UNION BANKSHARES INC
Form 10-K
March 31, 2014

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, 2013 Commission file number 001-15985
UNION BANKSHARES, INC.
VERMONT 03-0283552
P.O. BOX 667
20 LOWER MAIN STREET
MORRISVILLE, VT 05661-0667
Registrant's telephone number: 802-888-6600
Former name, former address and former fiscal year, if changed since last report: Not applicable
Securities registered pursuant to section 12(b) of the Act:

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes [ ] No [X]
The aggregate market value of the common stock held by non-affiliates of the registrant on June 30, 2013 was $70,280,470 based on the closing price on the NASDAQ Stock Market LLC on such date of $21.75 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 2014 Annual Meeting of Shareholders	III

UNION BANKSHARES, INC.
Table of Contents

Part I		
Item 1 -	Description of Business	4
Item 1A -	Risk Factors	13
Item 1B -	Unresolved Staff Comments	13
Item 2 -	Properties	13
Item 3 -	Legal Proceedings	13
Item 4 -	Mine Safety Disclosures	13
Part II		
Item 5 -	Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	14
Item 6 -	Selected Financial Data	15
Item 7 -	Management's Discussion and Analysis of Financial Condition and Results of Operations	16
Item 7A -	Quantitative and Qualitative Disclosures about Market Risk	37
Item 8 -	Financial Statements and Supplementary Data	44
Item 9 -	Changes in and Disagreements with Accountants on Accounting and Financial Disclosures	90
Item 9A -	Controls and Procedures	90
Item 9B -	Other Information	90
Part III		
Item 10 -	Directors, Executive Officers and Corporate Governance (a)	90
Item 11 -	Executive Compensation (a)	91
Item 12 -	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters (a)	91
Item 13 -	Certain Relationships and Related Transactions, and Director Independence (a)	91
Item 14 -	Principal Accountant Fees and Services (a)	91
Part IV		
Item 15 -	Exhibits, Financial Statement Schedules and Reports on Form 8-K	92
Signatures		93
Exhibit Index		94

(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 21, 2014. 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) and 407(e)(5) of Regulation S-K.

PART I
Item 1. Description of Business

General: Union Bankshares, Inc. (“Company”) is a one-bank holding company whose 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 16 banking offices, loan center, and 33 ATMs covering northern Vermont and northwestern New Hampshire. Also, many of Union's services are provided via the telephone and through its website, www.unionbankvt.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. 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 and service fees), provision for loan losses, noninterest expenses and income taxes. Our operations and profitability are subject to changes in interest rates, applicable statutes and regulations, general economic conditions, the competitive environment, as well as other factors beyond our control.

Employees: The Company itself does not have any paid employees. As of December 31, 2013, Union employed 188 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,
- professionals and the local tourism industry;
- Business checking accounts;
- Standby letters of credit, bank checks or money orders, and safe deposit boxes;
- Automated Teller Machine (“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, NOW accounts, savings accounts, money market accounts, certificates of deposit, IRA/SEP/KEOGH accounts and Health Savings accounts;
- Customer repurchase agreement sweeps; and
- Asset management and trust services to individuals and organizations.

Consistent with the objective of the Company to serve the needs of individuals, businesses and others within the communities served, the Company seeks to concentrate its assets in loans. For the year ended December 31, 2013, the Company's rate of average loans to average deposits was 91.9%. To be consistent with the requirements of prudent banking practices, adequate levels of assets are invested in high-grade securities, FDIC insured certificates of deposits, or other prudent investment alternatives such as company-owned life insurance or investments in real estate limited partnerships for affordable housing. Deposits are the primary source of funds for use in lending, investing and for other general operating purposes. In addition we obtain funds from principal repayments, sales and prepayments of loans, securities and FDIC insured certificates of deposit. Other funding sources may include brokered deposits purchased through CDARS or other brokerage accounts, borrowings from the FHLB of Boston, correspondent banks or the Federal Reserve discount window or utilization of a repurchase agreement line with a brokerage firm.

Competition: The Company and Union face substantial competition for loans and deposits in northern Vermont and northwestern 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.

Tax exempt credit unions have become an increasingly significant source of competition. Credit union common bond requirements and the definition of a credit union “member” have been interpreted liberally by federal and state credit union regulators while at the same time, the scope of products credit unions are permitted to offer has steadily expanded, resulting in greater penetration of this tax-advantaged segment of the financial services industry into traditional banking markets. Credit unions are also not required to reinvest in their communities or to pay federal income taxes. Credit unions' exemption from community reinvestment requirements as well as from federal taxation has been a major factor in increasing their market share and business lending. As of December 31, 2013, the most recently available information, there were more than 25 state or federally chartered credit unions operating in Vermont. With the inherent pricing advantages credit unions have due to their tax subsidy, community banks find it increasingly difficult to compete on this uneven playing field.

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 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 Bank Holding Company Act of 1956, as amended ("BHCA"), the Company is subject to regulation and supervision by the Board of Governors of the Federal Reserve System ("FRB"). As a state chartered commercial bank, Union bank is subject to the regulation and supervision by the Federal Deposit Insurance Corporation ("FDIC") and the Vermont Department of Financial Regulation ("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 Securities and Exchange Commission ("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 ("NASDAQ") 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 Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), comprehensively reformed the regulation of financial institutions, products and services. 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 Bureau of Consumer Financial Protection ("CFPB"),
- established new minimum mortgage underwriting standards for residential mortgages,
- barred banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain circumstances, and
- established the Financial Stability Oversight Council to designate certain activities as posing a risk to the United States financial systems and recommended new or heightened standards and safeguards for financial institutions engaging in such activities.

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

- A requirement that public companies solicit an advisory vote on executive compensation ("Say-on-Pay"), an advisory vote on the frequency of Say-on-Pay votes and, in the event of a merger or other extraordinary transaction, an advisory vote on certain "golden parachute" payments. This provision became applicable for Union Bankshares in 2013. At the 2013 annual meeting, the shareholders approved an advisory vote on the Company's executive compensation and a three year frequency for future advisory votes;
- 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. As a smaller reporting company, Union Bankshares is exempt from most of the provisions of the NASDAQ rule adopt in 2013 pursuant to this requirement;
- Provisions calling for the SEC to adopt expanded disclosure in the annual proxy statement and other filings, particularly in the area of executive compensation, such as disclosure of pay versus performance, the ratio of CEO pay to the pay of a median employee and policies with regard to hedging transactions conducted by employees and directors;
-

Provisions that will require the adoption or revision of certain other policies, such as compensation recovery policies providing for the recovery of executive compensation in the event of a financial restatement;

- A provision clarifying the SEC's authority to adopt rules requiring issuers to include in the proxy solicitations shareholder nominations for director; and
- A provision granting permanent relief from the auditor attestation requirements of Section 404 of the Sarbanes Oxley Act for public companies, such as Union Bankshares, that qualify as so-called "smaller reporting companies" under applicable SEC rules.

6

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, 2013, the Bank's total FDIC insurance assessment expense was $306 thousand compared to $351 thousand for the year ended December 31, 2012. The decrease in expense was attributable to improvement in factors and ratios utilized in the assessment calculations.

Brokered Deposits. The Federal Deposit Insurance Corporation Improvement Act of 1991 (“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 through its membership with the Promontory Interfinancial Network in CDARS and ICS, respectively.

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 Gramm-Leach-Bliley Financial Modernization Act of 1999 ("GLBA"). At its 2013 CRA compliance examination by the FDIC, Union again received a rating of “Outstanding.”

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, 2013, Union's reserve requirement was approximately $652 thousand which was satisfied by vault cash.

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

Capital Adequacy and Safety and Soundness

Capital Adequacy Guidelines. The FRB, the FDIC and other federal banking regulators have issued substantially similar risk based and leverage capital guidelines for United States banking organizations. Those regulatory agencies are also authorized to require that a banking organization maintain capital above the minimum levels, whether because of its financial condition or actual or anticipated growth. The FRB's risk based capital guidelines define a three-tier capital framework and specify three relevant capital ratios: Tier 1 Capital Ratio, a Total Capital Ratio and a Leverage Ratio. Tier 1 Capital consists of common and qualifying preferred shareholders' equity, plus or minus goodwill, core deposit intangible and certain other intangibles and adjustments. Certain hybrid securities, such as trust preferred securities, issued after May 19, 2010, do not count as Tier 1 capital. The Company has not issued any trust preferred or other hybrid securities. The remainder (Tier 2 and Tier 3 Capital) consists of subordinate and other qualifying debt, preferred stock that does not qualify as Tier 1 Capital, and the allowance for credit losses up to 1.25% of risk weighted assets. The Dodd-Frank Act requires the FRB to establish minimum risk based capital requirements that may not be lower than those in effect on July 21, 2010. Please refer to Note 21. Regulatory Capital Requirements in Item 8. in this form 10-K for the capital ratios for the Company and Union as of December 31, 2013 and December 31, 2012.

