SECURITIES & EXCHANGE COMMISSION EDGAR FILING

COMMUNITY BANCORP /VT

Form: 10-K

Date Filed: 2017-03-20

Corporate Issuer CIK: 718413

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from______ to ______

Commission File No. 000-16435

Community Bancorp.

Vermont	03-0284070
(State of Incorporation)	(IRS Employer Identification Number)

Address of Principal Executive Offices: 4811 US Route 5, Derby, Vermont 05829

Registrant's telephone number, including area code: (802) 334-7915

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of each exchange on which registered
NONE	NONE

Securities registered pursuant to Section 12(g) of the Act:
Common Stock - $2.50 par value per share

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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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)

As of June 30, 2016 the aggregate market value of the voting stock held by non-affiliates of the registrant was $65,497,364, based on a per share trade price on June 30, 2016 of $14.00, as reported on the OTC Link ATS® system maintained by the OTC Markets Group Inc. For purposes of the calculation, all directors and executive officers were deemed to be affiliates of the registrant. However, such assumption is not intended as an admission of affiliate status as to any such individual.

There were 5,072,976 shares outstanding of the issuer's class of common stock as of the close of business on March 15, 2017.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the Annual Report to Shareholders for the year ended December 31, 2016 (2016 Annual Report) are incorporated by reference to Part I of this Report.
Portions of the 2016 Annual Report are incorporated by reference to Part II of this report.
Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on Ma y 16, 2017 (2017 Annual Meeting) are incorporated by reference to Part III of this report.

Table of Contents

PART I

Item 1. The Business

Organization and Operation

The Company. Community Bancorp. (the Company) was organized under the laws of the State of Vermont in 1982 and became a registered bank holding company under the Bank Holding Company Act of 1956, as amended, in October 1983 when it acquired all of the voting shares of Community National Bank (the Bank), headquartered in Derby, Vermont. The Bank is the only subsidiary of the Company and principally all of the Company's business operations are presently conducted through it. Therefore, the following narrative and the other information about the Company contained in this report are based primarily on the Bank's operations.

The Bank; Banking Services. Community National Bank was organized in 1851 as the Peoples Bank, and was subsequently reorganized as the National Bank of Derby Line in 1865. In 1975, after 110 continuous years of operation as the National Bank of Derby Line, the Bank acquired the Island Pond National Bank and changed its name to "Community National Bank." On December 31, 2007, the Company completed its acquisition of LyndonBank, a Vermont bank headquartered in Lyndonville, Vermont, in a cash merger transaction. As a result of the merger, the Company expanded its existing branch network in Caledonia and Orleans Counties and extended it into Lamoille and Franklin Counties. In addition to its main office in Derby, the Company currently maintains eleven branch offices in northeastern and central Vermont.

The opportunities for growth continue to be primarily in the Central Vermont and Chittenden County markets where economic activity is more robust than in the Company's Orleans and Caledonia County markets, and where the Company is increasing its presence and market share. In line with this focus, the Company opened a loan production office in South Burlington during the first quarter of 2017.

The Company, through Community National Bank, provides a broad range of retail banking services to the residents, businesses, nonprofit organizations and municipalities in northeastern and central Vermont. Significant services offered by the Company include:

- *Business Banking* – The Company offers a range of credit products for a variety of general business purposes, including financing for commercial business properties, equipment, inventories and accounts receivable, as well as letters of credit. The Company also offers business checking and other deposit accounts, cash management services, repurchase agreements, automated clearing house (ACH) and wire transfer services and remote deposit capture.

- *Commercial Real Estate Lending* – The Company provides a range of products to meet the financing needs of commercial developers and investors, residential builders and developers and community development entities. Credit products are available to facilitate the purchase of land and/or build structures for business use and for investors who are developing residential or commercial property, as well as for real estate secured financing of existing businesses.

- *Residential Real Estate Lending* – The Company provides products to help meet the home financing needs of consumers, including conventional permanent and construction/permanent (fixed, adjustable, or variable rate) financing arrangements, and FHA/VA loan products. The Company offers both fixed-rate and adjustable rate residential mortgage (ARM) loans and home equity loans. A portion of the first lien residential mortgage loans originated by the Company are sold into the secondary market. The Company offers these products through its network of banking offices. The Company does not originate subprime residential real estate loans.

- *Retail Credit* – The Company provides a full-range of loan products to meet the needs of consumers, including personal loans, automobile loans and boat/recreational vehicle loans. In addition, through a marketing alliance with a third party, the Company offers credit cards.

