

UNION BANKSHARES INC  
Form 10-K  
March 15, 2017

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

FORM 10-K

(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.

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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

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UNION BANKSHARES, INC.

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The information required by Part III Items 10, 11, 12, 13 and 14 is incorporated herein by reference, in whole or in part, from the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 17, 2017.

The incorporation by reference herein of portions of the Proxy Statement shall not be deemed to specifically (a) incorporate by reference the information referred to in Items 407(d)(1)-(3) of Regulation S-K. Incorporation by reference of this report into any registration statement filed by the Company under the Securities Act of 1933, as amended shall not be deemed to incorporate by reference the information referred to in Item 201(e) of Regulation S-K.

## FORWARD-LOOKING STATEMENTS

The Company may from time to time make written or oral statements that are considered “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may include financial projections, statements of plans and objectives for future operations, estimates of future economic performance or conditions and assumptions relating thereto. The Company may include forward-looking statements in its filings with the SEC, in its reports to stockholders, including this Annual Report, in press releases, other written materials, and in statements made by senior management to analysts, rating agencies, institutional investors, representatives of the media and others.

Forward-looking statements reflect management's current expectations and are subject to uncertainties, both general and specific, and risk exists that actual results will differ from those predictions, forecasts, projections and other estimates contained in forward-looking statements. These risks cannot be readily quantified. When management uses any of the terms “believes,” “expects,” “anticipates,” “intends,” “projects,” “potential,” “plans,” “seeks,” “estimates,” “targets,” “goals,” “may,” “could,” “would,” “should,” or similar expressions, they are making forward-looking statements. Many possible events or factors, including those beyond the control of management, could affect the future financial results and performance of the Company.

Factors that may cause results or performance to differ materially from those expressed in forward-looking statements include, but are not limited to:

- General economic conditions and financial instability, either nationally, internationally, regionally or locally;
- Increased competitive pressures from tax-advantaged credit unions and other financial service providers in the Company's northern Vermont and New Hampshire market area or in the financial services industry generally, from increasing consolidation and integration of financial service providers, and from changes in technology and delivery systems;
- Interest rates change in such a way that continues to put pressure on the Company's margins, or result in lower fee income and lower gain on sale of real estate loans;
- Changes in laws or government rules, or the way in which courts or government agencies interpret or implement those laws or rules, that increase our costs of doing business or otherwise adversely affect the Company's business;
- Changes in federal or state tax policy;
- The effect of federal and state health care reform efforts;
- Changes in the level of nonperforming assets and charge-offs;
- Changes in estimates of future reserve requirements based upon relevant regulatory and accounting requirements;
  - Changes in information technology that require increased capital spending;
- Changes in consumer and business spending, borrowing and savings habits;
- Changes in accounting principles, including those governing the manner of estimating our credit risk and calculating our loan loss reserve;
- Further changes to the regulations governing the calculation of the Company's regulatory capital ratios; and
- The effect of and changes in the United States monetary and fiscal policies, including interest rate policies and regulation of the money supply by the FRB.

## 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](http://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 11.9% and 13.1% respectively, and its Leverage Capital Ratio was 8.2%, 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 1<sup>st</sup> of the following year and made available to the public no later than March 31<sup>st</sup>. 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](http://www.sec.gov).

Our Internet website address is [www.ublocal.com](http://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](http://www.materials.proxyvote.com/905400) no later than the date on which they are mailed to shareholders.

## Item 1A. Risk Factors

Our loans are concentrated in certain areas of Vermont and New Hampshire and adverse conditions in those markets could adversely affect our operations.

We are exposed to real estate and economic factors throughout Vermont and New Hampshire. Further, because a substantial portion of our loan portfolio is secured by real estate in Vermont and New Hampshire, the value of the associated collateral is subject to real estate market conditions in those states and in the northern New England region more generally. Adverse economic, political and business developments or natural hazards may affect these areas and the ability of property owners in these areas to make payments of principal and interest on the underlying mortgages. If these areas experience adverse economic, political or business conditions, or significant natural hazards, we would likely experience higher rates of loss and delinquency on our loan portfolio than if the portfolio were more geographically diverse.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. On a quarterly basis the allowance for loan loss is presented to Union's Board of Directors for discussion, review, and approval. We rely on our loan reviews, our experience, and our evaluation of economic conditions, among other factors, in determining the amount of the allowance for loan losses. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover the losses we could experience, resulting in additions to our allowance and a related charge to our income. In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, which may have a material adverse effect on our financial condition or results of operations.

