk.

The Company also originates commercial real estate and commercial loans under various SBA, USDA and State sponsored programs which provide a government agency guaranty for a portion of the loan amount. There was $5.2 million and $5.5 million guaranteed under these various programs at December 31, 2016 and 2015, respectively, on an aggregate balance of $6.5 million and $6.8 million in subject loans for the same time periods. The Company occasionally sells the guaranteed portion of a loan to other financial concerns and retains servicing rights, which generates fee income. There was $251 thousand in commercial real estate and commercial loans sold during 2016 and no commercial real estate or commercial loans sold in 2015. The Company recognizes gains and losses on the sale of the principal portion of these loans as they occur.

The Company serviced $16.4 million and $32.2 million of commercial and commercial real estate loans for unaffiliated third parties as of December 31, 2016 and 2015, respectively. This includes $12.9 million and $28.7 million of commercial or commercial real estate loans the Company had participated out to other financial institutions at December 31, 2016 and 2015, respectively. These loans were participated in the ordinary course of business on a nonrecourse basis, for liquidity or credit concentration management purposes.

The Company capitalizes servicing rights for all loans sold with servicing retained and recognizes gains and losses on the sale of the principal portion of these loans as they occur. The unamortized balance of servicing rights on loans sold with servicing retained was $1.6 million as of December 31, 2016 and $1.5 million as of December 31, 2015, with an estimated market value in excess of the carrying value at both year ends. Management periodically evaluates and measures the servicing assets for impairment.

The following table breaks down by classification the contractual maturities of the gross loans held in portfolio and for sale as of December 31, 2016:

	Within 1 Year	2-5 Years	Over 5 Years	Total
	(Dollars in thousands)			
Fixed rate				
Residential real estate	$338	$2,253	$89,543	$92,134
Construction real estate	16,000	263	301	16,564
Commercial real estate	326	17,056	15,076	32,458
Commercial	2,770	7,158	14,624	24,552
Consumer	1,532	2,175	218	3,925
Municipal	19,353	4,089	7,908	31,350
Total fixed rate	40,319	32,994	127,670	200,983
Variable rate				
Residential real estate	1,458	2,874	84,064	88,396
Construction real estate	2,951	1,599	13,075	17,625
Commercial real estate	10,030	4,952	201,623	216,605
Commercial	5,842	8,083	3,522	17,447
Consumer	37	—	—	37
Total variable rate	20,318	17,508	302,284	340,110
	$60,637	$50,502	$429,954	$541,093

Asset Quality. The Company, like all financial institutions, is exposed to certain credit risks, including those related to the value of the collateral that secures its loans and the ability of borrowers to repay their loans. Consistent application of the Company’s conservative loan policies has helped to mitigate this risk and has been prudent for both the Company and its customers. The Company's Board has set forth well-defined lending policies (which are periodically reviewed and revised as appropriate) that include conservative individual lending limits for officers, aggregate and advisory board approval levels, Board approval for large credit relationships, a quality control program, a loan review program and other limits or standards deemed necessary and prudent. The Company's loan review program encompasses a review process for loan documentation and underwriting for select loans as well as a monitoring process for credit extensions to assess the credit quality and degree of risk in the loan portfolio. Management performs, and shares with the Board, periodic concentration analyses based on various factors such as industries, collateral types, location, large credit sizes and officer portfolio loads. Board approved policies set forth portfolio diversification levels to mitigate concentration risk and the Company participates large credits out to other financial institutions to further mitigate that risk. The Company has established underwriting guidelines to be followed by its officers; material exceptions are required to be approved by a senior loan officer, the President or the Board. The Company does not make loans that are interest only, have teaser rates or that result in negative amortization of the principal, except for construction, lines of credit and other short-term loans for either commercial or consumer purposes where the credit risk is evaluated on a borrower-by-borrower basis. The Company evaluates the borrower's ability to pay on variable-rate loans over a variety of interest rate scenarios, not only the rate at origination.

The majority of the Company's loan portfolio is secured by real estate located throughout the Company's primary market area of northern Vermont and New Hampshire. For residential loans, the Company generally does not lend more than 80% of the appraised value of the home without a government guaranty or the borrower purchasing private mortgage insurance. Although the Company lends up to 80% of the collateral value on commercial real estate loans to strong borrowers, the majority of commercial real estate loans do not exceed 75% of the appraised collateral value. Rarely, the loan to value may go up to 100% on loans with government guarantees or other mitigating circumstances. Although the Company's loan portfolio consists of different business segments, there is a portion of the loan portfolio centered in tourism related loans. The Company has implemented risk management strategies to mitigate exposure in this industry through utilizing government guaranty programs as well as participations with other financial institutions as discussed above. Additionally, the loan portfolio contains many loans to seasoned and well established businesses and/or well secured loans which further reduce the Company's risk. Management closely follows the local and national economies and their impact on the local businesses, especially on the tourism industry, as part of the Company's risk management program.

The Company also monitors its delinquency levels for any adverse trends. There can be no assurance that the Company's loan portfolio will not become subject to increasing pressures from deteriorating borrower financial strength or declining collateral values due to general or local economic conditions. Renewed market volatility, high unemployment rates or weakness in the general economic condition of the country or our market area, may have a negative effect on our customers' ability to make their loan payments on a timely basis and/or on underlying collateral values. Management closely monitors the Company's loan and investment portfolios, OREO and OAO for potential problems and reports to the Company's and Union's Board at regularly scheduled meetings. Repossessed assets and loans or investments that are 90 days or more past due are considered to be nonperforming assets.

TDR loans involve one or more of the following: forgiving a portion of interest or principal, refinancing at a rate materially less than the market rate, rescheduling loan payments, or granting other concessions to a borrower due to financial or economic reasons related to the debtor's financial difficulties that the Company would not ordinarily grant. When evaluating the ALL, management makes a specific allocation for TDR loans as they are considered impaired.

The following table details the composition of the Company's nonperforming assets as of December 31:

	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Nonaccrual loans	$3,545	$2,521	$2,235	$1,434	$2,839
Loans past due 90 days or more and still accruing interest	840	836	2,344	263	307
Total nonperforming loans	4,385	3,357	4,579	1,697	3,146
OREO	—	—	297	559	1,052
Total nonperforming assets	$4,385	$3,357	$4,876	$2,256	$4,198
Guarantees of U.S. or state government agencies on the above nonperforming loans	$599	$291	$259	$19	$—
TDR loans	$3,419	$2,732	$1,691	$1,240	$2,850

There was one residential real estate loan totaling $50 thousand in process of foreclosure at December 31, 2016 included in nonperforming loans. The aggregate interest on nonaccrual loans not recognized was $1.3 million for the year ended December 31, 2016, $1.2 million for the year ended December 31, 2015 and $1.1 million for the year ended December 31, 2014.

The following table shows trends of certain asset quality ratios monitored by Company's management at December 31:

	2016	2015	2014	2013	2012
Allowance for loan losses to loans not held for sale (1)	0.98 %	1.04 %	0.98 %	1.01 %	1.05 %
Allowance for loan losses to nonperforming loans	119.66 %	154.93 %	102.51 %	273.84 %	148.03 %
Nonperforming loans to total loans	0.81 %	0.66 %	0.93 %	0.36 %	0.69 %
Nonperforming assets to total assets	0.63 %	0.53 %	0.78 %	0.39 %	0.73 %
Delinquent loans (30 days to nonaccruing) to total loans	1.55 %	1.61 %	2.20 %	2.15 %	2.56 %
Net charge-offs to average loans not held for sale	0.02 %	0.01 %	0.06 %	0.07 %	0.05 %

(1) Calculation includes the net carrying amount of loans recorded at fair value from the 2011 Branch Acquisition as of December 31, 2014 ($9.1 million), December 31, 2013 ($17.0 million) and December 31, 2012 ($22.9 million). Excluding such loans, the ALL to loans not purchased and not held for sale was 1.00% at December 31, 2014, 1.05% at December 31, 2013 and 1.11% at December 31, 2012. The acquired loan portfolios from the 2011 Branch Acquisition were transferred to the Company's existing loan portfolios during the fourth quarter of 2015.

Nonperforming loans at December 31, 2016 increased in terms of dollars by $1.0 million, or 30.6%, and as a percentage of assets from December 31, 2015, with the ALL as a percentage of nonperforming loans decreasing from 154.93% to 119.66%. The nonperforming ratios increased slightly in comparison to December 31, 2015, with the delinquent loans ratio also decreasing slightly during the same time period. Management considers the ratios to be at favorable levels. The Company's success at keeping the ratios at favorable levels in these challenging economic conditions is the result of continued focus on maintaining strict underwriting standards, as well as our practice, as a community bank, of actively working with troubled borrowers to resolve the borrower's delinquency, while maintaining the safe and sound credit practices of Union and safeguarding our strong capital position.

The Company had loans rated substandard that were on a performing status totaling $1.8 million at December 31, 2016 and $2.4 million at December 31, 2015. In management's view, such loans represent a higher degree of risk of becoming nonperforming loans in the future. While still on a performing status, in accordance with the Company's credit policy, loans are internally classified when a review indicates the existence of any of the following conditions, making the likelihood of collection questionable:

- the financial condition of the borrower is unsatisfactory;

- repayment terms have not been met;
- the borrower has sustained losses that are sizable, either in absolute terms or relative to net worth;
- confidence in the borrower's ability to repay is diminished;
- loan covenants have been violated;
- collateral is inadequate; or
- other unfavorable factors are present.

Although management believes that the Company's nonperforming and internally classified loans are generally well-secured and that probable credit losses inherent in the loan portfolio are provided for in the Company's ALL, there can be no assurance that future deterioration in economic conditions and/or collateral values, or changes in other relevant factors will not result in future credit losses. The Company's management is focused on the impact that the economy may have on its borrowers and closely monitors industry and geographic concentrations for evidence of financial problems. Last winter season saw a lack of snow which put some strain on the local tourism industry, however, the summer and fall seasons helped to lessen the impact on this industry and this winter season is following a more normal pattern of snowfall. The Company has managed through difficult tourism seasons in the past and management has closely monitored the results and impact of last winter on our borrowers. Outside of the poor winter weather and its effect on the tourism industry, improvement in local economic indicators has been identified over the past year. The unemployment rate has stabilized in Vermont and was 3.1% level at December 31, 2016 compared to 3.6% for December 31, 2015. The New Hampshire unemployment rate was 2.6% for December 31, 2016 compared to 3.1% for December 31, 2015. These rates compare favorably with the nationwide rate at 4.7% and 5.0% for the comparable periods. Management will continue to monitor the national, regional and local economic environment and its impact on unemployment, business failures and real estate values in the Company's market area.

On occasion, the Company acquires residential or commercial real estate properties through or in lieu of loan foreclosure. These properties are held for sale and are initially recorded as OREO at fair value less estimated selling costs at the date of the Company's acquisition of the property, with fair value based on an appraisal for more significant properties and on a broker's price opinion for less significant properties. Holding costs and declines in fair value of properties acquired are expensed as incurred. Declines in the fair value after acquisition of the property result in charges against income before tax. There were no such declines during 2016, compared to a $42 thousand decline recognized during 2015. The Company evaluates each OREO property at least quarterly for changes in the fair value. The Company had no properties classified as OREO at December 31, 2016 and December 31, 2015.

Allowance for Loan Losses. Some of the Company's loan customers ultimately do not make all of their contractually scheduled payments, requiring the Company to charge off a portion or all of the remaining principal balance due. The Company maintains an ALL to absorb such losses. The ALL is maintained at a level believed by management to be appropriate to absorb probable credit losses inherent in the loan portfolio as of the evaluation date; however, actual loan losses may vary from management's current estimates.

The ALL is evaluated quarterly using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectability of specific loans when determining the appropriate level of the ALL, management also takes into consideration other qualitative factors such as changes in the mix and size of the loan portfolio, credit concentrations, historic loss experience, the amount of delinquencies and loans adversely classified, industry trends, and the impact of the local and regional economy on the Company's borrowers as well as the estimated value of any underlying collateral. The appropriate level of the ALL is assessed by an allocation process whereby specific loss allocations are made against impaired loans and general loss allocations are made against segments of the loan portfolio that have similar attributes. Although the ALL is assessed by allocating reserves by loan category, the total ALL is available to absorb losses that may occur within any loan category.

The ALL is increased by a provision for loan losses charged to earnings, and reduced by charge-offs, net of recoveries. The provision for loan losses represents management's estimate of the current period credit cost associated with maintaining an appropriate ALL. Based on an evaluation of the loan portfolio and other relevant qualitative factors, management presents a quarterly analysis of the appropriate level of the ALL to the Board, indicating any changes in the ALL since the last review and any recommendations as to adjustments in the ALL and the level of future provisions.

Credit quality of the commercial portfolio is quantified by a credit rating system designed to parallel regulatory criteria and categories of loan risk and has historically been well received by the various regulatory authorities. Individual loan officers monitor their loans to ensure appropriate rating assignments are made on a timely basis. Risk ratings and quality of commercial and retail credit portfolios are also assessed on a regular basis by an independent loan review function.

The level of ALL allocable to each loan portfolio category with similar risk characteristics is determined based on historical charge-offs, adjusted for qualitative risk factors. A quarterly analysis of various qualitative factors, including portfolio characteristics, national and local economic trends, overall market conditions, and levels of, and trends in, delinquencies and nonperforming loans, helps to ensure that areas with the potential risk for loss are considered in management's ALL estimate. In addition, loans are also

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evaluated for specific impairment and may be classified as impaired when management believes it is probable that the Company will not collect all the contractual interest and principal payments as scheduled in the loan agreement. Commercial loans with balances greater than $500 thousand was established by management as the threshold for individual impairment evaluation with a specific reserve allocated when warranted. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer, real estate or small balance commercial loans for impairment evaluation, unless such loans are subject to a restructuring agreement or have been identified as impaired as part of a larger customer relationship. A specific reserve amount is allocated to the ALL for individual loans that have been classified as impaired on the basis of the fair value of the collateral for collateral dependent loans, an observable market price, or the present value of anticipated future cash flows.

