UNION BANKSHARES INC
Form 10-Q
May 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: March 31, 2012

Commission file number: 001-15985

UNION BANKSHARES, INC.
VERMONT 03-0283552

P.O. BOX 667
20 LOWER MAIN STREET
MORRISVILLE, VT 05661

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	Nasdaq Stock Market
(Title of class)	(Exchanges registered on)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of May 1, 2012:

Common Stock, $2 par value	4,456,504 shares

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS (Unaudited)

	March 31, 2012	December 31, 2011
Assets	(Dollars in thousands)	
Cash and due from banks	$5,050	$5,871
Federal funds sold and overnight deposits	14,443	18,510
Cash and cash equivalents	19,493	24,381
Interest bearing deposits in banks	23,482	24,020
Investment securities available-for-sale	43,198	42,954
Investment securities held-to-maturity (fair value $3.0 million and $4.0 million at March 31, 2012 and December 31, 2011, respectively)	3,000	4,000
Loans held for sale	12,084	4,888
Loans	425,489	424,319
Allowance for loan losses	(4,406)	(4,226)
Net deferred loan costs	151	177
Net loans	421,234	420,270
Accrued interest receivable	1,886	1,810
Premises and equipment, net	10,368	9,163
Core deposit intangible	1,566	1,608
Goodwill	2,223	2,223
Investment in real estate limited partnerships	4,316	4,473
Company-owned life insurance	3,706	3,676
Other assets	8,846	9,285
Total assets	$555,402	$552,751
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$75,511	$76,656
Interest bearing	249,312	239,058
Time	153,187	157,725
Total deposits	478,010	473,439
Borrowed funds	27,281	29,015
Liability for defined benefit pension plan	5,891	5,679
Accrued interest and other liabilities	3,726	4,279
Total liabilities	514,908	512,412
Commitments and Contingencies		
Stockholders' Equity		
Common stock, $2.00 par value; 7,500,000 shares authorized; 4,923,286 shares issued at March 31, 2012 and December 31, 2011	9,847	9,847
Additional paid-in capital	280	276
Retained earnings	38,498	38,385
Treasury stock at cost; 466,782 shares at March 31, 2012 and 466,082 shares at December 31, 2011	(3,836)	(3,823)
Accumulated other comprehensive loss	(4,295)	(4,346)

Total stockholders' equity	40,494	40,339
Total liabilities and stockholders' equity	$555,402	$552,751

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended March 31,	
	2012	2011
	(Dollars in thousands except per share data)	
Interest and dividend income		
Interest and fees on loans	$5,810	$5,196
Interest on debt securities:		
Taxable	199	143
Tax exempt	88	73
Dividends	18	4
Interest on federal funds sold and overnight deposits	4	6
Interest on interest bearing deposits in banks	77	76
Total interest and dividend income	6,196	5,498
Interest expense		
Interest on deposits	660	673
Interest on borrowed funds	250	288
Total interest expense	910	961
Net interest income	5,286	4,537
Provision for loan losses	180	150
Net interest income after provision for loan losses	5,106	4,387
Noninterest income		
Trust income	147	132
Service fees	1,175	1,006
Net gains on sales of investment securities available-for-sale	42	—
Net gains on sales of loans held for sale	473	168
Other income	66	95
Total noninterest income	1,903	1,401
Noninterest expenses		
Salaries and wages	2,234	1,730
Pension and employee benefits	1,058	817
Occupancy expense, net	344	290
Equipment expense	345	296
Other expenses	1,560	1,447
Total noninterest expenses	5,541	4,580
Income before provision for income taxes	1,468	1,208
Provision for income taxes	241	180
Net income	$1,227	$1,028
Earnings per common share	$0.28	$0.23
Weighted average number of common shares outstanding	4,457,081	4,455,737
Dividends per common share	$0.25	$0.25

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended March 31,	
	2012	2011
	(Dollars in thousands)	
Net income	$1,227	$1,028
Other comprehensive income, net of tax:		
Investment securities available-for-sale:		
Net unrealized holding (losses) gains arising during the period on investment securities available-for-sale	(38)	85
Reclassification adjustments for net gains on investment securities available-for-sale realized in net income	(28)	—
Total	(66)	85
Defined benefit pension plan:		
Net actuarial loss arising during period	26	—
Reclassification adjustment for amortization of net actuarial loss realized in net income	90	31
Reclassification adjustment for amortization of prior service cost realized in net income	1	—
Total	117	31
Total other comprehensive income	51	116
Total comprehensive income	$1,278	$1,144