The sum of Tier 1, Tier 2 and Tier 3 Capital, less investments in unconsolidated subsidiaries, represents qualifying “Total Capital,” at least 50% of which must consist of Tier 1 Capital. Risk based capital ratios are calculated by dividing Tier 1 Capital and Total Capital by risk weighted assets. Assets and off-balance-sheet exposures are assigned to one of four categories or risk weights, based primarily on relative credit risk. The minimum Tier 1 Capital Ratio is 4% and the minimum Total Capital Ratio is 8%. The Leverage Ratio is determined by dividing Tier 1 Capital by adjusted average total assets. Although the minimum Leverage Ratio is 3%, most banking organizations (including the Company) are required to maintain Leverage Ratios of at least 4%. 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.

FRB policy provides that banking organizations generally, and, in particular, those that are experiencing rapid internal growth or actively making acquisitions, will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets, such as goodwill. Furthermore, the capital guidelines indicate that the FRB will continue to consider a “Tangible Tier 1 Leverage Ratio” in evaluating proposals for expansion or new activities. The Tangible Tier 1 Leverage Ratio is calculated by dividing a banking organization's Tier 1 Capital less all intangible assets by its total consolidated quarterly average assets less all intangible assets. The FRB's capital adequacy guidelines generally provide that bank holding companies with a ratio of intangible assets to tangible Tier 1 Capital in excess of 25% will be subject to close scrutiny for certain purposes, including the FRB's evaluation of acquisition proposals.

The Basel Committee on Banking Supervision has released new global capital adequacy standards, known as Basel III, setting forth higher capital requirements, enhanced risk coverage, a global leverage ratio, and provisions for counter-cyclical capital and liquidity standards. On July 2, 2013, the federal banking agencies issued a final rule (the “Final Capital Rule”) implementing the Basel III capital standards and establishing the minimum capital requirements for banks and bank holding companies required under the Dodd-Frank Act. The majority of the provisions of the Final Capital Rule apply to bank holding companies and banks with consolidated assets of $500 million or more, such as the Company and Union. The Final Capital Rule establishes a new capital risk-based capital ratio, a minimum common equity Tier 1 capital ratio of 6.5% of risk-weighted assets to be a “well capitalized” institution, and increases the minimum total Tier 1 capital ratio to be a “well capitalized” institution from 6.0% to 8.0%. Additionally, the Final Capital Rule requires that an institution establish a capital conservation buffer of common equity Tier 1 capital in an amount above the minimum risk-based capital requirements for “adequately capitalized” institutions equal to 2.5% of total risk weight assets to avoid restrictions on capital distributions and executive bonuses. The Final Capital Rule increases the required capital for certain categories of assets, including higher-risk construction real estate loans and certain exposures related to securitizations. Under the Final Capital Rule, we may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If we do not make this election, unrealized gains and losses would be included in the calculation of our regulatory capital. We must comply with the Final Capital Rule beginning on January 1, 2015.

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, 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 current regulations, a “well capitalized” institution must have a Tier 1 capital ratio of at least 6%, 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. An “adequately capitalized” institution must have a Tier 1 capital ratio of at least 4%, a total capital ratio of at least 8% and a leverage ratio of at least 4%, or 3% in some cases.

At December 31, 2013, the Company's consolidated Tier I and Total Risk Based Capital Ratios were 12.0% and 13.3% respectively, and its Leverage Capital Ratio was 8.0%, and it is considered well capitalized under the current regulatory guidelines. As of December 31, 2013, our capital ratios were more than sufficient to satisfy those anticipated increases resulting from the proposed Basel III Capital Framework. However, an increase in the amount of capital that the Company or Union must maintain in order to support a given level of assets would reduce the amount of leverage that our capital could support and increased volatility could be problematic. Our ability to increase our level of interest earning assets or to allocate those assets in the best manner to generate interest income may be adversely affected.

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

FDICIA also contains a variety of other provisions that may affect Union's operations, including reporting requirements, regulatory guidelines for real estate lending, “truth in savings” disclosure provisions, and the requirement that a depository institution give 90 days prior notice to customers and regulatory authorities before closing any branch. Beginning in 2012, Union has been 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 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 which 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.

Consumer Protection Regulation

We are subject to a number of federal and state laws designed to protect consumers and prohibit unfair or deceptive business practices, including the Equal Credit Opportunity Act, the Fair Housing Act, Home Ownership Protection Act, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003 (the “FACT Act”), GLBA, the Truth in Lending Act, CRA, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the National Flood Insurance Act and various state law counterparts. Union is also subject to laws and regulations to protect consumers in connection with their deposit or electronic transactions. These laws include the Truth in Savings, the Electronic Funds Transfer and the Expedited Funds Availability Acts. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must interact with customers when taking deposits, making loans, collecting loans and providing other services. Further, the Dodd-Frank Act established the CFPB, which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services. The CFPB also has a broad mandate to prohibit unfair or deceptive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. The CFPB may lead to conflicting regulatory guidance for community banks versus banks with assets in excess of $10 billion 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 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.
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, and, except as otherwise required or permitted by law, we are prohibited from disclosing such information except as provided in such policies and procedures. The GLBA also requires that we develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information (as defined under the GLBA), to protect

against anticipated threats or hazards to the security or integrity of such information; and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. We are also required to send a notice to customers whose "sensitive information" has been compromised if unauthorized use of this information is "reasonably possible." Most of the states, including the states where we operate, have enacted legislation concerning breaches of data security and our duties in response to a data breach. Congress continues to consider federal legislation that would require consumer notice of data security breaches. Pursuant to the FACT Act, we have developed and implemented a written identity theft prevention program to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts.
Additionally, the FACT Act amends the Fair Credit Reporting Act to generally prohibit a person from using information received from an affiliate to make a solicitation for marketing purposes to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations.

Home Mortgage Disclosure Act (“HMDA”). HMDA makes information available to the public that helps to show whether financial institutions are serving the housing credit needs of their neighborhoods and communities. The Act requires institutions to gather and compile data about loan applications for home purchase, home improvement and refinances where the new loan is secured by a dwelling. The Dodd-Frank Act requires additional information be gathered and compiled but new regulations have not yet been promulgated. The information must be compiled each calendar year on a Loan/Application Register, sent to the FDIC by March 1st of the following year and made available to the public no later than March 31st. The Federal Financial Institutions Examinations Council prepares and sends to each reporting institution a series of tables that comprise the disclosure statement for the institution. HMDA applies to financial institutions that have their main office or any branch in a Metropolitan Statistical Area ("MSA"). Union is subject to HMDA as it has branch offices within the Burlington, Vermont MSA.

Regulation of Other Activities

Transactions with Related Parties. The Company's and Union's authority to extend credit, purchase or sell an asset from or to their directors, executive officers and 10% or more stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of the Federal Reserve Act and Regulation O of the FRB thereunder. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based in part, on the amount of the bank's capital. Under NASDAQ guidelines, any related party transaction, including a loan, must be reviewed by the Company's Audit Committee. In addition, under the federal Sarbanes-Oxley Act of 2002 (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 Board of Directors 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, followed by the May 2011 acquisition of three additional New Hampshire branches.

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.

Volcker Rule Restrictions on Proprietary Trading and Sponsorship of Hedge Funds and Private Equity Funds. The Dodd-Frank Act bars banking organizations, such as the Company and the Bank, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain circumstances, in a provision commonly referred to as the "Volcker Rule." Under the Dodd-Frank Act, proprietary trading generally means trading by a banking entity or its affiliate for its own account. Hedge funds and private equity funds are described by the Dodd-Frank Act as funds that would be registered under the 1940 Act but for certain enumerated exemptions. The Volcker Rule restrictions apply to the Company, the Bank and all of their subsidiaries and affiliates.

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

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

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

Sarbanes-Oxley Act of 2002 ("SOX" Act). This far reaching federal legislation was generally intended to protect investors by strengthening corporate governance and improving the accuracy and reliability of corporate disclosures made pursuant to federal securities laws. The SOX Act is applicable to the Company, which is a "smaller reporting company," in the following ways:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);
- independence requirements for audit committee members;
- corporate governance requirements;
- independence requirements for company auditors that restrict nonaudit services that accountants may provide to their audit clients;
- enhanced disclosure requirements pertaining to corporate operations and internal controls;
- certification of financial statements and internal controls on reports on Forms 10-K and 10-Q by the chief executive officer and the chief financial officer;
- the forfeiture by the chief executive officer and the chief financial officer of bonuses or other incentive based compensation and profits derived from the sale of an issuer's securities by such officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
- disclosure of off-balance-sheet transactions;
- two business day filing requirements for insiders filing reports on Form 4 of transactions in the issuer's securities;
- disclosure of a code of ethics for principal financial officers and filing a Form 8-K for a change in or waiver of such code;
- the reporting of securities violations “up the ladder” by both in house and outside attorneys;
- restrictions on the use of non-GAAP financial measures in press releases and SEC filings; and
- various increased criminal penalties for violations of 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 2012 and will do the same for 2013. No tax return is currently being examined or audited by any taxing authority that the Company is aware of. The taxing authorities also regulate the information reporting requirements that Union is subject to which continue to increase and require resources to comply with.

