UNION BANKSHARES INC
Form 10-K
March 15, 2019

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, 2018 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 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 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, a smaller reporting company or an emerging growth company. See definitions of “large accelerated filer,” ”accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

Emerging growth company [ ]
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards proviced pursuant to Section 13(a) of the Exchange Act. [ ]

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, 2018 was $200,451,696 based on the closing price on the NASDAQ Stock Market LLC on such date of $51.90 per share. For purposes of this calculation, all directors, executive officers, and named executives of the Registrant are assumed to be affiliates. Such assumption, however, shall not be deemed to be an admission of such status as to any such individual.

DOCUMENTS INCORPORATED BY REFERENCE

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

Document	Part
Proxy Statement for the 2019 Annual Meeting of Shareholders	III

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(a) 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 15, 2019. The incorporation by reference herein of portions of the Proxy Statement shall not be deemed to specifically 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,” “predicts,” “anticipates,” “intends,” "projects," "potential," “plans,” “seeks,” “estimates "targets," "goals," “may,” “might,” “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, including those 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 puts pressure on the Company's margins, or that results in lower fee income and lower gain on sale of real estate loans, or that increases interest costs;
- 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;
- Further changes in federal or state tax policy;
- Changes in the level of nonperforming assets and charge-offs;
- Changes in depositor behavior resulting in movement of funds out of bank deposits and into the stock market or other higher-yielding investments;
- Changes in estimates of future reserve requirements based upon relevant regulatory and accounting requirements;
- Changes in information technology that require increased capital spending or that result in new or increased risks;
- 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;
- Increased competitive pressures affecting the ability of the Company to attract, develop and retain employees;
- Increased cybersecurity threats; 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.

When evaluating forward-looking statements to make decisions about the Company and our stock, investors and others are cautioned to consider these and other risks and uncertainties, and are reminded not to place undue reliance on such statements. Investors should not consider the foregoing list of factors to be a complete list of risks or uncertainties. Forward-looking statements speak only as of the date they are made and the Company undertakes no

obligation to update them to reflect new or changed information or events, except as may be required by federal securities laws.

PART I

Item 1. 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 53 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 18 banking offices, two loan centers, and several ATMs covering northern Vermont and New Hampshire. Also, many of Union's services are provided via the telephone, mobile devices, and through its website, www.ublocal.com. Union seeks to make a profit for the Company while providing quality retail banking services to individuals and commercial banking services to small and medium sized corporations, partnerships, and sole proprietorships, as well as nonprofit organizations, local municipalities and school districts within its market area.

The Company's income is derived principally from interest and fees on loans and earnings on other investments. Its primary expenses arise from interest paid on deposits and borrowings, salaries and wages, health insurance and other employee benefits and other general overhead expenses. Our profitability depends primarily on net interest income, which is the difference between interest and dividend income on interest-earning assets and interest expense on interest-bearing liabilities. Interest-earning assets include loans, investment securities, and interest-earning deposits in banks. Interest-bearing liabilities primarily include customer deposit accounts and borrowings. Net interest income is dependent upon the level of interest rates and the extent to which such rates change, as well as changes in the volume of various categories of assets and liabilities. Our profitability is also dependent on the level of noninterest income (primarily gains on sale of real estate loans, loan servicing income, and service fees), provision for loan losses, noninterest expenses and income taxes. Our operations and profitability are subject to changes in interest rates, applicable statutes and regulations, changes in corporate tax rates, 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, 2018, Union employed 195 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; 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, 2018, the Company's rate of average loans to average deposits was 95.6%. 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 and 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, and 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, enacted in 2010, 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 and transferred rulemaking authority to it under various consumer protection laws relating to financial products and services,
- 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 the Dodd-Frank Act is focused principally on changes to the financial regulatory system, it includes several corporate governance, disclosure and compensation provisions applicable to public companies. Those 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. The Company's last Say-on-Pay vote was held at the 2016 annual meeting with shareholders approving the Company's executive compensation program by a wide margin, and the Company will again hold a Say-on-Pay vote at its 2019 annual shareholders meeting, as well as a "Say-on-Frequency" 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 requirements for annual proxy statements 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 requiring the adoption or revision of certain other corporate policies, such as compensation "clawback" 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 their proxy statements 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, 2018, the Bank's total FDIC insurance assessment expense was $350 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. The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 allows the Company to hold reciprocal deposits up to 20 percent of total liabilities without those deposits being treated as brokered for regulatory purposes.

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, 2018, Union's reserve requirement was approximately $1.0 million, 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 such 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 became effective for the Company and Union on January 1, 2019. The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 rolls back certain provisions of the Dodd-Frank Act of 2010 providing that a bank with less than $10 billion in assets may be exempt from current leverage and risk-based capital ratio requirements and will be deemed well capitalized under the FDIC's Prompt Corrective Action capital framework (described below)

if it maintains a community bank leverage ratio ("CBLR") above a threshold to be set by federal banking regulators between eight and 10 percent. The bank will be deemed "well capitalized" if it meets the CBLR. As of December 31, 2018, the banking regulators had not yet taken final action to establish the percentage for the CBLR. Please refer to Note 21(Regulatory Capital Requirements) to the Company's audited consolidated financial statements contained in Part II, Item 8 of this annual report on Form 10-K for the regulatory capital ratios for the Company and Union as of December 31, 2018 and December 31, 2017.

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.

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 2018, 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, 2018, Union's Tier I and Total Risk Based Capital Ratios were 11.8% and 12.8% respectively, and its Leverage Capital Ratio was 8.0%, 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 Standards. 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 a requirement to provide 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, but not limited to, 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 under the various federal consumer protection laws. The CFPB is charged with examining banks with assets in excess of $10 billion, while community banks continue to be subject to the enforcement authority of 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 residential 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 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. The information must be compiled each calendar year on a Loan/Application Register, and submitted to the FFIEC by March 1st of the following year and made available to the public no later than March 31st. The Federal Financial Institutions Examinations Council prepares a series of tables that comprise the disclosure statement for each reporting institution. HMDA applies to financial institutions that have their main office or any branch in a Metropolitan Statistical Area ("MSA"). Union is subject to HMDA as it has branch offices within the Burlington, Vermont MSA. In accordance with the Dodd-Frank Act, the CFPB adopted new regulations effective for covered loan applications with action taken dates on or after January 1, 2018. The new rules expand coverage to include the majority of loan applications secured by a dwelling, including many applications for open-end loans. Additionally, the CFPB has increased the number of data points that must be collected and reported upon, to include information regarding geographical data, loan terms, underwriting practices and loan pricing.

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 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 applicable 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, the opening of a full service branch in Lincoln in 2014, and the opening of a loan production office in North Conway, New Hampshire in 2018.

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. Effective May, 11, 2018, banks are required to comply with enhanced customer due diligence regulations requiring collection of information on beneficial owners and control persons of legal entity customers.

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 applications under these acts for mergers, acquisitions, and certain other expansion activities.

SOX Act. This far reaching federal legislation, enacted in 2002, 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 2017 and will do the same for 2018. 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"). These reports, proxy statements, and other documents are available to the public on the internet website maintained by the SEC at www.sec.gov.

Our Internet website address is www.ublocal.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, including any amendments to those reports filed or furnished pursuant to section 13(a) or 15(d), proxy

statements filed pursuant to Section 14(a) and reports filed pursuant to Section 16, 13(d) and 13(g) of the Exchange Act are available free of charge through the Investor Relations page of our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC. The information on our website is not incorporated by reference into this report.

The Company will also provide copies of its 2018 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 2019 Annual Meeting are available at 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, 2018, approximately 50% 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.

Changes in 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.

Our cost of funds for banking operations may increase as a result of loss of deposits or a change in deposit mix. Deposits are a low cost and stable source of funding. We compete with banks and other financial institutions for deposits. Funding costs may increase if we lose deposits and are forced to replace them with more expensive sources of funding, if clients shift their

deposits into higher cost products or if we need to raise interest rates to avoid losing deposits. Higher funding costs reduce our net interest margin, net interest income and net income.

Wholesale funding sources may prove insufficient to replace deposits at maturity and support our operations and future growth.
We and our bank subsidiary must maintain sufficient funds to respond to the needs of depositors and borrowers. To manage liquidity, we draw upon a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. These sources include Federal Home Loan Bank advances, proceeds from the sale of investments and loans, and liquidity resources at the holding company. Our ability to manage liquidity will be severely constrained if we are unable to maintain access to funding or if adequate financing is not available to accommodate future growth at acceptable costs. In addition, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, operating margins and profitability would be adversely affected. Turbulence in the capital and credit markets may adversely affect our liquidity and financial condition and the willingness of certain counterparties and customers to do business with 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.

If we do not maintain net income growth, the market price of our common stock could be adversely affected.
Our return on stockholders' equity and other measures of profitability, which affect the market price of our common stock, depend in part on our continued growth and expansion. Our growth strategy has two principal components: internal growth and external growth. Our ability to generate internal growth is affected by the competitive factors described below as well as by the primarily rural characteristics and related demographic features of the markets we serve. Our ability to continue to identify and invest in suitable acquisition candidates on acceptable terms is an important component of our external growth strategy. In pursuing acquisition opportunities, we may be in competition with other companies having similar growth strategies. As a result, we may not be able to identify or acquire promising acquisition candidates on acceptable terms. Competition for these acquisitions could result in increased acquisition prices and a diminished pool of acquisition opportunities. An inability to find suitable acquisition candidates at reasonable prices could slow our growth rate and have a negative effect on the market price of our common stock.

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 must adapt to information technology changes in the financial services industry, which could present operational issues, require significant capital spending, or impact our reputation.
The financial services industry is constantly undergoing technological changes, with frequent introductions of new technology-driven products and services. We invest significant resources in information technology system enhancements in order to provide functionality and security at an appropriate level. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully implement and integrate future system enhancements could adversely impact the ability to provide timely and accurate financial information

in compliance with legal and regulatory requirements, which could result in sanctions from regulatory authorities. Such sanctions could include fines and suspension of trading in our stock, among others. In addition, future system enhancements could have higher than expected costs and/or result in operating inefficiencies, which could increase the costs associated with the implementation as well as ongoing operations.

Failure to properly utilize system enhancements that are implemented in the future could result in impairment charges that adversely impact our financial condition and results of operations and could result in significant costs to remediate or replace the defective components. In addition, we may incur significant training, licensing, maintenance, consulting and amortization expenses during and after systems implementations, and any such costs may continue for an extended period of time.

A failure in or breach of our operational systems, information systems, or infrastructure, or those of our third party vendors and other service providers, may result in financial losses, loss of customers, or damage to our reputation. We rely heavily on communications and information systems to conduct our business. In addition, we rely on third parties to provide key components of our infrastructure, including internet connections, and network access. These types of information and related systems are critical to the operation of our business and essential to our ability to perform day-to-day operations, and, in some cases, are critical to the operations of certain of our customers. These third parties with which we do business or that facilitate our business activities, including exchanges, clearing firms, financial intermediaries or vendors that provide services or security solutions for our operations, could also be sources of operational and information security risk to us, including breakdowns or failures of their own systems or capacity constraints. Although we have safeguards and business continuity plans in place, our business operations may be adversely affected by significant and widespread disruption to our physical infrastructure or operating systems that support our business and our customers, resulting in financial losses, loss of customers, or damage to our reputation.

An interruption or breach in security of our information systems or those related to merchants and third party vendors, including as a result of cyber attacks, could disrupt our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, or result in financial losses.
Our technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. These cybersecurity threats and attacks may include, but are not limited to, attempts to access information, including customer and company information, malicious code, computer viruses and denial of service attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service or other events. These types of threats may result from human error, fraud or malice on the part of external or internal parties, or from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. The risk of a security breach or disruption, particularly through cyber-attack or cyber intrusion, including by computer hackers, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased.

Our business requires the collection and retention of large volumes of customer data, including payment card numbers and other personally identifiable information in various information systems that we maintain and in those maintained by third parties with whom we contract to provide data services. We also maintain important internal company data such as personally identifiable information about our employees and information relating to our operations. The integrity and protection of that customer and company data is important to us. As customer, public, legislative and regulatory expectations and requirements regarding operational and information security have increased, our operations systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions and breakdowns.
Our customers and employees have been, and will continue to be, targeted by parties using fraudulent e-mails and other communications in attempts to misappropriate passwords, payment card numbers, bank account information or

other personal information or to introduce viruses to our customers' computers. These communications may appear to be legitimate messages sent by the Bank or other businesses, but direct recipients to fake websites operated by the sender of the e-mail or request that the recipient send a password or other confidential information via e-mail or download a program. Despite our efforts to mitigate these threats through product improvements, use of encryption and authentication technology to secure online transmission of confidential consumer information, and customer and employee education, such attempted frauds against us or our merchants and our third party service providers remain a serious issue. The pervasiveness of cyber security incidents in general and the risks of cyber-crime are complex and will continue to evolve.

Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well-protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber-attacks and intrusions, or disruptions will occur in the future, and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be

detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is virtually impossible for us to entirely mitigate this risk. A security breach or other significant disruption could: 1) disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers; 2) result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers, including account numbers and other financial information; 3) result in a violation of applicable privacy, data breach and other laws, subjecting the Bank to additional regulatory scrutiny and exposing the Bank to civil litigation, governmental fines and possible financial liability; 4) require significant management attention and resources to remedy the damages that result; or 5) harm our reputation or cause a decrease in the number of customers that choose to do business with us or reduce the level of business that our customers do with us. The occurrence of any such failures, disruptions or security breaches could have a negative impact on our results of operations, financial condition, and cash flows as well as damage our brand and reputation.
Although we maintain an insurance policy covering certain cybersecurity risks which we believe provides appropriate coverage for a financial institution of our size and business and technology profile, we cannot provide any assurance that such policy would be sufficient to cover all financial losses or damages we might suffer in the event that we or one of our third party vendors experiences a system failure or suffers a system intrusion or other cyberattack.

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 stockholders 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 to us 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 will 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.

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, market 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, 2018, our goodwill and other identifiable intangible assets were approximately $2.6 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, 2018 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, 2018, Union operated 13 community banking locations in Lamoille, Caledonia, Franklin and Washington counties of Vermont, five in Grafton and Coos counties of New Hampshire and loan centers in South Burlington, Vermont and North Conway, New Hampshire. 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 three 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. 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, 2018, is set forth in Note 8 to the consolidated financial statements contained in Part II, 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.

PART II

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

Trading Market for Common Stock

The common stock of the Company is traded on the NASDAQ Global Select Market under the trading symbol "UNB."

On March 11, 2019, there were 4,467,614 shares of common stock outstanding held by 506 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."