See accompanying notes to unaudited interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2012 and 2011 (Unaudited)

	Common Stock						
	Shares, net of treasury	Amount	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive loss	Total stockholders’ equity
	(Dollars in thousands)						
Balances, December 31, 2011	4,457,204	$9,847	$276	$38,385	$(3,823)	$(4,346)	$40,339
Net income	—	—	—	1,227	—	—	1,227
Other comprehensive income	—	—	—	—	—	51	51
Cash dividends declared ($0.25 per share)	—	—	—	(1,114)	—	—	(1,114)
Stock based compensation expense	—	—	4	—	—	—	4
Purchase of treasury stock	(700)	—	—	—	(13)	—	(13)
Balances, March 31, 2012	4,456,504	$9,847	$280	$38,498	$(3,836)	$(4,295)	$40,494
Balances, December 31, 2010	4,455,704	$9,844	$244	$37,623	$(3,823)	$(2,163)	$41,725
Net income	—	—	—	1,028	—	—	1,028
Other comprehensive income	—	—	—	—	—	116	116
Issuance of common stock	1,500	3	23	—	—	—	26
Cash dividends declared ($0.25 per share)	—	—	—	(1,114)	—	—	(1,114)
Balances, March 31, 2011	4,457,204	$9,847	$267	$37,537	$(3,823)	$(2,047)	$41,781

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31,	
	2012	2011
	(Dollars in thousands)	
Cash Flows From Operating Activities		
Net income	$1,227	$1,028
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	200	177
Provision for loan losses	180	150
Deferred income tax (benefit) provision	(156)	98
Net amortization of investment securities	26	14
Equity in losses of limited partnerships	158	106
Stock based compensation expense	4	—
Net increase (decrease) in unamortized loan costs	26	(15)
Proceeds from sales of loans held for sale	22,865	16,912
Origination of loans held for sale	(29,588)	(13,747)
Net gains on sales of loans held for sale	(473)	(168)
Net losses on disposals of premises and equipment	1	—
Net gains on sales of investment securities available-for-sale	(42)	—
Write-downs of impaired assets	11	42
Net losses (gains) on sales of other real estate owned	6	(18)
Increase in accrued interest receivable	(76)	(90)
Amortization of core deposit intangible	43	—
Decrease in other assets	366	91
Increase in other liabilities	322	431
Net cash (used in) provided by operating activities	(4,900)	5,011
Cash Flows From Investing Activities		
Interest bearing deposits in banks		
Proceeds from maturities and redemptions	1,836	1,969
Purchases	(1,298)	(993)
Investment securities held-to-maturity		
Proceeds from maturities, calls and paydowns	1,000	—
Investment securities available-for-sale		
Proceeds from sales	789	—
Proceeds from maturities, calls and paydowns	2,718	685
Purchases	(3,834)	(2,277)
Redemption of nonmarketable stock	121	—
Net (increase) decrease in loans	(1,180)	7,169
Recoveries of loans charged off	10	19
Purchases of premises and equipment	(1,406)	(231)
Investments in limited partnerships	(486)	—
Proceeds from sales of other real estate owned	32	175
Net cash (used in) provided by investing activities	(1,698)	6,516

Cash Flows From Financing Activities		
Repayment of long-term debt	(483)	(247)
Net decrease in short-term borrowings outstanding	(1,251)	(1,847)
Net decrease in noninterest bearing deposits	(1,145)	(3,164)
Net increase in interest bearing deposits	10,254	14,750
Net decrease in time deposits	(4,538)	(4,227)
Issuance of common stock	—	26
Purchase of treasury stock	(13)	—
Dividends paid	(1,114)	(1,114)
Net cash provided by financing activities	1,710	4,177
Net (decrease) increase in cash and cash equivalents	(4,888)	15,704
Cash and cash equivalents		
Beginning of period	24,381	14,292
End of period	$19,493	$29,996
Supplemental Disclosures of Cash Flow Information		
Interest paid	$818	$864
Income taxes paid	$75	$50
Supplemental Schedule of Noncash Investing and Financing Activities		
Investment in limited partnerships acquired by capital contributions payable	$—	$953