Available Information

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

Our Internet website address is www.unionbankvt.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 Securities and Exchange Commission. The information on our website is not incorporated by reference into this report.

The Company will also provide copies of its 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 in a downloadable, printable and searchable format, are available at www.cfpproxy.com/6393.

Item 1A. Risk Factors

Not applicable as the Company meets the qualification requirements for smaller reporting companies.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

As of December 31, 2013, Union operated 12 community banking locations in Lamoille, Caledonia and Franklin counties of Vermont, four in Grafton and Coos counties of New Hampshire and a loan center in South Burlington, Vermont. In addition as of such date, Union also operated 29 ATMs in northern Vermont and four in New Hampshire. Union owns, free of encumbrances, fourteen of its branch locations and its operations center and leases two branch locations, the loan center and certain ATM premises from third parties under terms and conditions considered by management to be favorable to Union. Also, Union currently owns two parcels of real estate expected to be utilized for future branch locations. 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, 2013, is set forth in Note 8 to the consolidated financial statements contained in Item 8 to 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

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

	2013			2012		
	High	Low	Dividends	High	Low	Dividends
First Quarter	$22.15	$19.25	$0.25	$20.00	$18.56	$0.25
Second Quarter	$22.00	$20.21	$0.25	$19.90	$18.75	$0.25
Third Quarter	$22.08	$20.73	$0.25	$21.00	$18.80	$0.25
Fourth Quarter	$23.00	$21.03	$0.26	$20.09	$19.26	$0.25

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

On March 17, 2014, there were 4,458,262 shares of common stock outstanding held by 592 stockholders of record. The number of stockholders does not reflect the number of beneficial owners, including persons or entities who may hold the stock in nominee or “street name.” On January 15, 2014, the Company declared a regular dividend of $0.26 per share to stockholders of record as of January 25, 2014 payable February 6, 2014. Future dividends will depend upon the financial condition and earnings of the Company and its subsidiary, its need for funds and other factors, including government regulations.

There was no repurchase of the Company's common stock during the fourth quarter of 2013.

Pursuant to a discretionary stock repurchase program adopted in 2010, and most recently reauthorized in January 2014, the Company may repurchase up to 2,500 shares of its common stock each quarter, with no carry over from quarter to quarter of the unused portion of the authorization. Purchases may be made in the open market or negotiated transactions. As of December 31, 2013 the Company had repurchased 7,849 shares under this program since its inception in 2010 for a total cost of $147 thousand.

Equity Compensation Plans: During the quarter ended December 31, 2013, no incentive stock options previously granted pursuant to the Company's Incentive Stock Option Plan were exercised. There were options with respect to 6,000 shares granted during the quarter. There were no options that lapsed during the quarter ended December 31, 2013 leaving options with respect to 14,500 shares granted earlier in 2013 or in prior years outstanding at December 31, 2013, of which options with respect to 8,500 shares were exercisable at December 31, 2013. Participation in the 2008 Incentive Stock Option Plan (“Plan”) is limited to those senior officers of the Company or its subsidiary (currently three active participants) selected by the Board of Directors in its discretion. The exercise price of all options granted under the Plan represents the fair market value of the shares on the date of grant. Shares issuable to Plan participants upon exercise of incentive stock options have not been registered with the Securities and Exchange Commission. Such shares are restricted securities, issued under statutory exemptions available under the Securities Act of 1933, including Section 4(2) thereof, for offers and sales not involving a public offering.

The following table summarizes certain information regarding equity compensation under the Company's 2008 Incentive Stock Option Plan, currently the only equity compensation plan of the Company:

Equity Compensation Plan Information as of December 31, 2013:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders			
2008 Incentive Stock Option Plan	14,500	$20.56	25,000
Equity compensation plans not approved by security holders	—	—	—
Total	14,500	$20.56	25,000

The Company normally pays regular quarterly cash dividends in February, May, August and November of each year. The Company has occasionally declared a special cash or stock dividend. On October 15, 2013, the Company's Board of Director's voted to increase the regular quarterly dividend from $.25 per share to $.26, or a 4.0% increase for the quarter. The Company's Board of Directors will continue to manage dividends to be in line with long-term trends in earnings per share results and conservative earnings projections, while retaining sufficient profits to support capital strength, anticipated business growth, fund strategic investments and provide continued support for the Company's deposit taking and lending activities. Dividends paid by Union are the primary source of funds available to the Company for payment of dividends to its shareholders. Union is subject to certain requirements imposed by state and federal banking laws and regulations. These requirements, among other things, establish minimum levels of capital and restrict the amount of dividends that may be distributed by Union to the Company. Future dividends are subject to the discretion of the Company's Board of Directors, cash needs, general business conditions, dividends from Union, and applicable governmental regulations and policies.

Five Year Performance Graph: Not applicable as the Company meets the qualification requirements for smaller reporting companies.

Item 6. Selected Financial Data

Not applicable as the Company meets the qualification requirements for smaller reporting companies

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, 2013 and 2012, and its results of operations for the years ended December 31, 2013 and 2012. This discussion is being presented to provide a narrative explanation of the consolidated financial statements and should be read in conjunction with the consolidated financial statements and related notes and with other financial data in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. 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. The Company meets the qualification requirements under Securities and Exchange Commission ("SEC") rules for smaller reporting companies, and pursuant to such rules, has elected to present audited statements of income, comprehensive income, cash flows and changes in stockholders' equity for each of the preceding two, rather than three, fiscal years. Management is not aware of the occurrence of any events after December 31, 2013 which would materially affect the information presented.

FORWARD-LOOKING STATEMENTS

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

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

Factors that may cause results or performance to differ materially from those expressed in forward-looking statements include, but are not limited to: (1) continuing general economic conditions and financial instability, either nationally, internationally, regionally or locally resulting from elevated unemployment rates, changes in monetary and fiscal policies, and adverse changes in the credit rating of U.S. government debt; (2) increased competitive pressures from tax-advantaged credit unions and other financial service providers in the Company's northern Vermont and northwestern 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; (3) interest rates change in such a way that continues to put pressure on the Company's margins, or result in lower fee income and lower gain on sale of real estate loans; (4) 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; (5) changes in federal or state tax policy; (6) changes in the level of nonperforming assets and charge-offs; (7) changes in estimates of future reserve requirements based upon relevant regulatory and accounting requirements; (8) changes in consumer and business spending, borrowing and savings habits; (9) further changes to the calculation of the Company’s regulatory capital ratios which, among other things, would require additional regulatory capital, change the framework for risk-weighting of assets and require accumulated other comprehensive income to be reflected in regulatory capital; and (10) 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 Federal Reserve Board (“FRB”).

RISK FACTORS

The Company, like other financial institutions, is subject to a number of risks, many of which are outside of the Company's direct control, though efforts are made to manage those risks while optimizing returns. Managing those risks is an essential part of successfully managing a financial institution. Risk identification and monitoring are key elements in overall risk management. Among the risks inherent in the Company's business operations are: (1) credit risk, which is the risk that loan customers or other counterparties will be unable to perform their contractual obligations, (2) interest rate risk, which is the risk that changes in market rates and prices will adversely affect the Company's financial condition or results of operation, (3) liquidity risk, which is the risk that the Company will have insufficient funds or access to funds to meet operational needs, (4) price risk, which is the risk to earnings or capital that results from the changes in the value of portfolios of financial instruments, (4) transactional risk, which is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, (5) compliance risk, which is the risk of loss resulting from violations or nonconformance with laws, rules, regulations, prescribed practices, or ethical standards, (6) strategic risk, which is the risk from adverse business decisions or improper implementation of those decisions, and (7) reputation risk, which is the risk to earnings or capital from negative public opinion.

CRITICAL ACCOUNTING POLICIES

The Company has established various accounting policies which govern the application of U.S. Generally Accepted Accounting Principles ("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 allowance for loan losses 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 allowance is based on management's periodic evaluation of the collectability of the loan portfolio, including the nature, volume and risk characteristics of the portfolio, credit concentrations, trends in historical loss experience, estimated value of any underlying collateral, specific impaired loans and economic conditions. Changes in these qualitative factors may cause management's estimate of the allowance for loan losses 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 other than temporary impairment 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 other than temporary. A review of other than temporary impairment 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 other than temporary 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 Other comprehensive income (loss). Once an other than temporary loss on a debt or equity security is realized, subsequent gains in the value of the security may not be recognized in income until the security is sold.