The following table reflects activity in the ALL for the years ended December 31:

	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Balance at the beginning of year	$5,201	$4,694	$4,647	$4,657	$4,226
Charge-offs	163	126	340	402	272
Recoveries	59	83	42	87	43
Net charge-offs	(104)	(43)	(298)	(315)	(229)
Provision for loan losses	150	550	345	305	660
Balance at the end of year	$5,247	$5,201	$4,694	$4,647	$4,657
Provision charged to income as a percent of average loans	0.03 %	0.11 %	0.07 %	0.07 %	0.15 %

The following table (net of loans held for sale) shows the internal breakdown by risk component of the Company's ALL and the percentage of loans in each category to total loans in the respective portfolios at December 31:

	2016		2015		2014		2012		2011	
	$	%	$	%	$	%	$	%	$	%
	(Dollars in thousands)									
Residential real estate	$1,399	32.4	$1,419	33.0	$1,330	34.5	$1,251	34.6	$1,291	34.9
Construction real estate	391	6.4	514	8.6	439	7.8	390	6.7	456	8.1
Commercial real estate	2,687	46.7	2,792	46.0	2,417	44.1	2,644	45.7	2,532	44.4
Commercial	342	7.9	209	4.3	176	4.3	163	4.4	159	4.8
Consumer	26	0.7	28	0.8	27	0.9	23	1.2	39	1.4
Municipal	40	5.9	38	7.3	42	8.4	35	7.4	30	6.4
Unallocated	362	—	201	—	263	—	141	—	150	—
Total	$5,247	100.0	$5,201	100.0	$4,694	100.0	$4,647	100.0	$4,657	100.0

There were no changes to the reserve factors assigned to any of the loan portfolios based on the qualitative factor reviews performed during 2016. Management of the Company believes, in its best estimate, that the ALL at December 31, 2016 is appropriate to cover probable credit losses inherent in the Company’s loan portfolio as of such date. However, there can be no assurance that the Company will not sustain losses in future periods which could be greater than the size of the ALL at December 31, 2016. In addition, our banking regulators, as an integral part of their examination process, periodically review our ALL. Such agencies may require us to recognize adjustments to the ALL based on their judgments about information available to them at the time of their examination. A large adjustment to the ALL for losses in future periods may require increased provisions to replenish the ALL, which could negatively affect earnings. While the Company recognizes that economic slowdowns or financial and credit market turmoil may adversely impact its borrowers' financial performance and ultimately their ability to repay their loans, management continues to be cautiously optimistic about the collectability of the Company's loan portfolio.

Investment Activities. The investment portfolio is used to generate interest and dividend income, manage liquidity and mitigate interest rate sensitivity. At December 31, 2016, the fair value of investment securities AFS was $65.6 million, or 9.5% of total assets, compared to $54.1 million, or 8.6% of total assets at December 31, 2015. At December 31, 2016, there were $999 thousand of investment securities classified as HTM, compared to $5.2 million at December 31, 2015. The Company had no investments classified as trading. Investment securities classified as AFS are marked-to-market, with any unrealized gain or loss after estimated taxes charged to the equity portion of the balance sheet through the accumulated OCI component of stockholders' equity. The fair value of investment securities AFS at December 31, 2016 reflects a net unrealized loss of $1.0 million.

At December 31, 2016, 91 debt securities had unrealized losses of $1.2 million, with aggregate depreciation of 1.84% from the Company's amortized cost basis. Securities are evaluated at least quarterly for OTTI and at December 31, 2016, in management's estimation no security was OTTI. Management's evaluation of OTTI is subject to risks and uncertainties and is intended to determine the appropriate amount and timing of recognition of any impairment charge. The assessment of whether such impairment for debt securities has occurred is based on management's best estimate of the cash flows expected to be collected at the individual security level. We regularly monitor our investment portfolio to ensure securities that may be OTTI are identified in a timely manner and that any impairment charge is recognized in the proper period and, with respect to debt securities, that the impairment is properly allocated between credit losses recognized in earnings and noncredit unrealized losses recognized in OCI. Further deterioration in credit quality, imbalances in liquidity in the financial marketplace or a quick rise in interest rates might adversely affect the fair value of the Company's investment portfolio and may increase the potential that certain unrealized losses will be designated as OTT in future periods, resulting in write-downs.

At December 31, 2016, the Company had no investments in a single company or entity (other than U.S. Government-sponsored enterprise securities) that had an aggregate book value in excess of 2% of our stockholders' equity. As of December 31, 2016, all MBS the Company owned were issued by Government National Mortgage Association, Fannie Mae or the FHLMC/Freddie Mac. Although the Fannie Mae and Freddie Mac debt securities are not explicitly guaranteed by the federal government, one of the stated purposes of the U.S. Treasury's September, 2008 conservatorship and capital support of the two institutions was to stabilize the market in their debt securities, and that purpose was again evident in legislation passed by Congress in late 2009 which effectively lifted any dollar ceiling on the implicit U.S. Treasury guaranty of Fannie Mae and Freddie Mac debt securities.

The following tables show as of December 31, the amortized cost, fair value and weighted average yield on a tax equivalent basis of the Company's investment debt securities portfolio maturing within the stated periods:

	December 31, 2016			Maturities		
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Amortized Cost	Weighted Average Yield
Investment securities available-for-sale:	(Dollars in thousands)					
U.S. Government-sponsored enterprises	$—	$500	$3,290	$6,431	$10,221	1.94 %
Agency MBS	—	1,836	498	15,949	18,283	1.97 %
State and political subdivisions	627	3,298	13,064	10,920	27,909	2.54 %
Corporate debt	—	2,036	7,709	—	9,745	3.02 %
Investment securities held-to-maturity:						
U.S. Government-sponsored enterprises	—	999	—	—	999	0.95 %
Total investment debt securities	$627	$8,669	$24,561	$33,300	$67,157	2.34 %
Fair value	$631	$8,738	$24,262	$32,521	$66,152	
Weighted average yield	3.63 %	2.34 %	2.65 %	2.09 %	2.34 %	

	December 31, 2015			Maturities		
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Amortized Cost	Weighted Average Yield
Investment securities available-for-sale:	(Dollars in thousands)					
U.S. Government-sponsored enterprises	$—	$—	$2,803	$8,002	$10,805	2.14 %
Agency MBS	—	1,875	498	8,710	11,083	2.17 %
State and political subdivisions	360	3,014	10,980	5,299	19,653	2.81 %
Corporate debt	—	1,508	10,758	—	12,266	2.83 %
Investment securities held-to-maturity:						
U.S. Government-sponsored enterprises	—	998	1,000	3,219	5,217	1.95 %

Total investment debt securities	$360	$7,395	$26,039	$25,230	$59,024	2.50 %
Fair value	$360	$7,444	$26,017	$25,060	$58,881	
Weighted average yield	3.71 %	2.25 %	2.69 %	2.35 %	2.50 %	

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	December 31, 2014			Maturities		
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Amortized Cost	Weighted Average Yield
Investment securities available-for-sale:	(Dollars in thousands)					
U.S. Government-sponsored enterprises	$—	$6,028	$2,833	$6,702	$15,563	1.71 %
Agency MBS	—	477	2,884	3,155	6,516	2.34 %
State and political subdivisions	71	2,041	8,259	5,429	15,800	2.98 %
Corporate debt	500	—	6,243	500	7,243	2.66 %
Investment securities held-to-maturity:						
U.S. Government-sponsored enterprises	—	997	2,000	4,218	7,215	1.83 %
Total investment debt securities	$571	$9,543	$22,219	$20,004	$52,337	2.32 %
Fair value	$571	$9,584	$22,358	$19,953	$52,466	
Weighted average yield	1.27 %	1.64 %	2.53 %	2.44 %	2.32 %	

The tables above exclude mutual fund securities with a book and fair value of $403 thousand at December 31, 2016, of $345 thousand at December 31, 2015 and of $337 thousand at December 31, 2014.

Federal Home Loan Bank of Boston Stock. Union is a member of the FHLB, with an investment of $2.3 million in its Class B common stock at December 31, 2016 and $1.9 million at December 31, 2015. The Class B common stock has a five year notice requirement for redemption and there is no guarantee of future redemption. Also, there is the possibility of future capital calls by the FHLB on member banks to ensure compliance with its capital plan. Union's investment in FHLB stock is carried in Other assets at cost and is nonmarketable. Similar to evaluating investment securities for OTTI, the Company has evaluated its investment in the FHLB. The FHLB remains in compliance with all regulatory capital ratios as of December 31, 2016 and 2015. Management's most recent evaluation of the Company's holdings of FHLB common stock concluded that the investment was not impaired at December 31, 2016.

Deposits. The following table shows information concerning the Company's average deposits by account type and the weighted average nominal rates at which interest was paid on such deposits for the years ended December 31:

	2016			2015			2014		
	Average Balance	Percent of Total Deposits	Average Rate Paid	Average Balance	Percent of Total Deposits	Average Rate Paid	Average Balance	Percent of Total Deposits	Average Rate Paid
	(Dollars in thousands)								
Nontime deposits:									
Noninterest bearing deposits	$105,596	18.7	—	$96,994	17.8	—	$87,777	16.8	—
Interest bearing checking accounts	128,977	22.8	0.09 %	118,344	21.7	0.08 %	109,944	21.0	0.08 %
Money market accounts	110,938	19.6	0.35 %	100,128	18.4	0.19 %	101,365	19.3	0.20 %
Savings accounts	93,118	16.5	0.15 %	87,551	16.1	0.15 %	79,150	15.1	0.14 %
Total nontime deposits	438,629	77.6	0.15 %	403,017	74.0	0.10 %	378,236	72.2	0.11 %
Time deposits:									
Less than $100,000	63,720	11.3	0.66 %	64,254	11.8	0.67 %	70,131	13.4	0.74 %
$100,000 and over	62,528	11.1	0.90 %	77,327	14.2	1.08 %	75,519	14.4	1.09 %
Total time deposits	126,248	22.4	0.77 %	141,581	26.0	0.89 %	145,650	27.8	0.92 %
Total deposits	$564,877	100.0	0.29 %	$544,598	100.0	0.31 %	$523,886	100.0	0.33 %

The Company participates in CDARS, which permits the Company to offer full deposit insurance coverage to its customers by exchanging deposit balances with other CDARS participants. CDARS also provides the Company with an additional source of funding and liquidity through the purchase of deposits. There were $10.9 million of time deposits of $250,000 or less on the balance sheet at December 31, 2016, $11.2 million at December 31, 2015 and $11.0 million at December 31, 2014, which were exchanged with other CDARS participants and are therefore considered for certain regulatory purposes to be "brokered" deposits. There were no purchased CDARS deposits at December 31, 2016 or December 31, 2015.

The Company also participates in the ICS program, a service through which Union can offer its customers a savings product with access to unlimited FDIC insurance, while receiving reciprocal deposits from other banks. Like the exchange of certificate of deposit accounts through CDARS, exchange of savings deposits through ICS provides full deposit insurance coverage for the customer, thereby helping Union to retain the full amount of the deposit on its balance sheet. As with the CDARS program, in addition to reciprocal deposits, participating banks may also purchase one-way ICS deposits. During the third quarter of 2016, Union began offering an ICS money market account to its municipal and commercial customers. Several municipal customers began utilizing this account and as monies in time deposits matured they were placed into these money market accounts. There were $52.6 million in ICS money market deposits on the balance sheet at December 31, 2016, $2.1 million at December 31, 2015 and $2.2 million at December 31, 2014. As a result, an increase in the average balance and rate paid on total non-time deposit accounts occurred during the year ended December 31, 2016 with corresponding decreases in time deposits $100,000 and over. None of the Company's ICS deposits, as of the respective balance sheet dates, represent purchased deposits as all such deposits were matched dollar for dollar with Union's customer deposits which were placed in other participating financial institutions, in order to provide our customers with full FDIC insurance coverage for their deposit balances.

At December 31, 2016, there was $3.0 million in retail brokered deposits issued under master certificates of deposit to a deposit broker. These deposits will mature in $1.0 million increments in each of the next three years. There were no such deposits at December 31, 2015.

Deposits grew $37.3 million, or 6.6%, from $560.4 million at December 31, 2015 to $597.7 million at December 31, 2016. Total average deposits grew $20.3 million, or 3.7%, between years with average nontime deposits growing $35.6 million, or 8.8%, and average time deposits decreasing $15.3 million, or 10.8%, during the same time frame. These changes are the result of the third quarter 2016 shift in municipal deposit funds from time deposits to the ICS money market product, as well as time deposits trending towards short duration or migrating to nontime deposits because of the low interest rate environment and the perceived customer desire to be in a position to redeploy funds should there be a rise in interest rates.

A provision of the Dodd-Frank Act permanently raised FDIC deposit insurance coverage to $250 thousand per depositor per insured depository institution for each account ownership category. At December 31, 2016, the Company had deposit accounts with less than $250 thousand totaling $427.8 million, or 71.6% of its deposits, with FDIC insurance protection. An additional $7.1 million of municipal deposits were over the FDIC insurance coverage limit at December 31, 2016 and were collateralized by Union under applicable state regulations by investment securities or loans.

The following table provides a maturity distribution of the Company's time deposits in denominations of $100 thousand or more at December 31:

	2016	2015
	(Dollars in thousands)	
Three months or less	$5,202	$7,456
Over three months through six months	9,927	54,776
Over six months through twelve months	12,051	12,964
Over twelve months	13,401	13,444
	$40,581	$88,640

In total, the Company’s time deposits in amounts of $100 thousand and over decreased $48.1 million, or 54.2%, between December 31, 2015 and December 31, 2016, and the average total balance decreased from $77.3 million to $62.5 million. This decrease is primarily the result of several municipal customers placing funds that matured from time deposits on June 30, 2016 into a fully insured ICS money market account, with a corresponding change in the 3 to 6 months maturity time frame resulting from this movement in municipal deposit monies.

Borrowings. Advances from the FHLB are another key source of funds to support earning assets. These funds are also used to manage the Bank's interest rate and liquidity risk exposures. The Company's borrowed funds at December 31, 2016 were comprised of borrowings from the FHLB of $30.5 million, at a weighted average rate of 1.42%, and overnight secured customer repurchase agreement sweeps of $1.1 million, at a weighted average rate of 0.23%. At December 31, 2015, borrowed funds were comprised of FHLB advances of $7.9 million, at a weighted average rate of 3.46%, and overnight secured customer repurchase agreement sweeps of $1.6 million, at a weighted average rate of 0.25%. The maximum borrowings outstanding on overnight secured customer repurchase agreement sweeps was $4.4 million and $3.8 million during 2016 and 2015, respectively. During 2016, Union took advantage of low rate borrowings from the FHLB to fund loan demand and purchase investment securities. The increase in option advance borrowings reflects the addition of $25.5 million in long term advances that were partially offset by the maturity of a $2.0 million three year bullet advance and scheduled monthly payments of $307 thousand in 2016. In addition during 2016, the prepayment of $5.6 million in advances resulted in penalties paid of $21 thousand which are included in Other expenses on the Company's consolidated statements of income. There were no such penalties during 2015. The Company had no overnight federal funds purchased on December 31, 2016 or 2015. Average borrowings outstanding for 2016 were $27.6 million, compared to average borrowings outstanding for 2015 of $19.8 million. The weighted average interest rate on the Company's borrowings dropped from 1.71% for 2015 to 1.57% for 2016, reflecting the low rate borrowings advanced during 2016.