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation
The accompanying unaudited interim consolidated financial statements of Union Bankshares, Inc. and Subsidiary (the Company) as of March 31, 2012, and for the three months ended March 31, 2012 and 2011, have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) for interim financial information, general practices within the banking industry, and the accounting policies described in the Company’s Annual Report to Shareholders and Annual Report on Form 10-K for the year ended December 31, 2011. In the opinion of the Company’s management, all adjustments, consisting only of normal recurring adjustments and disclosures necessary for a fair presentation of the information contained herein, have been made. This information should be read in conjunction with the Company’s 2011 Annual Report to Shareholders and 2011 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2012, or any other interim period.

Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation.

Note 2. Legal Contingencies
In the normal course of business, the Company is involved in various legal and other proceedings. In the opinion of management, any liability resulting from such proceedings is not expected to have a material adverse effect on the Company’s consolidated financial condition or results of operations.

Note 3. Per Share Information
Earnings per common share are computed based on the weighted average number of shares of common stock outstanding during the period and reduced for shares held in treasury. The assumed conversion of available outstanding stock options does not result in material dilution and is not included in the calculation.

Note 4. Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU), Reconsideration of Effective Controls for Repurchase Agreements, to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The ASU removes the transferor's ability criterion from the consideration of effective control for repurchase or other agreements. The guidance in this ASU is effective for the first interim or annual period beginning on or after December 15, 2011. Management has adopted the ASU, which did not have a material effect on the Company's consolidated financial statements.

In May 2011, the FASB issued an ASU, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments in this update explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this ASU are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. Management has adopted the ASU, which did not have a material effect on the Company's consolidated financial statements. (See Note 11.)

In June 2011, the FASB issued an ASU, Presentation of Comprehensive Income, to improve the comparability, consistency and transparency of financial reporting, to increase the prominence of items reported in other comprehensive income and to facilitate convergence of GAAP and IFRS. The ASU eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity and requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both formats, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and other comprehensive income are presented. The amendments in the ASU are to be applied retrospectively and are effective for annual and interim periods beginning after December 15, 2011 except for the presentation requirements of reclassifications of items out of accumulated other comprehensive income which have been delayed indefinitely by an ASU issued by FASB in December 2011. Management has adopted the ASU and has opted to present two separate statements. (See Consolidated Statements of Comprehensive Income and Note 10.)

In December 2011, the FASB issued an ASU, Disclosures about Offsetting Assets and Liabilities, to enhance disclosures required to facilitate comparison between those entities that prepare their financial statements on the basis of GAAP and those entities that prepare their financial statements on the basis of IFRS by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either Topic 210-20-45 (Balance Sheet Offsets) or Topic 815-10-45 (Derivatives & Hedging) or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Topic 210-20-45 or Topic 815-10-45. The amendments in the ASU are to be applied retrospectively for all comparative periods presented and are effective for annual and interim periods beginning on or after January 1, 2013. Management is currently reviewing the ASU but does not believe that it will have a material effect on the Company's consolidated financial statements.

Note 5. Goodwill and Other Intangible Assets

As a result of the acquisition of three New Hampshire branches in May 2011, the Company recorded goodwill amounting to $2.2 million. The goodwill is not amortizable and is not deductible for tax purposes. Goodwill is evaluated for impairment when conditions warrant, as recommended by current authoritative guidance.

The Company also recorded $1.7 million of acquired identifiable intangible assets in connection with the branch acquisition, representing the core deposit intangible which is subject to straight-line amortization over the estimated 10 year average life of the core deposit base, absent any future impairment. The amortization expense is included in other noninterest expense on the consolidated statement of income and is deductible for tax purposes.

Amortization expense for the core deposit intangible was $43 thousand for the three months ended March 31, 2012. As of March 31, 2012, the remaining amortization expense related to the core deposit intangible, absent any future impairment, is expected to be as follows:

	(Dollars in thousands)
2012	$128
2013	171
2014	171
2015	171
2016	171
Thereafter	754
Total	$1,566

Management will evaluate the core deposit intangible for impairment if conditions warrant.