Intangible assets

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

Pension liabilities

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

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

Other

The Company also has other key accounting policies, which involve the use of estimates, judgments and assumptions, that are significant to understanding the Company's financial condition and results of operations, including the valuation of deferred tax assets, investment securities and other real estate owned ("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

Historically, the largest and most variable source of income for the Company is net interest income. The results of operations for the years ended December 31, 2013 and 2012 reflect the impact of changes in rates as well as growth in the volume and change in composition of both interest earning assets and interest bearing liabilities during these periods.

The prime rate remained at 3.25% throughout 2012 and 2013. The discount rate remained at 0.75% and the target federal funds range remained at the 0.00% to 0.25% range throughout both years as well. The continuing low interest rate environment and aggressive rate competition from in-market and out-of-market financial institutions makes deposit accounts increasingly difficult to attract and retain as well as intensifies the competition for loans.

The Company's average assets grew by $12.0 million, or 2.1%, during 2013 to an average of $572.7 million from $560.7 million in 2012. Net interest income increased slightly from $21.7 million in 2012 to $22.0 million in 2013. The net $345 thousand increase was due to the decrease in interest expense of $892 thousand from $3.4 million in 2012 to $2.5 million in 2013 reflecting results of the deleveraging transaction that was executed in December 2012 to payoff advances from the FHLB of Boston of $11.0 million with an average rate of 3.48%. Rates paid on all interest bearing liabilities dropped as well. This decrease in interest expense was partially offset by a decrease in interest income of $547 thousand from $25.0 million in 2012 to $24.5 million in 2013. Yields dropped as adjustable rate loans repriced at lower rates, existing loans were refinanced and new loans, interest bearing deposits in banks and investments were originated or repriced at lower rates. See Yields Earned and Rates Paid and the Rate/ Volume Analysis tables on page 20 through 22, respectively, for further details.

The Company continued to manage growth and interest rate risk during 2013 through the sale of $123.1 million in long-term fixed-rate residential loans and the net participation of an additional $815 thousand in commercial real estate loans. The Company realized $2.3 million in net gains on sales of loans held for sale in 2013 compared to $3.6 million in 2012. The historically low prime rate and low long-term mortgage rates throughout 2013 continued to drive customer refinancings and also contributed to the 6 basis point, or 1.4%, decrease in the net interest margin, to 4.21% for 2013 as compared to 4.27% for 2012.

With the modest improvements in the economy, loan demand remained steady in 2013, with total loan growth of $9.8 million, or 2.2%, over 2012, net of loan sales of $123.1 million in 2013. Commercial real estate loans grew $13.5 million, or 6.8%, residential real estate loans grew $4.5 million, or 2.9%, and municipal loans grew $5.7 million, or 20.0%, while construction real estate loans dropped $5.1 million, or 14.2%, and residential loans held for sale dropped $7.2 million, or 65.1%. The Company's asset quality remained strong compared to the banking industry as a whole, when measured by net charge-offs of 0.07% to average loans not held for sale in 2013, which reflects a slight increase from 0.05% in 2012. Loans in nonaccrual status decreased between years to $1.4 million at December 31, 2013 versus $2.8 million at December 31, 2012. Other nonperforming loans decreased to $263 thousand at December 31, 2013 from $307 thousand at December 31, 2012. The Company's ratio of allowance for loan losses to loans not held for sale was 1.01% at December 31, 2013 compared to 1.05% at December 31, 2012. The decrease in the 2013 loan loss provision to $305 thousand from $660 thousand in 2012 reflects the composition of the loan portfolio, net charge offs, the general economy and management's assessment of credit quality.

Deposits grew $8.4 million, or 1.6%, from $510.0 million at December 31, 2012 to $518.4 million at December 31, 2013. Total average deposits grew $19.9 million, or 4.1%, between years with average nontime deposits growing $21.5 million, or 6.5%, during the same time frame, while average time deposits dropped $1.6 million, or 1.0%. Interest rates paid on deposits have dropped steadily over the last three years but there is little room left to drop them more in the future. The growth in deposits was utilized to support growth in both the investment and loan portfolios.

The Company's total capital increased $4.8 million, or 10.60%, from $45.0 million at December 31, 2012 to $49.8 million at December 31, 2013. The increase in total capital is due to the combined effect of net income of $7.1 million and an increase of $3.1 million in other comprehensive income attributable to the change in the unfunded defined benefit pension liability, offset by $4.5 million in dividends paid in 2013 and a decrease in other comprehensive income of $1.0 million resulting from unrealized losses on investment securities available-for-sale. Capital ratios continue to meet the regulatory guidelines for well capitalized, and increased as of December 31, 2013. The Company's total risk based capital ratio at December 31, 2012 was 12.95% and had increased to 13.28% at December 31, 2013. The regulatory guideline for well capitalized insured depository institutions is 10.00% and the minimum requirement is 8.00%.

The following per share information and key ratios depict several measurements of performance or financial condition for or at the years ended December 31:

	2013	2012	2011
Return on average assets ("ROA")	1.25 %	1.22 %	1.04 %
Return on average equity ("ROE")	15.46 %	16.35 %	12.47 %
Net interest margin (1)	4.21 %	4.27 %	4.29 %
Efficiency ratio (2)	68.04 %	71.51 %	72.61 %
Net interest spread (3)	4.10 %	4.14 %	4.11 %
Total loans to deposits ratio	89.70 %	89.25 %	90.66 %
Net loan charge-offs to average loans not held for sale	0.07 %	0.05 %	0.08 %
Allowance for loan losses to loans not held for sale (4)	1.01 %	1.05 %	1.00 %
Nonperforming assets to total assets (5)	0.39 %	0.73 %	1.40 %
Equity to assets	8.51 %	7.80 %	7.30 %
Total capital to risk weighted assets	13.28 %	12.95 %	12.17 %
Book value per common share	$11.17	$10.11	$9.05
Earnings per common share	$1.60	$1.54	$1.17
Dividends paid per common share	$1.01	$1.00	$1.00
Dividend payout ratio (6)	63.13 %	64.94 %	85.47 %

(1) The ratio of tax equivalent net interest income to average earning assets. See page 21 for more information.

(2) The ratio of noninterest expense ($21.2 million in 2013, $23.0 million in 2012 and $19.8 million in 2011) to tax equivalent net interest income ($22.7 million in 2013, $22.4 million in 2012 and $20.3 million in 2011) and noninterest income ($8.5 million in 2013, $10.5 million in 2012 and $7.1 million in 2011) excluding securities (losses) gains ($(1) thousand in 2013, $673 thousand in 2012 and $183 thousand in 2011).

(3) The difference between the average rate earned on earning assets and the average rate paid on interest bearing liabilities. See page 21 for more information.

(4) Calculation includes the net carrying amount of loans recorded at fair value from the 2011 branch acquisition as of December 31, 2013 ($17.0 million), December 31, 2012 ($22.9 million) and December 31, 2011 ($27.9 million). Excluding such loans, the allowance for loan losses to loans not purchased and not held for sale was 1.05% at

December 31, 2013, 1.11% at December 31, 2012 and 1.07% at December 31, 2011.

(5) Nonperforming assets are loans or investment securities that are in nonaccrual or 90 or more days past due as well as other real estate or assets owned.

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

RESULTS OF OPERATIONS

The Company's net income for the year ended December 31, 2013, was $7.1 million compared with net income of $6.8 million for the year 2012, an increase of 4.3%. Pressure on the net interest margin continued due to the prevailing low interest rate environment, resulting in a decrease of 6 basis points from 4.27% for 2012 to 4.21% for 2013. Earnings per share increased to $1.60 in 2013 from $1.54 in 2012, reflecting the combined effect of the following income and expense items: Net interest income increased $345 thousand, or 1.6%, with a 2.9% growth in average interest earning assets; the Provision for loan losses decreased $355 thousand, or 53.8%; noninterest income decreased $2.0 million, or 19.2%; noninterest expense decreased $1.8 million, or 7.9% and the Provision for income taxes increased $199 thousand, or 12.0%.

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 expense paid on interest bearing liabilities. The Company's level of net interest income can fluctuate over time due to changes in the level and mix of interest earning assets and interest bearing liabilities and from changes in the yields earned and costs of funds. The Company’s net interest income increased slightly $345 thousand, or 1.6%, to $22.0 million for the year ended December 31, 2013, from $21.7 million for the year ended December 31, 2012. This increase was due primarily to the combined effect of the decrease in interest expense of $892 thousand from $3.4 million in 2012 to $2.5 million in 2013 and the decrease in interest income of $547 thousand from $25.0 million in 2012 to $24.5 million in 2013. The decrease in interest expense reflects a combination of lower rates paid on deposit accounts and results from the deleveraging transaction that was executed in December 2012 with the sale of $11.7 million in available-for-sale debt securities, of varying types, with an estimated yield of 3.10% and the payoff of advances from the FHLB of Boston of $11.0 million with an average rate of 3.48%. In addition, both years reflected the historically low 3.25% prime rate. Asset yields dropped as adjustable rate loans repriced at lower rates, existing loans were refinanced and new loans and investments originated at lower rates. However, the effect of this continuing decrease in yields was partially offset by the growth in average interest earning assets to $539.4 million in 2013 from $524.3 million in 2012. The Company’s net interest income increased $1.9 million, or 9.7%, to $21.7 million for the year ended December 31, 2012, from $19.8 million for the year ended December 31, 2011.