Liability for Pension Benefits. On October 5, 2012, the Company closed its defined benefit Pension Plan to new participants and froze the accrual of additional retirement benefits for current participants. The Plan net liability decreased from $1.5 million as of December 31, 2015 to $1.1 million as of December 31, 2016 due to a $750 thousand contribution to the Plan during 2016, partially offset by the negative effects of the decrease in the discount rate from 4.17% in 2015 to 3.99% in 2016 and to a lesser extent, poorer than expected investment performance experienced during 2016. Offsetting the pension liability at December 31, 2016, the Company had deferred tax assets of $1.2 million, and Accumulated other comprehensive loss, net of tax, of $2.3 million. The Accumulated other comprehensive loss has no impact on regulatory capital amounts or ratios or the Company's legal lending limit. Weighted average assumptions used to determine net periodic pension benefit for the years ended December 31, 2016 and 2015 were a discount rate of 4.17% and 3.83%, respectively, no rate of compensation increase for 2016 or 2015 and an expected long-term rate of return on plan assets of 6.75% for both years. Note 14 to the consolidated financial statements includes further discussion and information on the Company's employee benefits.

There was no minimum required contribution to the Plan under the ERISA guidelines for 2016 or 2015.

The Company's defined pension benefit obligation and net periodic benefit cost are actuarially determined based on assumptions regarding the appropriate discount rate, current and expected future return on Plan assets, and anticipated mortality rates. While a change in any of the assumptions would have an impact on financial condition and future results of operations, a change in the discount rate and future rate of return on Plan assets could be material. A discount rate is used both to determine the present value of future benefit obligations and the net periodic benefit. The expected rate of return on Plan assets is only used to determine net periodic benefit.

The 2016 pension benefit obligation discount rate utilized is based on the Plan's expected benefit payment stream utilizing December 2016 benchmark pension liability index yield curve spot rates. The discount rate at December 31, 2016 was 3.99%, down from 4.17% at December 31, 2015 and reflecting the increase in long-term rates between years.

The Company has established and investment policy to assist the Plan's investment advisors in meeting the Plan's objectives, which are to increase the fair value of assets to equal or exceed the present value of the the liabilities, while controlling volatility within asset allocation guidelines, to grow the Plan funding level such that investment risk can be progressively reduced, and to provide sufficient liquidity to meet anticipated cash needs. The expected rate of return on plan assets is 6.75% return balanced by our discount rate of 3.99%. Management estimates that the impact of the Plan for 2017 on the results of operations will approximate a benefit of $202 thousand, as calculated by the actuary as of December 31, 2016, compared to the actual benefit of $170 thousand, $408 thousand, and $436 thousand for the years ended December 31, 2016, 2015 and 2014, respectively.

Commitments, Contingent Liabilities, and Off-Balance-Sheet Arrangements. The Company 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, to reduce its own exposure to fluctuations in interest rates, and to implement its strategic objectives. These financial instruments include commitments to extend credit, standby letters of credit, interest rate caps and floors written on adjustable-rate loans, commitments to participate in or sell loans, commitments to buy or sell securities, certificates of deposit or other investment instruments and risk-sharing commitments or guarantees on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The contractual or notional amounts of these instruments reflect the extent of involvement the Company has in a particular class of financial instrument.

The Company'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 notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. For interest rate caps and floors written on adjustable-rate loans, the contractual or notional amounts do not represent the Company’s exposure to credit loss. The Company controls the risk of interest rate cap agreements through credit approvals, limits and monitoring procedures. The Company generally requires collateral or other security to support financial instruments with credit risk.

The following table details the contractual or notional amount of financial instruments that represented credit risk at December 31, 2016:

	Contract or Notional Amount						
	2017	2018	2019	2020	2021	Thereafter	Total
	(Dollars in thousands)						
Commitments to originate loans	$31,404	$—	$—	$—	$—	$ —	31,404
Unused lines of credit	59,504	9,672	1,959	5,295	114	—	76,544
Standby letters of credit	1,449	131	30	14	—	—	1,624
Credit card arrangement	1,341	—	—	—	—	—	1,341
FHLB MPF credit enhancement obligation, net	610	—	—	—	—	—	610
Commitment to purchase investment in a real estate limited partnership	416	505	9	50	—	—	980
Total	$94,724	$10,308	$1,998	$5,359	$114	$ —	$112,503

Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have a fixed expiration date or other termination clause and may require payment of a fee. The unused lines of credit total includes $11.0 million of lines available under the overdraft privilege program and is included in the 2017 funding period. Approximately $11.8 million of the unused lines of credit relate to real estate construction loans that are expected to fund within the next twelve months. The remaining lines primarily relate to revolving lines of credit for other real estate or commercial loans. Since many of the loan commitments are expected to expire without being drawn upon and not all credit lines will be utilized, the total commitment amounts do not necessarily represent future cash requirements. Lines of credit incur seasonal volume fluctuations due to the nature of some customers' businesses, such as tourism and maple syrup products production.

Unused lines of credit decreased $1.0 million, or 1.3%, from $77.5 million at December 31, 2015 to $76.5 million at December 31, 2016. Some of the larger lines have underlying participation agreements in place with other financial institutions in order to permit the Company to support the credit needs of larger dollar borrowers without bearing all the credit risk in the Company's balance sheet. Commitments to originate loans increased $7.2 million, or 29.9%, from $24.2 million at December 31, 2015 to $31.4 million at December 31, 2016.

The Company may, from time-to-time, enter into commitments to purchase, participate or sell loans, securities, certificates of deposit, or other investment instruments which involve market and interest rate risk. At December 31, 2016, the Company had binding loan commitments to sell residential mortgage loans at fixed rates totaling $7.3 million.

The Company sells 1-4 family residential mortgage loans under the MPF loss-sharing program with FHLB, when management believes it is economically advantageous to do so. Under this program the Company shares in the credit risk of each mortgage, while receiving fee income in return. The Company is responsible for a Credit Enhancement Obligation based on the credit quality of these loans. FHLB funds a first loss account based on the Company's outstanding MPF mortgage balances. This creates a laddered approach to sharing in any losses. In the event of default, homeowner's equity and private mortgage insurance, if any, are the first sources of repayment; the FHLB first loss account funds are then utilized, followed by the member's Credit Enhancement Obligation, with the balance the responsibility of FHLB. These loans must meet specific underwriting standards of the FHLB. As of December 31, 2016, the Company had $26.9 million in loans sold through the MPF program with an outstanding balance of $16.0 million and a contract for the potential delivery of an additional $9.2 million of future loan sales. The volume of loans sold to the MPF program and the corresponding Credit Enhancement Obligation are closely monitored by management. As of December 31, 2016, the notional amount of the maximum contingent contractual liability related to this program was $634 thousand, of which $24 thousand was recorded as a reserve through Other liabilities.

Contractual Obligations. The Company and Union have various financial obligations, including contractual obligations that may require future cash payments. The following table presents, as of December 31, 2016, significant fixed and determinable contractual obligations to third parties by payment date:

	Payments Due By Period				
	Less than 1 year	2 & 3 years	4 & 5 years	Thereafter	Total
	(Dollars in thousands)				
Operating lease commitments	$135	$168	$80	$ —	$383
Contractual payments on borrowed funds (1)	11,379	20,052	164	—	31,595
Deposits without stated maturity (1) (2)	494,467	—	—	—	494,467
Certificates of deposit (1) (2) (3)	60,952	34,541	7,700	—	103,193
Deferred compensation payouts (4)	136	191	108	251	686
Total	$567,069	$54,952	$8,052	$ 251	$630,324

(1) The amounts exclude interest payable, as such amounts other than $92 thousand in accrued interest payable at December 31, 2016 are not able to be estimated at this time.

(2) While Union has a contractual obligation to depositors should they wish to withdraw all or some of the funds on deposit, management believes, based on historical analysis as well as current conditions in the financial markets, that the majority of these deposits will remain on deposit for the foreseeable future.

(3) The amounts include $3.0 million in retail brokered deposits issued under master certificates of deposit to a deposit broker. These deposits mature in $1.0 million increments in each of the next three years.

(4) The amounts exclude $280 thousand in benefit payments, where the payment period begins at the individual's retirement which is not determinable at this time.

Union is required (as are all banks) to maintain vault cash or a noninterest bearing reserve balance as established by Federal Reserve regulations. The Bank’s average total required reserve for the 14 day maintenance period including December 31, 2016 was $891 thousand, which was satisfied by vault cash.

Liquidity. Liquidity is a measurement of the Company’s ability to meet potential cash requirements, including ongoing commitments to fund deposit withdrawals, repay borrowings, fund investment and lending activities, and for other general business
purposes. The primary objective of liquidity management is to maintain a balance between sources and uses of funds to meet our
cash flow needs in the most economical and expedient manner. The Company’s principal sources of funds are deposits; amortization,
prepayment and maturity of loans, investment securities, interest bearing deposits and other short-term investments; sales of securities and loans AFS; earnings; and funds provided from operations. Contractual principal repayments on loans are a relatively predictable source of funds, however, deposit flows and loan and investment prepayments can be significantly influenced by market interest rates, economic conditions, and rates offered by our competitors. Managing liquidity risk is essential to maintaining both depositor confidence and earnings stability.

At December 31, 2016, Union, as a member of FHLB, had access to unused lines of credit of $59.8 million over and above the $30.5 million in outstanding term advances with the purchase of required FHLB Class B common stock and evaluation by the FHLB of the underlying collateral available. This line of credit can be used for either short or long-term liquidity or other needs.

Union also maintains an IDEAL Way Line of Credit with the FHLB. The total line available was $551 thousand at December 31, 2016. There were no borrowings against this line of credit as of such date. Interest on these borrowings is chargeable at a rate determined by the FHLB and payable monthly. Should Union utilize this line of credit, qualified portions of the loan and investment portfolios would collateralize these borrowings.

In addition to its borrowing arrangements with the FHLB, Union maintains two pre-approved Federal Funds lines of credit totaling $12.0 million with two upstream correspondent banks, one-way buy options with CDARS and ICS as well as access to the FRB discount window, which would require pledging of qualified assets. Core deposits are our lowest cost funding source, but these deposits may not be sufficient to cover the on balance sheet liquidity needs which makes using these other sources necessary. In an attempt to control the cost of these other sources, an agreement was entered into with Promontory Interfinancial Network that locks in the cost of funds on purchased ICS deposits at 10 basis points over the federal funds rate for a period of one year. At December 31, 2016, there were no purchased ICS deposits under this agreement, no purchased CDARS deposits, and no outstanding advances on the federal funds lines or at the discount window .

Union's investment and residential loan portfolios provide a significant amount of contingent liquidity that could be accessed in a reasonable time period through sales of assets from those portfolios. We also have additional contingent liquidity sources with access to the brokered deposit market and the FRB discount window. These sources are considered as liquidity alternatives in our contingent liquidity plan. Management believes the Company has sufficient liquidity to meet all reasonable borrower, depositor, and creditor needs in the present economic environment. However, any projections of future cash needs and flows are subject to substantial uncertainty, including factors outside the Company's control.

Capital Resources. Capital management is designed to maintain an optimum level of capital in a cost-effective structure that meets target regulatory ratios, supports management's internal assessment of economic capital, funds the Company's business strategies and builds long-term stockholder value. Dividends are generally in line with long-term trends in earnings per share and conservative earnings projections, while sufficient profits are retained to support anticipated business growth, fund strategic investments, maintain required regulatory capital levels and provide continued support for deposits. The Company and Union continue to satisfy all capital adequacy requirements to which they are subject and Union is considered well capitalized under the Prompt Corrective Action framework. The Company continues to evaluate growth opportunities both through internal growth or potential acquisitions. The dividend payouts and treasury stock purchases during the last few years reflect the Board's desire to utilize our capital for the benefit of the stockholders.

Stockholders' equity increased from $53.6 million at December 31, 2015 to $56.3 million at December 31, 2016, reflecting net income of $8.5 million for 2016, an increase of $66 thousand from stock based compensation, a $10 thousand increase due to the issuance of common stock under the DRIP and a $56 thousand increase due to the issuance of 2,500 shares of common stock resulting from the exercise of incentive stock options. These increases were partially offset by cash dividends paid of $4.9 million, a decrease in accumulated OCI of $340 thousand attributable to the unfunded pension liability, a decrease of $1.3 million in accumulated OCI attributable to investment securities AFS, and stock repurchases of $6 thousand.

The Company has 7,500,000 shares of $2.00 par value common stock authorized. As of December 31, 2016, the Company had 4,936,652 shares issued, of which 4,462,135 were outstanding and 474,517 were held in treasury.

Effective May 21, 2014 upon approval by the stockholders, the Company adopted the 2014 Equity Plan which replaced the 2008 ISO Plan. As of December 31, 2016, there were outstanding employee incentive stock options with respect to 4,000 shares granted under the 2008 ISO Plan, all of which were exercisable and outstanding employee incentive stock options with respect to 4,500 shares granted under the 2014 Equity Plan, all of which were exercisable. Also, as of December 31, 2016, there were outstanding restricted stock units with respect to 6,654 shares granted in 2015 as to which vesting requirements had not yet been met.

In January 2017, the Company's Board reauthorized the limited stock repurchase plan that was established in May of 2010. The limited stock repurchase plan allows the repurchase of up to a fixed number of shares of the Company's common stock each calendar quarter in open market purchases or privately negotiated transactions, as management may deem advisable and as market conditions may warrant. The repurchase authorization for a calendar quarter expires at the end of that quarter to the extent it has not been exercised, and is not carried forward into future quarters. The quarterly repurchase program expired on December 31, 2016, and was reauthorized in January 2017 for another year, with 3,000 shares authorized for repurchase per quarter. Since inception, as of December 31, 2016, the Company had repurchased 13,754 shares under this program, for a total cost of $291 thousand.

During the first quarter of 2016, the Company adopted the DRIP whereby registered stockholders may elect to reinvest cash dividends and optional cash contributions to purchase additional shares of the Company's common stock. The Company has reserved 200,000 shares of its common stock for issuance and sale under the DRIP. As of December 31, 2016, 315 shares of stock had been issued from treasury stock under the DRIP.

The Company's total capital to risk weighted assets decreased slightly to 13.32% at December 31, 2016 from 13.42% at December 31, 2015. Tier I capital to risk weighted assets decreased slightly to 12.20% at December 31, 2016 from 12.22% at December 31, 2015 and Tier I capital to average assets decreased to 8.40% at December 31, 2016 from 8.54% at December 31, 2015. Union is categorized as well capitalized under the Prompt Corrective Action regulatory framework and the Company is well over the minimum capital adequacy requirements. The December 31, 2016 capital adequacy was determined based on the BASEL III requirements, which took effect on January 1, 2015, and the Company's evaluation indicates it would satisfy all capital adequacy requirements as fully phased in. See Note 21 for additional discussion of BASEL III. The Company remains focused on long-term growth and above-average shareholder return. It has become more important than ever in today's economic environment for banks to ensure and plan ahead to maintain strong capital reserves.