Our commercial, commercial real estate and construction loan portfolio may expose us to increased credit risks. At December 31, 2016, approximately 55% of our loan portfolio was comprised of commercial and commercial real estate loans. In general, commercial and commercial real estate loans have historically posed greater credit risks than owner occupied residential mortgage loans. The repayment of commercial real estate loans depends on the business and financial condition of borrowers. Economic events and changes in government regulations, which we and our borrowers cannot control or reliably predict, could have an adverse impact on the cash flows generated by the businesses and properties securing our commercial and commercial real estate loans and on the values of the collateral securing those loans. Repayment of commercial loans depends substantially on the borrowers' underlying business, financial condition and cash flows. Commercial loans are generally collateralized by equipment, inventory, accounts receivable and other fixed assets. Compared to real estate, that type of collateral is more difficult to monitor, its value is harder to ascertain, it may depreciate more rapidly and it may not be as readily saleable if repossessed.

Sustained low interest rates and interest rate volatility may reduce our profitability.

Our consolidated earnings and financial condition are primarily dependent upon net interest income, which is the difference between interest earned from loans and investments and interest paid on deposits and borrowings. Net interest income can be affected significantly by changes in market interest rates. In particular, changes in relative interest rates may reduce our net interest income as the difference between interest income and interest expense decreases. As a result, we have adopted asset and liability management policies to minimize the potential adverse effects of changes in interest rates on net interest income, primarily by altering the mix and maturity of loans, investments and funding sources. However, there can be no assurance that a change in interest rates will not negatively impact our results of operations or financial condition. Because market interest rates may change by differing magnitudes and at different times, significant changes in interest rates over an extended period of time could reduce overall net interest income. An increase in interest rates could also have a negative impact on our results of

operations by reducing the ability of borrowers to repay their current loan obligations, which could not only result in increased loan defaults, foreclosures and write-offs, but also necessitate further increases to our allowance for loan losses. Higher interest rates could also cause depositors to shift funds from accounts that have a comparatively lower cost, to accounts with a higher cost. If the cost of interest-bearing deposits increases at a rate greater than the yields on interest-earning assets, net interest income will be negatively affected.

We are subject to liquidity risk.

Liquidity risk is the risk of potential loss if we are unable to meet our funding requirements at a reasonable cost. Our liquidity could be impaired by an inability to access the capital markets or by unforeseen outflows of cash. This situation may arise due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or us.

We operate in a highly regulated environment and may be adversely affected by changes in laws, regulations and monetary policy.

We are subject to regulation and supervision by the FRB and Union Bank is subject to regulation and supervision by the FDIC and the DFR. Federal and state laws and regulations govern numerous matters affecting us, including changes in the ownership



or control of banks and bank holding companies, maintenance of adequate capital and sound financial condition, permissible types, amounts and terms of loans and investments, permissible nonbanking activities, the level of reserves against deposits and restrictions on dividend payments. The FDIC and the DFR possess the power to issue cease and desist orders against banks subject to their jurisdiction to prevent or remedy unsafe or unsound banking practices or violations of law, and the FRB possesses similar powers with respect to bank holding companies. These and other restrictions limit the manner in which we may conduct business and obtain financing.

We are also affected by the monetary policies of the FRB. Changes in monetary or legislative policies may affect the interest rates we must offer to attract deposits and the interest rates we must charge on our loans, as well as the manner in which we offer deposits and make loans. These monetary policies have had, and are expected to continue to have, significant effects on the operating results of depository institutions generally, including Union Bank.