Repurchase of Common Stock

The following table summarizes repurchases of the Company's equity securities during the quarter ended December 31, 2018:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Program

			(1)	(1)
October 2018	—	—	—	2,500
November 2018	—	—	—	2,500
December 2018	2,149	$48.28	2,149	—

(1) All repurchases shown in the table were made pursuant to a discretionary stock repurchase program under which the Company may repurchase up to 2,500 shares of its common stock each calendar quarter, in open market or privately negotiated transactions. The repurchase authorization for a calendar quarter expires at the end of that quarter to the extent it has not been exercised, and is not carried forward into future quarters. The program was initially authorized in 2010 and was reauthorized most recently in December 2018. The program will expire on December 31, 2019, unless reauthorized.

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, 2013 through December 31, 2018. 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, 2013 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, 2018.

	Period Ended					
Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Union Bankshares, Inc.	100.00	107.72	131.81	222.52	266.10	245.71
NASDAQ Composite	100.00	114.75	122.74	133.62	173.22	168.30
SNL Bank $500M-$1B	100.00	109.71	123.83	167.20	203.98	196.88

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 Part II, Item 8 of this Annual Report.

	At or For The Years Ended December 31,				
	2018	2017	2016	2015	2014
Financial Condition Data:	(Dollars in thousands, except per share data)				
Investment securities	$73,405	$66,439	$66,555	$59,327	$52,964
Loans and loans held for sale	645,360	594,562	541,093	506,141	490,721
Allowance for loan losses	5,739	5,408	5,247	5,201	4,694
Total assets	805,337	745,831	691,381	628,879	624,063
Deposits	706,770	647,574	597,660	560,408	552,064
Borrowed funds	27,821	31,581	31,595	9,564	15,118
Stockholders' equity	64,491	58,661	56,279	53,568	51,434
Operating Data:					
Interest and dividend income	$32,180	$29,017	$26,836	$25,144	$24,852
Interest expense	3,581	2,255	2,061	2,025	2,155
Net interest income	28,599	26,762	24,775	23,119	22,697
Provision for loan losses	450	200	150	550	345
Net interest income after provision for loan losses	28,149	26,562	24,625	22,569	22,352
Noninterest income	9,473	9,395	10,140	9,792	8,909
Noninterest expenses	29,363	23,905	23,656	21,820	20,794
Income before provision for income taxes	8,259	12,052	11,109	10,541	10,467
Provision for income taxes	1,187	3,603	2,598	2,663	2,773
Net income	$7,072	$8,449	$8,511	$7,878	$7,694
Ratios:					
Return on average assets	0.94%	1.21%	1.30%	1.27%	1.30%
Return on average equity	11.80%	14.53%	15.25%	14.80%	14.88%
Net interest margin (1)	4.08%	4.22%	4.17%	4.10%	4.17%
Efficiency ratio (2)	76.22%	64.52%	67.97%	66.25%	67.40%
Net interest spread (3)	3.95%	4.13%	4.09%	4.02%	4.08%
Total loans to deposits ratio	91.31%	91.81%	90.54%	90.32%	88.89%
Net loan charge-offs to average loans not held for sale	0.02%	0.01%	0.02%	0.01%	0.06%
Allowance for loan losses to loans not held for sale (4)	0.89%	0.92%	0.98%	1.04%	0.98%
Nonperforming assets to total assets (5)	0.24%	0.23%	0.63%	0.53%	0.78%
Equity to assets	8.01%	7.87%	8.14%	8.52%	8.24%
Total capital to risk weighted assets (6)	12.86%	13.66%	13.32%	13.42%	13.60%
Per common share data:					
Book value per common share	$14.44	$13.14	$12.61	$12.02	$11.54
Earnings per common share	$1.58	$1.89	$1.91	$1.77	$1.73
Dividends paid per common share	$1.20	$1.16	$1.11	$1.08	$1.04
Dividend payout ratio (7)	75.95%	61.38%	58.12%	61.02%	60.12%

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(1) The ratio of tax equivalent net interest income to average earning assets. See page 27 in Part II, Item 7 of this Annual Report 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 27 in Part II, Item 7 of this Annual Report for more information.

(4) Calculation includes the net carrying amount of acquired loans recorded at fair value from the 2011 Branch Acquisition as of December 31, 2014 ($9.1 million). Excluding such loans, the ALL to loans not purchased and not held for sale was 1.00% at December 31, 2014. 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, 2014 ratios are calculated under the rules in effect prior to the Basel III capital rules, which 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, 2018 and 2017, and its results of operations for the years ended December 31, 2018, 2017 and 2016. 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 contained in Item 8, Part II of this Annual Report. 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, 2018 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 53 of this Annual Report.

NON-GAAP FINANCIAL MEASURES

The following discussion contains certain non-GAAP financial measures in addition to results presented in accordance with GAAP. These non-GAAP measures are intended to provide the reader with additional supplemental perspectives on operating results, performance trends, and financial condition. Non-GAAP financial measures are not a substitute for GAAP measures; they should be read and used in conjunction with the Company’s GAAP financial information. The Company’s non-GAAP measures may not be comparable to similar non-GAAP information which may be presented by other companies. In all cases, it should be understood that non-GAAP operating measures do not depict amounts that accrue directly to the benefit of shareholders. An item that management excludes when computing non-GAAP adjusted earnings can be of substantial importance to the Company’s results and condition for any particular year. A reconciliation of non-GAAP financial measures to GAAP measures is provided below.

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.

The discussion below includes references to the Company's net income and earnings per share for the year ended December 31, 2018 before deduction of expenses related to termination of Union's Defined Benefit Pension Plan. In

management's view, that information, which is considered non-GAAP information, may be useful to investors as it will improve comparability of core operations year over year and in future periods. The non-GAAP net income amount and EPS reflect adjustments of the non-recurring charges associated with termination of the Company’s defined benefit pension plan, net of tax effect. A reconciliation of the non-GAAP information to GAAP net income and EPS is provided below.

Non-GAAP Reconciliation - Net Income Before Pension Expense
(Unaudited)

	Year Ended December 31, 2018	Earnings Per Common Share (1)
	(Dollars in thousands, except per share data)	
Net income - GAAP	$7,072	$ 1.58
Pension expense	4,631	
Income tax benefit	(900)	
Net income before pension expense - Non-GAAP	$10,803	$ 2.42

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(1) Basic earnings per share were computed based on the weighted average number of shares outstanding during the year (4,465,675 shares). The assumed exercise of outstanding stock options and vesting of restricted stock units do not result in material dilution and were excluded from the calculation.

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 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

In 2017, the Company's Board of Directors voted to terminate Union Bank's Defined Benefit Pension Plan, which had been frozen in 2012 to new participants and the accrual of additional retirement benefits for existing participants. The liabilities under the Plan were settled by the Company during 2018 by offering participants the option to receive an annuity purchased from an insurance carrier, a lump-sum cash payment, or a direct rollover into a qualifying retirement plan. A cash contribution of $850 thousand was made to the plan during 2018 to cover the lump-sum payments and annuity purchases. The transfer of all liabilities and administrative responsibilities under the Plan was completed by December 31, 2018, and as a result the Company will not have any defined benefit pension plan obligations and thus no periodic pension expense in future periods related to the Plan.

The Company's defined benefit pension obligation and net periodic benefit costs were 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 reported financial condition and/or results of operations for 2018 and prior periods.

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

On October 18, 2017, the Company's Board of Directors voted to terminate Union's Defined Benefit Pension Plan. The settlement of all assets and liabilities under the Plan was completed by December 31, 2018. During 2018, participants were provided distribution options to either purchase an annuity, take a lump-sum cash payment, or do a direct rollover into a qualifying retirement plan. Net periodic pension expense for 2018 includes a settlement loss in the amount of $4.0 million, resulting in total pension expense of $4.6 million. This expense was partially offset by a reduction in the provision for income taxes of $900 thousand as a result of the settlement of the Plan assets and liabilities. Although termination of the Plan had a significant adverse impact on 2018 net income, in future periods the Company will no longer have any remaining defined benefit pension plan obligations and thus no periodic pension expense related to the Plan.

The Company's net income was $7.1 million, or $1.58 per share, for 2018 compared to $8.4 million for 2017, or $1.89 per share, a decrease of $1.4 million, or 16.3%. These results reflected the effect of an increase in net interest income of $1.8 million or 6.9%, an increase in noninterest income of $78 thousand, or 0.8%, a decrease in the provision for income taxes of $2.4 million, or 67.1%, offset by an increase in the provision for loan losses of $250 thousand, or 125.0%, and an increase in noninterest expenses of $5.5 million, or 22.8%.

Excluding the one-time charges of $3.7 million (net of tax effect) related to the settlement of the Plan, the Company would have reported net income of $10.8 million, or $2.42 per share, for the twelve months ended December 31, 2018. (Please refer to the discussion under "Non-GAAP Financial Measures" above, including the reconciliation to GAAP net income.)

As of December 31, 2018, the Company had total consolidated assets of $805.3 million, an increase of 8.0% compared to December 31, 2017. The growth year over year is attributable to strong loan demand, funded with customer deposits, low rate funding options from the FHLB, and purchased deposits.

Net loans and loans held for sale increased $50.6 million or 8.6%, to $640.6 million, or 79.5% of total assets, at December 31, 2018, compared to $589.9 million, or 79.1% of total assets, at December 31, 2017. The Company experienced growth in all loan classes except consumer loans which remained flat year over year.

The Company's primary source of funding, customer deposits, increased $59.2 million, or 9.1%, to reach $706.8 million at December 31, 2018. During 2018, management successfully focused on growing deposits by expanding its products and services to meet the needs of customers. This organic growth was supplemented by the use of purchased deposits.

The Company's total capital increased from $58.7 million at December 31, 2017 to $64.5 million at December 31, 2018. This increase reflects net income of $7.1 million for 2018, less regular cash dividends paid of $5.4 million, and a $4.1 million increase in accumulated other comprehensive income resulting primarily from the settlement of the pension plan. (See Capital Resources on page 43.)

RESULTS OF OPERATIONS

For the year ended December 31, 2018, we reported net income of $7.1 million compared to $8.4 million for the year ended December 31, 2017 and $8.5 million for the year ended December 31, 2016. 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 years ended December 31, 2018, 2017 and 2016 was 4.08%, 4.22%, and 4.17%, respectively.

2018 compared with 2017. Net interest income was $28.6 million on a fully tax equivalent basis for 2018, compared to $26.8 million for 2017, an increase of $1.8 million, or 6.9%. The increase in net interest income is reflective of growth in average earning assets of $56.6 million, or 8.6% during 2018 and a two bp increase in the average yield on average earning assets. These increases were partially offset by an increase of $45.3 million, or 8.7% in average interest bearing liabilities and a 20 bp increase in average rates paid on interest bearing liabilities. As illustrated in the Rate/Volume Analysis in the following pages, the increase in volume of average loan balances of $55.7 million, or 9.9%, compared to 2017 was the primary driver of the increase in interest income. Conversely, the increase in rates paid on customer deposit balances was the primary driver of the increase in interest expense. As a result, the net interest margin decreased 14 bp to 4.08% in 2018 compared to 4.22% in 2017.

The average cost of funding, which is tied primarily to our customer deposits, increased 20 bp to 0.63% for the year ended December 31, 2018, compared to 0.43% for the year ended December 31, 2017. During 2018, Union's municipal and commercial customers continued to utilize the Insured Cash Sweep account, a fully FDIC insured money market account through Promontory, contributing to the $24.4 million, or 10.44%, increase in average balances in savings and money market accounts. Average time deposits increased $13.7 million, or 13.30% during 2018 due to deposit accounts opened at the new Berlin, Vermont branch opened mid-year, as well as the utilization of purchased CDARs funds to supplement liquidity. Additionally, the average rate paid on savings and money market accounts increased 18 bps to 0.55% for the year ended December 31, 2018, compared to 0.37% for the year ended December 31, 2017 and the average rate paid on time deposits increased 35 bps to 1.04% for the year ended December 31, 2018, compared to 0.69% for the year ended December 31, 2017. The average balance of borrowed funds increased $7.4 million, or 21.01%, for the year ended December 31, 2018. The additional borrowed funds were utilized to supplement Union's liquidity, resulting in an increase in the average rate paid by 29 bps, to 1.65% for the year ended December 31, 2018, compared to 1.36% for the year ended December 31, 2017. See the following tables for details.

2017 compared with 2016. Net interest income was $26.8 million on a fully tax equivalent basis for 2017, compared to $24.8 million for 2016, an increase of $2.0 million, or 8.0%. The increase in net interest income is reflective of growth in average earning assets of $43.2 million, or 7.1% during 2017 coupled with a five bp increase in the average yield on average earning assets, partially offset by an increase of $32.3 million, or 6.6% in average interest bearing liabilities. The net interest margin increased five bp to 4.22% in 2017 compared to 4.17% in 2016. The increase in interest income was primarily driven by growth in average loans of $38.6 million, or 7.4%, compared to 2016 and to a lesser extent the increases in short term interest rates initiated by the Federal Reserve during 2017.

The average cost of funding, which is tied primarily to our customer deposits, increased one bp to 0.43% for the year ended December 31, 2017, compared to 0.42% for the year ended December 31, 2016. During 2017, Union's municipal and commercial customers continued to utilize the Insured Cash Sweep account, a fully FDIC insured

money market account through Promontory, contributing to the $29.3 million, or 14.35%, increase in average balances in savings and money market accounts and a $23.2 million, or 18.40% decrease in time deposits. Additionally, the average rate paid on savings and money market accounts increased 11 bps to 0.37% for the year ended December 31, 2017, compared to 0.26% for the year ended December 31, 2016. Conversely, the average rate paid on time deposits decreased eight bps to 0.69% for the year ended December 31, 2017, compared to 0.77% for the year ended December 31, 2016. Average balances in borrowed funds increased $7.6 million, or 27.43%, for the year ended December 31, 2017. The additional borrowed funds were utilized to supplement Union's liquidity and to take advantage of lower rate borrowings, resulting in a decrease in the average rate paid by 21 bps, to 1.36% for the year ended December 31, 2017, compared to 1.57% for the year ended December 31, 2016. See the following tables for details.