Regulatory Matters. The Company and Union are subject to periodic examinations by the various regulatory agencies. These examinations include, but are not limited to, procedures designed to review lending practices, risk management, credit quality, liquidity, compliance and capital adequacy. In February of 2017 the FDIC began its regular periodic compliance examination of Union. In January of 2016 the FRB performed its regular, periodic examination of the Company. During 2015, the Vermont Department of Financial Regulation performed a regular safety and soundness examination of Union. During 2014, the FDIC performed its regular, periodic regulatory examination of Union. No comments were received that would have a material adverse effect on the Company’s or Union’s liquidity, financial position, capital resources, or results of operations.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market Risk and Interest Rate Risk. Market risk is the potential of loss in a financial instrument arising from adverse changes in market prices, interest rates, foreign currency exchange rates, commodity prices, and equity prices. The Company did not have any trading securities during 2016 and 2015. The Company's market risk arises primarily from interest rate risk inherent in its lending, investing, deposit taking and borrowing activities. Management of interest rate risk is an important component of our asset and liability management process, which is governed by established policies that
are reviewed and approved annually. Our investment policy details the types of securities that may be purchased, and establishes
portfolio limits and maturity limits for the various sectors. Our investment policy also establishes specific investment quality limits. The ALCO develops guidelines and strategies impacting our asset and liability management-related activities based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends. Members of the ALCO also manage the investment portfolio to maximize net interest income while mitigating market and interest rate risk.

Interest rate risk arises naturally from imbalances in repricing, maturity and cash flow characteristics of our assets and liabilities. The ALCO takes into consideration the cash flow and repricing attributes of balance sheet and off-balance sheet items and their relation to possible changes in interest rates. The ALCO manages interest rate exposure primarily by using on-balance sheet strategies, generally accomplished through the management of the duration, rate sensitivity and average lives of our various investments, and by extending or shortening maturities of borrowed funds, as well as carefully managing and monitoring the maturities and pricing of loans and deposits.

An outside consultant is utilized to perform rate shocks of our balance sheet to assess our risk to earnings in different interest rate
environments, and to perform a variety of other analyses. The consultant's most recent analysis was as of December 31, 2016. The base simulation assumed no changes in rates, as well as 200 and 300 basis point rising interest rate scenarios which assume a parallel shift of the yield curve over a one-year period, and no growth assumptions. A summary of the results is as follows:

- Current/Flat Rates: If rates remain at current levels net interest income is projected to trend downward for the entire simulation period as decreasing asset yields outpace any reductions to funding costs.
- Rising Rates: If rates rise in a parallel fashion, net interest income is expected to trend close to the base case scenario over the near term as higher funding costs outweigh near term improvements to asset yields. Subsequently, net interest income trends upward for the remainder of the simulation period as the benefit to the adjustable rate loan portfolio more than outweighs the funding cost increases, which are assumed to lag market rate movements.

The net interest income simulation as of December 31, 2016 showed that the change in net interest income for the next 12 months from our expected or "most likely" forecast was as follows:

Rate Change	Percent Change in Net Interest Income Limit	Percent Change in Net Interest Income
Up 300 basis points	(21.00)%	4.80 %
Up 200 basis points	(14.00)%	3.20 %

The preceding sensitivity analysis does not represent our forecast and should not be relied upon as being indicative of expected
operating results. These estimates are based upon numerous assumptions including, among others, the nature and timing of interest rate levels including yield curve shape, prepayments on loans and securities, deposit run-off rates, pricing decisions on loans and deposits and reinvestment/replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, we cannot make any assurances as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

The model used to perform the base case balance sheet simulation assumes a parallel shift of the yield curve over twelve months
and reprices every interest earning asset and interest bearing liability on our balance sheet, simultaneously. The use of pricing betas help simulate the expected pricing behavior regarding non-maturing deposits, limiting the rate increases that occur when market rates rise. Investment securities with call provisions are examined on an individual basis to estimate the likelihood of a call.

As market conditions vary from those assumed in the sensitivity analysis, actual results will likely differ due to: the varying impact
of changes in the balances and mix of loans and deposits differing from those assumed, the impact of possible off balance sheet commitments, and other internal/external variables. Furthermore, the sensitivity analysis does not reflect all actions that the ALCO
might take in responding to or anticipating changes in interest rates.

Interest Rate Sensitivity "Gap" Analysis. An interest rate sensitivity "gap" is defined as the difference between interest earning assets and interest bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market interest rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The Company prepares its interest rate sensitivity "gap" analysis by scheduling interest earning assets and interest bearing liabilities into periods based upon the next date on which such assets and liabilities could mature or reprice. The amount of assets and liabilities shown within a particular period was determined in accordance with the contractual terms of the assets and liabilities, except that:

- adjustable-rate loans, investment securities, variable rate interest bearing deposits in banks, variable-rate time deposits, FHLB advances and other secured borrowings are included in the period when they are first scheduled to adjust and not in the period in which they mature;
- fixed-rate mortgage-related securities and residential loans reflect estimated prepayments, which were estimated based on analyses of broker estimates, the results of a prepayment model utilized by the Company, and empirical data;
- other nonmortgage related fixed-rate loans reflect scheduled contractual amortization, with no estimated prepayments; and
- interest bearing checking, money market and savings deposits, which do not have contractual maturities, reflect estimated levels of attrition, which are based on detailed studies by the Company of the sensitivity of each such category of deposit to changes in interest rates.

Management believes that these assumptions approximate actual experience and considers them reasonable. However, the interest rate sensitivity of the Company's assets and liabilities in the following table could vary substantially if different assumptions were used, callable investment options were modeled, prepayment speeds changed or actual experience differs from the historical experience on which the assumptions are based.

The following table shows the Company's rate sensitivity analysis as of December 31, 2016:

	Cumulative repriced within					
	3 Months or Less	4 to 12 Months	1 to 3 Years	3 to 5 Years	Over 5 Years	Total
Interest sensitive assets:	(Dollars in thousands, by repricing date)					
Overnight deposits	$35,003	$—	$—	$—	$—	$35,003
Interest bearing deposits in banks	1,743	1,894	5,029	498	340	9,504
Investment securities (1)(3)	8,542	6,014	8,862	12,703	30,031	66,152
Nonmarketable securities	—	—	—	—	2,354	2,354
Loans and loans held for sale (2)(3)	165,289	110,003	127,792	79,994	58,664	541,742
Total interest sensitive assets	$210,577	$117,911	$141,683	$93,195	$91,389	$654,755
Interest sensitive liabilities:						
Time deposits	$14,436	$46,848	$34,209	$7,700	$—	$103,193
Money markets	141,678	—	—	—	1,442	143,120
Regular savings	—	—	—	—	95,926	95,926
Interest bearing checking	36,359	—	—	—	106,678	143,037
Borrowed funds	1,840	12,269	17,322	164	—	31,595
Total interest sensitive liabilities	$194,313	$59,117	$51,531	$7,864	$204,046	$516,871
Net interest rate sensitivity gap	$16,264	$58,794	$90,152	$85,331	$(112,657)	$137,884
Cumulative net interest rate sensitivity gap	$16,264	$75,058	$165,210	$250,541	$137,884	
Cumulative net interest rate sensitivity gap as a percentage of total assets	2.4 %	10.9 %	23.9 %	36.2 %	19.9 %	
Cumulative net interest rate sensitivity gap as a percentage of total interest sensitive assets	2.5 %	11.5 %	25.2 %	38.3 %	21.1 %	
Cumulative net interest rate sensitivity gap as a percentage of total interest sensitive liabilities	3.1 %	14.5 %	32.0 %	48.5 %	26.7 %	

(1) Investment securities exclude mutual funds with a fair value of $403 thousand at December 31, 2016 that may be sold by the Company at any time.
(2) Balances shown include deferred unamortized loan costs of $649 thousand.
(3) Reflects estimated repayment assumptions considered in Asset/Liability model.

Impact of Inflation and Changing Prices. The Company's consolidated financial statements have been prepared in accordance with GAAP, which allows for the measurement of financial position and results of operations in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Banks have asset and liability structures that are essentially monetary in nature, and their general and administrative costs constitute relatively small percentages of total expenses. Thus, increases in the general price levels for goods and services have a relatively minor effect on the Company's total expenses but could have an impact on our loan customers' financial condition. Interest rates have a more significant impact on the Company's financial performance than the effect of general inflation. Prior to December of 2015, the Federal Reserve maintained a target federal funds rate of 0.00% to 0.25% while the U.S. prime rate, which is the base rate that banks use in pricing short-term maturity commercial loans to their best, or most creditworthy, customers remained at 3.25%. The target federal funds rate has increased twice since December 2015, which has resulted in an increase in the U.S prime rate to 3.75% as of December 31, 2016. These increases in rates have had a positive impact on the Company's net interest income for the years ended December 31, 2016. The FRB has not stated rates would increase in 2017 but comments suggest level increases throughout 2017 could occur. These market rates are out of the Company's control but have a dramatic impact on net interest income. For further details on the impact rising rates could have on the Company's net interest income see Market Risk and Interest Rate Risk above.

Interest rates do not necessarily move in the same direction or change in the same magnitude as the prices of goods and services, although periods of increased inflation may accompany a rising interest rate environment. Inflation in the price of goods and services, while not having a substantial impact on the operating results of the Company, does affect all customers and therefore may impact their ability to keep funds on deposit or make timely loan payments. The Company is aware of and evaluates this risk along with others in making business decisions. Unprecedented deficit spending by federal, state and local governments and control of the money supply by the FRB including further quantitative easing of the money supply, may have unanticipated impacts on interest rates or inflation in future periods that could have an unfavorable impact on the future operating results of the Company.

Item 8. Financial Statements and Supplementary Data
UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2016 and 2015

	2016	2015
Assets	(Dollars in thousands)	
Cash and due from banks	$4,272	$4,217
Federal funds sold and overnight deposits	35,003	13,744
Cash and cash equivalents	39,275	17,961
Interest bearing deposits in banks	9,504	12,753
Investment securities available-for-sale	65,556	54,110
Investment securities held-to-maturity (fair value $999 thousand and $5.1 million at December 31, 2016 and December 31, 2015, respectively)	999	5,217
Loans held for sale	7,803	5,635
Loans	533,290	500,506
Allowance for loan losses	(5,247)	(5,201)
Net deferred loan costs	649	515
Net loans	528,692	495,820
Accrued interest receivable	2,259	1,832
Premises and equipment, net	13,525	13,055
Core deposit intangible	754	925
Goodwill	2,223	2,223
Investment in real estate limited partnerships	2,783	2,373
Company-owned life insurance	8,617	8,800
Other assets	9,391	8,175
Total assets	$691,381	$628,879
Liabilities and Stockholders’ Equity		
Liabilities		
Deposits		
Noninterest bearing	$112,384	$99,826
Interest bearing	382,083	310,203
Time	103,193	150,379
Total deposits	597,660	560,408
Borrowed funds	31,595	9,564
Accrued interest and other liabilities	5,847	5,339
Total liabilities	635,102	575,311
Commitments and Contingencies (Notes 8, 14, 15, 17, 18 and 21)		
Stockholders’ Equity		
Common stock, $2.00 par value; 7,500,000 shares authorized; 4,936,652 shares issued at December 31, 2016 and 4,931,796 shares issued at December 31, 2015	9,874	9,864
Additional-paid-in capital	620	501
Retained earnings	53,086	49,524
Treasury stock at cost; 474,517 shares at December 31, 2016 and 474,619 shares at December 31, 2015	(4,022)	(4,019)
Accumulated other comprehensive loss	(3,279)	(2,302)
Total stockholders' equity	56,279	53,568
Total liabilities and stockholders' equity	$691,381	$628,879

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2016, 2015 and 2014

	2016	2015	2014
Interest and dividend income	(Dollars in thousands, except per share data)		
Interest and fees on loans	$25,056	$23,531	$23,416
Interest on debt securities:			
Taxable	885	950	817
Tax exempt	589	436	367
Dividends	95	43	68
Interest on federal funds sold and overnight deposits	51	15	24
Interest on interest bearing deposits in banks	160	169	160
Total interest and dividend income	26,836	25,144	24,852
Interest expense			
Interest on deposits	1,622	1,682	1,746
Interest on short-term borrowed funds	8	9	5
Interest on long-term borrowed funds	431	334	404
Total interest expense	2,061	2,025	2,155
Net interest income	24,775	23,119	22,697
Provision for loan losses	150	550	345
Net interest income after provision for loan losses	24,625	22,569	22,352
Noninterest income			
Trust income	737	719	726
Service fees	5,871	5,568	5,354
Net gains on sales of investment securities available-for-sale	71	53	315
Net gains on sales of loans held for sale	2,898	2,871	2,097
Other income	563	581	417
Total noninterest income	10,140	9,792	8,909
Noninterest expenses			
Salaries and wages	10,203	9,517	8,916
Pension and other employee benefits	3,525	2,977	2,725
Occupancy expense, net	1,263	1,279	1,199
Equipment expense	2,115	1,875	1,674
Other expenses	7,115	6,656	7,080
Total noninterest expenses	24,221	22,304	21,594
Income before provision for income taxes	10,544	10,057	9,667
Provision for income taxes	2,033	2,179	1,973
Net income	$8,511	$7,878	$7,694
Earnings per common share	$1.91	$1.77	$1.73
Dividends per common share	$1.11	$1.08	$1.04

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2016, 2015 and 2014

	2016	2015	2014
	(Dollars in thousands)		
Net income	$8,511	$7,878	$7,694
Other comprehensive loss, net of tax:			
Investment securities available-for-sale:			
Net unrealized holding (losses) gains arising during the year on investment securities available-for-sale	(590)	(184)	913
Reclassification adjustments for net gains on investment securities available-for-sale realized in net income	(47)	(35)	(208)
Total	(637)	(219)	705
Defined benefit pension plan:			
Net actuarial loss arising during the year	(449)	(740)	(2,162)
Reclassification adjustment for amortization of net actuarial loss realized in net income	109	37	—
Total	(340)	(703)	(2,162)
Total other comprehensive loss	(977)	(922)	(1,457)
Total comprehensive income	$7,534	$6,956	$6,237

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2016, 2015 and 2014

	Common Stock						
	Shares, net of treasury	Amount	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive income (loss)	Total stockholders' equity
	(Dollars in thousands, except per share data)						
Balances, December 31, 2013	4,458,359	$ 9,855	$ 363	$ 43,405	$ (3,880)	$ 77	$ 49,820
Net income	—	—	—	7,694	—	—	7,694
Other comprehensive loss	—	—	—	—	—	(1,457)	(1,457)
Cash dividends declared ($1.04 per share)	—	—	—	(4,637)	—	—	(4,637)
Stock based compensation expense	—	—	20	—	—	—	20
Exercise of stock options	2,010	4	35	—	—	—	39
Purchase of treasury stock	(1,939)	—	—	—	(45)	—	(45)
Balances, December 31, 2014	4,458,430	9,859	418	46,462	(3,925)	(1,380)	51,434
Net income	—	—	—	7,878	—	—	7,878
Other comprehensive loss	—	—	—	—	—	(922)	(922)
Cash dividends declared ($1.08 per share)	—	—	—	(4,816)	—	—	(4,816)
Stock based compensation expense	—	—	35	—	—	—	35
Exercise of stock options	2,500	5	48	—	—	—	53
Purchase of treasury stock	(3,753)	—	—	—	(94)	—	(94)
Balances, December 31, 2015	4,457,177	9,864	501	49,524	(4,019)	(2,302)	53,568
Net income	—	—	—	8,511	—	—	8,511
Other comprehensive loss	—	—	—	—	—	(977)	(977)
Dividend reinvestment plan	315	—	7	—	3	—	10
Cash dividends declared ($1.11 per share)	—	—	—	(4,949)	—	—	(4,949)
Stock based compensation expense	2,356	5	61	—	—	—	66
Exercise of stock options	2,500	5	51	—	—	—	56
Purchase of treasury stock	(213)	—	—	—	(6)	—	(6)
Balances, December 31, 2016	4,462,135	$ 9,874	$ 620	$ 53,086	$ (4,022)	$ (3,279)	$ 56,279

See accompanying notes to consolidated financial statements.