The laws, rules, regulations, and supervisory guidance and policies applicable to us are subject to regular modification and change. It is impossible to predict the competitive impact that any such changes would have on the banking and financial services industry in general or on our business in particular. Such changes may, among other things, increase the cost of doing business, limit permissible activities, or affect the competitive balance between banks and other financial institutions. The Dodd-Frank Act instituted major changes to the banking and financial institutions regulatory regimes in light of government intervention in the financial services sector. Other changes to statutes, regulations, or regulatory policies, including changes in interpretation or implementation of statutes, regulations, or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer, and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, or policies could result in sanctions by regulatory agencies, civil money penalties, and/or reputational damage, which could have a material adverse effect on our business, financial condition, or results of operations.

Additional requirements imposed by the Dodd-Frank Act could adversely affect us.

The Dodd-Frank Act comprehensively reformed the regulation of financial institutions, products and services. Among other things, the Dodd-Frank Act established the CFPB as an independent bureau of the FRB. The CFPB has the authority to prescribe rules for all depository institutions governing the provision of consumer financial products and services, which may result in rules and regulations that reduce the profitability of such products and services or impose greater costs and restrictions on us and our subsidiaries. The Dodd-Frank Act also established new minimum mortgage underwriting standards for residential mortgages, and the regulatory agencies have focused on the examination and supervision of mortgage lending and servicing activities.

The CFPB's qualified mortgage rule, or "QM Rule," became effective on January 10, 2014. The QM Rule requires mortgage lenders, prior to originating most residential mortgage loans, to make a determination of a borrower's ability to repay the loan and establishes protections from liability under this requirement for so-called "qualified mortgages" that meet certain heightened criteria. If a mortgage lender does not appropriately establish a borrower's ability to repay the loan, the borrower may be able to assert against the originator of the loan or any subsequent transferee, as a defense to foreclosure by way of recoupment or setoff, a violation of the ability-to-repay requirement. Loans that meet the definition of "qualified mortgage" will be presumed to have complied with the ability-to-repay standard. The QM Rule and related ability-to-repay requirements and similar rules could limit Union's ability to make certain types of loans or loans to certain borrowers, or could make it more expensive and time-consuming to make these loans, which could limit the Bank's growth or profitability.

Current and future legal and regulatory requirements, restrictions, and regulations, including those imposed under the Dodd-Frank Act, may adversely impact our profitability and may have a material and adverse effect on our business, financial condition, or results of operations; may require us to invest significant management attention and resources to evaluate and make any changes required by the legislation and related regulations; and may make it more difficult

for us to attract and retain qualified executive officers and employees.

We may become subject to more stringent capital requirements.

The federal banking agencies issued a joint final rule, or the “Final Capital Rule,” that implemented the Basel III capital standards and established the minimum capital levels required under the Dodd-Frank Act which became effective as of January 1, 2015. The Final Capital Rule established a minimum common equity Tier I capital ratio of 6.5% of risk-weighted assets for a “well capitalized” institution and increased the minimum Tier I capital ratio for a “well capitalized” institution from 6.0% to 8.0%. Additionally, subject to a transition period, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier I capital conservation buffer over the 6.5% minimum risk-based capital requirement for “adequately capitalized” institutions, or face restrictions on the ability to pay dividends or discretionary bonuses, and engage in share repurchases. The Final Capital Rule increased the required capital for certain categories of assets, including high-volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retained the current capital treatment of residential mortgages. Under the Final Capital Rule, we made a one-time, permanent election to continue to exclude accumulated other

comprehensive income from capital. If we had not made this election, unrealized gains and losses would be included in the calculation of our regulatory capital. Further increases in capital requirements may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

We may incur fines, penalties and other negative consequences from regulatory violations, possibly even inadvertent or unintentional violations.

We maintain systems and procedures designed to ensure that we comply with applicable laws and regulations. However, some legal/regulatory frameworks provide for the imposition of fines or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though there was in place at the time systems and procedures designed to ensure compliance. For example, we are subject to regulations issued by the Office of Foreign Assets Control, or “OFAC,” that prohibit financial institutions from participating in the transfer of property belonging to the governments of certain foreign countries and designated nationals of those countries and certain other persons or entities whose interest in property is blocked by OFAC-administered sanctions. OFAC may impose penalties for inadvertent or unintentional violations even if reasonable processes are in place to prevent the violations. There may be other negative consequences resulting from a finding of noncompliance, including restrictions on certain activities. Such a finding may also damage our reputation and could restrict the ability of institutional investment managers to invest in our securities.