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,								
	2018			2017			2016		
	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Average Assets:									
Federal funds sold and overnight deposits	$12,274	$104	0.84 %	$17,700	$114	0.64 %	$16,953	$51	0.30 %
Interest bearing deposits in banks	9,805	207	2.11 %	8,642	147	1.70 %	10,816	160	1.48 %
Investment securities (1), (2)	71,673	1,836	2.75 %	66,925	1,678	2.96 %	61,111	1,496	2.88 %
Loans, net (1), (3)	615,739	29,883	4.91 %	560,059	26,978	4.92 %	521,435	25,056	4.91 %
Nonmarketable equity securities	2,840	150	5.27 %	2,423	100	4.12 %	2,215	73	3.30 %
Total interest earning assets (1)	712,331	32,180	4.58 %	655,749	29,017	4.56 %	612,530	26,836	4.51 %
Cash and due from banks	4,264			4,217			4,565		
Premises and equipment	15,043			13,286			13,189		
Other assets	22,769			22,477			22,795		
Total assets	$754,407			$695,729			$653,079		
Average Liabilities and Stockholders' Equity:									
Interest bearing checking accounts	$147,553	$233	0.16 %	$147,677	$205	0.14 %	$128,977	$120	0.09 %
Savings/money market accounts	257,717	1,423	0.55 %	233,345	856	0.37 %	204,056	524	0.26 %
Time deposits	116,717	1,215	1.04 %	103,019	710	0.69 %	126,248	978	0.77 %
Borrowed funds	42,582	710	1.65 %	35,190	484	1.36 %	27,616	439	1.57 %
Total interest bearing liabilities	564,569	3,581	0.63 %	519,231	2,255	0.43 %	486,897	2,061	0.42 %
Noninterest bearing deposits	121,902			112,914			105,596		
Other liabilities	7,986			5,446			4,761		
Total liabilities	694,457			637,591			597,254		
Stockholders' equity	59,950			58,138			55,825		
Total liabilities and stockholders' equity	$754,407			$695,729			$653,079		
Net interest income		$28,599			$26,762			$24,775	
Net interest spread (1)			3.95 %			4.13 %			4.09 %
Net interest margin (1)			4.08 %			4.22 %			4.17 %

(1) Average yields reported on a tax equivalent basis using a marginal tax rate of 21% and 34% for the years ended December 31, 2018 and 2017, respectively.

(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 $2.0 million, $1.9 million and $1.8 million for the years ended December 31, 2018, 2017 and 2016, respectively. The following table presents the effect of tax exempt income on the calculation of net interest income, using a marginal tax rate of 21% for the year ended December 31, 2018 and 34% for the years ended December 31, 2017 and 2016:

	Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Net interest income as presented	$28,599	$26,762	$24,775
Effect of tax-exempt interest			
Investment securities	136	306	265
Loans	328	605	524
Net interest income, tax equivalent	$29,063	$27,673	$25,564

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, 2018 Compared to Year Ended December 31, 2017 Increase/(Decrease) Due to Change In			Year Ended December 31, 2017 Compared to Year Ended December 31, 2016 Increase/(Decrease) Due to Change In		
	Volume	Rate	Net	Volume	Rate	Net
	(Dollars in thousands)					
Interest earning assets:						
Federal funds sold and overnight deposits	$(40)	$30	$(10)	$2	$61	$63
Interest bearing deposits in banks	22	38	60	(35)	22	(13)
Investment securities	223	(65)	158	151	31	182
Loans, net	3,008	(103)	2,905	1,860	62	1,922
Nonmarketable equity securities	19	31	50	8	19	27
Total interest earning assets	$3,232	$(69)	$3,163	$1,986	$195	$2,181
Interest bearing liabilities:						
Interest bearing checking accounts	$—	$28	$28	$19	$66	$85
Savings/money market accounts	97	470	567	83	249	332
Time deposits	104	401	505	(168)	(100)	(268)
Borrowed funds	112	114	226	107	(62)	45
Total interest bearing liabilities	$313	$1,013	$1,326	$41	$153	$194
Net change in net interest income	$2,919	$(1,082)	$1,837	$1,945	$42	$1,987

Provision for Loan Losses. The provision for loan losses was $450 thousand, $200 thousand, and $150 thousand for the years ended December 31, 2018, 2017 and 2016, respectively. The provision for 2018 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, 2018, 2017 and 2016:

	For The Years Ended December 31,						
			Variance from 2018 to 2017			Variance from 2017 to 2016	
	2018	2017	$	%	2016	$	%
	(Dollars in thousands)						
Trust income	$751	$739	$12	1.6	$737	$2	0.3
Service fees	6,151	5,951	200	3.4	5,871	80	1.4
Net gains on sales of loans held for sale	1,847	2,303	(456)	(19.8)	2,898	(595)	(20.5)
Income from Company-owned life insurance	488	244	244	100.0	339	(95)	(28.0)
Other income	226	141	85	60.3	224	(83)	(37.1)
Subtotal	9,463	9,378	85	0.9	10,069	(691)	(6.9)
Net gains on sales of investment securities AFS	10	17	(7)	(41.2)	71	(54)	(76.1)
Total noninterest income	$9,473	$9,395	$78	0.8	$10,140	$(745)	(7.3)

The significant changes in noninterest income for the year ended December 31, 2018 compared to the year ended December 31, 2017 are described below:

- Service fees. There was a $200 thousand increase in service fees for 2018 compared to 2017. Loan servicing fees increased $116 thousand due to the increase in our serviced loan portfolio from $499.2 million at December 31, 2017 to $534.2 million at December 31, 2018, or an increase of 7.0%. Additionally, increases of $66 thousand in ATM network income, $51 thousand in credit card income, and $20 thousand in merchant program income, were partially offset by a decrease of $42 thousand in service charge income on deposit accounts for the comparison periods.
- 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 $116.7 million were sold to the secondary market during 2018, versus residential and commercial loan sales of $122.2 million during 2017. The decline in net gains on sales of real estate loans is due to a combination of lower volumes of loans sold and lower average premiums on sold loans for the comparison periods.
- Income from Company-owned life insurance. Proceeds from the death benefit on an insurance policy on the life of a former director resulted in $252 thousand of additional income during the first quarter of 2018. The death benefit was partially offset by lower yields on existing policies.
- Other income. Other income increased $85 thousand for 2018 compared to 2017 The increase between the comparison periods is due primarily to the gain on the sale of a bank owned branch building of $191 thousand during the first quarter of 2018, partially offset by a loss of $24 thousand on the disposal of fixed assets no longer in service, and a decrease in income from MSR, net of amortization of $76 thousand for the comparison periods. The decrease in MSR income is due to lower volumes of loans sold in 2018.

The significant changes in noninterest income for the year ended December 31, 2017 compared to the year ended December 31, 2016 are described below:

- Service fees. There was an $80 thousand increase in service fees for 2017 compared to 2016. Loan servicing fees increased $92 thousand due to the increase in our serviced loan portfolio from $452.0 million at December 31, 2016 to $499.2 million at December 31, 2017, or an increase of 10.5%. Additionally, increases of $56 thousand and $28 thousand in overdraft fees and ATM network income, respectively were partially offset by a decrease of $62 thousand in service charge income on deposit accounts for the comparison periods.
- 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 $122.2 million were sold to the secondary market during 2017, versus residential and commercial loan sales of $135.5 million during 2016, The decline in net gains on sales of real estate loans is due to a combination of lower volumes of loans sold and lower average premiums on sold loans for the

comparison periods.

- Income from Company-owned life insurance. 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 and accounting for the majority of the $95 thousand variance year over year.
- Other income. Other income decreased $83 thousand for 2017 compared to 2016 primarily due to a decrease in income from MSR, net of amortization of $49 thousand and $34 thousand in other miscellaneous income for the comparison periods.

Noninterest Expense. The following table sets forth the components of noninterest expenses for the years ended December 31, 2018, 2017 and 2016:

	For The Years Ended December 31,						
			Variance from 2018 to 2017			Variance from 2017 to 2016	
	2018	2017	$	%	2016	$	%
	(Dollars in thousands)						
Salaries and wages	$10,748	$10,257	$491	4.8	$10,203	$54	0.5
Pension expense (benefit)	4,631	(81)	4,712	(5,817.3)	(170)	89	(52.4)
Employee benefits	3,653	3,789	(136)	(3.6)	3,695	94	2.5
Occupancy expense, net	1,447	1,415	32	2.3	1,263	152	12.0
Equipment expense	2,134	2,208	(74)	(3.4)	2,115	93	4.4
ATM and debit card expense	690	698	(8)	(1.1)	639	59	9.2
Electronic banking expenses	263	126	137	108.7	107	19	17.8
Other loan related expenses	249	192	57	29.7	225	(33)	(14.7)
Vermont franchise tax	620	582	38	6.5	555	27	4.9
FDIC insurance assessment	350	337	13	3.9	307	30	9.8
Trust expenses	347	362	(15)	(4.1)	409	(47)	(11.5)
Professional fees	625	573	52	9.1	731	(158)	(21.6)
Director and advisory board fees	450	405	45	11.1	368	37	10.1
Other expenses	3,156	3,042	114	3.7	3,209	(167)	(5.2)
Total noninterest expense	$29,363	$23,905	$5,458	22.8	$23,656	$249	1.1

The significant changes in noninterest expense for the year ended December 31, 2018 compared to the year ended December 31, 2017 are described below:

- Salaries and wages. The $491 thousand increase in salaries and wages is primarily due to normal salary increases as well as an increase in the number of full time equivalent employees from 190 for the majority of 2017 to 195 as of December 31, 2018.
- Pension expense (benefit). With the termination of Union Bank's Defined Benefit Pension Plan, the settlement of all assets and liabilities under the Plan was completed by December 31, 2018. Net periodic pension expense for 2018 includes a settlement loss in the amount of $4.0 million, resulting in total pension expense of $4.6 million.
- Employee benefits. The decrease in employee benefits is primarily the result of a $242 thousand medical plan credit received in 2018 due to favorable claims experience in 2017. A similar experience-based credit received in 2017 was $130 thousand.
- Occupancy expense, net. The Company incurred an increase of $32 thousand in net occupancy expenses during the comparison period due to increases of $46 thousand in depreciation expense and $20 thousand in utilities, partially offset by a reduction of $45 in repairs and maintenance costs.
- Equipment expense. The decrease in equipment expenses during the comparison period is primarily due to the reduction of $53 thousand in depreciation expense and a decrease of $24 thousand in equipment service contracts.
- Electronic banking expenses. During the first quarter of 2018, Union changed its service provider for its internet and mobile banking product. The new system was selected to provide a more robust product to Union's customers that includes additional functionality. The utilization of the product resulted in an increase in electronic banking expenses.
- Other loan related expenses. There was an increase in the underlying fees related to processing and servicing loans and loan applications in 2018, such as loan closing costs paid by Union, the implementation of a tax tracking service and an increase in the cost of credit report fees.
- Vermont franchise taxes. The overall increase in deposit accounts during 2018 resulted in an increase in Vermont franchise tax expense.

- Professional fees. During 2018, additional consultants were engaged to assist with internal audits, compensation and benefit analysis, and other advisory services that were not utilized in 2017 resulting in a $51 thousand increase during the comparison periods. Also, legal fees incurred for loan and real estate transactions as well as other corporate matters increased $28 thousand.

- Director and advisory board fees. The increase in fees is attributable to a 3% increase in annual directors fees and the addition of a member to Union's board of directors during 2018.

The significant changes in noninterest expense for the year ended December 31, 2017 compared to the year ended December 31, 2016 are described below:

- Pension expense (benefit). The actuarial calculation for the fiscal year ended December 31, 2017 decreased the pension benefit by $89 thousand compared to December 31, 2016.
- Employee benefits. The cost of the Company's medical and dental plans increased $193 thousand, due to increases in premium rates and higher dental claims. The increase in premium rates was partially offset by a $130 thousand medical plan credit due to favorable claims experience in 2016.
- Occupancy expense, net. The Company incurred an increase of $89 thousand in repairs and maintenance costs for the year ended December 31, 2017 compared to the year ended December 31, 2016. The mild winter experienced in Vermont and New Hampshire during 2016 resulted in lower than normal plowing costs. Also, the Company's janitorial costs increased due to a change in vendor. Net lease expense increased $30 thousand during 2017 due to a reduction in rental income as a result of the sale of one of the Company's properties.
- Equipment expense. Increases in software license and maintenance costs of $114 thousand occurred during 2017 as compared to 2016 as a result of expected annual increases in existing contracts and the addition of software programs to facilitate bank operations.
- ATM and debit card expense. The $59 thousand increase between 2016 and 2017 reflects the increase in expense related to the anticipated redemption of reward points earned on customer debit cards.
-
- Professional fees. Professional fee expenses had increased during 2016 as a result of engaging consultants for advisory services related to a review of the Company's core operating system, a review of the Company's branch network and facilities, and additional outsourced internal audit services.

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 $1.2 million for 2018, $3.6 million for 2017, and $2.6 million for 2016. The Company’s effective tax rate for 2018 decreased to 14.4% compared to 29.9% for 2017 and 23.4% for 2016.
The reduction in the Company's effective tax rate for 2018 was primarily due to a decrease in the corporate income tax rate from 34% to 21% as a result of the 2017 Tax Act.
The increase in the Company's effective tax rate for 2017 was the result of a one-time charge to earnings of $447 thousand for the revaluation of the Company's deferred tax assets as permitted by the 2017 Tax Act.
The Company reduced the provision for current federal income taxes by $65 thousand for 2018, $33 thousand for 2017, and $316 thousand for 2016 from benefits from its investments in affordable housing projects. See Note 10 to the Company's consolidated financial statements.

FINANCIAL CONDITION
At December 31, 2018, the Company had total consolidated assets of $805.3 million, including gross loans and loans held for sale (total loans) of $645.4 million, deposits of $706.8 million and stockholders' equity of $64.5 million. The Company’s total assets increased $59.5 million, or 8.0%, from $745.8 million at December 31, 2017.

Net loans and loans held for sale increased $50.6 million, or 8.6%, to $640.6 million, or 79.5% of total assets, at December 31, 2018, compared to $589.9 million, or 79.1% of total assets, at December 31, 2017. (See Loan Portfolio below.)

Total deposits increased $59.2 million, or 9.1% to $706.8 million at December 31, 2018, from $647.6 million at December 31, 2017. There were increases in time deposits of $27.9 million, or 27.6%, interest bearing deposits of $26.1 million, or 6.2%, and noninterest bearing deposits of $5.1 million, or 4.0%. (See average balances and rates in

the Yields Earned and Rates Paid table on page 27.)

Total borrowed funds decreased $3.8 million, or 11.9%, from $31.6 million at December 31, 2017 to $27.8 million at December 31, 2018. There were decreases in FHLB advances of $2.8 million and in customer overnight collateralized repurchase sweeps of $995 thousand between December 31, 2017 and December 31, 2018. (See Borrowings on page 40.)

Total stockholders' equity increased $5.8 million, or 9.9%, from $58.7 million at December 31, 2017 to $64.5 million at December 31, 2018. (See Capital Resources on page 43.)

Loan Portfolio. The Company's gross loan portfolio (including loans held for sale) increased $50.8 million, or 8.5%, to $645.4 million, representing 80.1% of assets at December 31, 2018, from $594.6 million, representing 79.7% of assets at December 31, 2017. 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 $522.0 million, or 80.9%, of total loans at December 31, 2018 compared to $484.2 million, or 81.4%, of total loans at December 31, 2017. 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. Other than the increase in the municipal portfolio reflecting the successful bid season for municipal lending opportunities, the composition of the Company's loan portfolio remained relatively unchanged from December 31, 2017. There was no material change in the Company's lending programs or terms during 2018.