Note 6. Investment Securities

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

March 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$18,491	$82	$(44)	$18,529
Agency mortgage-backed	2,818	54	(3)	2,869
State and political subdivisions	12,626	961	(19)	13,568
Corporate	7,113	176	(1)	7,288
Total debt securities	41,048	1,273	(67)	42,254
Marketable equity securities	746	57	(11)	792
Mutual funds	152	—	—	152
Total	$41,946	$1,330	$(78)	$43,198
Held-to-maturity				
U.S. Government-sponsored enterprises	$3,000	$3	$—	$3,003

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$17,456	$99	$(18)	$17,537
Agency mortgage-backed	3,326	61	(1)	3,386
State and political subdivisions	11,813	1,018	(1)	12,830
Corporate	8,127	179	(13)	8,293
Total debt securities	40,722	1,357	(33)	42,046
Marketable equity securities	746	39	(12)	773
Mutual funds	135	—	—	135
Total	$41,603	$1,396	$(45)	$42,954
Held-to-maturity				
U.S. Government-sponsored enterprises	$4,000	$1	$(3)	$3,998

Proceeds from the sale of securities available-for-sale were $789 thousand for the three months ended March 31, 2012. Gross realized gains from the sale of securities available-for-sale were $42 thousand for the three months ended March 31, 2012. Gross realized losses were $0 for the three months ended March 31, 2012. There were no sales of securities available-for-sale for the three months ended March 31, 2011. The specific identification method is used to determine realized gains and losses on sales of available-for-sale securities.

The amortized cost and estimated fair value of debt securities by contractual scheduled maturity as of March 31, 2012 were as follows:

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Available-for-sale		
Due in one year or less	$1,003	$1,016
Due from one to five years	10,972	11,190
Due from five to ten years	10,964	11,256
Due after ten years	15,291	15,923
	38,230	39,385
Agency mortgage-backed securities	2,818	2,869
Total debt securities available-for-sale	$41,048	$42,254
Held-to-maturity		
Due from one to five years	$1,000	$1,001
Due from five to ten years	2,000	2,002
Total debt securities held-to-maturity	$3,000	$3,003

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

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

March 31, 2012	Less Than 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
	(Dollars in thousands)					
Debt securities:						
U.S. Government-sponsored enterprises	$5,454	$(44)	$—	$—	$5,454	$(44)
Agency mortgage-backed	—	—	337	(3)	337	(3)
State and political subdivisions	1,113	(19)	—	—	1,113	(19)
Corporate	504	(1)	—	—	504	(1)
Total debt securities	7,071	(64)	337	(3)	7,408	(67)
Marketable equity securities	155	(7)	10	(4)	165	(11)
Total	$7,226	$(71)	$347	$(7)	$7,573	$(78)

December 31, 2011	Less Than 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
	(Dollars in thousands)					
Debt securities:						
U.S. Government-sponsored enterprises	$7,389	$(21)	$—	$—	$7,389	$(21)
Agency mortgage-backed	—	—	361	(1)	361	(1)
State and political subdivisions	347	(1)	—	—	347	(1)
Corporate	3,075	(13)	—	—	3,075	(13)
Total debt securities	10,811	(35)	361	(1)	11,172	(36)
Marketable equity securities	193	(7)	10	(5)	203	(12)
Total	$11,004	$(42)	$371	$(6)	$11,375	$(48)

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

An unrealized loss on a debt security is generally deemed to be other-than temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an other-than-temporary impairment write-down is recorded, net of tax effect, through net income as a component of net other-than-temporary impairment losses in the consolidated statement of income, while the remaining portion of the impairment loss is recognized in other comprehensive income (loss), provided the Company does not intend to sell the underlying debt security and it is "more likely than not" that the Company will not have to sell the debt security prior to recovery.