We face significant legal risks, both from regulatory investigations and proceedings and from private actions brought against us.

From time to time we are named as a defendant or are otherwise involved in various legal proceedings. There is no assurance that litigation with private parties will not increase in the future. Future actions against us may result in judgments, settlements, fines, penalties or other results adverse to us, which could materially adversely affect our business, financial condition or results of operations, or cause serious reputational harm to us. As a participant in the financial services industry, we are exposed to a high level of litigation related to our businesses and operations. Although we maintain insurance, the scope of this coverage may not provide us with full, or even partial, coverage in any particular case. As a result, a judgment against us in any such litigation could have a material adverse effect on our financial condition and results of operation.

Our businesses and operations are also subject to increasing regulatory oversight and scrutiny, which could lead to regulatory investigations or enforcement actions. These and other initiatives from federal and state officials could result in judgments, settlements, fines or penalties, or cause us to be required to restructure our operations and activities, all of which could lead to reputational issues, or higher operational costs, thereby reducing our revenue.

Our financial condition and results of operations have been adversely affected, and may continue to be adversely affected, by general market and economic conditions.

We have been, and continue to be, impacted by general business and economic conditions in the United States and, to a lesser extent, abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, unemployment and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. Deterioration or continued weakness in any of these conditions could result in increases in loan delinquencies and nonperforming assets, decreases in loan collateral values, the value of our investment portfolio and demand for our products and services.

Competition in the local banking industry may impair our ability to attract and retain customers at current levels. Competition in the markets in which we operate may limit our ability to attract and retain customers. In particular, we compete for loans, deposits and other financial products and services with local independent banks, thrift institutions, savings institutions, mortgage brokerage firms, credit unions, finance companies, trust companies, mutual funds,

insurance companies and brokerage and investment banking firms operating locally as well as nationally. Additionally, banks and other financial institutions with larger capitalization, as well as financial intermediaries not subject to bank regulatory restrictions, have larger lending limits and are able to serve the credit and investment needs of larger customers. There is also increased competition by out-of-market competitors through the Internet. If we are unable to attract and retain customers, we may be unable to continue our loan growth and our results of operations and financial condition may otherwise be negatively impacted.

Prepayments of loans may negatively impact our business.

Generally, our customers may prepay the principal amount of their outstanding loans at any time. The speed at which such prepayments occur, as well as the size of such prepayments, are within our customers' discretion. If customers prepay the principal amount of their loans, and we are unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates, our interest income will be reduced. A significant reduction in interest income could have a negative impact on our results of operations and financial condition.

We may incur significant losses as a result of ineffective risk management processes and strategies.

We seek to monitor and control our risk exposure through a risk and control framework encompassing a variety of separate but complementary financial, credit, operational, compliance and legal reporting systems, internal controls, management review processes and other mechanisms. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgments that accompany their application may not be effective and may not anticipate every economic and financial outcome in all market environments or the specifics and timing of such outcomes. Market conditions over the last several years have involved unprecedented dislocations and highlight the limitations inherent in using historical data to manage risk.

Environmental liability associated with our lending activities could result in losses.

In the course of business, we may acquire, through foreclosure, properties securing loans we have originated or purchased that are in default. Particularly in commercial real estate lending, there is a risk that material environmental violations could be discovered at these properties. In this event, we might be required to remedy these violations at the affected properties at our sole cost and expense. The cost of remedial action could substantially exceed the value of affected properties. We may not have adequate remedies against the prior owners or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have an adverse effect on our financial condition and results of operations.

We face security risks, including denial of service attacks, hacking and identity theft that could result in the disclosure of confidential information, adversely affect our business or reputation and create significant legal and financial exposure.

We are subject to certain operational risks, including, but not limited to, data processing system failures and errors, inadequate or failed internal processes, customer or employee fraud, unauthorized intrusions and catastrophic failures resulting from terrorist acts or natural disasters. We depend upon data processing, software, communication, and information exchange on a variety of computing platforms and networks and over the internet, and we rely on the services of a variety of vendors to meet our data processing and communication needs. Despite instituted safeguards, we cannot be certain that all of our systems are entirely free from vulnerability to attack or other technological difficulties or failures. Information security risks have increased significantly due to the use of online, telephone and mobile banking channels by customers and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties. Our technologies, systems, networks and our customers' devices may be the target of, cyber-attacks, computer viruses, malicious code, phishing attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our or our customers' confidential, proprietary and other information, the theft of customer assets through fraudulent transactions or disruption of our or our customers' or other third parties' business operations. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and we could be exposed to legal claims from customers.