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UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2016, 2015 and 2014

	2016	2015	2014
Cash Flows From Operating Activities	(Dollars in thousands)		
Net income	$8,511	$7,878	$7,694
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,255	1,080	976
Provision for loan losses	150	550	345
Deferred income tax provision (benefit)	566	341	(37)
Net amortization of investment securities	384	214	105
Equity in losses of limited partnerships	565	484	800
Stock based compensation expense	66	35	20
Net increase in unamortized loan costs	(134)	(160)	(185)
Proceeds from sales of loans held for sale	138,443	134,578	96,989
Origination of loans held for sale	(137,713)	(126,599)	(101,795)
Net gains on sales of loans held for sale	(2,898)	(2,871)	(2,097)
Net loss on disposals of premises and equipment	13	7	19
Net gains on sales of investment securities available-for-sale	(71)	(53)	(315)
Write-downs of impaired assets	—	42	23
Net gains on sales of other real estate owned	—	(29)	(134)
(Increase) decrease in accrued interest receivable	(427)	22	(191)
Amortization of core deposit intangible	171	171	171
(Increase) decrease in other assets	(1,202)	(1,387)	1,849
Contribution to defined benefit pension plan	(750)	—	—
Increase (decrease) in other liabilities	715	(1,173)	(2,033)
Net cash provided by operating activities	7,644	13,130	2,204
Cash Flows From Investing Activities			
Interest bearing deposits in banks			
Proceeds from maturities and redemptions	4,244	3,579	10,423
Purchases	(996)	(4,080)	(5,062)
Investment securities held-to-maturity			
Proceeds from maturities, calls and paydowns	4,220	2,000	6,000
Purchases	—	—	(2,000)
Investment securities available-for-sale			
Proceeds from sales	6,620	11,540	7,420
Proceeds from maturities, calls and paydowns	9,754	7,020	4,307
Purchases	(29,098)	(27,416)	(21,921)
Purchase of nonmarketable stock	(1,143)	(269)	—
Redemption of nonmarketable stock	722	389	—
Net increase in loans	(32,947)	(20,713)	(19,369)
Recoveries of loans charged off	59	83	42
Purchases of premises and equipment	(1,938)	(2,289)	(2,170)
Investments in limited partnerships	(948)	(32)	(354)
Purchase of Company-owned life insurance	—	(5,000)	—
Proceeds of Company-owned life insurance death benefit	527	—	—
Proceeds from sales of other real estate owned	—	342	536
Proceeds from sales of premises and equipment	200	—	—
Net cash used in investing activities	(40,724)	(34,846)	(22,148)

Cash Flows From Financing Activities			
Advances on long-term borrowings	25,451	—	—
Repayment of long-term debt	(2,898)	(294)	(3,589)
Net (decrease) increase in short-term borrowings outstanding	(522)	(5,260)	5,491
Net increase in noninterest bearing deposits	12,558	9,441	3,138
Net increase in interest bearing deposits	71,880	7,481	33,108
Net decrease in time deposits	(47,186)	(8,578)	(2,536)
Issuance of common stock	56	53	39
Purchase of treasury stock	(6)	(94)	(45)
Dividends paid	(4,939)	(4,816)	(4,637)
Net cash provided by (used in) financing activities	54,394	(2,067)	30,969
Net increase (decrease) in cash and cash equivalents	21,314	(23,783)	11,025
Cash and cash equivalents			
Beginning of year	17,961	41,744	30,719
End of year	$39,275	$17,961	$41,744
Supplemental Disclosures of Cash Flow Information			
Interest paid	$2,239	$2,060	$2,146
Income taxes paid	$1,505	$2,040	$1,945
Supplemental Schedule of Noncash Investing and Financing Activities			
Other real estate acquired in settlement of loans	$—	$59	$464
Loans originated to finance the sale of other real estate owned	$—	$—	$300
Investment in limited partnerships acquired by capital contributions payable	$27	$—	$151
Dividends paid on Common Stock:			
Dividends declared	$4,949	$4,816	$4,637
Dividends reinvested	(10)	—	—
	$4,939	$4,816	$4,637

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Note 1. Significant Accounting Policies

Basis of financial statement presentation
The accounting and reporting policies of Union Bankshares, Inc. and the Subsidiary (the Company) are in conformity with GAAP and general practices within the banking industry. The following is a description of the more significant policies.
The consolidated financial statements include the accounts of Union Bankshares, Inc., and its wholly owned subsidiary, Union Bank headquartered in Morrisville, Vermont. All significant intercompany transactions and balances have been eliminated. The Company utilizes the accrual method of accounting for financial reporting purposes.
Certain amounts in the 2015 and 2014 consolidated financial statements have been reclassified to conform to the current year presentation.

The acronyms, abbreviations and capitalized terms identified below are used throughout this Form 10-K, including Part I, Part II and III. The following is provided to aid the reader and provide a reference page when reviewing this Form 10-K:

AFS:	Available-for-sale	HUD:	U.S. Department of Housing and Urban Development
ALCO:	Asset Liability Management Committee	ICS:	Insured Cash Sweeps of the Promontory Interfinancial Network
ALL:	Allowance for loan losses	IRS:	Internal Revenue Service
ASC:	Accounting Standards Codification	MBS:	Mortgage-backed security
ASU:	Accounting Standards Update	MPF:	Mortgage Partnership Finance Program
BHCA:	Bank Holding Company Act of 1956	MSRs:	Mortgage Servicing rights
Board:	Board of Directors	NASDAQ:	NASDAQ Global Security Market
bp or bps:	Basis point(s)	OAO:	Other assets owned
Branch Acquisition:	The acquisition of three New Hampshire branches in May 2011	OCI:	Other comprehensive income (loss)
CDARS:	Certificate of Deposit Accounts Registry Service of the Promontory Interfinancial Network	OFAC:	U.S. Office of Foreign Assets Control
CFPB:	Consumer Financial Protection Bureau	OREO:	Other real estate owned
COLI:	Company-Owned Life Insurance	OTTI:	Other-than-temporary impairment
Company:	Union Bankshares, Inc. and Subsidiary	OTT:	Other-than-temporary
DFR:	Vermont Department of Financial Regulation	Plan:	The Union Bank Pension Plan
Dodd-Frank Act:	The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	RD:	USDA Rural Development
DRIP:	Dividend Reinvestment and Stock Purchase Plan	SBA:	U.S. Small Business Administration
FASB:	Financial Accounting Standards Board	SEC:	U.S. Securities and Exchange Commission
FDIC:	Federal Deposit Insurance Corporation	SOX Act:	Sarbanes Oxley Act of 2002
FDICIA:	The Federal Deposit Insurance Corporation Improvement Act of 1991	TDR:	Troubled-debt restructuring
FHA:	U.S. Federal Housing Administration	Union:	Union Bank, the sole subsidiary of Union Bankshares, Inc
FHLB:	Federal Home Loan Bank of Boston	USDA:	U.S. Department of Agriculture

FRB:	Federal Reserve Board	VA:	U.S. Veterans Administration
Fannie Mae:	Federal National Mortgage Association	2006 Plan:	Executive Nonqualified Excess Plan
FHLMC/Freddie Mac:	Federal Home Loan Mortgage Corporation	2008 Plan:	2008 Amended and Restated Nonqualified Deferred Compensation Plan
GAAP:	Generally accepted accounting principles in the United States	2008 ISO Plan:	2008 Incentive Stock Option Plan of the Company
GLBA:	Gramm-Leach-Bliley Financial Modernization Act of 1999	2014 Equity Plan:	2014 Equity Incentive Plan
HTM:	Held-to-maturity		

Nature of operations

The Company provides a variety of financial services to individuals, municipalities, commercial businesses and nonprofit customers through its branches, ATMs, telebanking, mobile and internet banking systems in northern Vermont and New Hampshire. This market area encompasses primarily retail consumers, small businesses, municipalities, agricultural producers and the tourism industry. The Company's primary deposit products are checking accounts, savings accounts, money market accounts, certificates of deposit and individual retirement accounts and its primary lending products are commercial, real estate, municipal and consumer loans. The Company also offers fiduciary and asset management services through its Asset Management Group, an unincorporated division of Union.

Concentration of risk

The Company's operations are affected by various risk factors, including liquidity risk, interest rate risk, credit risk, fraud risk and risk from geographic concentration of its deposit taking and lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities/repricing of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to creditworthy borrowers, although credit losses are expected to occur because of subjective factors and factors beyond the control of the Company. Although national economic conditions have been volatile during the last few years, local economic conditions have been somewhat more stable. The Company has a diversified loan portfolio with a substantial portion of the Company's loans secured by real estate and/or partially guaranteed by a U.S. Government agency. Most of its lending activities are conducted within the northern Vermont and New Hampshire market areas where its banking offices are located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy and real estate market conditions. Notes 5 and 6 discuss the types of lending in which the Company engages.

Use of estimates in preparation of consolidated financial statements

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Material estimates that are particularly susceptible to significant change in the near term and involve inherent uncertainties relate to the determination of the ALL on loans, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, deferred tax assets, judgments regarding valuation and impairment of investment securities and other assets as well as pension plan accounting. These estimates involve a significant degree of complexity and subjectivity and the amount of the change that is reasonably possible, should any of these estimates prove inaccurate, cannot be estimated.

Presentation of cash flows

For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks (including cash items in process of clearing), federal funds sold (generally purchased and sold for one day periods) and overnight deposits.

Trust operations

Assets held by Union's Asset Management Group in a fiduciary or agency capacity, other than trust cash on deposit with Union, are not included in these consolidated financial statements because they are not assets of Union or the

Company.

Fair value measurement

The Company utilizes FASB ASC Topic 820, Fair Value Measurement, as guidance for accounting for assets and liabilities carried at fair value. This standard defines fair value as the price that would be received, without adjustment for transaction costs, to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The guidance in FASB ASC Topic 820 establishes a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The three levels of the fair value hierarchy are:

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The following is a description of the valuation methodologies used for the Company’s assets that are measured on a recurring basis at estimated fair value:

AFS securities: Marketable equity securities and mutual funds have been valued using unadjusted quoted prices from active markets and therefore have been classified as Level 1. However, the majority of the Company’s AFS securities have been valued utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Investment securities

Investment securities purchased and held primarily for resale in the near future are classified as trading securities and are reported at fair value with unrealized gains and losses included in earnings. The Company does not generally hold any securities classified as trading. Debt securities the Company has the positive intent and ability to hold to maturity are classified as HTM and reported at amortized cost. Debt and equity securities not classified as either HTM or trading are classified as AFS. Investments classified as AFS are reported at fair value.

Accretion of discounts and amortization of premiums arising at acquisition on investment securities are included in income using the effective interest method over the life of the securities to maturity or call date for non amortizing securities and the level yield method which anticipates prepayments for amortizing securities. Unrealized gains and losses on investment securities AFS are excluded from earnings and reported in Accumulated OCI, net of tax and reclassification adjustment, as a separate component of stockholders' equity. The specific identification method is used to determine realized gains and losses on sales of AFS or trading securities.

The Company evaluates all investment securities on a quarterly basis, and more frequently when economic conditions warrant, to determine if an OTTI exists. A security is considered impaired if the fair value is lower than its amortized cost basis at the report date. If impaired, management then assesses whether the unrealized loss is OTT.

An unrealized loss on a debt security is generally deemed to be OTT and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI write-down is recorded, net of tax effect, through net income as a component of net OTTI losses in the consolidated statement of income, while the remaining portion of the impairment loss is recognized in OCI, provided the Company does not intend to sell the underlying debt security and it is "more likely than not" that the Company will not have to sell the debt security prior to recovery. Declines in the fair values of individual equity securities that are deemed by management to be OTT are reflected in noninterest income when identified.

Management considers the following factors in determining whether an OTTI exists and the period over which the security is expected to recover:

- The length of time, and extent to which, the fair value has been less than the amortized cost;
- Adverse conditions specifically related to the security, industry, or geographic area;
- The historical and implied volatility of the fair value of the security;
- The payment structure of the debt security and the likelihood of the issuer being able to make payments that may increase in the future;
- Failure of the issuer of the security to make scheduled interest or principal payments;

- Any changes to the rating of the security by a rating agency;
- Recoveries or additional declines in fair value subsequent to the balance sheet date; and
- The nature of the issuer, including whether it is a private company, public entity or government-sponsored enterprise, and the existence or likelihood of any government or third party guaranty.