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

	2018		2017		2016		2015		2014	
	$	%	$	%	$	%	$	%	$	%
	(Dollars in thousands)									
Residential real estate	$187,320	29.0	$178,999	30.1	$172,727	31.9	$165,396	32.7	$165,475	33.7
Construction real estate	55,322	8.6	42,935	7.2	34,189	6.3	42,889	8.5	37,258	7.6
Commercial real estate	276,500	42.8	254,291	42.8	249,063	46.0	230,442	45.5	211,710	43.1
Commercial	47,228	7.3	50,719	8.5	41,999	7.8	21,397	4.2	20,620	4.2
Consumer	3,241	0.5	3,894	0.7	3,962	0.7	3,963	0.8	4,435	0.9
Municipal	72,850	11.3	55,777	9.4	31,350	5.8	36,419	7.2	40,480	8.3
Loans held for sale	2,899	0.5	7,947	1.3	7,803	1.5	5,635	1.1	10,743	2.2
Total loans	$645,360	100.0	$594,562	100.0	$541,093	100.0	$506,141	100.0	$490,721	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, 2018, the Company serviced a $709.7 million residential real estate mortgage portfolio, of which $2.9 million was held for sale and approximately $519.5 million was serviced for unaffiliated third parties. This compares to a residential real estate mortgage serviced portfolio of $670.8 million at December 31, 2017, of which $7.9 million was held for sale and approximately $483.8 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 $116.7 million of qualified residential real estate loans originated during 2018 to the secondary market to mitigate long-term interest rate risk and to generate fee income, compared to sales of $122.0 million during 2017. 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 underwriting approval. The Company sells FHA, VA and RD 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 $4.1 million and $4.6 million guaranteed under these various programs at December 31, 2018 and 2017, respectively, on

aggregate balances of $5.2 million and $5.9 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 were no commercial real estate or commercial loans sold during 2018 and $226 thousand in commercial real estate and commercial loans sold during 2017. The Company recognizes gains and losses on the sale of the principal portion of these loans as they occur.

The Company serviced $14.8 million and $15.4 million of commercial and commercial real estate loans for unaffiliated third parties as of December 31, 2018 and 2017, respectively. This includes $12.8 million and $12.6 million of commercial or commercial real estate loans the Company had participated out to other financial institutions at December 31, 2018 and 2017, respectively.

These loans were participated in the ordinary course of business on a nonrecourse basis, for liquidity or credit concentration management purposes.

As of December 31, 2018, total loans serviced had grown to $1.2 billion, which includes total loans on the balance sheet of $645.4 million as well as total loans sold with servicing retained of $534.2 million, compared to total loans serviced of $1.1 billion as of December 31, 2017.

The Company capitalizes MSRs 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 MSRs on loans sold with servicing retained was $1.7 million as of December 31, 2018 and December 31, 2017, 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, 2018:

	Within 1 Year	2-5 Years	Over 5 Years	Total
	(Dollars in thousands)			
Fixed rate				
Residential real estate	$491	$2,340	$93,726	$96,557
Construction real estate	30,143	472	633	31,248
Commercial real estate	6,933	8,806	20,692	36,431
Commercial	2,239	9,522	18,294	30,055
Consumer	1,486	1,498	217	3,201
Municipal	56,282	5,247	11,321	72,850
Total fixed rate	97,574	27,885	144,883	270,342
Variable rate				
Residential real estate	1,460	1,311	90,891	93,662
Construction real estate	2,254	6,108	15,712	24,074
Commercial real estate	10,303	6,886	222,880	240,069
Commercial	5,868	5,176	6,129	17,173
Consumer	40	—	—	40
Total variable rate	19,925	19,481	335,612	375,018
	$117,499	$47,366	$480,495	$645,360

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:

	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Nonaccrual loans	$816	$1,191	$3,545	$2,521	$2,235
Loans past due 90 days or more and still accruing interest	1,140	494	840	836	2,344
Total nonperforming loans	1,956	1,685	4,385	3,357	4,579
OREO	—	36	—	—	297
Total nonperforming assets	$1,956	$1,721	$4,385	$3,357	$4,876
Guarantees of U.S. or state government agencies on the above nonperforming loans	$114	$131	599	$291	$259
TDR loans	$3,309	$3,252	$3,419	$2,732	$1,691

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

	2018	2017	2016	2015	2014
Allowance for loan losses to loans not held for sale (1)	0.89 %	0.92 %	0.98 %	1.04 %	0.98 %
Allowance for loan losses to nonperforming loans	293.40 %	320.95 %	119.66 %	154.93 %	102.51 %
Nonperforming loans to total loans	0.30 %	0.28 %	0.81 %	0.66 %	0.93 %
Nonperforming assets to total assets	0.24 %	0.23 %	0.63 %	0.53 %	0.78 %
Delinquent loans (30 days to nonaccruing) to total loans	1.41 %	1.05 %	1.55 %	1.61 %	2.20 %
Net charge-offs to average loans not held for sale	0.02 %	0.01 %	0.02 %	0.01 %	0.06 %

(1) Calculation includes the net carrying amount of loans recorded at fair value from the 2011 Branch Acquisition as of December 31, 2014 ($9.1 million). Excluding such loans, the ALL to loans not purchased and not held for sale was 1.00% at December 31, 2014. 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, 2018 increased $271 thousand, or 16.1%, and increased slightly as a percentage of assets from December 31, 2017, with the ALL as a percentage of nonperforming loans decreasing from 320.95% to 293.40%. Management considers the asset quality ratios to be at favorable levels. The Company's success at keeping the ratios at favorable levels 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. There were three residential real estate loans totaling $255 thousand in process of foreclosure at December 31, 2018. The aggregate interest on nonaccrual loans not recognized was $1.3 million for the year ended December 31, 2018, $1.2 million for the year ended December 31, 2017 and $1.3 million for the year ended December 31, 2016.

The Company had loans rated substandard that were on a performing status totaling $2.0 million at December 31, 2018 and $3.0 million at December 31, 2017. 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. The past two years have resulted in strong tourist visits for all seasons throughout the year, which appears to have improved the related business' financial performance. Improvement in local economic indicators have also been identified over the past two years. The unemployment rate has stabilized in Vermont and was 2.7% for December 31, 2018 compared to 2.8% for December 31, 2017. The New Hampshire unemployment rate was 2.5% for December 31, 2018 compared to 2.6% for December 31, 2017. These rates compare favorably with the nationwide rate of 3.9% and 4.1% 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 2018 and 2017. 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, 2018 and one residential real estate property valued at $36 thousand classified as OREO at December 31, 2017.

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 risk 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 and credit department personnel monitor 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:

	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Balance at the beginning of year	$5,408	$5,247	$5,201	$4,694	$4,647
Charge-offs	157	207	163	126	340
Recoveries	38	168	59	83	42
Net charge-offs	(119)	(39)	(104)	(43)	(298)
Provision for loan losses	450	200	150	550	345
Balance at the end of year	$5,739	$5,408	$5,247	$5,201	$4,694
Provision charged to income as a percent of average loans	0.07%	0.04%	0.03%	0.11%	0.07%

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

	2018		2017		2016		2015		2014	
	$	%	$	%	$	%	$	%	$	%
	(Dollars in thousands)									
Residential real estate	$1,368	29.2	$1,361	30.5	$1,399	32.4	$1,419	33.0	$1,330	34.5
Construction real estate	617	8.6	488	7.3	391	6.4	514	8.6	439	7.8
Commercial real estate	2,933	43.0	2,707	43.4	2,687	46.7	2,792	46.0	2,417	44.1
Commercial	354	7.4	395	8.6	342	7.9	209	4.3	176	4.3
Consumer	23	0.5	30	0.7	26	0.7	28	0.8	27	0.9
Municipal	82	11.3	64	9.5	40	5.9	38	7.3	42	8.4
Unallocated	362	—	363	—	362	—	201	—	263	—
Total	$5,739	100.0	5,408	100.0	$5,247	100.0	$5,201	100.0	$4,694	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 2018. Management of the Company believes, in its best estimate, that the ALL at December 31, 2018 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, 2018. 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, 2018, the fair value of investment securities AFS was $73.4 million, or 9.1% of total assets, compared to $65.4 million, or 8.8% of total assets at December 31, 2017. There were no investment securities classified as HTM at December 31, 2018 and $1.0 million classified as HTM at December 31, 2017. The Company had no investments classified as trading as of either date. 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, 2018 reflects a net unrealized loss of $1.3 million, compared to a net unrealized loss of $381 thousand at December 31, 2017.

At December 31, 2018, 109 debt securities had unrealized losses of $1.5 million, with aggregate depreciation of 2.04% from the Company's amortized cost basis. Securities are evaluated at least quarterly for OTTI and at December 31, 2018, 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 and related charges to earnings.

At December 31, 2018, 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, 2018, all MBS the Company owned were issued by the 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, 2018			Maturities		
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Amortized Cost	Weighted Average Yield
Investment securities available-for-sale:	(Dollars in thousands)					
U.S. Government-sponsored enterprises	$—	$—	$2,846	$3,682	$6,528	2.83 %
Agency MBS	—	1,382	1,681	33,788	36,851	2.81 %
State and political subdivisions	200	3,572	10,798	8,957	23,527	2.42 %
Corporate debt	—	490	7,302	—	7,792	3.67 %
Total investment debt securities	$200	$5,444	$22,627	$46,427	$74,698	2.78 %
Fair value	$202	$5,443	$22,227	$45,533	$73,405	
Weighted average yield	3.30 %	2.47 %	2.87 %	2.76 %	2.78 %	

	December 31, 2017			Maturities		
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Amortized Cost	Weighted Average Yield
Investment securities available-for-sale:	(Dollars in thousands)					
U.S. Government-sponsored enterprises	$—	$—	$2,756	$5,049	$7,805	2.33 %
Agency MBS	—	907	737	26,734	28,378	2.57 %
State and political subdivisions	—	3,818	9,690	11,196	24,704	2.48 %
Corporate debt	—	—	4,412	—	4,412	3.27 %
Investment securities held-to-maturity:						
U.S. Government-sponsored enterprises	1,000	—	—	—	1,000	0.95 %
Total investment debt securities	$1,000	$4,725	$17,595	$42,979	$66,299	2.53 %
Fair value	$999	$4,777	$17,571	$42,570	$65,917	
Weighted average yield	1.00 %	2.64 %	2.63 %	2.52 %	2.53 %	

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

The tables above exclude mutual fund securities with a book and fair value of $556 thousand at December 31, 2018, $521 thousand at December 31, 2017 and $345 thousand at December 31, 2016.

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, 2018 and December 31, 2017. Union is required to invest in $100 par value stock of the FHLB in an amount to satisfy unpaid principal balances on qualifying loans, plus an amount to satisfy an activity based requirement. The stock is nonmarketable, and is redeemable by the FHLB at par value. 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 at cost in Other assets on the consolidated balance sheets. 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, 2018 and 2017. Management's most recent evaluation of the Company's holdings of FHLB common stock concluded that the investment was not impaired at December 31, 2018.

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:

	2018			2017			2016		
	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	$121,902	18.9	—	$112,914	19.0	—	$105,596	18.7	—
Interest bearing checking accounts	147,553	22.9	0.16 %	147,677	24.9	0.14 %	128,977	22.8	0.09 %
Money market accounts	153,135	23.8	0.83 %	131,008	22.0	0.53 %	110,938	19.6	0.35 %
Savings accounts	104,582	16.3	0.15 %	98,930	16.6	0.15 %	93,118	16.5	0.15 %
Total nontime deposits	527,172	81.9	0.31 %	490,529	82.5	0.21 %	438,629	77.6	0.15 %
Time deposits:									
Less than $100,000	63,710	9.9	0.87 %	61,787	10.4	0.65 %	63,720	11.3	0.66 %
$100,000 and over	53,007	8.2	1.24 %	41,976	7.1	0.72 %	62,528	11.1	0.90 %
Total time deposits	116,717	18.1	1.04 %	103,763	17.5	0.69 %	126,248	22.4	0.77 %
Total deposits	$643,889	100.0	0.45 %	$594,292	100.0	0.30 %	$564,877	100.0	0.29 %

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. At December 31, 2018, $15.0 million of the Company's CDARS deposits represented purchased deposits which are considered "brokered" deposits. There were no purchased deposits as of December 31, 2017. These deposits are included in time deposits on the consolidated balance sheets. There were $11.3 million of time deposits of $250,000 or less on the balance sheet at December 31, 2018 and $11.5 million at December 31, 2017, which were exchanged with other CDARS participants.

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. There were $102.9 million and $67.0 million in exchanged ICS money market deposits on the balance sheet at December 31, 2018 and December 31, 2017, respectively. There were no purchased ICS deposits at December 31, 2018 or December 31, 2017.

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 allows the Company to hold reciprocal deposits up to 20 percent of total liabilities without those deposits being treated as brokered for regulatory purposes.

At December 31, 2018, there was $1.0 million in retail brokered deposits issued under master certificates of deposit to a deposit broker for the purpose of providing a supplemental source of funding and liquidity. These deposits will mature in the next year. There were $2.0 million of retail brokered deposits at December 31, 2017.

Deposits grew $59.2 million, or 9.1%, from $647.6 million at December 31, 2017 to $706.8 million at December 31, 2018. Total average deposits grew $49.6 million, or 8.3%, between years with average nontime deposits growing $36.6 million, or 7.5%, and average time deposits increasing $13.0 million, or 12.5%, during the same time frame. These changes are primarily the result of increased and continued use of the fully insured ICS money market product by Union's municipal and commercial customers, customers taking advantage of time deposit promotions offered

during 2018, as well as the utilization of purchased CDARS deposits to supplement liquidity.

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, 2018, the Company had deposit accounts with less than $250 thousand totaling $549.5 million, or 77.7% of its deposits, with FDIC insurance protection. An additional

$19.4 million of municipal deposits were over the FDIC insurance coverage limit at December 31, 2018 and were collateralized by Union under applicable state regulations by investment securities or letters of credit issued by the FHLB.

The following table provides a maturity distribution of the Company’s time deposits in amounts of $100 thousand and over at December 31:

	2018	2017
	(Dollars in thousands)	
Three months or less	$24,518	$5,345
Over three months through six months	9,125	9,752
Over six months through twelve months	12,820	13,737
Over twelve months	18,011	12,348
	$64,474	$41,182

The Company's time deposits in amounts of $100 thousand and over increased $23.3 million, or 56.6%, between December 31, 2017 and December 31, 2018, resulting primarily from the $15.0 million of purchased CDARS deposits outstanding at December 31, 2018 which will mature within three months. The remaining increase was the result of customers taking advantage of time deposit promotions that were offered during 2018.

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, 2018 were comprised of borrowings from the FHLB of $27.5 million, at a weighted average rate of 1.84%, and overnight secured customer repurchase agreement sweeps of $370 thousand, at a weighted average rate of 0.20%. At December 31, 2017, borrowed funds were comprised of FHLB advances of $30.2 million, at a weighted average rate of 1.42%, and overnight secured customer repurchase agreement sweeps of $1.4 million, at a weighted average rate of 0.25%. The maximum borrowings outstanding on overnight secured customer repurchase agreement sweeps was $3.5 million and $4.9 million during 2018 and 2017, respectively. The Company had no overnight federal funds purchased on December 31, 2018 or 2017. Average borrowings outstanding for 2018 were $42.6 million, compared to average borrowings outstanding for 2017 of $35.2 million, with the weighted average interest rate on the Company's borrowings increasing from 1.36% for 2017 to 1.65% for 2018, reflecting the rising interest rate environment.