Management considers the following factors in determining whether an other-than-temporary impairment exists and the period over which the debt security is expected to recover:

- The length of time, and extent to which, the fair value has been less than the amortized cost;
- Adverse conditions specifically related to the security, industry, or geographic area;
- The historical and implied volatility of the fair value of the security;
- The payment structure of the debt security and the likelihood of the issuer being able to make payments that may increase in the future;
- Failure of the issuer of the security to make scheduled interest or principal payments;
- Any changes to the rating of the security by a rating agency;
- Recoveries or additional declines in fair value subsequent to the balance sheet date; and
- The nature of the issuer, including whether it is a private company, public entity or government-sponsored enterprise, and the existence or likelihood of any government or third party guaranty.

At March 31, 2012, held-to-maturity and available-for-sale securities, consisting of eight U.S. Government-sponsored enterprises, one agency mortgage-backed obligation, two tax-exempt municipal securities, one taxable municipal bond, one corporate bond and four marketable equity securities, had aggregate unrealized losses of $78 thousand. One marketable equity security and the agency mortgage-backed obligation had continuous unrealized losses for longer than twelve months. The Company has the ability to hold such securities for the foreseeable future. No declines were deemed by management to be other-than-temporary at March 31, 2012.

Investment securities with a carrying amount of $7.5 million and $11.2 million at March 31, 2012 and December 31, 2011, respectively, were pledged as collateral for public deposits and for other purposes as required or permitted by law.

Note 7. Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their unpaid principal balances, adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

Loan interest income is accrued daily on outstanding balances. The following accounting policies, related to accrual and nonaccrual loans, apply to all loan segments and classes. The Company considers its loan segments and loan classes to be the same. The accrual of interest is discontinued when a loan is specifically determined to be impaired and/or management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Normally, any unpaid interest previously accrued on those loans is reversed against current period interest income. A loan may be restored to accrual status when its financial status has significantly improved and there is no principal or interest past due. A loan may also be restored to accrual status if the borrower makes six consecutive monthly payments or the lump sum equivalent. Income on nonaccrual loans is generally not recognized unless a loan is placed back in accrual status or after all principal has been collected. Interest income generally is not recognized on impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Delinquency status is determined based on contractual terms for all loan segments and classes.

Loan origination fees and direct loan origination costs are deferred and amortized as an adjustment of the related loan's yield using methods that approximate the interest method. The Company generally amortizes these amounts over the estimated average life of the related loans.

The loans purchased in the May 2011 acquisition of branches were recorded at the estimated fair market value at the time of purchase and totaled $32.9 million. The estimated fair value contains both accretable and nonaccretable components. The accretable component is amortized as an adjustment to the related loan yield over the average life of the loan. The nonaccretable component represents probable loss due to credit risk and is reviewed by management periodically and adjusted as deemed necessary. The fair value of the loans acquired resulted in an accretable loan premium component of $545 thousand, less a nonaccretable credit risk component of $318 thousand at the acquisition date. Loan premium amortization of $23 thousand has been charged to Interest and fees on loans on the Company's statement of income for the three months ended March 31, 2012. The remaining accretable loan premium component balance was $468 thousand at March 31, 2012 and $491 thousand at December 31, 2011. There has been no change in the nonaccretable credit risk component balance of $318 thousand since acquisition. The net carrying amount of the acquired loans included in the March 31, 2012 loan balances below totals $27.1 million.

The composition of Net loans as of the balance sheet dates was as follows:

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Residential real estate	$146,555	$147,426
Construction real estate	27,972	28,077
Commercial real estate	186,658	189,770
Commercial	22,036	23,018
Consumer	6,252	6,134
Tax exempt	36,016	29,894
Gross loans	425,489	424,319
Allowance for loan losses	(4,406)	(4,226)
Net deferred loan costs	151	177
Net loans	$421,234	$420,270

Residential real estate loans aggregating $14.6 million and $9.9 million at March 31, 2012 and December 31, 2011, respectively, were pledged as collateral on deposits of municipalities. Qualified residential first mortgages held by Union and up to $25 million in qualified small business loans may also be pledged as collateral for borrowings from the Federal Home Loan Bank (FHLB) of Boston under a blanket lien.