We may be unable to attract and retain key personnel.

Our success depends, in large part, on our ability to attract and retain key personnel. Competition for qualified personnel in the financial services industry can be intense and we may not be able to hire or retain the key personnel that we depend upon for success. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of the loss of their skills, knowledge of the markets in which we operate and years of industry experience, and because of the difficulty of promptly finding qualified replacement personnel.

We are subject to reputational risk.

We are dependent on our reputation within our market area, as a trusted and responsible financial company, for all aspects of our relationships with customers, employees, vendors, third-party service providers, and others, with whom

we conduct business or potential future business. Our actual or perceived failure to (a) identify and address potential conflicts of interest, ethical issues, money-laundering, or privacy issues; (b) meet legal and regulatory requirements applicable to the Bank and to the Company; (c) maintain the privacy of customer and accompanying personal information; or (d) maintain adequate record keeping; and (e) identify the legal, reputational, credit, liquidity and market risks inherent in our products, could give rise to reputational risk that could harm our business prospects and adversely affect our financial condition and results of operations. If we fail to address any of these issues in an appropriate manner, we could be subject to additional legal risks, which, in turn, could increase the size and number of litigation claims and damages asserted or subject us to enforcement actions, fines and penalties and cause us to incur related costs and expenses. Our ability to attract and retain customers and employees could be adversely affected to the extent our reputation is damaged.

We may suffer losses as a result of operational risk or technical system failures.

The potential for operational risk exposure exists throughout our organization. Integral to our performance is the continued efficacy of our internal processes, systems, relationships with third parties and the associates and executives in our day-to-day and ongoing operations. Operational risk also encompasses the failure to implement strategic objectives in a successful, timely and cost-effective

manner. Failure to properly manage operational risk subjects us to risks of loss that may vary in size, scale and scope, including loss of customers, operational or technical failures, unlawful tampering with our technical systems, ineffectiveness or exposure due to interruption in third party support, as well as the loss of key individuals or failure on the part of key individuals to perform properly. Although we seek to mitigate operational risk through a system of internal controls, losses from operational risk could take the form of explicit charges, increased operational costs, harm to our reputation or foregone opportunities.

We rely on other companies to provide key components of our business infrastructure.

Third party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of their not providing us their services for any reason or their performing their services poorly, could adversely affect our ability to deliver products and services to our customers or otherwise conduct our business efficiently and effectively. Replacing these third party vendors could also entail significant delay and expense.

We are a holding company and depend on Union Bank for dividends, distributions and other payments.

We are legal entity that is separate and distinct from Union Bank. Our revenue (on a parent company only basis) is derived primarily from interest and dividends paid to us by Union Bank. Our right, and consequently the right of our shareholders, to participate in any distribution of the assets or earnings of any subsidiary through the payment of such dividends or otherwise is necessarily subject to the prior claims of creditors of the subsidiary (including depositors, in the case of Union Bank), except to the extent that certain claims of Union in a creditor capacity may be recognized.

Our shareholders may not receive dividends on our common stock.

Holders of our common stock are entitled to receive dividends only when, as and if declared by our board of directors. Although we have historically declared cash dividends on our common stock, we are not required to do so and our board of directors may reduce or eliminate our common stock dividend in the future. The FRB has the authority to prohibit a bank holding company, such as us, from paying dividends if it deems such payment to be an unsafe or unsound practice. The FDIC has the authority to use its enforcement powers to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. Further, our ability to pay dividends would be restricted if we do not maintain a capital conservation buffer. A reduction or elimination of dividends could adversely affect the market price of our common stock.

Changes in accounting standards can be difficult to predict and can materially impact how we record and report our financial condition and results of operations.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the FASB changes the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to anticipate and implement and can materially impact how we record and report our financial condition and results of operations. For example, the FASB's current financial instruments project could, among other things, significantly change the way loan loss provisions are determined from an incurred loss model to an expected loss model.