A separate agreement has been established with the FHLB where the Company has the authority, up to its available borrowing capacity, to collateralize public unit deposits with letters of credit issued by the FHLB. FHLB letters of credit in the amount of $17.3 million and $29.6 million were utilized as collateral for these deposits at December 31, 2018 and December 31, 2017, respectively.

Liability for Pension Benefits. In 2017, the Company's Board of Directors voted to terminate Union Bank’s Defined Benefit Pension Plan, which had been frozen in 2012 to new participants and the accrual of additional retirement benefits for existing participants. The liabilities under the Plan were settled by the Company during 2018 by offering participants the option to receive an annuity purchased from an insurance carrier, a lump-sum cash payment, or a direct rollover into a qualifying retirement plan. A cash contribution of $850 thousand was made to the plan during 2018 to cover the lump-sum payments and annuity purchases. The transfer of all liabilities and administrative responsibilities under the Plan was completed by December 31, 2018, and as a result, in future periods the Company will not have any defined benefit pension plan obligations and thus no periodic pension expense related to the Plan. Net periodic pension expense for 2018 includes a settlement loss in the amount of $4.0 million, resulting in total pension expense of $4.6 million. This expense was partially offset by a reduction in the provision for income taxes of $900 thousand as a result of the settlement of the assets and liabilities.

Commitments, Contingent Liabilities, and Off-Balance-Sheet Arrangements. The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers,

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

The Company's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments.

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

The following table details the contractual or notional amount of financial instruments that represented credit risk at December 31, 2018:

	Contract or Notional Amount						
	2019	2020	2021	2022	2023	Thereafter	Total
	(Dollars in thousands)						
Commitments to originate loans	$22,673	$—	$—	$—	$—	$ —	$22,673
Unused lines of credit	86,042	13,055	7,703	141	2,134	382	109,457
Standby and commercial letters of credit	483	298	216	25	14	1,272	2,308
Credit card arrangements	259	—	—	—	—	—	259
MPF credit enhancement obligation, net	684	—	—	—	—	—	684
Commitment for purchase of Jericho branch property	1,220	—	—	—	—	—	1,220
Commitment for construction of Williston branch	3,208	—	—	—	—	—	3,208
Total	$114,569	$13,353	$7,919	$166	$2,148	$ 1,654	$139,809

Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have a fixed expiration date or other termination clause and may require payment of a fee. The unused lines of credit total includes $11.4 million of lines available under the overdraft privilege program and is included in the 2019 funding period. Approximately $19.2 million of the unused lines of credit relate to real estate construction loans that are expected to fund within the next twelve months. The remaining lines primarily relate to revolving lines of credit for other real estate or commercial loans. Since many of the loan commitments are expected to expire without being drawn upon and not all credit lines will be utilized, the total commitment amounts do not necessarily represent future cash requirements. Lines of credit incur seasonal volume fluctuations due to the nature of some customers' businesses, such as tourism and maple syrup products production.

Unused lines of credit increased $23.6 million, or 27.4%, from $85.9 million at December 31, 2017 to $109.5 million at December 31, 2018. Some of the larger lines have underlying participation agreements in place with other financial institutions in order to permit the Company to support the credit needs of larger dollar borrowers without bearing all the credit risk in the Company's balance sheet. Commitments to originate loans decreased $2.7 million, or 10.7%, from $25.4 million at December 31, 2017 to $22.7 million at December 31, 2018.

The Company may, from time-to-time, enter into commitments to purchase, participate or sell loans, securities, certificates of deposit, or other investment instruments which involve market and interest rate risk. At December 31, 2018, the Company had binding commitments to sell residential mortgage loans at fixed rates totaling $2.7 million.

The Company sells 1-4 family residential mortgage loans under the MPF loss-sharing program with FHLB, when management believes it is economically advantageous to do so. Under this program the Company shares in the credit risk of each mortgage, while receiving fee income in return. The Company is responsible for a Credit Enhancement Obligation based on the credit quality of these loans. FHLB funds a first loss account based on the Company's outstanding MPF mortgage balances. This creates a laddered approach to sharing in any losses. In the event of default, homeowner's equity and private mortgage insurance, if any, are the first sources of repayment; the FHLB first loss account funds are then utilized, followed by the member's Credit Enhancement Obligation, with the balance the responsibility of FHLB. These loans must meet specific underwriting standards of the FHLB. As of December 31,

2018, the Company had $30.6 million in loans sold through the MPF program with an outstanding balance of $15.5 million and a contract for the potential delivery of an additional $6.4 million of future loan sales. The volume of loans sold to the MPF program and the corresponding Credit Enhancement Obligation are closely monitored by management. As of December 31, 2018, the notional amount of the maximum contingent contractual liability related to this program was $702 thousand, of which $18 thousand was recorded as a reserve through Other liabilities. Since inception of the Company's MPF participation in 2015, the Company has not experienced any losses under this program.

Contractual Obligations. The Company and Union have various financial obligations, including contractual obligations that may require future cash payments. The following table presents, as of December 31, 2018, significant fixed and determinable contractual obligations to third parties by payment date:

	Payments Due By Period				
	Less than 1 year	2 & 3 years	4 & 5 years	Thereafter	Total
	(Dollars in thousands)				
Operating lease commitments	$213	$352	$228	$ 1,804	$2,597
Contractual payments on borrowed funds (1)	27,657	164	—	—	27,821
Deposits without stated maturity (1) (2)	577,693	—	—	—	577,693
Certificates of deposit (1) (2) (3)	83,078	37,812	8,187	—	129,077
Deferred compensation payouts (4)	89	86	103	189	467
Total	$688,730	$38,414	$8,518	$ 1,993	$737,655

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(1) The amounts exclude interest payable, as such amounts other than $203 thousand in accrued interest payable at December 31, 2018, are not able to be estimated at this time.

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

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

(4) The amounts exclude $478 thousand in benefit payments, where the payment period will begin at the individual's retirement, which is not determinable at this time.

Union is required (as are all banks) to maintain vault cash or a noninterest bearing reserve balance as established by Federal Reserve regulations. The Bank's average total required reserve for the 14 day maintenance period that included December 31, 2018 was $1.0 million, which was satisfied by vault cash.

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

At December 31, 2018, Union, as a member of FHLB, had access to unused lines of credit of $54.5 million, over and above the $45.6 million in borrowings and other credit subject to collateralization, with the purchase of required FHLB Class B common stock and evaluation by the FHLB of the underlying collateral available. This line of credit can be used for either short or long-term liquidity or other needs.

Union also maintains an IDEAL Way Line of Credit with the FHLB. The total line available was $551 thousand at December 31, 2018. There were no borrowings against this line of credit as of such date. Interest on these borrowings is chargeable at a rate determined by the FHLB and payable monthly. Should Union utilize this line of credit, qualified portions of the loan and investment portfolios would collateralize these borrowings.

In addition to its borrowing arrangements with the FHLB, Union maintains a pre-approved federal funds line of credit totaling $15.0 million with an upstream correspondent bank and one-way buy options with CDARS and ICS as well as

access to the FRB discount window, which would require pledging of qualified assets. Core deposits are the lowest cost of funds the Company has access to but these deposits may not be sufficient to cover the on balance sheet liquidity needs which makes using these other sources necessary. At December 31, 2018 there was $15.0 million outstanding in purchased CDARS deposits and no outstanding advances on the federal funds line or at the discount window.

Union's investment and residential loan portfolios provide a significant amount of contingent liquidity that could be accessed in a reasonable time period through sales of those portfolios. We also have additional contingent liquidity sources with access to the brokered deposit market and the FRB discount window. These sources are considered as liquidity alternatives in our contingent liquidity plan. At December 31, 2018, there was $1.0 million in retail brokered deposits issued under master certificates of deposit

to a deposit broker. Management believes the Company has sufficient liquidity to meet all reasonable borrower, depositor, and creditor needs in the present economic environment. However, any projections of future cash needs and flows are subject to substantial uncertainty, including factors outside the Company's control.

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

Stockholders’ equity increased from $58.7 million at December 31, 2017 to $64.5 million at December 31, 2018, reflecting net income of $7.1 million for 2018, an increase of $120 thousand from stock based compensation, a $30 thousand increase due to the issuance of common stock under the DRIP and a net increase in accumulated OCI of $4.1 million attributable to investment securities AFS and the settlement of the defined benefit pension plan obligations. These increases were partially offset by cash dividends paid of $5.4 million and stock repurchases of $107 thousand.

The Company has 7,500,000 shares of $2.00 par value common stock authorized. As of December 31, 2018, the Company had 4,943,690 shares issued, of which 4,466,679 were outstanding and 477,011 were held in treasury.

Effective May 21, 2014 upon approval by the stockholders, the Company adopted the 2014 Equity Plan which replaced the 2008 ISO Plan. As of December 31, 2018, there were outstanding employee incentive stock options with respect to 3,000 shares granted under the 2008 ISO Plan, all of which were exercisable, and outstanding employee incentive stock options with respect to 4,500 shares granted under the 2014 Equity Plan, all of which were exercisable. Also, as of December 31, 2018, there were outstanding RSUs with respect to 478 shares granted in 2016, 1,831 shares granted in 2017 and 3,734 shares granted in 2018 as to which vesting requirements had not yet been met.

In December 2018, the Company's Board reauthorized for 2019 the limited stock repurchase plan that was initially established in May of 2010. The limited stock repurchase plan allows the repurchase of up to a fixed number of shares of the Company's common stock each calendar quarter in open market purchases or privately negotiated transactions, as management may deem advisable and as market conditions may warrant. The repurchase authorization for a calendar quarter (currently 2,500 shares) expires at the end of that quarter to the extent it has not been exercised, and is not carried forward into future quarters. During 2018, the Company repurchased 2,209 shares under the program at a total cost of $107 thousand. Since inception, as of December 31, 2018, the Company had repurchased 17,393 shares under the program, for a total cost of $458 thousand.

The Company maintains a DRIP whereby registered stockholders may elect to reinvest cash dividends and optional cash contributions to purchase additional shares of the Company's common stock. The Company has reserved 200,000 shares of its common stock for issuance and sale under the DRIP. As of December 31, 2018, 1,460 shares of stock had been issued from treasury stock since inception of the DRIP, including 583 shares in 2018.

The Company's total capital to risk weighted assets decreased to 12.9% at December 31, 2018, from 13.7% at December 31, 2017. Tier I capital to risk weighted assets decreased to 11.8% at December 31, 2018, from 12.6% at December 31, 2017 and Tier I capital to average assets decreased to 8.0% at December 31, 2018 from 8.5% at December 31, 2017. Union is categorized as well capitalized under the Prompt Corrective Action regulatory framework and the Company is well over applicable minimum capital adequacy requirements. The Company's December 31, 2018 capital adequacy was determined based on the BASEL III requirements, which took effect on January 1, 2015 and will be fully phased in on January 1, 2019. The Company's evaluation indicates it satisfies all capital adequacy requirements as fully phased in. See Note 21 for additional discussion of the Company's and Union's regulatory capital ratios.

Regulatory Matters. The Company and Union are subject to periodic examinations by the various regulatory agencies. These examinations include, but are not limited to, procedures designed to review lending practices, risk management, credit quality, liquidity, compliance and capital adequacy. In February 2019, the Vermont Department of Financial Regulation began a regular safety and soundness examination of Union. In May of 2017, the FDIC performed its regular, periodic safety and soundness examination of Union. In February of 2017, the FDIC performed its regular periodic compliance examination of Union. In September of 2017, the FRB performed its regular, periodic examination of the Company. No comments were received that would have a material adverse effect on the Company's or Union's liquidity, financial position, capital resources, or results of operations.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market Risk and Interest Rate Risk. Market risk is the potential of loss in a financial instrument arising from adverse changes in market prices, interest rates, foreign currency exchange rates, commodity prices, and equity prices. The Company did not have any trading securities during 2018 or 2017. The Company's market risk arises primarily from interest rate risk inherent in its lending, investing, deposit taking and borrowing activities. Management of interest rate risk is an important component of our asset and liability management process, which is governed by established policies that are reviewed and approved annually. Our investment policy details the types of securities that may be purchased, and establishes portfolio limits and maturity limits for the various sectors. Our investment policy also establishes specific investment quality limits. The ALCO develops guidelines and strategies impacting our asset and liability management-related activities based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends. Members of the ALCO also manage the investment portfolio to maximize net interest income while mitigating market and interest rate risk.

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

An outside consultant is utilized to perform rate shocks of our balance sheet to assess our risk to earnings in different interest rate
environments, and to perform a variety of other analyses. The consultant's most recent analysis was as of December 31, 2018. The base simulation assumed no changes in rates, as well as a 200 basis point falling interest rate scenario and 200 and 300 basis point rising interest rate scenarios which assume a parallel shift of the yield curve over a 24 month period, with no growth assumptions. A summary of the results is as follows:

- Current/Flat Rates: If rates remain at current levels net interest income is projected to trend steadily upwards as investments and loans replace/reprice upward at a faster pace than expected increases to funding costs.
- Rising Rates: Net interest income is anticipated to trend in line with the Current/Flat Rates scenario over the next 24 months as retail and wholesale term funding replacing into the elevated rate environment temporarily matches improvements to asset yields. The degree of benefit of rising rates will depend on the pace and extent of market rate increases as well as the terminal slope of the yield curve as rates rise.
- Falling Rates: Net interest income is projected to trend downward in a falling rate scenario. Accelerated asset cash flow, driven by faster assumed mortgage related prepayment speeds, is expected to continue to adjust into lower rates with limited cost of funds relief. Continued utilization of floors on new loan volume would help to mitigate additional downward pressure on yields.

The net interest income simulation as of December 31, 2018 showed that the change in net interest income for the next 24 months from our expected or "most likely" forecast was as follows:

Rate Change	Percent Change in Net Interest Income Limit	Percent Change in Net Interest Income
Up 300 basis points	(45.00)%	12.40 %
Up 200 basis points	(30.00)%	9.40 %
Down 200 basis points	(30.00)%	(10.50)%

The preceding sensitivity analysis does not represent our forecast and should not be relied upon as being indicative of expected

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

The model used to perform the base case balance sheet simulation assumes a parallel shift of the yield curve over twelve and 24 months and reprices every interest earning asset and interest bearing liability on our balance sheet, simultaneously. The use of pricing betas helps simulate the expected pricing behavior regarding non-maturing deposits, limiting the rate increases that occur when market rates rise. Investment securities with call provisions are examined on an individual basis to estimate the likelihood of a call.