- *Municipal and Institutional Banking* – The Company provides banking services to meet the needs of state and local governments, schools, charities, membership and not-for-profit associations including deposit account services, tax-exempt loans, lines of credit and term loans. In addition, through an arrangement with the Federal Home Loan Bank of Boston (FHLBB), the Company offers a secured deposit product to its municipal customers, collateralized by FHLBB letters of credit.

- *Retail Banking* – The Company provides a full-range of consumer banking services, including checking accounts, savings programs, automated teller machines (ATMs), debit/credit cards, night deposit facilities and online, mobile and telephone banking.

The Company focuses on establishing and maintaining long-term relationships with customers and is committed to providing for the financial services needs of the communities it serves. In particular, the Company continues to emphasize its relationships with individual customers and small-to-medium-sized businesses. The Company actively evaluates the banking needs of its markets, including low- and moderate-income areas, and offers products that are responsive to the needs of its customer base. The Company's markets provide a mix of real estate, commercial and industrial, municipal and consumer lending opportunities, as well as a stable core deposit base. Additional information about our business, including the Company's deposit-taking activities, lending activities and credit and risk management policies, is set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in the 2016 Annual Report filed as Exhibit 13 to this Report and is incorporated herein by reference.

Related Trust Company. In 2002, the Bank transferred its trust operations to a newly formed Vermont-chartered nondepository trust and investment management company, Community Financial Services Group, LLC, based in Newport, Vermont (CFSG). The Bank's ownership interest in CFSG is held indirectly, through Community Financial Services Partners, LLC, a Vermont limited liability company (CFSG Partners), which owns 100% of the limited liability company equity interests of CFSG. Immediately following transfer of its trust operations to CFSG, the Bank sold a two-thirds interest in CFSG Partners, equally to the National Bank of Middlebury, headquartered in Middlebury, Vermont and Guaranty Bancorp Inc., the bank holding company parent of Woodsville Guaranty Savings Bank, headquartered in Woodsville, New Hampshire. CFSG offers fiduciary services throughout the market areas of the three owner financial institutions and leases space from them in some of their branch offices.

Statutory Business Trust. In 2007, the Company formed CMTV Statutory Trust I (the Trust), a Delaware statutory business trust, for the purpose of issuing $12.5 million of trust preferred securities and lending the proceeds to the Company. This funding provided a portion of the cash consideration paid by the Company in the acquisition of LyndonBank and provided additional regulatory capital. The Trust is a variable interest entity for which the Company is not the primary beneficiary, within the meaning of applicable accounting standards. Accordingly, the Trust is not consolidated with the Company for financial reporting purposes.

Tax Credit Entity. In 2011, the Company formed a limited liability company (LLC) to facilitate its purchase of federal New Markets Tax Credits (NMTCs) under an investment structure designed by a local community development entity. The LLC is a variable interest entity for which, in the context of the overall NMTC structure, the Company is not the primary beneficiary, within the meaning of applicable accounting standards. Accordingly, the LLC is not consolidated with the Company for financial reporting purposes.

Competition

All of the Bank's offices are located in northern and central Vermont. The Bank's main office is located in Derby, in Orleans County. In addition to its main office, the Bank has four other banking offices in Orleans County, one office in Essex County, two offices in Caledonia County, two offices in Washington County and one office each in Franklin and Lamoille Counties. (See Part I, Item 2 (Properties) of this report.)

The Bank competes in all aspects of its business with other banks and credit unions in northern and central Vermont, including three of the largest banks in the state, which maintain branch offices throughout the Bank's service area. Changes in the regulatory framework of the banking industry during the past decade have broadened the competition for commercial bank products, such as deposits and loans, to include not only traditional rivals such as banks, savings banks and credit unions, but also many non-traditional rivals such as insurance companies, brokerage firms, mutual funds and consumer and commercial finance and leasing companies. In addition, many out-of-market nationwide banks, nonbank lenders and other financial service firms operate in the Company's market areas through mass marketing solicitations by mail, radio, television, the internet and email. At the same time, technological changes have facilitated remote delivery of financial services by bank and nonbank competitors outside the context of a traditional branch bank network, thereby intensifying competition from out-of-market firms.

Competition from the tax-exempt credit union industry has also intensified in recent years. A number of the Bank’s credit union competitors, including the largest state-chartered Vermont credit union, have converted in recent years from an employment based common bond to a community common bond, thereby significantly increasing their fields of membership in the Bank’s market areas. Because federal law subsidizes credit unions by giving them a general exemption from federal income taxes, they have a significant pricing advantage over commercial banks for their deposit and loan products. This pricing advantage, coupled with the relaxing of membership and regulatory restrictions on product offerings, has resulted in increased competition for the Bank from this tax exempt sector of the financial services industry.