On average for the year, 94.2% of assets earned interest in 2013 compared to 93.5% in 2012. The net interest spread decreased to 4.10% for the year ended December 31, 2013, from 4.14% for the year ended December 31, 2012, as rates dropped slightly more on interest earning assets than on interest bearing liabilities. Rates were already near historic lows coming into 2012 and have moved even lower in 2013. The net interest margin for the 2013 period decreased 6 basis points to 4.21% from 4.27% for the 2012 period, reflecting the change in the composition of average interest earning assets and repricing of such assets at lower rates.

Yields Earned and Rates Paid. 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. Yield and rate information is average information for the year, and is calculated by dividing the tax equivalent income or expense item for the year by the average balance of the appropriate balance sheet item for that year. Net interest margin is tax equivalent net interest income divided by average earning assets. Nonaccrual loans or investments are included in asset balances for the appropriate periods, but recognition of interest on such loans or investments is discontinued and any remaining accrued interest receivable is reversed in conformity with federal regulations.

The following table presents average balance sheet data and an analysis of net interest income which illustrates interest income earned and interest expense paid for each major component of interest earning assets and interest bearing liabilities:

	Years Ended December 31,								
	2013			2012			2011		
	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	$17,920	$32	0.18 %	$17,789	$27	0.15 %	$18,578	$34	0.18 %
Interest bearing deposits in banks	21,371	226	1.06 %	21,994	270	1.23 %	16,596	309	1.86 %
Investment securities (1), (2)	35,690	882	2.85 %	37,698	1,037	3.20 %	34,625	1,051	3.44 %
Loans, net (1), (3)	462,438	23,334	5.16 %	444,836	23,684	5.44 %	401,625	22,269	5.64 %
Nonmarketable equity securities	1,964	7	0.37 %	1,942	10	0.50 %	1,924	6	0.29 %
Total interest earning assets (1)	539,383	24,481	4.66 %	524,259	25,028	4.91 %	473,348	23,669	5.11 %
Cash and due from banks	4,573			4,683			5,683		
Premises and equipment	10,465			10,070			8,513		
Other assets	18,313			21,725			16,022		
Total assets	$572,734			$560,737			$503,566		
Average Liabilities and Stockholders' Equity:									
Interest bearing checking accounts	$94,213	$85	0.09 %	$88,007	$140	0.16 %	$74,862	$171	0.23 %
Savings/money market accounts	174,680	347	0.20 %	167,846	414	0.25 %	141,136	554	0.39 %
Time deposits	150,497	1,511	1.00 %	152,085	1,862	1.22 %	144,494	2,100	1.45 %
Borrowed funds	17,955	516	2.84 %	27,267	935	3.38 %	29,621	1,083	3.61 %
Total interest bearing liabilities	437,345	2,459	0.56 %	435,205	3,351	0.77 %	390,113	3,908	1.00 %
Noninterest bearing deposits	83,744			75,265			66,389		
Other liabilities	5,483			8,400			5,195		
Total liabilities	526,572			518,870			461,697		
Stockholders' equity	46,162			41,867			41,869		
Total liabilities and stockholders’ equity	$572,734			$560,737			$503,566		
Net interest income		$22,022			$21,677			$19,761	
Net interest spread (1)			4.10 %			4.14 %			4.11 %
Net interest margin (1)			4.21 %			4.27 %			4.29 %

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

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

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

Tax exempt interest income amounted to $1.5 million for both years ended December 31, 2013 and 2012 and $1.2 million for 2011. To improve comparability of results across periods, the following table presents the effect of tax-exempt income on the calculation of net interest income, using a marginal tax rate of 34% for all years:

	Years Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Net interest income as presented	$22,022	$21,677	$19,761
Effect of tax-exempt interest			
Investment securities	135	170	141
Loans	530	512	390
Net interest income, tax equivalent	$22,687	$22,359	$20,292

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, 2013 Compared to Year Ended December 31, 2012 Increase/(Decrease) Due to Change In			Year Ended December 31, 2012 Compared to Year Ended December 31, 2011 Increase/(Decrease) Due to Change In		
	Volume	Rate	Net	Volume	Rate	Net
	(Dollars in thousands)					
Interest earning assets:						
Federal funds sold and overnight deposits	$—	$5	$5	$(1)	$(6)	$(7)
Interest bearing deposits in banks	(8)	(36)	(44)	84	(123)	(39)
Investment securities	(43)	(112)	(155)	89	(103)	(14)
Loans, net	926	(1,276)	(350)	2,316	(901)	1,415
FHLB of Boston stock	—	(3)	(3)	—	4	4
Total interest earning assets	$875	$(1,422)	$(547)	$2,488	$(1,129)	$1,359
Interest bearing liabilities:						
Interest bearing checking accounts	$9	$(64)	$(55)	$28	$(59)	$(31)
Savings/money market accounts	17	(84)	(67)	92	(232)	(140)
Time deposits	(19)	(332)	(351)	106	(344)	(238)
Borrowed funds	(285)	(134)	(419)	(81)	(67)	(148)
Total interest bearing liabilities	$(278)	$(614)	$(892)	$145	$(702)	$(557)
Net change in net interest income	$1,153	$(808)	$345	$2,343	$(427)	$1,916

Interest and Dividend Income. The Company's interest and dividend income decreased $547 thousand, or 2.2%, to $24.5 million for the year ended December 31, 2013, from $25.0 million for the year ended December 31, 2012, mostly driven by the lower rates earned on all interest earning assets except federal funds sold and overnight deposits, as the persistent low interest rate environment resulted in lower yields earned on new earning assets in the year ended

December 31, 2013 versus 2012. The negative effect on interest income resulting from the lower rates was partially offset by an increase in average earning assets of $15.1 million, or 2.9%, from $524.3 million for the year ended December 31, 2012 to $539.4 million for the year ended December 31, 2013. The Company's interest and dividend income increased $1.4 million, or 5.7%, to $25.0 million for the year ended December

31, 2012, from $23.7 million for the year ended December 31, 2011. Average loans approximated $462.4 million at an average yield of 5.16% for the year ended December 31, 2013, up $17.6 million, or 4.0% from an average volume of $444.8 million at an average yield of 5.44% for the year ended December 31, 2012. Despite the increase in average loan volume between years, the lower yields earned resulted in a decrease in interest income on loans of $350 thousand, or 1.5%, to $23.3 million for the year ended December 31, 2013 versus $23.7 million for 2012. The positive impact of the increase in average total loan volume was more than offset by a 28 basis point decrease in average yield. Interest income on loans increased $1.4 million, or 6.4%, to $23.7 million for the year ended December 31, 2012 compared to $22.3 million for 2011.

The average balance of investments decreased $2.0 million, or 5.3%, from $37.7 million for the year ended December 31, 2012, to $35.7 million for the year ended December 31, 2013, with a 35 basis point decrease in the yield on the investment portfolio from 3.20% for 2012 to 2.85% for 2013. The average balance of FDIC insured interest bearing deposits in banks decreased $623 thousand, or 2.8%, to $21.4 million for the year ended December 31, 2013 from $22.0 million for the year ended December 31, 2012, with a 17 basis point decrease in the average yield from 1.23% for 2012 to 1.06% for 2013, reflecting the maturity during 2013 of interest bearing deposits with higher rates and original terms of two to five years that are unable to be reinvested at these same rates due to the continued low interest rate environment during the last year. The average balance of federal funds sold and overnight deposits increased $131 thousand, or 0.7%, from $17.8 million for the year ended December 31, 2012 to $17.9 million for the year ended December 31, 2013, with a slight increase in the average yield from 0.15% for 2012 to 0.18% for 2013, as the Federal Funds target rate set by the FOMC stayed between 0.00% and 0.25% throughout 2012 and 2013. Interest income from nonloan instruments decreased $197 thousand, or 14.7%, between years, with $1.1 million in income for 2013 and $1.3 million for 2012, reflecting the overall decrease in average yields on interest bearing deposits and investment securities. The average volume of nonloan interest bearing asset categories decreased from $79.4 million for the year ended December 31, 2012 to $76.9 million for the year ended December 31, 2013 contributing to the drop in interest income. Interest income from nonloan instruments decreased $56 thousand, or 4.0%, to $1.3 million for the year ended December 31, 2012 compared to $1.4 million for 2011.