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

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

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

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

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

The following table shows the Company's rate sensitivity analysis as of December 31, 2018:

	Cumulative repriced within					
	3 Months or Less	4 to 12 Months	1 to 3 Years	3 to 5 Years	Over 5 Years	Total
Interest sensitive assets:	(Dollars in thousands, by repricing date)					
Overnight deposits	$33,244	$—	$—	$—	$—	$33,244
Interest bearing deposits in banks	747	995	3,735	3,483	340	9,300
Investment securities (1)(3)	7,315	5,427	12,028	13,062	35,573	73,405
Nonmarketable securities	—	—	—	—	2,376	2,376
Loans and loans held for sale (2)(3)	154,468	170,424	163,202	94,415	63,789	646,298
Total interest sensitive assets	$195,774	$176,846	$178,965	$110,960	$102,078	$764,623
Interest sensitive liabilities:						
Time deposits	$45,038	$46,935	$28,917	$8,187	$—	$129,077
Money markets	181,082	—	—	—	—	181,082
Regular savings	—	—	—	—	105,793	105,793
Interest bearing checking	39,297	—	—	—	118,550	157,847
Borrowed funds	17,369	10,288	164	—	—	27,821
Total interest sensitive liabilities	$282,786	$57,223	$29,081	$8,187	$224,343	$601,620
Net interest rate sensitivity gap	$(87,012)	$119,623	$149,884	$102,773	$(122,265)	$163,003
Cumulative net interest rate sensitivity gap	$(87,012)	$32,611	$182,495	$285,268	$163,003	
Cumulative net interest rate sensitivity gap as a percentage of total assets	(10.8)%	4.0 %	22.7 %	35.4 %	20.2 %	
Cumulative net interest rate sensitivity gap as a percentage of total interest sensitive assets	(11.4)%	4.3 %	23.9 %	37.3 %	21.3 %	
Cumulative net interest rate sensitivity gap as a percentage of total interest sensitive liabilities	(14.5)%	5.4 %	30.3 %	47.4 %	27.1 %	

(1) Investment securities exclude mutual funds with a fair value of $556 thousand at December 31, 2018 that may be sold by the Company at any time.
(2) Balances shown include deferred unamortized loan costs of $938 thousand.
(3) Reflects estimated repayment assumptions considered in Asset/Liability model.

Impact of Inflation and Changing Prices. The Company's consolidated financial statements have been prepared in accordance with GAAP, which allows for the measurement of financial position and results of operations in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Banks have asset and liability structures that are essentially monetary in nature, and their general and administrative costs constitute relatively small percentages of total expenses. Thus, increases in the general price levels for goods and services have a relatively minor effect on the Company's total expenses but could have an impact on our loan customers' financial condition. Interest rates have a more significant impact on the Company's financial performance than the effect of general inflation. The target federal funds rate has increased nine times since December 2015, which has resulted in an increase in the U.S prime rate to 5.50% as of December 31, 2018. These increases in rates have had a positive impact on the Company's net interest income for the years ended December 31, 2018, 2017 and 2016. The FRB has not stated rates would increase in 2019 but comments suggest increases throughout 2019 could occur. Through December 31, 2018 the increases in the target federal funds rate have not had a direct impact on the rates paid on customer deposit accounts. Further increases in the target federal funds rate in 2019 may result in the need to increase rates paid on deposit accounts in order to remain competitive in the market place. These market rates are out of the Company's control but have a dramatic impact on net interest income. For further details on the impact rising rates could have on the Company's net interest income see Market Risk and Interest Rate Risk above.

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

Item 8. Financial Statements and Supplementary Data
UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2018 and 2017

Assets	2018	2017
	(Dollars in thousands)	
Cash and due from banks	$4,045	$3,857
Federal funds sold and overnight deposits	33,244	34,651
Cash and cash equivalents	37,289	38,508
Interest bearing deposits in banks	9,300	9,352
Investment securities available-for-sale	73,405	65,439
Investment securities held-to-maturity (fair value $999 thousand at December 31, 2017)	—	1,000
Other investments	556	—
Total investments	73,961	66,439
Loans held for sale	2,899	7,947
Loans	642,461	586,615
Allowance for loan losses	(5,739)	(5,408)
Net deferred loan costs	938	795
Net loans	637,660	582,002
Accrued interest receivable	2,812	2,500
Premises and equipment, net	16,073	14,255
Core deposit intangible	412	583
Goodwill	2,223	2,223
Investment in real estate limited partnerships	4,046	3,166
Company-owned life insurance	9,040	8,861
Other assets	9,622	9,995
Total assets	$805,337	$745,831
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$132,971	$127,824
Interest bearing	444,722	418,621
Time	129,077	101,129
Total deposits	706,770	647,574
Borrowed funds	27,821	31,581
Accrued interest and other liabilities	6,255	8,015
Total liabilities	740,846	687,170
Commitments and Contingencies (Notes 8, 14, 15, 17, 18 and 21)		
Stockholders' Equity		
Common stock, $2.00 par value; 7,500,000 shares authorized; 4,943,690 shares issued at December 31, 2018 and 4,940,961 shares issued at December 31, 2017	9,888	9,882
Additional-paid-in capital	894	755
Retained earnings	58,911	57,197
Treasury stock at cost; 477,011 shares at December 31, 2018 and 475,385 shares at December 31, 2017	(4,179)	(4,077)
Accumulated other comprehensive loss	(1,023)	(5,096)
Total stockholders' equity	64,491	58,661
Total liabilities and stockholders' equity	$805,337	$745,831

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2018, 2017 and 2016

	2018	2017	2016
Interest and dividend income	(Dollars in thousands, except per share data)		
Interest and fees on loans	$29,883	$26,978	$25,056
Interest on debt securities:			
Taxable	1,276	977	885
Tax exempt	577	634	589
Dividends	133	167	95
Interest on federal funds sold and overnight deposits	104	114	51
Interest on interest bearing deposits in banks	207	147	160
Total interest and dividend income	32,180	29,017	26,836
Interest expense			
Interest on deposits	2,871	1,771	1,622
Interest on short-term borrowed funds	61	12	8
Interest on long-term borrowed funds	649	472	431
Total interest expense	3,581	2,255	2,061
Net interest income	28,599	26,762	24,775
Provision for loan losses	450	200	150
Net interest income after provision for loan losses	28,149	26,562	24,625
Noninterest income			
Trust income	751	739	737
Service fees	6,151	5,951	5,871
Net gains on sales of investment securities available-for-sale	10	17	71
Net gains on sales of loans held for sale	1,847	2,303	2,898
Other income	714	385	563
Total noninterest income	9,473	9,395	10,140
Noninterest expenses			
Salaries and wages	10,748	10,257	10,203
Pension expense (benefit)	4,631	(81)	(170)
Employee benefits	3,653	3,789	3,695
Occupancy expense, net	1,447	1,415	1,263
Equipment expense	2,134	2,208	2,115
Other expenses	6,750	6,317	6,550
Total noninterest expenses	29,363	23,905	23,656
Income before provision for income taxes	8,259	12,052	11,109
Provision for income taxes	1,187	3,603	2,598
Net income	$7,072	$8,449	$8,511
Earnings per common share	$1.58	$1.89	$1.91
Dividends per common share	$1.20	$1.16	$1.11

See accompanying notes to consolidated financial statements.

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UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2018, 2017 and 2016

	2018	2017	2016
	(Dollars in thousands)		
Net income	$7,072	$8,449	$8,511
Other comprehensive income (loss), net of tax:			
Investment securities available-for-sale:			
Net unrealized holding (losses) gains arising during the year on investment securities available-for-sale	(714)	423	(590)
Reclassification adjustment for net gains on investment securities available-for-sale realized in net income	(8)	(11)	(47)
Total	(722)	412	(637)
Defined benefit pension plan:			
Net actuarial gain (loss) arising during the year	1,221	(1,525)	(449)
Reclassification adjustment for amortization of net actuarial loss realized in net income	397	134	109
Reclassification adjustment for recognized settlement loss	3,177	—	—
Total	4,795	(1,391)	(340)
Total other comprehensive income (loss)	4,073	(979)	(977)
Total comprehensive income	$11,145	$7,470	$7,534

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2018, 2017 and 2016

	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, except per share data)						
Balances, December 31, 2015	4,457,177	$ 9,864	$ 501	$ 49,524	$ (4,019)	$ (2,302)	$ 53,568
Net income	—	—	—	8,511	—	—	8,511
Other comprehensive loss	—	—	—	—	—	(977)	(977)
Dividend reinvestment plan	315		7		3		10
Cash dividends declared ($1.11 per share)	—	—	—	(4,949)	—	—	(4,949)
Stock based compensation expense	2,356	5	61	—	—	—	66
Exercise of stock options	2,500	5	51	—	—	—	56
Purchase of treasury stock	(213)	—	—	—	(6)	—	(6)
Balances, December 31, 2016	4,462,135	9,874	620	53,086	(4,022)	(3,279)	56,279
Net income	—	—	—	8,449	—	—	8,449
Other comprehensive loss	—	—	—	—	—	(979)	(979)
Reclassification adjustment for effect of enacted tax law changes	—	—	—	838	—	(838)	—
Dividend reinvestment plan	562	—	20	—	5	—	25
Cash dividends declared ($1.16 per share)	—	—	—	(5,176)	—	—	(5,176)
Stock based compensation expense	3,309	6	98	—	—	—	104
Exercise of stock options	1,000	2	17	—	—	—	19
Purchase of treasury stock	(1,430)	—	—	—	(60)	—	(60)
Balances, December 31, 2017	4,465,576	9,882	755	57,197	(4,077)	(5,096)	58,661
Net income	—	—	—	7,072	—	—	7,072
Other comprehensive income	—	—	—	—	—	4,073	4,073
Dividend reinvestment plan	583	—	25	—	5	—	30
Cash dividends declared ($1.20 per share)	—	—	—	(5,358)	—	—	(5,358)
Stock based compensation expense	2,729	6	114	—	—	—	120
Purchase of treasury stock	(2,209)	—	—	—	(107)	—	(107)
Balances, December 31, 2018	4,466,679	$ 9,888	$ 894	$ 58,911	$ (4,179)	$ (1,023)	$ 64,491

See accompanying notes to consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018, 2017 and 2016

	2018	2017	2016
Cash Flows From Operating Activities	(Dollars in thousands)		
Net income	$7,072	$8,449	$8,511
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,216	1,223	1,255
Provision for loan losses	450	200	150
Deferred income tax (credit) provision	(508)	993	566
Net amortization of investment securities	390	423	384
Equity in losses of limited partnerships	591	627	565
Stock based compensation expense	120	104	66
Net increase in unamortized loan costs	(143)	(146)	(134)
Proceeds from sales of loans held for sale	118,557	124,514	138,443
Origination of loans held for sale	(111,662)	(122,355)	(137,713)
Net gains on sales of loans held for sale	(1,847)	(2,303)	(2,898)
Net (gain) loss on disposals of premises and equipment	(168)	34	13
Net gains on sales of investment securities available-for-sale	(10)	(17)	(71)
Net gain on sales of other real estate owned	(11)	—	—
Increase in accrued interest receivable	(312)	(241)	(427)
Amortization of core deposit intangible	171	171	171
Increase in other assets	(685)	(1,323)	(1,202)
Contribution to defined benefit pension plan	(850)	(750)	(750)
Pension plan termination expense	4,631	—	—
(Decrease) increase in other liabilities	(241)	265	715
Net cash provided by operating activities	16,761	9,868	7,644
Cash Flows From Investing Activities			
Interest bearing deposits in banks			
Proceeds from maturities and redemptions	3,784	4,882	4,244
Purchases	(3,732)	(4,730)	(996)
Investment securities held-to-maturity			
Proceeds from maturities, calls and paydowns	1,000	—	4,220
Investment securities available-for-sale			
Proceeds from sales	1,060	14,409	6,620
Proceeds from maturities, calls and paydowns	5,593	6,926	9,754
Purchases	(16,434)	(21,001)	(29,098)
Other investments			
Proceeds from sales	44	—	—
Purchases	(79)	—	—
Net (increase) decrease in nonmarketable stock	(46)	23	(421)
Net increase in loans	(56,003)	(53,568)	(32,947)
Recoveries of loans charged off	38	168	59
Purchases of premises and equipment	(3,070)	(1,987)	(1,938)
Investments in limited partnerships	(694)	(465)	(948)
Proceeds of Company-owned life insurance death benefit	307	—	527
Proceeds from sales of other real estate owned	47	—	—
Proceeds from sales of premises and equipment	204	—	200
Net cash used in investing activities	(67,981)	(55,343)	(40,724)

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Cash Flows From Financing Activities			
Advances on long-term borrowings	7,000	10,000	25,451
Repayment of long-term debt	(19,765)	(10,279)	(2,898)
Net increase (decrease) in short-term borrowings outstanding	9,005	265	(522)
Net increase in noninterest bearing deposits	5,147	15,440	12,558
Net increase in interest bearing deposits	26,101	36,538	71,880
Net increase (decrease) in time deposits	27,948	(2,064)	(47,186)
Issuance of common stock	—	19	56
Purchase of treasury stock	(107)	(60)	(6)
Dividends paid	(5,328)	(5,151)	(4,939)
Net cash provided by financing activities	50,001	44,708	54,394
Net (decrease) increase in cash and cash equivalents	(1,219)	(767)	21,314
Cash and cash equivalents			
Beginning of year	38,508	39,275	17,961
End of year	$37,289	$38,508	$39,275
Supplemental Disclosures of Cash Flow Information			
Interest paid	$3,476	$2,249	$2,239
Income taxes paid	$1,550	$1,520	$1,505
Supplemental Schedule of Noncash Investing and Financing Activities			
Other real estate acquired in settlement of loans	$—	$36	$—
Investment in limited partnerships acquired by capital contributions payable	$1,321	$546	$27
Dividends paid on Common Stock:			
Dividends declared	$5,358	$5,176	$4,949
Dividends reinvested	(30)	(25)	(10)
	$5,328	$5,151	$4,939

See accompanying notes to consolidated financial statements.