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

March 31, 2012	Current	30-89 Days	Over 90 Days and accruing	Nonaccrual	Total
	(Dollars in thousands)				
Residential real estate	$139,603	$3,609	$411	$2,932	$146,555
Construction real estate	27,492	176	153	151	27,972
Commercial real estate	180,990	2,835	912	1,921	186,658
Commercial	21,757	143	12	124	22,036
Consumer	6,142	61	—	49	6,252
Tax exempt	36,016	—	—	—	36,016
Total	$412,000	$6,824	$1,488	$5,177	$425,489

December 31, 2011	Current	30-89 Days	Over 90 Days and accruing	Nonaccrual	Total
	(Dollars in thousands)				
Residential real estate	$140,330	$3,819	$606	$2,671	$147,426
Construction real estate	26,849	961	175	92	28,077
Commercial real estate	182,122	5,165	1,104	1,379	189,770
Commercial	22,519	376	12	111	23,018
Consumer	6,045	34	—	55	6,134
Tax exempt	29,894	—	—	—	29,894
Total	$407,759	$10,355	$1,897	$4,308	$424,319

Aggregate interest on nonaccrual loans not recognized was $977 thousand and $755 thousand as of March 31, 2012 and 2011, respectively, and $903 thousand as of December 31, 2011.

Note 8. Allowance for Loan Losses and Credit Quality

The allowance for loan losses is established for estimated losses in the loan portfolio through a provision for loan losses charged to earnings. For all loan classes, loan losses are charged against the allowance when management believes the loan balance is uncollectible or in accordance with federal guidelines. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level believed by management to be appropriate to absorb probable credit losses inherent in the loan portfolio as of the balance sheet date. The amount of the allowance is based on management's periodic evaluation of the collectability of the loan portfolio, including the nature, volume and risk characteristics of the portfolio, credit concentrations, trends in historical loss experience, estimated value of any underlying collateral, specific impaired loans and economic conditions. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions or other relevant factors.

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

The allowance consists of specific, general and unallocated components. The specific component relates to the loans that are classified as either substandard or doubtful. For such loans, the level of allowance allocable to those loans is determined through estimating probable loss for each individual credit based on its specific risk attributes. Loans are also evaluated for impairment and may be classified as impaired when management believes it is probable that the Company will not collect all the contractual interest and principal payments as scheduled in the loan agreement. Impaired loans may also include troubled loans that are restructured. A troubled debt restructuring occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. Troubled debt restructuring may include the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms (such as reduction of stated interest rates below market rates, extension of maturity that does not conform to the Company's policies or procedures, reduction of face amount of loan, reduction of accrued interest, and reduction or deferment of cash payments in the near future), or a combination of both. A specific reserve amount is allocated to the allowance 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 Company accounts for the change in present value attributable to the passage of time in the loan loss reserve. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer, real estate or small balance commercial loans for impairment evaluation, unless such loans are subject to a restructuring agreement or have been identified as impaired as part of a larger customer relationship.

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

- Residential real estate - Loans in this segment are collateralized by owner-occupied 1-4 family residential real estate, second and vacation homes, 1-4 family investment properties, home equity and second mortgage loans. Repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, could have an effect on the credit quality of this segment.

- Construction real estate - Loans in this segment include residential and commercial construction properties, land and land development loans. Repayment is dependent on the credit quality of the individual borrower and/or the underlying cash flows generated by the properties being constructed. The overall health of the economy, including unemployment rates, housing prices, vacancy rates and material costs, could have an effect on the credit quality of this segment.

- Commercial real estate - Loans in this segment are primarily properties occupied by businesses or income-producing properties. The underlying cash flows generated by the properties may be adversely impacted by a downturn in the economy as evidenced by a general slowdown in business or increased vacancy rates which, in turn, could have an effect on the credit quality of this segment. Management requests business financial statements at least annually and monitors the cash flows of these loans.

- Commercial - Loans in this segment are made to businesses and are generally secured by nonreal estate assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer or business spending, could have an effect on credit quality of this segment.

- Consumer - Loans in this segment are made to individuals for personal expenditures, such as an automobile purchase, and include unsecured loans. Repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment, could have an effect on the credit quality of this segment.

- Municipal - Loans in this segment are made to municipalities located within the Company's service area. Repayment is primarily dependent on taxes or other funds collected annually by the municipalities. Management considers there to be minimal risk surrounding the credit quality of this segment.