Loans held for sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. The estimated fair value of loans held for sale is based on current price quotes that determine the amount that the loans could be sold for in the secondary market. Loans transferred from held for sale to portfolio are transferred at the lower of cost or fair value in the aggregate. Sales are normally made without recourse. Gains and losses on the disposition of loans held for sale are determined on the specific identification basis. Net unrealized losses are recognized through a valuation allowance by charges to income.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their unpaid principal balances, adjusted for any charge-offs, the ALL, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.
Loan interest income is accrued daily on outstanding balances. The following accounting policies, related to accrual and nonaccrual loans, apply to all portfolio segments and loan classes, which the Company considers to be the same. The accrual of interest is normally discontinued when a loan is specifically determined to be impaired and/or management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Generally, any unpaid interest previously accrued on those loans is reversed against current period interest income. A loan may be restored to accrual status when its financial status has significantly improved and there is no principal or interest past due. A loan may also be restored to accrual status if the borrower makes six consecutive monthly payments or the lump sum equivalent. Income on nonaccrual loans is generally not recognized unless a loan is returned to accrual status or after all principal has been collected. Interest income generally is not recognized on impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Delinquency status is determined based on contractual terms for all portfolio segments and loan classes. Loans past due 30 days or more are considered delinquent. Loans are considered in process of foreclosure when a judgment of foreclosure has been issued by the court.
Loan origination fees and direct loan origination costs are deferred and amortized as an adjustment of the related loan's yield using methods that approximate the interest method. The Company generally amortizes these amounts over the estimated average life of the related loans.
The loans purchased in the 2011 Branch Acquisition were recorded at the estimated fair value at the time of purchase. The estimated fair value contains both accretable and nonaccretable components. The accretable component is amortized as an adjustment to the related loan yield over the average life of the loan. The nonaccretable component represents probable loss due to credit risk and is reviewed by management periodically and adjusted as deemed necessary.

Allowance for loan losses

The ALL is established for estimated losses in the loan portfolio through a provision for loan losses charged to earnings. For all loan classes, loan losses are charged against the ALL when management believes the loan balance is uncollectible or in accordance with federal guidelines. Subsequent recoveries, if any, are credited to the ALL.
The ALL is maintained at a level believed by management to be appropriate to absorb probable credit losses inherent in the loan portfolio as of the balance sheet date. The amount of the ALL is based on management's periodic evaluation of the collectability of the loan portfolio, including the nature, volume and risk characteristics of the portfolio, credit concentrations, trends in historical loss experience, estimated value of any underlying collateral, specific impaired loans and economic conditions. While management uses available information to recognize losses on loans, future additions to the ALL may be necessary based on changes in economic conditions or other relevant factors.

In addition, various regulatory agencies, as an integral part of their examination process, regularly review the Company's ALL. Such agencies may require the Company to recognize additions to the ALL, with a corresponding charge to earnings, based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

The ALL consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. Loans are evaluated for impairment and may be classified as impaired when management believes it is probable that the Company will not collect all the contractual interest and principal payments as scheduled in the loan agreement. Impaired loans may also include troubled loans that are restructured. A TDR occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. A TDR classification may result from the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms (such as reduction of stated interest rates below market rates, extension of maturity that does not conform to the

Company's policies, reduction of the face amount of the loan, reduction of accrued interest, or reduction or deferment of loan payments), or a combination. A specific reserve amount is allocated to the ALL for individual loans that have been classified as impaired based on management's estimate of the fair value of the collateral for collateral dependent loans, an observable market price, or the present value of anticipated future cash flows. The Company accounts for the change in present value attributable to the passage of time in the loan loss reserve. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer, real estate or small balance commercial loans for impairment evaluation, unless such loans are subject to a restructuring agreement or have been identified as impaired as part of a larger customer relationship. Management has established the threshold for individual impairment evaluation for commercial loans with balances greater than $500 thousand, based on an evaluation of the Company's historical loss experience on substandard commercial loans.

The general component represents the level of ALL allocable to each loan portfolio segment with similar risk characteristics and is determined based on historical loss experience, adjusted for qualitative factors, for each class of loan. Management deems a five year average to be an appropriate time frame on which to base historical losses for each portfolio segment. Qualitative factors considered include underwriting, economic and market conditions, portfolio composition, collateral values, delinquencies, lender experience and legal issues. The qualitative factors are determined based on the various risk characteristics of each portfolio segment. Risk characteristics relevant to each portfolio segment are as follows:

- Residential real estate - Loans in this segment are collateralized by owner-occupied 1-4 family residential real estate, second and vacation homes, 1-4 family investment properties, home equity and second mortgage loans. Repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, could have an effect on the credit quality of this segment.
- Construction real estate - Loans in this segment include residential and commercial construction properties, commercial real estate development loans (while in the construction phase of the projects), land and land development loans. Repayment is dependent on the credit quality of the individual borrower and/or the underlying cash flows generated by the properties being constructed. The overall health of the economy, including unemployment rates, housing prices, vacancy rates and material costs, could have an effect on the credit quality of this segment.
- Commercial real estate - Loans in this segment are primarily properties occupied by businesses or income-producing properties. The underlying cash flows generated by the properties may be adversely impacted by a downturn in the economy as evidenced by a general slowdown in business or increased vacancy rates which, in turn, could have an effect on the credit quality of this segment. Management requests business financial statements at least annually and monitors the cash flows of these loans.
- Commercial - Loans in this segment are made to businesses and are generally secured by nonreal estate assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer or business spending, could have an effect on credit quality of this segment.
- Consumer - Loans in this segment are made to individuals for personal expenditures, such as an automobile purchase, and include unsecured loans. Repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment, could have an effect on the credit quality of this segment.
- Municipal - Loans in this segment are made to municipalities located within the Company's service area. Repayment is primarily dependent on taxes or other funds collected by the municipalities. Management considers there to be minimal risk surrounding the credit quality of this segment.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the ALL reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

All evaluations are inherently subjective as they require estimates that are susceptible to significant revision as more information becomes available or as changes occur in economic conditions or other relevant factors.

Other real estate owned

Real estate properties acquired through or in lieu of loan foreclosure are to be sold and are initially recorded based on an independent appraisal or a broker price opinion at the estimated fair value less estimated selling costs at the date of acquisition, establishing a new carrying basis. Thereafter, valuations are periodically performed by management, and the real estate is carried in Other assets at the lower of carrying amount or fair value, less estimated cost to sell. Costs of significant property improvements are capitalized, if deemed recoverable, whereas revenue and expenses from operations and changes in valuation are charged to Other expenses on the Company's consolidated statements of income. There were no properties in OREO at December 31, 2016 or at December 31, 2015.

Premises and equipment

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed principally by the straight line method over the estimated useful lives of the assets. The cost of assets sold or otherwise disposed of and the related accumulated depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the consolidated statement of income. Maintenance and repairs are charged to current expense as incurred and the costs of major renovations and betterments are capitalized. Construction in progress is stated at cost, which includes the cost of construction and other direct costs attributable to the construction. No provision for depreciation is made on construction in progress until such time as the relevant assets are completed and put into use.

Intangible assets

Intangible assets include goodwill, which represents the excess of the purchase price over the fair value of net assets acquired in the 2011 Branch Acquisition , as well as a core deposit intangible related to the deposits acquired (see Note 9). The core deposit intangible is amortized on a straight line basis over the estimated average life of the acquired core deposit base of 10 years. The Company evaluates the valuation and amortization of the core deposit intangible if events occur that could result in possible impairment. With respect to goodwill, in accordance with current authoritative guidance, the Company assesses qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the Company is less than its carrying amount, which could result in goodwill impairment.

Federal Home Loan Bank stock

As a member of the FHLB, Union is required to invest in Class B common stock of the FHLB. The Class B common stock has a five year notice requirement for redemption and there is no guarantee of future redemption. Also, there is the possibility of future capital calls by the FHLB on member banks to ensure compliance with its capital plan. FHLB stock is reported in Other assets at its par value of $2.3 million at December 31, 2016 and $1.9 million at December 31, 2015. The stock is nonmarketable, and is redeemable by the FHLB at par value.

Company-owned life insurance

COLI represents life insurance on the lives of certain current or former directors or employees who have provided positive consent allowing the Company to be the beneficiary of such policies. The Company utilizes COLI as tax-efficient funding for certain benefit obligations to its employees and directors, including obligations under one of the Company's nonqualified deferred compensation plans. (See Note 14.) The Company is the primary beneficiary of the insurance policies. Increases in the cash value of the policies, as well as any gain on insurance proceeds received, are recorded in Other income, and are not currently subject to income taxes. COLI is recorded at the cash value of the policies, less any applicable cash surrender charges (of which there are currently none). The Company reviews the financial strength of the insurance carriers prior to the purchase of COLI to ensure minimum credit ratings of at least investment grade. The financial strength of the carriers is reviewed annually and COLI with any individual carrier is limited by Company policy to 10% of capital plus reserves.

Servicing assets

Servicing assets are recognized as separate assets when servicing rights are acquired through purchase or through sale of loans with servicing rights retained. Capitalized servicing rights are reported in Other assets, are initially recorded at estimated fair market value and are amortized against noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. The estimated fair value of capitalized servicing rights represents the present value of the future servicing fees arising from the right to service loans that have been previously sold. Servicing assets are evaluated regularly for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value of a stratum is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that estimated fair value is less than the capitalized amount for the stratum.

Investment in real estate limited partnerships

The Company has purchased various limited partnership interests in affordable housing partnerships. These partnerships were established to acquire, own and rent residential housing for elderly, low or moderate income residents in northern Vermont or in New Hampshire. Under current accounting rules, the investments are accounted for under a method approximating the equity method of accounting. These equity investments are recorded at cost and adjusted for the Company's proportionate share of the partnerships' undistributed earnings or losses through the consolidated statements of income.

Defined benefit pension plan

Union sponsors a noncontributory defined benefit pension plan covering all eligible employees employed prior to October 5, 2012. On that date, the Company closed The Plan to new participants and froze the accrual of retirement benefits for current participants. It is Union's current intent to continue to maintain the frozen Plan and related Trust account and to distribute benefits to participants at such a time and in such manner as provided under the terms of the Plan. The Company will continue to recognize the pension benefit and cash funding obligations for the remaining life of the associated liability for the frozen benefits under the Plan. The Plan provides defined benefits based on years of service and final average salary prior to October 5, 2012. The costs of this Plan, based on actuarial computations of current benefits for employees, are credited to Pension and other employee benefits.

Advertising costs

The Company expenses advertising costs as incurred and they are included in Other expenses in the Company's consolidated statement of income.

Earnings per common share

Earnings per common share for the period are computed based on the weighted average number of shares of common stock issued during the period, including DRIP shares issuable upon reinvestment of dividends, retroactively adjusted for stock splits and stock dividends, if any, and reduced for shares held in treasury.

Income taxes

The Company prepares its federal income tax return on a consolidated basis. Federal income taxes are allocated to members of the consolidated group based on taxable income. The Company recognizes income taxes under the asset and liability method. This involves estimating the Company's actual current tax exposure as well as assessing temporary differences resulting from differing treatment of items, such as timing of the deduction of expenses, for tax and GAAP purposes. These differences result in deferred tax assets and liabilities, which are netted and included in Other assets. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company must also assess the likelihood that any deferred tax assets will be recovered from future taxable income and to the extent that recovery is not likely, a valuation allowance must be established. Significant management judgment is required in determining the provision for income taxes and deferred tax assets and liabilities. Affordable housing tax credits are recognized as a reduction of the Provision for income taxes in the year they are earned.

Off-balance-sheet financial instruments

In the ordinary course of business, the Company is a party to off-balance-sheet financial instruments consisting of commitments to originate credit, unused lines of credit including commitments under credit card arrangements, commitments to purchase investment securities, commitments to invest in real estate limited partnerships, commercial letters of credit, standby letters of credit and risk-sharing commitments on certain sold loans. Such financial instruments are recorded in the financial statements when they become fixed and certain.

Comprehensive income (loss)

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income or loss. Certain changes in assets and liabilities, such as the after tax effect of unrealized gains and losses on investment securities AFS that are not OTTI and the unfunded liability for the defined benefit pension plan, are not reflected in the consolidated statement of income. The cumulative effect of such items, net of tax effect, is reported as a separate component of the equity section of the consolidated balance sheet (Accumulated OCI) (See Note 23). OCI, along with net income, comprises the Company's total comprehensive income or loss.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Stock Based Compensation

Effective May 21, 2014 upon approval by the stockholders, the Company adopted the 2014 Equity Plan. Under the 2014 Equity Plan, 50,000 shares of the Company’s common stock (including approximately 25,000 unused shares from the 2008 ISO Plan) are available for equity awards of incentive stock options, nonqualified stock options, restricted stock and restricted stock units to eligible officers and (except for awards of incentive stock options) nonemployee directors.

Recent accounting pronouncements

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities. The ASU was issued to enhance the reporting model for financial instruments to provide users of financial statements with more useful information for decisions. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted for only one of the six amendments, otherwise it is not permitted. The Company will adopt the ASU effective January 1, 2018 and does not believe it will have a material effect on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and liabilities (including operating leases) on the balance sheet and disclosing key information about leasing arrangements. Previous lease accounting did not require the inclusion of operating leases in the balance sheet. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. The Company does not expect the ASU will have a material effect on its consolidated financial statements based on its existing lease agreements. The Company continues to evaluate the impact of adoption of this standard.

In March 2016, the FASB issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU simplifies several aspects of the accounting for share-based payment award transactions, including: (1) income tax consequences; (2) classification of awards as either equity or liabilities, and (3) classification on the statement of cash flows. The ASU is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. The Company will adopt the ASU effective January 1, 2017 and does not believe it will have a material effect on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model ("CECL"), requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available for sale. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within such years. The Company has established a CECL implementation team and developed a transition project plan. Team members have been assigned specific tasks to begin the implementation process and evaluation of the potential impact of the ASU on the Company's consolidated financial statements.

Note 2. Restrictions on Cash and Cash Equivalents

The nature of the Company's business requires that it maintain amounts due from correspondent banks which, at times, may exceed federally insured limits. The balances in these accounts at December 31, were as follows:

	2016	2015
	(Dollars in thousands)	
Noninterest bearing accounts	$ 289	$ 315
Federal Reserve Bank of Boston	34,777	13,530
FHLB of Boston	572	253

No losses have been experienced in these accounts and the Company believes it is not exposed to any significant risk with respect to the accounts.

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The Company had no requirement to maintain contracted clearing balances at December 31, 2016 or 2015. Balances at the Federal Reserve Bank of Boston and a portion of the funds at the FHLB are classified as overnight deposits as they earn interest. The Company is required to maintain vault cash or noninterest bearing reserve balances with Federal Reserve Bank of Boston. Total reserve balances required at December 31, 2016 and 2015 were $891 thousand and $726 thousand, respectively, which were both satisfied by vault cash.

Note 3. Interest Bearing Deposits in Banks

Interest bearing deposits in banks consist of certificates of deposit purchased from various financial institutions. Deposits at each institution are generally maintained at or below the FDIC insurable limit of $250 thousand. Certificates are held with rates ranging from 0.55% to 2.55% and mature at various dates through 2028, with $3.1 million scheduled to mature in 2017.