In order to compete with other bank and non-bank service providers, the Company stresses the community orientation of its banking operations and relies to a large extent upon personal relationships established by its officers, directors and employees with their customers and on their strong ties to the local community. In addition, management's knowledge of the local community assists it in tailoring the Company's products and services to meet the needs of its customer base. Although competition is strong throughout the Company's market area, management believes that the Company can continue to compete effectively, in view of its local market knowledge and community ties and its understanding of customer needs.

Employees

As of December 31, 2016, the Company did not have any employees at the holding company level. However, as of such date, the Bank employed 125 full-time employees and 10 part-time employees. The Bank is not a party to any collective bargaining agreement and management of the Bank considers its employee relations to be good.

Regulation and Supervision

The following discussion describes elements of an extensive regulatory framework applicable to bank holding companies and banks, to which the Company and the Bank are subject. Regulation of banks and bank holding companies is intended primarily for the protection of depositors and the Deposit Insurance Fund of the FDIC, rather than for the protection of shareholders and creditors.

The Company’s earnings are affected by general economic conditions, management policies, changes in federal and state laws and regulations and actions of various regulatory authorities, including those referred to below. Banking is a highly regulated business and proposals to change the laws and regulations to which the Company and the Bank are subject are frequently introduced at both the federal and state levels. The likelihood and timing of any such changes and the impact such changes may have on the Company and the Bank is impossible to predict with any certainty.

The following summary does not purport to be complete and is qualified by reference to the particular statutes and regulations.

Dodd–Frank Act. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) represents a comprehensive revision and restructuring of many aspects of financial services industry regulation and impacts practically all aspects of a banking organization. Many of the provisions of the Dodd-Frank Act are designed to reduce systemic risk from large, complex “systemically significant” financial institutions, and thus do not apply to a smaller banking organization such as the Company. Nevertheless, certain of its provisions do directly apply to the Company and others will indirectly impact its operations, as the Dodd-Frank Act continues to reshape the financial services environment. Among other things, the Act:

- Established a new independent agency, the Consumer Financial Protection Bureau (CFPB), with centralized responsibility for implementing and (with respect to large organizations) enforcing and examining compliance with federal consumer financial laws. Although the CFPB does not have enforcement or examination authority over smaller banking organizations such as the Company, many of its regulatory standards and mandates apply to them, with enforcement authority vested in other regulatory agencies such as (with respect to the Bank) the Office of the Comptroller of the Currency (OCC);

- Applies the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, savings and loan holding companies and systemically important non-bank financial companies on a consolidated basis. These changes prohibit the use of additional trust preferred securities as Tier 1 capital, but the Company’s existing trust preferred securities are grandfathered;

- Requires debit card interchange transaction fees charged by large financial institutions to be reasonable and proportional to the cost incurred by the issuer for the transaction. The Federal Reserve adopted regulations in 2011 establishing such fee standards, eliminating exclusivity arrangements between issuers and networks for debit card transactions and limiting restrictions on merchant discounting for use of certain payment forms and minimum or maximum amount thresholds as a condition for acceptance of credit cards. Although smaller institutions such as the Company are not subject to the interchange fee restrictions, it is possible that, over time, competitive pricing pressures in the marketplace may operate to make the restrictions applicable to them by default;

- Requires public companies to periodically seek “say on executive pay” and “say on frequency” votes of shareholders, and in some circumstances, a “say on golden parachute” vote of shareholders. As a smaller reporting company, these vote requirements first became applicable for the Company’s 2013 annual meeting of shareholders;

- Allowed depository institutions to pay interest on demand deposits effective July 21, 2011;

- Established by statute the Federal Reserve’s “source of strength” doctrine mandating holding company financial support of subsidiary insured depository institutions;

- Eliminated state restrictions on de novo interstate branching;

- Established new requirements related to mortgage lending, including prohibitions against payment of steering incentives and provisions relating to underwriting standards, disclosures, appraisals and escrows. Many of these provisions have been implemented through CFPB rulemakings;

- Weakened federal preemption standards for national banks and federal savings associations and their operating subsidiaries by granting states greater authority to enforce consumer protection laws against them;

- Provided permanent relief for smaller reporting companies, such as the Company, from the requirements of Section 404 of the Sarbanes-Oxley Act for auditor attestation of management’s assessment of internal controls and their effectiveness;

- Requires a bank holding company to be well capitalized and well managed to receive regulatory approval of an interstate bank acquisition; and

- Permanently increased the FDIC’s standard maximum deposit insurance amount to $250,000, changed the FDIC insurance assessment base to assets rather than deposits and increased the reserve ratio for the deposit insurance fund to ensure the future strength of the fund.