Our financial statements are based in part on assumptions and estimates, which, if wrong, could cause unexpected losses in the future.

Pursuant to GAAP, we are required to use certain assumptions and estimates in preparing our financial statements, including in determining credit loss reserves, reserves related to litigation and the fair value of certain assets and liabilities, among other items. If assumptions or estimates underlying our financial statements are incorrect, we may experience material losses.

We may need to raise additional capital in the future and such capital may not be available when needed.

As a bank holding company, we are required by regulatory authorities to maintain adequate levels of capital to support our operations. We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and our financial performance. We cannot assure you that such capital will be available to us on acceptable terms or at all. Our inability to raise sufficient additional capital on acceptable terms when needed could subject us to certain activity restrictions or to a variety of enforcement remedies available to the regulatory authorities, including limitations on our ability to pay dividends or pursue acquisitions, the issuance by regulatory authorities of a capital directive to increase capital and the termination of deposit insurance by the FDIC.

Certain provisions of our articles of incorporation may have an anti-takeover effect.

Provisions of our certificate of incorporation and bylaws and regulations and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to



our shareholders. The combination of these provisions may inhibit a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock.

Continued market volatility may impact our business and the value of our common stock.

Our business performance and the trading price of shares of our common stock may be affected by many factors affecting financial institutions, including volatility in the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and the value of debt and mortgage-backed and other securities that we hold in our investment portfolio. Government action and legislation may also impact us and the value of our common stock. We cannot predict what impact, if any, volatility will have on our business or share price and for these and other reasons our shares of common stock may trade at a price lower than that at which they were purchased.

We may be required to write down goodwill and other identifiable intangible assets.

When we acquire a business, a portion of the purchase price of the acquisition may be allocated to goodwill and other identifiable intangible assets. The excess of the purchase price over the fair value of the net identifiable tangible and intangible assets acquired determines the amount of the purchase price that is allocated to goodwill acquired. At December 31, 2016, our goodwill and other identifiable intangible assets were approximately \$3.0 million. Under current accounting standards, if we determine goodwill or intangible assets are impaired, we would be required to write down the value of these assets to fair value. We conduct an annual review, or more frequently if events or circumstances warrant such, to determine whether goodwill is impaired. We recently completed our goodwill impairment analysis as of December 31, 2016 and concluded goodwill was not impaired. We conduct a review of our other intangible assets for impairment should events or circumstances warrant such. We cannot provide assurance that we will not be required to take an impairment charge in the future. Any impairment charge would have a negative effect on our shareholders' equity and financial results and may cause a decline in our stock price.

#### Item 1B. Unresolved Staff Comments

None

#### Item 2. Properties

As of December 31, 2016, Union operated 12 community banking locations in Lamoille, Caledonia and Franklin counties of Vermont, five in Grafton and Coos counties of New Hampshire and loan centers in Barre, Newport, and South Burlington, Vermont. In addition as of such date, Union also operated several ATMs in northern Vermont and New Hampshire. Union owns, free of encumbrances, fifteen of its branch locations and its headquarters and leases two branch locations, all loan center locations and certain ATM premises from third parties under terms and conditions considered by management to be favorable to Union. Also, Union currently owns a building in Jeffersonville, Vermont which is for sale and was previously utilized as a branch location. Union also owns or leases certain properties contiguous to its branch locations for staff and customer parking convenience.

Additional information relating to the Company's properties as of December 31, 2016, is set forth in Note 8 to the consolidated financial statements contained in Item 8 of this report.

#### Item 3. Legal Proceedings

There are no known pending legal proceedings to which the Company or its subsidiary is a party, or to which any of their properties is subject, other than ordinary litigation arising in the normal course of business activities. Although the amount of any ultimate liability with respect to such proceedings cannot be determined, in the opinion of management, any such liability will not have a material effect on the consolidated financial position or results of operations of the Company and its subsidiary.

Item 4. Mine Safety Disclosures

Not applicable.