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

All evaluations are inherently subjective as they require estimates that are susceptible to significant revision as more information becomes available or as changes occur in economic conditions or other relevant factors. Despite the allocation shown in the tables below, the Allowance for loan losses is general in nature and is available to absorb losses from any loan type.

Changes in the Allowance for loan losses, by class of loans, for the three months ended March 31, 2012 and 2011 were as follows:

For The Three Months Ended March 31, 2012	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer, Municipal and Unallocated	Total
	(Dollars in thousands)					
Balance, December 31, 2011	$1,250	$367	$2,278	$232	$99	$4,226
Provision for loan losses	10	11	127	13	19	180
Recoveries of amounts charged off	—	3	—	3	4	10
	1,260	381	2,405	248	122	4,416
Amounts charged off	—	—	—	—	(10)	(10)
Balance, March 31, 2012	$1,260	$381	$2,405	$248	$112	$4,406

For The Three Months Ended March 31, 2011	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer, Municipal and Unallocated	Total
	(Dollars in thousands)					
Balance, December 31, 2010	$1,033	$240	$2,117	$250	$115	$3,755
Provision (credit) for loan losses	134	—	19	11	(14)	150
Recoveries of amounts charged off	1	—	—	3	15	19
	1,168	240	2,136	264	116	3,924
Amounts charged off	(8)	—	—	—	(8)	(16)
Balance, March 31, 2011	$1,160	$240	$2,136	$264	$108	$3,908

The allocation of the Allowance for loan losses, summarized on the basis of the Company's impairment methodology by class of loan, as of the balance sheet dates was as follows:

March 31, 2012	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer, Municipal and Unallocated	Total
	(Dollars in thousands)					
Individually evaluated for impairment	$346	$26	$362	$86	$8	$828
Collectively evaluated for impairment	914	355	2,043	162	104	3,578
Total allocated	$1,260	$381	$2,405	$248	$112	$4,406

December 31, 2011	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer, Municipal and Unallocated	Total
	(Dollars in thousands)					
Individually evaluated for impairment	$328	$12	$293	$41	$11	$685
Collectively evaluated for impairment	922	355	1,985	191	88	3,541

Total allocated	$1,250	$367	$2,278	$232	$99	$4,226

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

March 31, 2012	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Tax Exempt	Total
	(Dollars in thousands)						
Individually evaluated for impairment	$3,495	$254	$5,862	$432	$31	$—	$10,074
Collectively evaluated for impairment	131,359	27,709	167,067	20,816	5,887	35,466	388,304
	134,854	27,963	172,929	21,248	5,918	35,466	398,378
Acquired loans	11,701	9	13,729	788	334	550	27,111
Total	$146,555	$27,972	$186,658	$22,036	$6,252	$36,016	$425,489

December 31, 2011	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Tax Exempt	Total
	(Dollars in thousands)						
Individually evaluated for impairment	$2,810	$92	$6,499	$355	$33	$—	$9,789
Collectively evaluated for impairment	132,115	27,976	169,576	21,861	5,724	29,344	386,596
	134,925	28,068	176,075	22,216	5,757	29,344	396,385
Acquired loans	12,501	9	13,695	802	377	550	27,934
Total	$147,426	$28,077	$189,770	$23,018	$6,134	$29,894	$424,319

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

1-3 Rating - Pass

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

4/M Rating - Satisfactory/Monitor

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

5-8 Rating - Substandard

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

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

March 31, 2012	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Tax Exempt	Total
	(Dollars in thousands)						
Pass	$126,535	$26,446	$129,705	$19,441	$5,813	$35,466	$343,406
Satisfactory/Monitor	4,824	1,263	37,362	1,375	74	—	44,898
Substandard	3,495	254	5,862	432	31	—	10,074
	134,854	27,963	172,929	21,248	5,918	35,466	398,378
Acquired loans	11,701	9	13,729	788	334	550	27,111
Total	$146,555	$27,972	$186,658	$22,036	$6,252	$36,016	$425,489

December 31, 2011	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Tax Exempt	Total
	(Dollars in thousands)						
Pass	$127,338	$26,928	$135,764	$19,069	$5,652	$29,344	$344,095
Satisfactory/Monitor	4,777	1,048	33,812	2,792	72	—	42,501
Substandard	2,810	92					