Note 4. Investment Securities

Investment securities as of the balance sheet dates consisted of the following:

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$10,221	$ 15	$ (196)	$10,040
Agency MBS	18,283	27	(269)	18,041
State and political subdivisions	27,909	113	(650)	27,372
Corporate	9,745	84	(129)	9,700
Total debt securities	66,158	239	(1,244)	65,153
Mutual funds	403	—	—	403
Total	$66,561	$ 239	$ (1,244)	$65,556
Held-to-maturity				
U.S. Government-sponsored enterprises	$999	$ —	$ —	$999

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$10,805	$ 30	$ (143)	$10,692
Agency MBS	11,083	39	(64)	11,058
State and political subdivisions	19,653	404	(25)	20,032
Corporate	12,266	76	(359)	11,983
Total debt securities	53,807	549	(591)	53,765
Mutual funds	345	—	—	345
Total	$54,152	$ 549	$ (591)	$54,110
Held-to-maturity				
U.S. Government-sponsored enterprises	$5,217	$ —	$ (101)	$5,116

Investment securities with a carrying amount of $8.4 million and $25.7 million at December 31, 2016 and 2015, respectively, were pledged as collateral for public deposits, customer repurchase agreements and for other purposes as required or permitted by law.

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Information pertaining to all investment securities with gross unrealized losses as of the balance sheet dates, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

December 31, 2016	Less Than 12 Months			12 Months and Over			Total		
	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss
	(Dollars in thousands)								
Debt securities:									
U.S. Government-sponsored enterprises	13	$8,351	$ (180)	3	$1,172	$ (16)	16	$9,523	$ (196)
Agency MBS	22	15,141	(261)	1	344	(8)	23	15,485	(269)
State and political subdivisions	40	16,481	(650)	—	—	—	40	16,481	(650)
Corporate	8	3,973	(56)	4	1,627	(73)	12	5,600	(129)
Total	83	$43,946	$ (1,147)	8	$3,143	$ (97)	91	$47,089	$ (1,244)

December 31, 2015	Less Than 12 Months			12 Months and Over			Total		
	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss
	(Dollars in thousands)								
Debt securities:									
U.S. Government-sponsored enterprises	12	$9,081	$ (157)	5	$3,607	$ (87)	17	$12,688	$ (244)
Agency MBS	12	7,459	(58)	1	259	(6)	13	7,718	(64)
State and political subdivisions	4	1,512	(14)	2	785	(11)	6	2,297	(25)
Corporate	12	5,750	(277)	4	1,632	(82)	16	7,382	(359)
Total	40	$23,802	$ (506)	12	$6,283	$ (186)	52	$30,085	$ (692)

The Company has the ability to hold the investment securities that had unrealized losses at December 31, 2016 for the foreseeable future and no declines were deemed by management to be OTT.

The following table presents the proceeds, gross gains and gross losses from sales of available-for-sale securities:

	For The Years Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Proceeds	$6,620	$11,540	$7,420
Gross gains	131	66	393
Gross losses	(60)	(13)	(78)
Net gains	$71	$53	$315

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The amortized cost and estimated fair value of debt securities by contractual scheduled maturity as of December 31, 2016, were as follows:

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Available-for-sale		
Due in one year or less	$627	$631
Due from one to five years	5,834	5,882
Due from five to ten years	24,063	23,768
Due after ten years	17,351	16,831
	47,875	47,112
Agency MBS	18,283	18,041
Total debt securities available-for-sale	$66,158	$65,153
Held-to-maturity		
Due from one to five years	$999	$999
Total debt securities held-to-maturity	$999	$999

Actual maturities may differ for certain debt securities that may be called by the issuer prior to the contractual maturity. Actual maturities may differ from contractual maturities on agency MBS because the mortgages underlying the securities may be prepaid, usually without any penalties. Therefore, these agency MBS are shown separately and not included in the contractual maturity categories in the above maturity summary.

Note 5. Loans Held for Sale and Loan Servicing

At December 31, 2016 and 2015, Loans held for sale consisted of conventional residential mortgages originated for subsequent sale. At December 31, 2016 and 2015, the estimated fair value of these loans was in excess of their carrying value, and therefore no valuation reserve was necessary for loans held for sale.

Commercial and residential mortgage loans serviced for others are not included in the accompanying balance sheets. The unpaid principal balance of commercial and residential mortgage loans serviced for others was $452.0 million and $422.3 million at December 31, 2016 and 2015, respectively.

Loans sold consisted of the following during the years ended December 31:

	2016		2015		2014	
	Loans Sold	Net Gains on Sale	Loans Sold	Net Gains on Sale	Loans Sold	Net Gains on Sale
	(Dollars in thousands)					
Residential loans	$135,294	$2,880	$131,706	$2,871	$94,892	$2,097
Commercial loans	251	18	—	—	—	—
Total	$135,545	$2,898	$131,706	$2,871	$94,892	$2,097

There were no obligations to repurchase loans for any amount at December 31, 2016, but there were contractual risk sharing commitments on certain sold loans totaling $634 thousand as of such date.

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The Company generally retains the servicing rights on loans sold. At December 31, 2016 and 2015, the unamortized balance of servicing rights on loans sold with servicing retained was $1.6 million and $1.5 million, respectively, included in Other assets. The estimated fair value of these servicing rights was in excess of their carrying value at December 31, 2016 and 2015, and therefore no impairment reserve was necessary. The net capitalization and amortization of MSRs is included in Other income.

The following table presents the capitalization and amortization of loan servicing rights:

	For The Years Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Capitalization of servicing rights	$823	$839	$571
Amortization of servicing rights	720	670	528
Net capitalization of servicing rights	$103	$169	$43

Note 6. Loans

The composition of Net loans at December 31, was as follows:

	2016	2015
	(Dollars in thousands)	
Residential real estate	$172,727	$165,396
Construction real estate	34,189	42,889
Commercial real estate	249,063	230,442
Commercial	41,999	21,397
Consumer	3,962	3,963
Municipal	31,350	36,419
Gross loans	533,290	500,506
Allowance for loan losses	(5,247)	(5,201)
Net deferred loan costs	649	515
Net loans	$528,692	$495,820

The loans purchased in the 2011 Branch Acquisition were initially recorded at $32.9 million, the estimated fair value at the time of purchase, which contained an accretable loan premium component of $545 thousand and a nonaccretable credit risk component of $318 thousand. The accretable component was amortizable as an adjustment to the related loan yield over the average life of the loan and the nonaccretable component represented probable loss due to credit risk, which was reviewed by management periodically and subject to adjustment as deemed necessary. There were no acquired loans at December 31, 2016 and December 31, 2015, as the remaining residential and commercial real estate acquired loan portfolios were transferred to the Bank's existing loan portfolios during 2015. Prior to that transfer, changes in the accretable and nonaccretable components of the fair value of the acquired loans were charged to Interest and fees on loans on the Company's consolidated statements of income for the applicable periods.

The following table summarizes activity in the accretable loan premium component for the acquired loan portfolio:

	For The Years Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		

Balance at beginning of year	$ —	$292	$374
Loan premium amortization	—	(72)	(80)
Changes in expected cash flows due to paydowns	—	(7)	2
Adjustment to transfer acquired loans into the Bank's existing loan portfolio	—	(213)	(4)
Balance at end of year	$ —	$ —	$292

The following table summarizes activity in the nonaccretable credit risk component for the acquired loan portfolio:

	For The Years Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Balance at beginning of year	$ —	$ 193	$ 296
Loss recognized on acquired residential loan	—	—	(24)
Adjustment to transfer acquired loans into the Bank's existing loan portfolio	—	(193)	(79)
Balance at end of year	$ —	$ —	$ 193

Residential real estate loans aggregating $17.2 million at December 31, 2015 were pledged as collateral on deposits of municipalities. There were no loans pledged as collateral on deposits of municipalities at December 31, 2016. Qualifying residential first mortgage loans and certain commercial real estate loans held by Union may also be pledged as collateral for borrowings from the FHLB under a blanket lien.

A summary of current, past due and nonaccrual loans as of the balance sheet dates follows:

December 31, 2016	Current	30-59 Days	60-89 Days	90 Days and over and accruing	Nonaccrual	Total
	(Dollars in thousands)					
Residential real estate	$ 168,125	$ 1,661	$ 472	$ 672	$ 1,797	$ 172,727
Construction real estate	34,148	17	—	—	24	34,189
Commercial real estate	245,402	1,642	153	157	1,709	249,063
Commercial	41,920	12	42	10	15	41,999
Consumer	3,946	12	3	1	—	3,962
Municipal	31,350	—	—	—	—	31,350
Total	$ 524,891	$ 3,344	$ 670	$ 840	$ 3,545	$ 533,290

December 31, 2015	Current	30-59 Days	60-89 Days	90 Days and over and accruing	Nonaccrual	Total
	(Dollars in thousands)					
Residential real estate	$ 159,895	$ 2,034	$ 1,195	$ 368	$ 1,904	$ 165,396
Construction real estate	42,616	7	204	34	28	42,889
Commercial real estate	228,513	667	641	111	510	230,442
Commercial	20,977	—	20	321	79	21,397
Consumer	3,950	10	1	2	—	3,963
Municipal	36,419	—	—	—	—	36,419
Total	$ 492,370	$ 2,718	$ 2,061	$ 836	$ 2,521	$ 500,506

There was one residential real estate loan totaling $50 thousand in process of foreclosure at December 31, 2016. Aggregate interest on nonaccrual loans not recognized was $1.3 million for the year ended December 31, 2016, $1.2 million for the year ended December 31, 2015 and $1.1 million for the year ended December 31, 2014.

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Note 7. Allowance for Loan Losses and Credit Quality

Changes in the ALL, by class of loans, were as follows for the years ended:

December 31, 2016	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2015	$1,419	$ 514	$ 2,792	$ 209	$ 28	$ 38	$ 201	$5,201
Provision (credit) for loan losses	64	(135)	(105)	158	5	2	161	150
Recoveries of amounts charged off	36	12	—	8	3	—	—	59
	1,519	391	2,687	375	36	40	362	5,410
Amounts charged off	(120)	—	—	(33)	(10)	—	—	(163)
Balance, December 31, 2016	$1,399	$ 391	$ 2,687	$ 342	$ 26	$ 40	$ 362	$5,247

December 31, 2015	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2014	$1,330	$ 439	$ 2,417	$ 176	$ 27	$ 42	$ 263	$4,694
Provision (credit) for loan losses	136	47	375	46	12	(4)	(62)	550
Recoveries of amounts charged off	36	28	—	16	3	—	—	83
	1,502	514	2,792	238	42	38	201	5,327
Amounts charged off	(83)	—	—	(29)	(14)	—	—	(126)
Balance, December 31, 2015	$1,419	$ 514	$ 2,792	$ 209	$ 28	$ 38	$ 201	$5,201

December 31, 2014	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2013	$1,251	$ 390	$ 2,644	$ 163	$ 23	$ 35	$ 141	$4,647
Provision (credit) for loan losses	177	37	(93)	59	36	7	122	345
Recoveries of amounts charged off	1	12	8	8	13	—	—	42
	1,429	439	2,559	230	72	42	263	5,034
Amounts charged off	(99)	—	(142)	(54)	(45)	—	—	(340)
Balance, December 31, 2014	$1,330	$ 439	$ 2,417	$ 176	$ 27	$ 42	$ 263	$4,694

The allocation of the ALL, summarized on the basis of the Company's impairment methodology by class of loan, as of the balance sheet dates were as follows:

December 31, 2016	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Individually evaluated for impairment	$63	$ —	$ 40	$ —	$ —	$ —	$ —	$103
Collectively evaluated	1,336	391	2,647	342	26	40	362	5,144

for impairment								
Total allocated	$1,399	$ 391	$ 2,687	$ 342	$ 26	$ 40	$ 362	$5,247

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December 31, 2015	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Individually evaluated for impairment	$109	$ —	$ 227	$ 21	$ —	$ —	$ —	$357
Collectively evaluated for impairment	1,310	514	2,565	188	28	38	201	4,844
Total allocated	$1,419	$ 514	$ 2,792	$ 209	$ 28	$ 38	$ 201	$5,201

Despite the allocation shown in the tables above, the ALL is general in nature and is available to absorb losses from any class of loan.

The recorded investment in loans, summarized on the basis of the Company's impairment methodology by class of loan, as of the balance sheet dates were as follows:

December 31, 2016	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Individually evaluated for impairment	$1,448	$ 88	$ 3,328	$ 432	$ —	$ —	$5,296
Collectively evaluated for impairment	171,279	34,101	245,735	41,567	3,962	31,350	527,994
Total	$172,727	$ 34,189	$ 249,063	$ 41,999	$ 3,962	$ 31,350	$533,290

December 31, 2015	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Individually evaluated for impairment	$1,197	$ 92	$ 3,094	$ 493	$ —	$ —	$4,876
Collectively evaluated for impairment	164,199	42,797	227,348	20,904	3,963	36,419	495,630
Total	$165,396	$ 42,889	$ 230,442	$ 21,397	$ 3,963	$ 36,419	$500,506

Risk and collateral ratings are assigned to loans and are subject to ongoing monitoring by lending and credit personnel with such ratings updated annually or more frequently if warranted. The following is an overview of the Company's loan rating system:

1-3 Rating - Pass

Risk-rating grades "1" through "3" comprise loans ranging from those with lower than average credit risk, defined as borrowers with high liquidity, excellent financial condition, strong management, favorable industry trends or loans secured by highly liquid assets, through those with marginal credit risk, defined as borrowers that, while creditworthy, exhibit some characteristics requiring special attention by the account officer.

4/M Rating - Satisfactory/Monitor

Borrowers exhibit potential credit weaknesses or downward trends warranting management's attention. While potentially weak, these borrowers are currently marginally acceptable; no loss of principal or interest is envisioned. When warranted, these credits may be monitored on the watch list.

5-7 Rating - Substandard

Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. The loan may be inadequately protected by the net worth and paying capacity of the obligor and/or the underlying collateral is inadequate.