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UNION BANKSHARES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Note 1. Significant Accounting Policies
Basis of financial statement presentation
The accounting and reporting policies of Union Bankshares, Inc. and the Subsidiary (the Company) are in conformity with GAAP and general practices within the banking industry. The following is a description of the more significant policies.
The consolidated financial statements include the accounts of Union Bankshares, Inc., and its wholly owned subsidiary, Union Bank, headquartered in Morrisville, Vermont. All significant intercompany transactions and balances have been eliminated. The Company utilizes the accrual method of accounting for financial reporting purposes.
Certain amounts in the 2017 and 2016 consolidated financial statements have been reclassified to conform to the current year presentation.
The acronyms, abbreviations and capitalized terms identified below are used throughout this Annual Report on Form 10-K, including Parts I, II and III. The following is provided to aid the reader and provide a reference page when reviewing this Annual Report:

AFS:	Available-for-sale	ICS:	Insured Cash Sweeps of the Promontory Interfinancial Network
ALCO:	Asset Liability Management Committee	IRS:	Internal Revenue Service
ALL:	Allowance for loan losses	MBS:	Mortgage-backed security
ASC:	Accounting Standards Codification	MPF:	Mortgage Partnership Finance Program
ASU:	Accounting Standards Update	MSRs:	Mortgage Servicing rights
BHCA:	Bank Holding Company Act of 1956	NASDAQ:	NASDAQ Global Security Market
Board:	Board of Directors	OAO:	Other assets owned
bp or bps:	Basis point(s)	OCI:	Other comprehensive income (loss)
Branch Acquisition:	The acquisition of three New Hampshire branches in May 2011	OFAC:	U.S. Office of Foreign Assets Control
CDARS:	Certificate of Deposit Accounts Registry Service of the Promontory Interfinancial Network	OREO:	Other real estate owned
CFPB:	Consumer Financial Protection Bureau	OTTI:	Other-than-temporary impairment
COLI:	Company-Owned Life Insurance	OTT:	Other-than-temporary
Company:	Union Bankshares, Inc. and Subsidiary	Plan:	The Union Bank Pension Plan
DFR:	Vermont Department of Financial Regulation	RD:	USDA Rural Development
Dodd-Frank Act:	The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	RSU:	Restricted Stock Units
DRIP:	Dividend Reinvestment and Stock Purchase Plan	SBA:	U.S. Small Business Administration
EPS:	Earnings per share	SEC:	U.S. Securities and Exchange Commission
FASB:	Financial Accounting Standards Board	SOX Act:	Sarbanes Oxley Act of 2002
FDIC:	Federal Deposit Insurance Corporation	Tax Act:	Tax Cut and Jobs Act
FDICIA:	The Federal Deposit Insurance Corporation Improvement Act of 1991	TDR:	Troubled-debt restructuring
FHA:	U.S. Federal Housing Administration	Union:	Union Bank, the sole subsidiary of Union Bankshares, Inc
FHLB:	Federal Home Loan Bank of Boston	USDA:	U.S. Department of Agriculture
FRB:	Federal Reserve Board	VA:	U.S. Veterans Administration
Fannie Mae:	Federal National Mortgage Association	2006 Plan:	Executive Nonqualified Excess Plan

FHLMC/Freddie Mac:	Federal Home Loan Mortgage Corporation	2008 Plan:	2008 Amended and Restated Nonqualified Deferred Compensation Plan
GAAP:	Generally accepted accounting principles in the United States	2008 ISO Plan:	2008 Incentive Stock Option Plan of the Company
GLBA:	Gramm-Leach-Bliley Financial Modernization Act of 1999	2014 Equity Plan:	2014 Equity Incentive Plan
HTM:	Held-to-maturity	2017 Tax Act:	Tax Cuts and Jobs Act of 2017
HUD:	U.S. Department of Housing and Urban Development		

Nature of operations

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

Significant concentration of credit risk

The Company grants loans primarily to customers in Vermont and New Hampshire. Although it has a diversified loan portfolio, a large portion of the Company's loans are secured by commercial or residential real estate located in Vermont and New Hampshire and is subject to volatility with each state's real estate market. Additionally, the borrower's ability to repay loans is highly dependent upon other economic factors throughout Vermont and New Hampshire. The Company typically requires the principals of any commercial borrower to obligate themselves personally on the loan.

Use of estimates in preparation of consolidated financial statements

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

Presentation of cash flows

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

Asset management operations

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

Fair value measurement

The Company utilizes FASB ASC Topic 820, Fair Value Measurement, as guidance for accounting for assets and liabilities carried at fair value. This standard defines fair value as the price that would be received, without adjustment

for transaction costs, to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The guidance in FASB ASC Topic 820 establishes a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The three levels of the fair value hierarchy are:

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

The following is a description of the valuation methodologies used for the Company's assets that are measured on a recurring basis at estimated fair value:
AFS securities: The majority of the Company's AFS securities have been valued utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Investment securities

Debt securities the Company has the positive intent and ability to hold to maturity are classified as HTM and reported at amortized cost. Debt securities not classified as either HTM or trading are classified as AFS. Investments classified as AFS are reported at fair value. Investment securities purchased and held primarily for resale in the near future are classified as trading securities and are reported at fair value with unrealized gains and losses included in earnings. The Company does not generally hold any securities classified as trading.
Accretion of discounts and amortization of premiums arising at acquisition on investment securities are included in income using the effective interest method over the life of the securities to the call date. Unrealized gains and losses on investment securities AFS are excluded from earnings and reported in Accumulated OCI, net of tax and reclassification adjustment, as a separate component of stockholders' equity. The specific identification method is used to determine realized gains and losses on sales of AFS or trading securities.
The Company evaluates all investment securities on a quarterly basis, and more frequently when economic conditions warrant, to determine if an OTTI exists. A security is considered impaired if the fair value is lower than its amortized cost basis at the report date. If impaired, management then assesses whether the unrealized loss is OTT.
An unrealized loss on a debt security is generally deemed to be OTT and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI write-down is recorded, net of tax effect, through net income as a component of net OTTI losses in the consolidated statement of income, while the remaining portion of the impairment loss is recognized in OCI, provided the Company does not intend to sell the underlying debt security and it is "more likely than not" that the Company will not have to sell the debt security prior to recovery.
Management considers the following factors in determining whether an OTTI exists and the period over which the security is expected to recover:

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

Loans held for sale

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

are recognized through a valuation allowance by charges to income.

Loans

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

Loan interest income is accrued daily on outstanding balances. The following accounting policies, related to accrual and nonaccrual loans, apply to all portfolio segments and loan classes, which the Company considers to be the same. The accrual of interest is normally discontinued when a loan is specifically determined to be impaired and/or management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Generally, any unpaid interest previously accrued on those loans is reversed against current period interest income. A loan may be restored to accrual status when its financial status has significantly improved and there is no principal or interest past due. A loan may also be restored to accrual status if the borrower makes six consecutive monthly payments or the lump sum equivalent. Income on nonaccrual loans is generally not recognized unless a loan is returned to accrual status or after all principal has been collected. Interest income generally is not recognized on impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Delinquency status is determined based on contractual terms for all portfolio segments and loan classes. Loans past due 30 days or more are considered delinquent. Loans are considered in process of foreclosure when a judgment of foreclosure has been issued by the court.

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

Allowance for loan losses

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

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

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

The ALL consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. Loans are evaluated for impairment and may be classified as impaired when management believes it is probable that the Company will not collect all the contractual interest and principal payments as scheduled in the loan agreement. Impaired loans may also include troubled loans that are restructured. A TDR occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. A TDR classification may result from the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms (such as reduction of stated interest rates below market rates, extension of maturity that does not conform to the Company's policies, reduction of the face amount of the loan, reduction of accrued interest, or reduction or deferment of loan payments), or a combination. A specific reserve amount is allocated to the ALL for individual loans that have been classified as impaired based on management's estimate of the fair value of the collateral for collateral dependent loans, an observable market price, or the present value of anticipated future cash flows. The Company accounts for the change in present value attributable to the passage of time in the loan loss reserve. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer, real estate or small balance commercial loans for impairment evaluation, unless such loans are subject to a restructuring agreement

or have been identified as impaired as part of a larger customer relationship. Management has established the threshold for individual impairment evaluation for commercial loans with balances greater than $500 thousand, based on an evaluation of the Company's historical loss experience on substandard commercial loans.

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

- Residential real estate - Loans in this segment are collateralized by owner-occupied 1-4 family residential real estate, second and vacation homes, 1-4 family investment properties, home equity and second mortgage loans. Repayment is dependent on

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the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, could have an effect on the credit quality of this segment.

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

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

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

Other real estate owned

Real estate properties acquired through or in lieu of loan foreclosure are to be sold and are initially recorded based on an independent appraisal or a broker price opinion at the estimated fair value less estimated selling costs at the date of acquisition, establishing a new carrying basis. Thereafter, valuations are periodically performed by management, and the real estate is carried in Other assets at the lower of carrying amount or fair value, less estimated cost to sell. Costs of significant property improvements are capitalized, if deemed recoverable, whereas revenue and expenses from operations and changes in valuation are charged to Other expenses on the Company's consolidated statements of income. There were no OREO properties at December 31, 2018. There was one property in OREO at December 31, 2017 valued at $36 thousand.

Premises and equipment

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

Intangible assets

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

Federal Home Loan Bank stock

As a member of the FHLB, Union is required to invest in $100 par value stock of the FHLB in an amount to satisfy unpaid principal balances on qualifying loans, plus an amount to satisfy an activity based requirement. The stock is nonmarketable, and is redeemable by the FHLB at par value. Also, there is the possibility of future capital calls by the FHLB on member banks to ensure compliance with its capital plan. FHLB stock is reported in Other assets at its par value of $2.3 million at December 31, 2018 and December 31, 2017.

Company-owned life insurance

COLI represents life insurance on the lives of certain current or former directors or employees who have provided positive consent allowing the Company to be the beneficiary of such policies. The Company utilizes COLI as tax-efficient funding for certain benefit obligations to its employees and directors, including obligations under one of the Company's nonqualified deferred compensation plans. (See Note 14.) The Company is the primary beneficiary of the insurance policies. Increases in the cash value of the policies, as well as any gain on insurance proceeds received, are recorded in Other income, and are not currently subject to income taxes. COLI is recorded at the cash value of the policies, less any applicable cash surrender charges (of which there are currently none). The Company reviews the financial strength of the insurance carriers prior to the purchase of COLI to ensure minimum credit ratings of at least investment grade. The financial strength of the carriers is reviewed annually and COLI with any individual carrier is limited by Company policy to 15% of the sum of Tier 1 Capital and allowable Tier 2 capital.

Servicing assets

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

Investment in real estate limited partnerships

The Company has purchased various limited partnership interests in affordable housing partnerships. These partnerships were established to acquire, own and rent residential housing for elderly, low or moderate income residents in northern Vermont or in New Hampshire. GAAP permits an entity to amortize the initial cost of the investment in proportion to the amount of the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense. There were no impairment losses during the year resulting from the forfeiture or ineligibility of tax credits related to qualified affordable housing project investments. (See Note 10.)

Defined benefit pension plan

On October 18, 2017, the Company's Board of Directors voted to terminate Union Bank’s Defined Benefit Pension Plan. The settlement of all assets and liabilities under the Plan was completed by December 31, 2018. Participants were provided distribution options to either purchase an annuity, take a lump-sum cash payment, or do a direct rollover into a qualifying retirement plan. In future periods, the Company will no longer have any remaining defined benefit pension plan obligations and thus no periodic pension expense related to the Plan. (See Note 14.)

Advertising costs

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

Earnings per common share

Earnings per common share for the period are computed based on the weighted average number of shares of common stock issued during the period, including DRIP shares issuable upon reinvestment of dividends, retroactively adjusted for stock splits and stock dividends, if any, and reduced for shares held in treasury. (See Note 16.)

Income taxes

The Company prepares its federal income tax return on a consolidated basis. Federal income taxes are allocated to members of the consolidated group based on taxable income. The Company recognizes income taxes under the asset and liability method. This involves estimating the Company's actual current tax exposure as well as assessing temporary differences resulting from differing treatment of items, such as timing of the deduction of expenses, for tax and GAAP purposes. These differences result in deferred tax assets and liabilities, which are netted and included in Other assets. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company must also assess the likelihood that any deferred tax assets will be recovered from future taxable income and to the extent that recovery is not likely, a valuation allowance must be established. A change in enacted federal income tax rates for future periods, such as occurred with enactment of the 2017 Tax Act, requires revaluation of deferred taxes. Significant management judgment is required in determining the provision for income taxes and valuation of deferred tax assets and liabilities. (See Note 13.)

Off-balance-sheet financial instruments

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

Comprehensive income (loss)

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

Transfers of financial assets

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

Stock Based Compensation

Effective May 21, 2014 upon approval by the stockholders, the Company adopted the 2014 Equity Plan. Under the 2014 Equity Plan, 50,000 shares of the Company's common stock (including approximately 25,000 unused shares from the 2008 ISO Plan) are available for equity awards of incentive stock options, nonqualified stock options, restricted stock and restricted stock units to eligible officers and (except for awards of incentive stock options) nonemployee directors. (See Note 15.)

Recent accounting pronouncements

The Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) using a modified-retrospective transition method, as of January 1, 2018. The ASU requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. While the guidance replaces most existing revenue recognition guidance in GAAP, the ASU is not applicable to financial instruments and, therefore, did not impact a majority of the Company's revenues, including net interest income. The Company's assessment determined that no cumulative-effect adjustment

to beginning stockholders' equity was required under the modified retrospective transition method within the consolidated financial statements as there was no change in revenue recognition upon adoption of ASU No. 2014-09.
The Company adopted ASU No. 2016-01, Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. The ASU was issued to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This ASU changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. The ASU also changes certain disclosure requirements and other aspects of GAAP, including a requirement for public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The ASU became effective for the Company on January 1, 2018. Adoption of the ASU did not have a material effect on the Company's consolidated financial statements.
In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and liabilities (including operating leases) on the balance sheet and disclosing key information about leasing arrangements. Previous lease accounting did not require the inclusion of operating leases in the balance sheet. In July 2018, the FASB provided additional guidance on implementation of Topic 842 as well as an additional transition method. The ASU, including the updated guidance, became effective for the Company on January 1, 2019. The Company has evaluated the impact of the ASU on its consolidated financial statements by reviewing its lease contracts and has estimated increases of $2.0 million in other assets and other liabilities as a result of recording the right of use assets and related lease liabilities.
In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model ("CECL"), requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as AFS. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within such years. The Company has established a CECL implementation team and developed a transition project plan. Following evaluation of CECL implementation software providers by the Company's CECL implementation team, the Company entered into an agreement with Sageworks. Historical data has been compiled and training on utilizing the software for the existing incurred loss model has been completed. Training was ongoing during 2018 surrounding CECL implementation and methodologies, including the running of parallel incurred loss calculations throughout the year, and continues during 2019. This will facilitate the implementation process and management's evaluation of the potential impact of the ASU on the Company's consolidated financial statements.
In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU was issued to reduce the cost and complexity of the goodwill impairment test. To simplify the subsequent measurement of goodwill, step two of the goodwill impairment test was eliminated. Instead, a company will recognize an impairment of goodwill should the carrying value of a reporting unit exceed its fair value (i.e. step one). The ASU will be effective for the Company on January 1, 2020 and will be applied prospectively. The Company does not expect the implementation to have a material effect on the Company's consolidated financial statements.
The Company adopted ASU No. 2017-09, Compensation - Stock Compensation, Scope of Modification Accounting (Topic 718), effective January 1, 2018. The ASU was issued to provide clarity and reduce both 1) diversity in practice and 2) cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a share-based payment award. The ASU includes guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. Adoption of the ASU did not have a material effect on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The ASU was issued to make certain specific improvements to hedge accounting to better align hedge accounting with risk management activities, eliminate the separate measurement and recording of hedge ineffectiveness, improve presentation and disclosure, and other simplifications. The ASU became effective for the Company on January 1, 2019. All transition requirements and elections are to be applied to existing hedging relationships upon adoption. While the Company continues to assess the impact of ASU 2017-12, it does not believe that adoption of the ASU will have a material effect on the Company's consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Loss). This ASU was issued to allow a reclassification from accumulated other comprehensive income (loss) to retained earnings for stranded tax effects resulting from

the 2017 Tax Act. Consequently, the amendments eliminate the stranded tax effects resulting from the 2017 Tax Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the 2017 Tax Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The ASU is effective for fiscal years beginning after December 15, 2018, with early adoption permitted for financial statements that have not yet been issued. The Company adopted the ASU for its December 31, 2017 consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820), Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This guidance, which is a part of the FASB’s disclosure framework project to improve disclosure effectiveness, eliminates certain disclosure requirements for fair value measurements regarding the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, an entity’s policy for the timing of transfers between levels of the fair value hierarchy and an entity’s valuation processes for Level 3 fair value measurements. This guidance also adds new disclosure requirements for public entities regarding changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements of instruments held at the end of the reporting period, and the range and weighted average of significant unobservable inputs used to develop recurring and nonrecurring Level 3 fair value measurements, including how the weighted average is calculated. In addition, this guidance modifies certain requirements regarding the disclosure of transfers into and out of Level 3 of the fair value hierarchy, purchases and issuances of Level 3 assets and liabilities, and information about the measurement uncertainty of Level 3 fair value measurements as of the reporting date. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company does not expect that adoption of the ASU will have a material effect on the Company’s consolidated financial statements.