Interest Expense. The Company’s interest expense decreased $892 thousand, or 26.6%, to $2.5 million for the year ended December 31, 2013, from $3.4 million for the year ended December 31, 2012, despite a volume increase of $2.1 million in average volume of interest bearing liabilities between years. The decrease was attributable to lower rates paid on all interest bearing liabilities reflecting the persistent low interest rate environment, an increase in lower cost deposit products and the early payoff of higher rate FHLB of Boston advances at the end of 2012. The Company’s interest expense decreased $557 thousand, or 14.3%, to $3.4 million for the year ended December 31, 2012, from $3.9 million for the year ended December 31, 2011.

Interest expense on deposits decreased $473 thousand, or 19.6%, from $2.4 million for the year ended December 31, 2012 to $1.9 million for the year ended December 31, 2013, despite an increase in the average volume of interest bearing deposits between years. Interest rates dropped significantly during the last two years as it became apparent that the low interest rate environment was not going to be of a short duration. Average interest bearing deposits increased $11.5 million, or 2.8%, from $407.9 million for the year ended December 31, 2012 to $419.4 million for the year ended December 31, 2013. This increase reflects the overall growth in the franchise as well as the continued uncertainty surrounding the financial markets as customers retain cash in lieu of other less liquid investments. Average time deposits decreased $1.6 million, or 1.0%, to $150.5 million for 2013 from $152.1 million for 2012. Average interest bearing checking accounts increased $6.2 million, or 7.1%, from $88.0 million for the year ended December 31, 2012 to $94.2 million for the year ended December 31, 2013. The average balances of savings and money market accounts increased $6.8 million, or 4.1%, from $167.8 million for the year ended December 31, 2012 to $174.7 million for the year ended December 31, 2013. The average rate paid on interest bearing deposits decreased 13 basis points from 0.59% in 2012 to 0.46% in 2013.

Interest expense on borrowed funds decreased $419 thousand, or 44.8%, to $516 thousand for the year ended December 31, 2013, from $935 thousand for the year ended December 31, 2012. The deleveraging transaction that occurred in December 2012, in which the Company prepaid seven amortizing and bullet advances and the May and December 2013 prepayment of three amortizing advances, partially offset by a three year bullet advance taken during the third quarter of 2013, account for most of the decrease in average borrowed funds of $9.3 million, or 34.2%, from $27.3 million for 2012, to $18.0 million for 2013, with average borrowings from the FHLB of Boston decreasing $9.0 million, or 40.0% from $22.5 million for 2012 to $13.5 million for 2013. In addition, average customer overnight collateralized repurchase sweeps decreased $697 thousand, partially offset by an increase of $379 thousand in the average of other interest bearing liabilities. The average rate paid on borrowed funds decreased from 3.38% for the year ended December 31, 2012 to 2.84% for the year ended December 31, 2013, reflecting the effect of the paydowns of higher rate FHLB of Boston advances.

Provision for Loan Losses. The provision for loan losses decreased from $660 thousand in 2012 to $305 thousand in 2013. During 2013, nonperforming loans decreased by $1.4 million and loans rated substandard, net of government guarantees, that represent a higher degree of risk of loss decreased by $1.9 million. As a result of the qualitative factor reviews during the year ended December 31, 2013, no changes were made to the qualitative factors assigned to any segment of the loan portfolio. Despite the growth in the loan portfolio during 2013, the lower provision in 2013 was deemed appropriate by management in light of the decrease in nonperforming loans, the decrease in substandard loans, the change in the mix of the portfolio and the outlook for future economic conditions. Refer to Asset Quality and Allowance for Loan Losses sections below for a more in depth discussion.

Noninterest Income. Noninterest income before gains and losses on investment securities available-for-sale was $8.5 million, or 25.8%, of total income for the year ended December 31, 2013, compared to $9.9 million, or 28.2%, for the year ended December 31, 2012. The following table sets forth the components of noninterest income and changes from 2012 to 2013:

	For The Years Ended December 31,			
	2013	2012	$ Variance	% Variance
	(Dollars in thousands)			
Trust income	$644	$615	$29	4.7
Service fees	5,059	4,877	182	3.7
Net gains on sales of loans held for sale	2,305	3,614	(1,309)	(36.2)
Income from life insurance	128	397	(269)	(67.8)
Other income	366	349	17	4.9
Subtotal	8,502	9,852	(1,350)	(13.7)
Net (losses) gains on sales of investment securities available-for-sale	(1)	673	(674)	(100.1)
Total noninterest income	$8,501	$10,525	$(2,024)	(19.2)

The significant changes in noninterest income for the year ended December 31, 2013 compared to the year ended December 31, 2012 are described below:

- Service fees. The $182 thousand increase in service fees for 2013 compared to 2012 was primarily due to an increase of $117 thousand, or 6.1%, in debit card and ATM fees resulting from the growth in the volume of electronic transactions and an increase in loan servicing fees of $151 thousand, or 26.11%, due to the increased volume of residential mortgage loans serviced. These increases were partially offset by a decrease of $101 thousand, or 8.9%, in overdraft fee income on deposit accounts.

- Net gains on sales of loans held for sale. Residential loans totaling $123.1 million were sold during 2013, versus residential loan sales of $125.7 million during 2012. The volume of residential loans sold dropped $2.6 million, or 2.03%, between periods, with net gains on sold loans decreasing $1.3 million, or 36.2%, reflecting the decline in margins on sales of loans during 2013 along with the decrease in volumes sold.

- Income from life insurance. The $269 thousand decrease between 2013 and 2012 primarily represents the one-time death benefit receivable recorded in 2012 of $249 thousand.

- Net gains on sales of investment securities available-for-sale. Available-for-sale debt securities of $1.0 million were sold in 2013 at a loss of $1 thousand. This compares to available-for-sale debt securities of $13.0 million sold in 2012 at a net gain of $673 thousand, including sales of $11.7 million as part of the deleveraging transaction that occurred during December 2012 in which higher cost FHLB of Boston borrowings of $11.0 million were prepaid.

Noninterest Expense. Noninterest expense decreased $1.8 million, or 7.9%, for the year ended December 31, 2013, compared to the year ended December 31, 2012. The following table sets forth the components of noninterest expense and changes from 2012 to 2013:

	For The Years Ended December 31,			
	2013	2012	$ Variance	% Variance
	(Dollars in thousands)			
Salaries and wages	$8,964	$8,953	$11	0.1
Pension and employee benefits	2,777	3,908	(1,131)	(28.9)
Occupancy expense, net	1,156	1,156	—	—
Equipment expense	1,597	1,490	107	7.2
ATM and debit card expense	795	730	65	8.9
Communications	339	323	16	5.0
Advertising and public relations	364	341	23	6.7
Vermont franchise tax	489	459	30	6.5
FDIC insurance assessment	306	351	(45)	(12.8)
Prepayment penalties on borrowings	169	890	(721)	(81.0)
Equity in losses of limited partnerships	690	660	30	4.5
Professional fees	512	424	88	20.8
Supplies and printing	351	395	(44)	(11.1)
Expenses of OREO, net	274	489	(215)	(44.0)
Director and advisory board fees	319	275	44	16.0
Postage and shipping	285	293	(8)	(2.7)
Amortization of core deposit intangible	171	171	—	—
Other expenses	1,663	1,727	(64)	(3.7)
Total noninterest expense	$21,221	$23,035	$(1,814)	(7.9)

The significant changes in noninterest expense for the year ended December 31, 2013 compared to the year ended December 31, 2012 are described below:

- Pension and employee benefits. The $1.1 million decrease relates to a reduction in expense for the defined benefit pension plan of $1.3 million, or 109.9%, due to the October 5, 2012 plan freeze which stopped the accrual of additional benefits and closed the plan to new participants. In addition, the cost of the Company's medical plan decreased $74 thousand, or 5.5%, from a decrease in premium levels with a change in insurance providers in 2013. These decreases were partially offset by an increase of $286 thousand, or 66.0%, in the 401K employer contribution expense related to Safe Harbor contributions that became effective January 1, 2013 with the amendment of the 401K plan.

- Equipment expense. The increase between years is due to an increase of $98 thousand, or 11.9%, in software licenses and maintenance contracts expense related to the renewal of license and maintenance coverage where the first year's fees were included in the purchase cost of the related equipment.

- ATM and debit card expense. The increase between 2012 and 2013 reflects higher utilization of both services and growth in the deposit base.

- FDIC insurance assessment. The decrease in expense was due to a reduced assessment rate during 2013, even with an increase in the assessment base in comparison to 2012. The improved loan quality ratios throughout 2013 were key contributors to the reduction in the assessment rate, which takes into account asset risk weights.

-

Prepayment penalties on borrowings. The 2013 results reflect penalties on the prepayment of $1.4 million in FHLB of Boston advances in 2013 compared to penalties on the prepayment of $11.3 million of advances primarily in connection with the deleveraging transaction in December 2012. This resulted in the decrease in prepayment penalties between years of $721 thousand.