The following tables summarize the loan ratings applied to the Company's loans by class as of the balance sheet dates:

December 31, 2016	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Pass	$158,140	$ 29,248	$ 182,247	$ 38,219	$ 3,928	$ 31,350	$443,132
Satisfactory/Monitor	10,641	4,830	62,193	3,109	34	—	80,807
Substandard	3,946	111	4,623	671	—	—	9,351
Total	$172,727	$ 34,189	$ 249,063	$ 41,999	$ 3,962	$ 31,350	$533,290

December 31, 2015	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Pass	$150,535	$ 37,750	$ 175,438	$ 18,347	$ 3,902	$ 36,419	$422,391
Satisfactory/Monitor	11,329	4,968	49,745	2,384	61	—	68,487
Substandard	3,532	171	5,259	666	—	—	9,628
Total	$165,396	$ 42,889	$ 230,442	$ 21,397	$ 3,963	$ 36,419	$500,506

The following tables provide information with respect to impaired loans by class of loan as of and for the years ended December 31, 2016, 2015 and 2014:

	December 31, 2016			For The Year Ended December 31, 2016	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
Residential real estate	$308	$ 317	$ 63		
Commercial real estate	488	520	40		
With an allowance recorded	796	837	103		
Residential real estate	1,140	1,561	—		
Construction real estate	88	88	—		
Commercial real estate	2,840	2,910	—		
Commercial	432	432	—		
With no allowance recorded	4,500	4,991	—		
Residential real estate	1,448	1,878	63	$1,303	$ 50
Construction real estate	88	88	—	90	4
Commercial real estate	3,328	3,430	40	3,113	107
Commercial	432	432	—	462	33
Total	$5,296	$ 5,828	$ 103	$4,968	$ 194

	December 31, 2015			For The Year Ended December 31, 2015	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
Residential real estate	$659	$ 668	$ 109		
Commercial real estate	2,142	2,161	227		
Commercial	493	493	21		
With an allowance recorded	3,294	3,322	357		
Residential real estate	538	697	—		
Construction real estate	92	92	—		
Commercial real estate	952	1,015	—		
With no allowance recorded	1,582	1,804	—		
Residential real estate	1,197	1,365	109	$942	$ 34
Construction real estate	92	92	—	162	19
Commercial real estate	3,094	3,176	227	3,523	219
Commercial	493	493	21	123	—
Total	$4,876	$ 5,126	$ 357	$4,750	$ 272

	December 31, 2014			For The Year Ended December 31, 2014	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
Residential real estate	$537	$ 546	$ 73		
Commercial real estate	2,127	2,136	70		
With an allowance recorded	2,664	2,682	143		
Residential real estate	413	602	—		
Construction real estate	275	298	—		
Commercial real estate	1,205	1,256	—		
Commercial	123	172	—		
With no allowance recorded	2,016	2,328	—		
Residential real estate	950	1,148	73	$805	$ 26
Construction real estate	275	298	—	314	14
Commercial real estate	3,332	3,392	70	3,883	195
Commercial	123	172	—	106	7
Total	$4,680	$ 5,010	$ 143	$5,108	$ 242

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(1) Does not reflect government guaranties on impaired loans as of as of December 31, 2016, 2015 and 2014 totaling $637 thousand, $606 thousand and $244 thousand, respectively.

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The following is a summary of TDR loans by class of loan as of the balance sheet dates:

	December 31, 2016		December 31, 2015	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance
	(Dollars in thousands)			
Residential real estate	20	$ 1,448	11	$ 1,197
Construction real estate	1	88	1	92
Commercial real estate	10	1,452	5	950
Commercial	2	431	2	493
Total	33	$ 3,419	19	$ 2,732

The TDR loans above represent loan modifications in which a concession was provided to the borrower, including due date extensions, maturity date extensions, interest rate reductions or the forgiveness of accrued interest. Troubled loans that are restructured and meet established thresholds are classified as impaired and a specific reserve amount is allocated to the ALL on the basis of the fair value of the collateral for collateral dependent loans, an observable market price, or the present value of anticipated future cash flows.

The following table provides new TDR activity by class of loan for the years ended December 31, 2016 and 2015:

	New TDRs During the Year Ended December 31, 2016			New TDRs During the Year Ended December 31, 2015		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)					
Residential real estate	9	$ 349	$ 371	6	$ 590	$ 597
Commercial real estate	6	803	807	2	281	281
Commercial	—	—	—	2	493	493

At December 31, 2016 and 2015, there were no TDR loans modified within the previous twelve months that had subsequently defaulted during the years then ended. TDR loans are considered defaulted at 90 days past due.

At December 31, 2016 and 2015, the Company was not committed to lend any additional funds to borrowers whose loans were nonperforming, impaired or restructured.

Note 8. Premises and Equipment

The major classes of premises and equipment and accumulated depreciation at December 31, were as follows:

	2016	2015
	(Dollars in thousands)	
Land and land improvements	$2,930	$2,617
Building and improvements	13,057	12,288
Furniture and equipment	8,833	7,890
Construction in progress and deposits on equipment	34	442
	24,854	23,237
Less accumulated depreciation	(11,329)	(10,182)
	$13,525	$13,055

Depreciation included in Occupancy and Equipment expenses amounted to $1.3 million, $1.1 million and $976 thousand for the years ended December 31, 2016, 2015 and 2014, respectively.

The Company is obligated under noncancelable operating leases for premises that expire in various years through the year 2021. Options to renew for additional periods are available with these leases. Future minimum rental commitments for these leases with original or remaining terms of one year or more at December 31, 2016 were as follows:

	(Dollars in thousands)
2017	$ 135
2018	103
2019	65
2020	40
2021	40
	$ 383

Rent expense for 2016, 2015 and 2014 amounted to $144 thousand, $138 thousand and $123 thousand, respectively. Occupancy expense is shown in the consolidated statements of income, net of rental income of $220 thousand, $227 thousand and $224 thousand in 2016, 2015 and 2014, respectively.

Note 9. Goodwill and Other Intangible Assets

As a result of the 2011 Branch Acquisition, the Company recorded goodwill amounting to $2.2 million. The goodwill is not amortizable. Goodwill is evaluated for impairment annually, in accordance with current authoritative accounting guidance. Management assesses qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the Company, in total, is less than its carrying amount. Management is not aware of any such events or circumstances that would cause it to conclude that the fair value of the Company is less than its carrying amount.

The Company also recorded $1.7 million of acquired identifiable intangible assets in connection with the 2011 Branch Acquisition, representing the core deposit intangible which is subject to straight-line amortization over the estimated 10 year average life of the acquired core deposit base, absent any future impairment. Management will evaluate the core deposit intangible for impairment if conditions warrant.

Amortization expense for the core deposit intangible was $171 thousand for 2016, 2015 and 2014. The amortization expense is included in Other expenses on the consolidated statements of income and is deductible for tax purposes. As of December 31, 2016, the remaining amortization expense related to the core deposit intangible, absent any future impairment, is expected to be as follows:

	(Dollars in thousands)
2017	171
2018	171
2019	171
2020	171
2021	70
Total	$ 754

Note 10. Investment in Real Estate Limited Partnerships

The Company has purchased from time to time various limited partnership interests established to acquire, own and rent residential housing for elderly, low or moderate income individuals in northern Vermont and New Hampshire. The carrying values of investments carried at equity were $2.8 million and $2.4 million at December 31, 2016 and 2015, respectively. The capital contribution payable related to these investments at December 31, 2016 was $27 thousand and there was no capital contribution payable at December 31, 2015. The provision for undistributed net losses of the partnerships charged to earnings was $565 thousand for 2016, $484 thousand for 2015, and $800 thousand for 2014. In 2014, $144 thousand of the provision for undistributed net losses charged to earnings related to the exit from three limited partnerships that had reached the final year of tax credits and were near or at the end of the limited partnership compliance period under the applicable federal tax credit program. The federal income tax credits related to limited partnership investments were $881 thousand, $564 thousand, and $735 thousand for the years ended December 31, 2016, 2015 and 2014, respectively, and are recorded as a reduction of the Provision for income taxes.

Note 11. Deposits

The following is a summary of interest bearing deposits at December 31:

	2016	2015
	(Dollars in thousands)	
Interest bearing checking accounts	$143,037	$126,404
Savings and money market accounts	239,046	183,799
Time deposits, $100,000 and over	40,581	88,640
Other time deposits	62,612	61,739
	$485,276	$460,582

The following is a summary of time deposits by maturity at December 31, 2016:

	(Dollars in thousands)
2017	$ 60,952
2018	23,746
2019	10,795
2020	2,711
2021	4,989
	$ 103,193

Time deposits of $8.7 million and $54.8 million meet or exceed the FDIC insurance limit of $250 thousand at December 31, 2016 and 2015, respectively.

Note 12. Borrowed Funds

Borrowed funds were comprised of option advance borrowings from the FHLB of $30.5 million and $7.9 million at December 31, 2016 and 2015, respectively, and secured customer repurchase agreement sweeps of $1.1 million and $1.6 million at December 31, 2016 and 2015, respectively.

The FHLB option advance borrowings are a mix of straight bullets, balloons and amortizers with maturities through 2021. All of the FHLB borrowings had fixed interest rates ranging from 0.00% to 4.31% at December 31, 2016 and 0.99% to 5.32% at December 31, 2015. The weighted average interest rates on the borrowings were 1.42% and 3.46% at December 31, 2016 and 2015, respectively.

The contractual payments due for FHLB option advance borrowings, as of December 31, 2016, were as follows:

	(Dollars in thousands)
2017	$ 10,280
2018	9,765
2019	10,287
2020	—
2021	164
	$ 30,496

The Company has established both overnight and longer term lines of credit with the FHLB . These borrowings are secured by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by one-to-four family properties and certain commercial real estate loans. At December 31, 2016, pledged loans with a carrying value of $162.3 million carried a $91.5 million borrowing capacity at the FHLB, less borrowings and other credit subject to collateralization of $31.7 million, resulting in remaining year-end capacity of $59.8 million. At December 31, 2015, pledged loans with a carrying value of $81.7 million carried a $49.5 million borrowing capacity at the FHLB, less borrowings and other credit subject to collateralization of $9.1 million, resulting in remaining year-end capacity of $40.4 million.

In addition to its borrowing arrangements with the FHLB, Union maintains preapproved Federal Funds lines of credit with correspondent banks totaling $12.0 million. Interest on these borrowings is payable daily and charged at the federal funds rate at the time of the borrowing. Union also maintains a repurchase agreement line of credit and has access to the Federal Reserve discount window. There were no outstanding borrowings on the Federal Funds purchase lines, repurchase agreement line, or at the discount window at December 31, 2016 or 2015.

Secured customer repurchase agreement sweeps are collateralized by U.S. Government-sponsored enterprise securities with a carrying value of $1.8 million at December 31, 2016 and $2.4 million at December 31, 2015. The average daily balance of these repurchase agreement sweeps was $1.6 million during 2016 and 2015 with weighted average interest rates of 0.26% and 0.27%, during 2016 and 2015, respectively. The maximum borrowings outstanding on these agreements during 2016 and 2015 was $4.4 million and $3.8 million, respectively. These repurchase agreements mature the next business day and carried weighted average interest rates of 0.23% at December 31, 2016 and and 0.25% as of December 31,2015.

Note 13. Income Taxes

The components of the Provision for income taxes for the years ended December 31, were as follows:

	2016	2015	2014
	(Dollars in thousands)		
Current tax provision	$1,467	$1,838	$2,010
Deferred tax provision (benefit)	566	341	(37)
	$2,033	$2,179	$1,973

The total Provision for income taxes differs from the amounts computed at the statutory federal income tax rate of 34% primarily due to the following for the years ended December 31:

	2016	2015	2014
	(Dollars in thousands)		
Computed “expected” tax expense	$3,585	$3,419	$3,287
Tax exempt interest	(596)	(613)	(560)
Increase in cash surrender value of COLI	(115)	(96)	(42)
Tax credits	(896)	(564)	(735)
Other	55	33	23
	$2,033	$2,179	$1,973

Listed below are the significant components of the net deferred tax asset at December 31:

	2016	2015
	(Dollars in thousands)	
Components of the deferred tax asset		
Bad debts	$1,813	$1,768
Deferred compensation	334	338
Net pension liability	316	470
Core deposit intangible	110	89
Limited partnership investments	—	91
Unrealized loss on investment securities available-for-sale	342	14
Other	146	164
Total deferred tax asset	3,061	2,934
Components of the deferred tax liability		
Depreciation	(893)	(819)
Mortgage servicing rights	(563)	(519)

Limited partnership investments	(17)	—
Goodwill	(286)	(231)
Total deferred tax liability	(1,759)	(1,569)
Net deferred tax asset	$1,302	$1,365

Deferred tax assets are recognized subject to management's judgment that it is more likely than not that the deferred tax asset will be realized. Based on the temporary taxable items, historical taxable income and estimates of future taxable income, the Company believes that it is more likely than not that the deferred tax assets at December 31, 2016 will be realized and therefore no valuation allowance is warranted.

Net deferred income tax assets are included in Other assets in the consolidated balance sheets at December 31, 2016 and 2015.

Based on management's evaluation, management has concluded that there were no significant uncertain tax positions requiring recognition in the Company's financial statements at December 31, 2016 and 2015. Although the Company is not currently the subject of a tax examination by the IRS, the Company's tax years ended December 31, 2013 through 2015 are open to examination by the IRS under the applicable statute of limitations. The 2016 tax return has not yet been filed.

The Company may from time to time be assessed interest and/or penalties by federal or state tax jurisdictions, although any such assessments historically have been minimal and immaterial to the Company's financial results. In the event that the Company receives an assessment for interest and/or penalties, it will be classified in the financial statements as Other expenses.

Note 14. Employee Benefit Plans

Defined Benefit Pension Plan: Union sponsors a noncontributory defined benefit pension plan covering all eligible employees employed prior to October 5, 2012. On that date, the Company closed the Plan to new participants and froze the accrual of retirement benefits for current participants. Union continues to maintain the frozen Plan and related trust and continues to distribute benefits to participants at such time and in such manner as provided under the terms of the Plan. The Company will continue to recognize pension expense/benefit and cash funding obligations for the remaining life of the associated liability for the frozen benefits under the Plan. The Plan provides defined benefits based on years of service and final average salary prior to October 5, 2012, as defined by the Plan.
There was no minimum required contribution under the ERISA guidelines for 2016 or 2015. Union measures defined benefit plan assets and obligations as of December 31, its fiscal year-end.
Union's policy is to accrue annually an amount equal to the actuarially calculated expense for future benefits.
Information pertaining to the activity in the Plan is as follows:

Obligations and funded status at December 31:

	2016	2015
	(Dollars in thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	$17,177	$18,103
Interest cost	701	680
Actuarial loss (gain)	544	(809)
Benefits paid	(735)	(797)
Projected benefit obligation at end of year	17,687	17,177
Change in fair value of plan assets		
Fair value of plan assets at beginning of year	15,717	17,300
Actuarial gain (loss) on plan assets	899	(786)
Employer contributions	750	—

Benefits paid	(735)	(797)
Fair value of plan assets at end of year	16,631	15,717
Net liability for pension benefits	$(1,056)	$(1,460)

	2016	2015
	(Dollars in thousands)	
Accumulated benefit obligation at December 31	$17,687	