Note 2. Restrictions on Cash and Cash Equivalents

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

	2018	2017
	(Dollars in thousands)	
Noninterest bearing accounts	$ 266	$ 210
Federal Reserve Bank of Boston	32,077	34,344
FHLB of Boston	1,374	310

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

The Company had no requirement to maintain contracted clearing balances at December 31, 2018 or 2017. Balances at the Federal Reserve Bank of Boston and a portion of the funds at the FHLB are classified as overnight deposits as they earn interest. The Company is required to maintain vault cash or noninterest bearing reserve balances with Federal Reserve Bank of Boston. Total reserve balances required at December 31, 2018 and 2017 were $1.0 million and $1.4 million, respectively, which were both satisfied by vault cash.

Note 3. Interest Bearing Deposits in Banks

Interest bearing deposits in banks consist of certificates of deposit purchased from various financial institutions. Deposits at each institution are generally maintained at or below the FDIC insurable limit of $250 thousand. As of December 31, 2018, the Company held certificates with rates ranging from 1.25% to 3.55% and various maturity dates through 2028, with $1.7 million scheduled to mature in 2019.

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Note 4. Investment Securities

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

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$6,528	$ 1	$ (208)	$6,321
Agency MBS	36,851	84	(683)	36,252
State and political subdivisions	23,527	130	(486)	23,171
Corporate	7,792	18	(149)	7,661
Total	$74,698	$ 233	$ (1,526)	$73,405

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$7,805	$ 12	$ (122)	$7,695
Agency MBS	28,378	12	(274)	28,116
State and political subdivisions	24,704	249	(239)	24,714
Corporate	4,412	48	(67)	4,393
Total debt securities	65,299	321	(702)	64,918
Mutual funds (1)	521	—	—	521
Total	$65,820	$ 321	$ (702)	$65,439
Held-to-maturity				
U.S. Government-sponsored enterprises	$1,000	$ —	$ (1)	$999

(1) As of December 31, 2017, mutual funds were classified as AFS investment securities. Effective January 1, 2018, these investments were reclassified to other investments on the consolidated balance sheets as they are no longer eligible to be classified as AFS upon adoption of ASU No. 2016-01.

There were no investment securities HTM at December 31, 2018. Investment securities with a carrying amount of $2.5 million and $4.6 million at December 31, 2018 and 2017, respectively, were pledged as collateral for public deposits, customer repurchase agreements and for other purposes as required or permitted by law.

As of December 31, 2018, other investments consisted of mutual funds with a fair value of $556 thousand, a cost basis of $652 thousand and unrealized loss of $96 thousand.

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

December 31, 2018	Less Than 12 Months			12 Months and Over			Total		
	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss
	(Dollars in thousands)								
Debt securities:									
U.S. Government-sponsored enterprises	2	$1,184	$ (11)	12	$4,854	$ (197)	14	$6,038	$ (208)
Agency MBS	5	3,516	(21)	40	26,198	(662)	45	29,714	(683)
State and political subdivisions	4	1,301	(16)	36	15,067	(470)	40	16,368	(486)
Corporate	5	2,424	(12)	5	2,285	(137)	10	4,709	(149)
Total	16	$8,425	$ (60)	93	$48,404	$ (1,466)	109	$56,829	$ (1,526)

December 31, 2017	Less Than 12 Months			12 Months and Over			Total		
	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss	Number of Securities	Fair Value	Gross Unrealized Loss
	(Dollars in thousands)								
Debt securities:									
U.S. Government-sponsored enterprises	3	$1,824	$ (7)	9	$4,374	$ (116)	12	$6,198	$ (123)
Agency MBS	26	19,315	(143)	7	5,222	(131)	33	24,537	(274)
State and political subdivisions	8	3,803	(22)	18	7,899	(217)	26	11,702	(239)
Corporate	2	870	(31)	2	964	(36)	4	1,834	(67)
Total	39	$25,812	$ (203)	36	$18,459	$ (500)	75	$44,271	$ (703)

The Company has the ability to hold the investment securities that had unrealized losses at December 31, 2018 for the foreseeable future and no declines were deemed by management to be OTT.

The following table presents the proceeds, gross gains and gross losses from sales of AFS securities:

	For The Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Proceeds	$1,060	$14,409	$6,620
Gross gains	10	147	131
Gross losses	—	(130)	(60)
Net gains	$10	$17	$71

The amortized cost and estimated fair value of debt securities by contractual scheduled maturity as of December 31, 2018, were as follows:

Available-for-sale	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	$200	$202
Due from one to five years	4,062	4,078
Due from five to ten years	20,946	20,536
Due after ten years	12,639	12,337
	37,847	37,153
Agency MBS	36,851	36,252
Total debt securities available-for-sale	$74,698	$73,405

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

Note 5. Loans Held for Sale and Loan Servicing

At December 31, 2018 and 2017, loans held for sale consisted of conventional residential mortgages originated for subsequent sale, with an estimated fair value in excess of their carrying value. Therefore, no valuation reserve was necessary for loans held for sale as of the balance sheet dates.

Commercial and residential mortgage loans serviced for others are not included in the accompanying balance sheets. The unpaid principal balance of commercial and residential mortgage loans serviced for others was $534.2 million and $499.2 million at December 31, 2018 and 2017, respectively.

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

	2018		2017		2016	
	Loans Sold	Net Gains on Sale	Loans Sold	Net Gains on Sale	Loans Sold	Net Gains on Sale
	(Dollars in thousands)					
Residential loans	$116,710	$1,847	$121,985	$2,279	$135,294	$2,880
Commercial loans	—	—	226	24	251	18
Total	$116,710	$1,847	$122,211	$2,303	$135,545	$2,898

There were no obligations to repurchase loans for any amount at December 31, 2018, but there were contractual risk sharing commitments on certain sold loans totaling $702 thousand as of such date.

The Company generally retains the servicing rights on loans sold. At December 31, 2018 and 2017, the unamortized balance of servicing rights on loans sold with servicing retained was $1.7 million and is included in Other assets. The estimated fair value of these servicing rights was in excess of their carrying value at December 31, 2018 and 2017, and therefore no impairment reserve was necessary. The net capitalization and amortization of MSRs is included in Other income.

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

For The Years
Ended December

	31,		
	2018	2017	2016
	(Dollars in thousands)		
Capitalization of servicing rights	$697	$770	$823
Amortization of servicing rights	720	716	720
Net (amortization) capitalization of servicing rights	$(23)	$54	$103

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Note 6. Loans

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

	2018	2017
	(Dollars in thousands)	
Residential real estate	$187,320	$178,999
Construction real estate	55,322	42,935
Commercial real estate	276,500	254,291
Commercial	47,228	50,719
Consumer	3,241	3,894
Municipal	72,850	55,777
Gross loans	642,461	586,615
Allowance for loan losses	(5,739)	(5,408)
Net deferred loan costs	938	795
Net loans	$637,660	$582,002

Qualifying residential first mortgage loans and certain commercial real estate loans with a carrying value of $167.7 million and $164.5 million were pledged as collateral for borrowings from the FHLB under a blanket lien at December 31, 2018 and December 31, 2017, respectively.

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

December 31, 2018	Current	30-59 Days	60-89 Days	90 Days and over and accruing	Nonaccrual	Total
	(Dollars in thousands)					
Residential real estate	$183,624	$1,984	$696	$ 422	$ 594	$187,320
Construction real estate	52,807	1,451	1,023	—	41	55,322
Commercial real estate	273,778	1,703	153	718	148	276,500
Commercial	47,163	24	8	—	33	47,228
Consumer	3,215	21	5	—	—	3,241
Municipal	72,789	61	—	—	—	72,850
Total	$633,376	$5,244	$1,885	$ 1,140	$ 816	$642,461

December 31, 2017	Current	30-59 Days	60-89 Days	90 Days and over and accruing	Nonaccrual	Total
	(Dollars in thousands)					
Residential real estate	$173,914	$3,047	$750	$ 472	$ 816	$178,999
Construction real estate	42,857	—	—	22	56	42,935
Commercial real estate	253,266	357	361	—	307	254,291
Commercial	50,675	21	11	—	12	50,719
Consumer	3,884	7	3	—	—	3,894
Municipal	55,777	—	—	—	—	55,777
Total	$580,373	$3,432	$1,125	$ 494	$ 1,191	$586,615

There were three residential real estate loans totaling $255 thousand and one commercial real estate loan totaling $146 thousand in process of foreclosure at December 31, 2018. Aggregate interest on nonaccrual loans not recognized was $1.3 million for the year ended December 31, 2018, $1.2 million for the year ended December 31, 2017 and $1.3 million for the year ended December 31, 2016.

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Note 7. Allowance for Loan Losses and Credit Quality

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

December 31, 2018	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2017	$1,361	$ 488	$ 2,707	$ 395	$ 30	$ 64	$ 363	$5,408
Provision (credit) for loan losses	118	128	226	(36)	(3)	18	(1)	450
Recoveries of amounts charged off	20	1	—	—	17	—	—	38
	1,499	617	2,933	359	44	82	362	5,896
Amounts charged off	(131)	—	—	(5)	(21)	—	—	(157)
Balance, December 31, 2018	$1,368	$ 617	$ 2,933	$ 354	$ 23	$ 82	$ 362	$5,739

December 31, 2017	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2016	$1,399	$ 391	$ 2,687	$ 342	$ 26	$ 40	$ 362	$5,247
Provision for loan losses	17	73	20	49	16	24	1	200
Recoveries of amounts charged off	138	24	—	4	2	—	—	168
	1,554	488	2,707	395	44	64	363	5,615
Amounts charged off	(193)	—	—	—	(14)	—	—	(207)
Balance, December 31, 2017	$1,361	$ 488	$ 2,707	$ 395	$ 30	$ 64	$ 363	$5,408

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

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

December 31, 2018	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Individually evaluated for impairment	$47	$ —	$ 9	$ 10	$ —	$ —	$ —	$66
Collectively evaluated for impairment	1,321	617	2,924	344	23	82	362	5,673
Total allocated	$1,368	$ 617	$ 2,933	$ 354	$ 23	$ 82	$ 362	$5,739

December 31, 2017	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Individually evaluated for impairment	$47	$ —	$ 1	$ —	$ —	$ —	$ —	$48
Collectively evaluated for impairment	1,314	488	2,706	395	30	64	363	5,360
Total allocated	$1,361	$ 488	$ 2,707	$ 395	$ 30	$ 64	$ 363	$5,408

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

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

December 31, 2018	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Individually evaluated for impairment	$1,678	$ 119	$ 2,276	$ 352	$ —	$ —	$4,425
Collectively evaluated for impairment	185,642	55,203	274,224	46,876	3,241	72,850	638,036
Total	$187,320	$ 55,322	$ 276,500	$ 47,228	$ 3,241	$ 72,850	$642,461

December 31, 2017	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Individually evaluated for impairment	$1,718	$ 82	$ 1,074	$ 378	$ —	$ —	$3,252
Collectively evaluated for impairment	177,281	42,853	253,217	50,341	3,894	55,777	583,363
Total	$178,999	$ 42,935	$ 254,291	$ 50,719	$ 3,894	$ 55,777	$586,615

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

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

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

5-7 Rating - Substandard
Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. The loan may be inadequately protected by the net worth and paying capacity of the obligor and/or the underlying collateral is inadequate.

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

December 31, 2018	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Pass	$170,416	$ 41,141	$ 174,802	$ 34,303	$ 3,209	$ 72,850	$496,721
Satisfactory/Monitor	14,008	14,053	98,327	12,150	31	—	138,569
Substandard	2,896	128	3,371	775	1	—	7,171
Total	$187,320	$ 55,322	$ 276,500	$ 47,228	$ 3,241	$ 72,850	$642,461

December 31, 2017	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Pass	$164,733	$ 33,401	$ 177,388	$ 38,877	$ 3,859	$ 55,777	$474,035
Satisfactory/Monitor	11,296	9,374	73,772	11,165	30	—	105,637
Substandard	2,970	160	3,131	677	5	—	6,943
Total	$178,999	$ 42,935	$ 254,291	$ 50,719	$ 3,894	$ 55,777	$586,615

The following tables provide information with respect to impaired loans by class of loan as of and for the years ended December 31, 2018, 2017 and 2016:

	December 31, 2018			For The Year Ended December 31, 2018	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
Residential real estate	$228	$ 238	$ 47		
Commercial real estate	193	193	9		
Commercial	12	13	10		
With an allowance recorded	433	444	66		
Residential real estate	1,450	2,039	—		
Construction real estate	119	135	—		
Commercial real estate	2,083	2,174	—		
Commercial	340	340	—		
With no allowance recorded	3,992	4,688	—		
Residential real estate	1,678	2,277	47	$1,730	$ 65
Construction real estate	119	135	—	88	4
Commercial real estate	2,276	2,367	9	1,699	77
Commercial	352	353	10	367	29
Total	$4,425	$ 5,132	$ 66	$3,884	$ 175

	December 31, 2017			For The Year Ended December 31, 2017	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
Residential real estate	$238	$ 247	$ 47		
Commercial real estate	137	141	1		
With an allowance recorded	375	388	48		
Residential real estate	1,480	1,983	—		
Construction real estate	82	82	—		
Commercial real estate	937	1,011	—		
Commercial	378	378	—		
With no allowance recorded	2,877	3,454	—		
Residential real estate	1,718	2,230	47	$1,691	$ 67
Construction real estate	82	82	—	85	4
Commercial real estate	1,074	1,152	1	1,975	86
Commercial	378	378	—	405	26
Total	$3,252	$ 3,842	$ 48	$4,156	$ 183

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