Expenses of OREO, net. Expenses for 2013 included $178 thousand in the write-down of value of eight OREO properties to their fair market value less estimated costs to sell, while the expenses for 2012 included write-downs of $380 thousand, of which $202 thousand was related to one commercial real estate property.

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 increased to $1.9 million for 2013 from $1.7 million for 2012. The Company’s effective tax rate for 2013 was 20.7% compared to 19.5% for 2012. Federal income taxes and the effective tax rate increased due to the increase in taxable income. However, the effect of that increase was partially mitigated by an increase in tax credits recorded from investments in affordable housing projects to $631 thousand for 2013 versus $597 thousand for 2012. With the filing of our 2012 income tax return $44 thousand of low income housing tax credits were recorded as the result of a carryover of a prior period.

FINANCIAL CONDITION

At December 31, 2013, the Company had total consolidated assets of $585.4 million, including gross loans and loans held for sale (“total loans”) of $465.0 million, deposits of $518.4 million and stockholders' equity of $49.8 million. The Company’s total assets increased $8.2 million, or 1.4%, to $585.4 million at December 31, 2013, from $577.3 million at December 31, 2012.

Total net loans and loans held for sale increased a total of $9.8 million, or 2.2%, to $460.5 million, or 78.7% of total assets, at December 31, 2013, compared to $450.6 million, or 78.1% of total assets, at December 31, 2012. The increase in 2013 resulted mainly from growth of $13.5 million in commercial real estate loans, $4.5 million in residential real estate loans, and $5.7 million in municipal loans. These increases were partially offset by decreases of $5.1 million in construction real estate loans, and $7.2 million in residential loans held for sale. Residential mortgage loan demand was strong during the year but growth of the loan portfolio was moderated significantly by management's decision to continue to sell qualified lower fixed rate residential loans into the secondary market during 2013 to mitigate future interest rate risk and to participate out some commercial real estate loans to mitigate the level of credit and interest rate risk.

Federal funds sold and overnight deposits decreased $16.0 million to $25.5 million at December 31, 2013 from $41.5 million at December 31, 2012. Interest bearing deposits in banks decreased $4.3 million, or 19.7%, from $21.9 million at December 31, 2012 to $17.6 million at December 31, 2013. Investment securities available-for-sale increased $13.7 million, or 66.2%, from $20.6 million at December 31, 2012 to $34.3 million at December 31, 2013, with investment securities held-to-maturity increasing $5.7 million from $5.5 million at December 31, 2012 to $11.2 million at December 31, 2013.

Deposits increased $8.4 million, or 1.6%, to $518.4 million at December 31, 2013, from $510.0 million at December 31, 2012. Noninterest bearing deposits increased $3.5 million, or 4.2%, from $83.7 million at December 31, 2012 to $87.2 million at December 31, 2013. Interest bearing deposits decreased $3.9 million, or 1.4%, from $273.5 million at December 31, 2012 to $269.6 million at December 31, 2013. Time deposits increased $8.7 million, or 5.7%, from $152.8 million at December 31, 2012, to $161.5 million at December 31, 2013. (See average balances and rates in the Yields Earned and Rates Paid table on page 21.)

Total borrowed funds decreased $2.5 million, or 16.1%, from $15.7 million at December 31, 2012 to $13.2 million at December 31, 2013. The decrease is primarily due to a reduction in customer overnight collateralized repurchase sweeps of $2.6 million, or 65.2%, from $4.0 million at December 31, 2012 to $1.4 million at December 31, 2013.

Stockholders’ equity increased $4.8 million, or 10.6%, from $45.0 million at December 31, 2012 to $49.8 million at December 31, 2013. Refer to Capital Resources section below for a more in depth discussion.

Loan Portfolio. The Company's loan portfolio (including loans held for sale) primarily consists of adjustable-rate and fixed-rate mortgage loans secured by one-to-four family, multi-family residential or commercial real estate. As of December 31, 2013, the gross loan portfolio totaled $465.0 million, or 79.4% of assets, compared to $455.2 million, or 78.8% of assets, as of December 31, 2012. Total loans increased $9.8 million, or 2.2%, since December 31, 2012, despite the sale of $123.1 million of residential loans held for sale during 2013, which resulted in a gain on sale of loans of $2.3 million, and the net participation of an additional $815 thousand of commercial real estate loans. Sales of residential and commercial real estate loans in 2012 totaled $126.3 million with a gain of $3.6 million. Management expects to continue to manage interest rate risk, credit exposure or liquidity needs in the future by determining whether to sell and/or participate loans or to maintain them in portfolio. This management strategy is consistent with the strategies utilized in 2013 and 2012. Although competition for good loans is strong, especially in the commercial sector, the Company has been able to originate loans to both current and new customers while maintaining credit quality.

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

	2013		2012		2011		2010		2009	
	$	%	$	%	$	%	$	%	$	%
	(Dollars in thousands)									
Residential real estate	159,441	34.3	154,938	34.0	147,426	34.4	132,533	34.7	123,915	34.6
Construction real estate	30,898	6.7	36,018	7.9	28,077	6.5	18,578	4.9	19,391	5.4
Commercial real estate	210,718	45.3	197,240	43.3	200,120	46.6	177,794	46.5	166,725	46.6
Commercial	20,569	4.4	21,463	4.7	23,018	5.4	20,604	5.4	15,597	4.4
Consumer	5,396	1.2	6,065	1.3	6,134	1.4	6,046	1.6	6,967	1.9
Municipal	34,091	7.3	28,421	6.3	19,544	4.6	20,717	5.4	16,232	4.5
Loans held for sale	3,840	0.8	11,014	2.5	4,888	1.1	5,611	1.5	9,262	2.6
Total loans	464,953	100.0	455,159	100.0	429,207	100.0	381,883	100.0	358,089	100.0

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 90% on loans with government guarantees or other mitigating circumstances. The Vermont and northwestern New Hampshire real estate market experienced declines in home prices as a result of the stagnant economy in recent years but to a lesser extent than in many areas of the country. Sales of homes in Vermont and northwestern New Hampshire slowed considerably from 2007 through 2011 but signs of improvement were seen during both 2012 and 2013 in the majority of our local markets. Real estate secured loans represent $404.9 million, or 87.1%, of total loans at December 31, 2013 compared to $399.2 million, or 87.7%, of total loans at December 31, 2012.

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 Company originates and sells residential mortgages into the secondary market, with most of the sales made to Freddie Mac with additional sales to the FHLB of Boston Mortgage Partnership Finance Program ("MPF"), the Vermont Housing Finance Agency ("VHFA") or the New Hampshire Housing Finance Agency ("NHHFA"). As of December 31, 2013, the Company had sold $20.8 million in loans through the MPF program and had a contract for delivery of up to an additional $14.2 million of future loan sales. These loans are classified as held for sale at the time of origination or when a decision is made to sell the loans. The Company generally retains the servicing rights on sold residential mortgage loans. The Company originates and sells Federal Housing Administration ("FHA"), Veterans Administration ("VA"), and Rural Development ("RD") residential mortgage loans, and in April 2012, Union received an Unconditional Direct Endorsement Approval from the Department of Housing and Urban Development ("HUD") which allows us to approve FHA loans originated in any of our Vermont or New Hampshire locations without needing prior HUD approval. Some of the government backed loans qualify for zero down payments without geographic or income restrictions. The Company sells VA and FHA loans as originated with servicing released. 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. 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 serviced a residential real estate mortgage portfolio of $455.1 million and $399.5 million at December 31, 2013 and 2012, respectively. Of that portfolio, $291.8 million at December 31, 2013 and $233.6 million at December 31, 2012 was serviced for unaffiliated third parties. Additionally, the Company originates commercial real estate and commercial loans under various Small Business Administration ("SBA"), U.S. Department of Agriculture Rural Development Authority ("USDA") and Vermont Economic Development Authority ("VEDA") programs that provide an agency guarantee for a portion of the loan amount. There was $5.3 million guaranteed under these various programs at December 31, 2013 on an aggregate balance of $6.6 million in subject loans. 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 loans sold during 2013. The Company recognizes gains and losses on the sale of the principal portion of these loans as they occur.

The Company serviced $27.7 million and $26.9 million of commercial and commercial real estate loans for unaffiliated third parties as of December 31, 2013 and 2012, respectively. This includes $23.9 million and $23.1 million of commercial or commercial real estate loans the Company has participated out to other financial institutions at December 31, 2013 and 2012, respectively. These loans were participated in the ordinary course of business on a nonrecourse basis, for liquidity or credit concentration management purposes.

The Company capitalizes servicing rights for all loans sold with servicing retained and recognizes gains and losses on the sale of the principal portion of these loans as they occur. The unamortized balance of servicing rights on loans sold with servicing retained was $1.3 million as of December 31, 2013 and $1.1 million as of December 31, 2012, with an estimated market value in excess of their carrying value at both year ends. Management periodically evaluates and measures the servicing assets for impairment.