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## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Common Stock and Dividends

The common stock of the Company is traded on the NASDAQ Global Select Market under the trading symbol "UNB". Quarterly stock prices and cash dividends per share paid for each quarterly period during the last two years were as follows:

	2016			2015		
	High	Low	Dividends	High	Low	Dividends
First Quarter	\$29.10	\$27.06	\$0.27	\$26.68	\$23.75	\$0.27
Second Quarter	\$37.18	\$28.26	\$0.28	\$28.06	\$25.16	\$0.27
Third Quarter	\$36.92	\$33.69	\$0.28	\$27.07	\$25.50	\$0.27
Fourth Quarter	\$48.80	\$32.75	\$0.28	\$28.05	\$26.06	\$0.27

High and low stock prices are based upon closing price quotations as reported by NASDAQ. Prices of transactions between private parties may vary from the ranges quoted above.

On March 7, 2017, there were 4,462,019 shares of common stock outstanding held by 539 stockholders of record. The number of stockholders does not reflect the number of beneficial owners, including persons or entities who may hold the stock in nominee or "street name." On January 18, 2017, Union Bankshares, Inc. declared a \$0.29 per share regular quarterly cash dividend payable February 8, 2017 to stockholders of record on January 28, 2017. Although the Company currently pays quarterly cash dividends, future dividends will depend upon the financial condition and earnings of the Company and its subsidiary, its need for funds and other factors, including government regulations.

The Company normally pays regular quarterly cash dividends in February, May, August and November of each year. The Company has occasionally declared a special cash or stock dividend. The Company's Board will continue to manage dividends to be in line with long-term trends in earnings per share results and conservative earnings projections, while retaining sufficient profits to support capital strength, anticipated business growth, fund strategic investments and provide continued support for the Company's deposit taking and lending activities. Dividends paid by Union are the primary source of funds available to the Company for payment of dividends to its shareholders. Union is subject to certain requirements imposed by state and federal banking laws and regulations. These requirements, among other things, establish minimum levels of capital and restrict the amount of dividends that may be distributed by Union to the Company. Future dividends are subject to the discretion of the Company's Board, cash needs, general business conditions, dividends from Union, and applicable governmental regulations and policies.

#### Repurchase of Common Stock

During the quarter ended December 31, 2016, there was no repurchase of the Company's equity securities.

#### Securities Authorized for Issuance Under Equity Compensation Plans

Information regarding equity securities authorized for issuance under the Company's equity compensation plans is included in Part III, Item 12 of this report under the caption "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters", and is incorporated herein by reference.

**Five Year Performance Graph:** The following graph illustrates the annual percentage change in the cumulative total shareholder return of the Company's common stock for the period December 31, 2011 through December 31, 2016. For purposes of comparison, the graph illustrates comparable shareholder returns of the SNL Bank \$500M-\$1B Index and the NASDAQ Composite Index. The graph assumes a \$100 investment on December 31, 2011 in each case and measures the amount by which the market value, assuming reinvestment of dividends, has changed during the five

year period ended December 31, 2016.

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Index	Period Ending					
	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Union Bankshares, Inc.	100.00	107.98	133.23	143.51	175.61	296.47
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
SNL Bank \$500M-\$1B	100.00	128.21	166.25	182.39	205.86	277.96

The performance graph and related information furnished under Part II, Item 5 of this Annual Report on Form 10-K shall not be deemed to be “soliciting material” or “filed” with the SEC, nor subject to Exchange Act Regulations 14A or 14C, other than as provided in Item 201 of Regulation S-K, or to the liabilities of Section 18 of the Exchange Act. Such information shall not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act except to the extent that the Company specifically incorporates it by reference into such filing.

# 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)	13.05	% 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	%

(1) The ratio of tax equivalent net interest income to average earning assets. See page 25 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 25 for more information.



- 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 41.)

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)								
<b>Average Assets:</b>									
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		
<b>Average Liabilities and Stockholders' Equity:</b>									
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.



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			Year Ended December 31, 2015		
	Compared to Year Ended December 31, 2015			Compared to Year Ended December 31, 2014		
	Increase/(Decrease) Due to Change In			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 25.)

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 37.)

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 41.)

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

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).

(1) 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

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 to One Year	Five 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 to One Year	Five 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	%

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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		Weighted Average Yield	
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Amortized Cost		
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