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 northwestern New Hampshire. Although the Company's loan portfolio consists of different segments, there is a portion of the loan portfolio centered in tourism related loans. The local tourism industry had been adversely affected by the weakened economy but the outlook improved somewhat with with good snowfall and skiing throughout the winter of 2013 and an excellent summer and fall foliage season. 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 following table breaks down by classification the contractual maturities of the gross loans held in portfolio and for sale as of December 31, 2013:

	Within 1 Year	2-5 Years	Over 5 Years
	(Dollars in thousands)		
Residential real estate			
Fixed-rate	$42	$2,673	$83,320
Variable-rate	1,886	2,622	72,738
Construction real estate			
Fixed-rate	16,253	585	1,064
Variable-rate	2,357	581	10,058
Commercial real estate			
Fixed-rate	96	5,988	20,777
Variable-rate	26,658	4,928	152,271
Commercial			
Fixed-rate	2,310	2,111	5,725
Variable-rate	4,479	3,667	2,277
Municipal			
Fixed-rate	28,679	1,519	3,893
Variable-rate	—	—	—
Consumer & Other			
Fixed-rate	2,433	2,449	342
Variable-rate	61	56	55
Total	$85,254	$27,179	$352,520

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. 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 Other Assets Owned ("OAO") for potential problems and reports to the Company's and the subsidiary's Boards of Directors at regularly scheduled meetings. Repossessed assets and loans or investments that are 90 days or more past due are considered to be nonperforming assets. 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's Board of Directors 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 of Directors, periodic concentration analyses based on various factors such as industries, collateral types, location, large credit sizes and officer portfolio loads. The Company has established underwriting guidelines to be followed by its officers; material exceptions are required to be approved by a senior loan officer or the Board of Directors. The Company monitors its delinquency levels for any adverse trends. There can be no assurance, however, 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.

Restructured loans include the Company's troubled debt restructurings that involved 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. Restructured loans do not include qualifying restructured loans that have complied with the terms of their restructure agreement for a satisfactory period of time. When evaluating the loan loss reserve, management makes a specific allocation for restructured loans as they are considered impaired.

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

	2013	2012	2011	2010	2009
	(Dollars in thousands)				
Nonaccrual loans	$1,434	$2,839	$4,308	$2,792	$3,738
Loans past due 90 days or more and still accruing interest	263	307	1,897	806	538
Total nonperforming loans	1,697	3,146	6,205	3,598	4,276
OREO	559	1,052	1,476	1,609	886
OAO	—	—	40	—	—
Total nonperforming assets	$2,256	$4,198	$7,721	$5,207	$5,162
Guarantees of U.S. or state government agencies on the above nonperforming loans	$19	$—	$730	$129	$243
Troubled debt restructured loans	1,240	2,850	2,195	2,017	2,176

There was one loan in process of foreclosure at December 31, 2013 included in nonperforming loans. The aggregate interest on nonaccrual loans not recognized for the years ended December 31, 2013, 2012 and 2011 was $1.1 million, $1.0 million and $903 thousand, respectively.

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

	2013	2012	2011	2010	2009
Allowance for loan losses to loans not held for sale (1)	1.01 %	1.05 %	1.00 %	1.00 %	1.00 %
Allowance for loan losses to nonperforming loans	273.84 %	148.03 %	68.11 %	104.36 %	81.69 %
Nonperforming loans to total loans	0.36 %	0.69 %	1.45 %	0.94 %	1.19 %
Nonperforming assets to total assets	0.39 %	0.73 %	1.40 %	1.15 %	1.15 %
Delinquent loans (30 days to nonaccruing) to total loans	2.15 %	2.56 %	3.86 %	3.43 %	3.26 %
Net charge-offs to average loans not held for sale	0.07 %	0.05 %	0.08 %	0.07 %	0.13 %

Loan loss provision to net charge-offs	96.90 %	287.66 %	254.93 %	201.42 %	86.39 %

(1) Calculation includes the net carrying amount of loans recorded at fair value from the 2011 branch acquisition as of December 31, 2013 ($17.0 million), December 31, 2012 ($22.9 million) and December 31, 2011 ($27.9 million). Excluding such loans, the allowance for loan losses to loans not purchased and not held for sale was 1.05% at December 31, 2013, 1.11% at December 31, 2012 and 1.07% at December 31, 2011.

Nonperforming loans at December 31, 2013 decreased in terms of dollars by $1.4 million, or 46.1%, and as a percentage of assets from December 31, 2012, with the allowance for loan losses as a percentage of nonperforming loans increasing significantly from 148.03% to 273.84%. The nonperforming and delinquency ratios have also dropped in comparison to December 31, 2012 and management considers the ratios to be at favorable levels. The Company's success at keeping the ratios at favorable levels in these challenging economic conditions is the result of continued focus on maintaining strict underwriting standards, as well as our practice, as a community bank, of actively working with troubled borrowers to resolve the borrower's delinquency, while maintaining the safe and sound credit practices of the Bank and safeguarding our strong capital position.

At December 31, 2013, the Company had loans rated substandard that were on a performing status totaling $4.0 million, representing 16 customer relationships, compared to $6.2 million at December 31, 2012, representing 19 customer relationships. 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.

The Company actively works with customers who may be delinquent or who may have financial difficulties. One of the benefits of being a community financial institution is our employees' and Boards' knowledge of the community and borrowers, which allows us to be proactive in working closely with our loan customers. The Company's delinquency rates have historically run higher than similar institutions nationally, while losses have been lower. 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 allowance for loan losses, 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.

Except for those nonperforming loans discussed above, the Company's management is not aware of any loans as of December 31, 2013, for which known financial problems of the borrower would cause serious doubts as to the borrower's ability to materially comply with the present loan repayment terms, nor are there any known events that would result in any other loans being designated as nonperforming as of December 31, 2013. The Company’s management is focused on the impact that the prolonged weakened economy may have on its borrowers and closely monitors industry and geographic concentrations for evidence of financial problems. In the fourth quarter of 2007, residential and commercial real estate values started declining nationally with some other areas of the country experiencing significant weakening. The region's real estate market has also experienced declines in prices as a result of the stagnant economy but to a lesser extent than in many areas of the country. The residential and commercial real estate values in Vermont and northwestern New Hampshire decreased considerably during the recession that began in 2008. Real estate values have stabilized over the past couple of years in the majority of our markets as well as many parts of the country, particularly in the west, and appreciation has started to be seen in some markets during 2013. The real estate market decline significantly contributed to the downturn in the general economy, and unemployment rates and business failures rose nationwide. Locally these indicators have improved but conditions can cause borrowers who are current in their payments to experience deterioration in the value of their collateral and increase the potential of default if their income levels decline. Management continues 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. The unemployment rate has started to stabilize in Vermont and was at a 4.2% level at December 31, 2013 compared to 5.1% at December 31, 2012. New Hampshire was at 5.1% at December 31, 2013 compared to 5.7% at December 31, 2012, with the nationwide rate at 6.7% and 7.8% for the comparable periods.

Vermont and New Hampshire continue to have lower residential foreclosure rates than the average in the United States. 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 minor properties. Holding costs and declines in fair value on properties acquired are expensed as incurred. The Company had five residential real estate properties classified as OREO at December 31, 2013 valued at $559 thousand, and 12 residential, land development or commercial real estate properties valued at $1.1 million so classified on December 31, 2012. Further softening in the local real estate market would make the potential to recover all principal and related costs for OREO properties uncertain.

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 allowance for loan losses to absorb such losses. The allowance is maintained at a level believed by management to be appropriate to absorb probable credit losses inherent in the loan portfolio; however, actual loan losses may vary from current estimates.

The allowance for loan losses 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 allowance, 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 allowance for loan losses 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 allowance for loan losses is assessed by allocating reserves by loan category, the total allowance for possible loan losses is available to absorb losses that may occur within any loan category.

The allowance 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 allowance for loan losses. Based on an evaluation of the loan portfolio and other relevant qualitative factors, management presents a quarterly analysis of the appropriate level of the allowance to the Board of Directors, indicating any changes in the allowance since the last review and any recommendations as to adjustments in the allowance and the level of future provisions.

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

The level of allowance 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 allowance 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 allowance for individual loans that have been classified as impaired on the basis of the fair value of the collateral for collateral dependent loans, an observable market price, or the present value of anticipated future cash flows.

The composition of the Company’s loan portfolio remained relatively unchanged from December 31, 2012, and there was no material change in the Company’s lending programs or terms during the year.

31

The following table reflects activity in the allowance for loan losses for the years ended December 31:

	2013	2012	2011	2010	2009
	(Dollars in thousands)				
Balance at the beginning of year	$4,657	$4,226	$3,755	$3,493	$3,556
Charge-offs					
Real estate	362	247	314	268	379
Commercial	24	—	1	27	101
Consumer and other	16	25			