The Company will continue to monitor the impact of ongoing regulatory implementation of this significant legislation.

Bank Holding Company Act. As a registered bank holding company, the Company is subject to on-going regulation, supervision and examination by the Board of Governors of the Federal Reserve System (Federal Reserve), under the Bank Holding Company Act of 1956, as amended (the Act). A bank holding company for example, must generally obtain the prior approval of the Federal Reserve before it acquires all or substantially all of the assets of any bank, or acquires ownership or control of more than 5% of the voting shares of a bank. Federal Reserve approval is also generally required before a bank holding company may acquire more than 5% of any outstanding class of voting securities of a company other than a bank or a more than 5% interest in its property.

The Act generally limits the activity in which the Company and its subsidiaries may engage to certain specified activities, including those activities which the Federal Reserve may find, by order or regulation, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the activities that the Federal Reserve has determined to be closely related to banking are: (1) making and servicing loans that could be made by mortgage, finance, credit card or factoring companies; (2) performing the functions of a trust company; (3) certain leasing of real or personal property; (4) providing certain financial, banking or economic data processing services; (5) except as otherwise prohibited by law, acting as an insurance agent or broker with respect to insurance that is directly related to the extension of credit or the provision of other financial services or, under certain circumstances, with respect to insurance that is sold in certain small communities in which the bank holding company system maintains banking offices; (6) acting as an underwriter for credit life insurance and credit health and accident insurance directly related to extensions of credit by the holding company system; (7) providing certain kinds of management consulting advice to unaffiliated banks and non-bank depository institutions; (8) performing real estate appraisals; (9) issuing and selling money order and similar instruments and travelers checks and selling U.S. Savings Bonds; (10) providing certain securities brokerage and related services for the account of bank customers; (11) underwriting and dealing in certain government obligations and other obligations such as bankers' acceptances and certificates of deposit; (12) providing consumer financial counseling; (13) providing tax planning and preparation services; (14) providing check guarantee services to merchants; (15) operating a collection agency; and (16) operating a credit bureau. Trust and investment management activities conducted through a nondepository trust company such as the Company's affiliate, CFSG, are also considered by the Federal Reserve to be permissible nonbanking activities that are closely related to banking.

Except for CFSG's trust and investment management operations, the Company does not presently engage, directly or indirectly through any affiliate, in any other permissible non-banking activities.

A bank holding company must also obtain prior Federal Reserve approval in order to purchase or redeem its own stock if the gross consideration to be paid, when added to the net consideration paid by the company for all purchases or redemptions by the company of its equity securities within the preceding 12 months, will equal 10% or more of the company's consolidated net worth.

The Company is required to file with the Federal Reserve Board annual and quarterly reports and such additional information as the Board may require pursuant to the Act. The Board may also make examinations of the Company and any direct or indirect subsidiary of the Company.

The Company, the Bank, CFSG Partners and CFSG are all considered "affiliates" of each other for the purposes of Section 18(j) of the Federal Deposit Insurance Act (FDIA), as amended, and Sections 23A and 23B of the Federal Reserve Act, as amended. In particular, section 23A limits loans or other extensions of credit to, asset purchases with and investments in affiliates of the Bank to 10% of the Bank's capital and surplus. In addition, such loans and extensions of credit and certain other transactions must be collateralized in specified amounts. Section 23B requires, among other things, that certain transactions between the Bank and its affiliates must be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving non-affiliated persons. Further, the Company is prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or lease or sale of any property or the furnishing of services.

Capital Adequacy Requirements. Revised regulatory capital rules were adopted in July 2013 by the federal banking regulators to implement the Basel III capital standards and certain capital requirements of the Dodd-Frank Act. The effect of the rules is to impose higher minimum capital requirements for bank holding companies and banks. The rules apply to all national and state banks and savings associations regardless of size and bank holding companies and savings and loan holding companies with $500 million or more in total consolidated assets. More stringent requirements apply to certain larger banking organizations. The requirements in the rule began to phase in on January 1, 2015, for the Company and the Bank and will be fully phased in by January 1, 2019.

The Basel III capital rules include certain new and higher risk-based capital and leverage requirements than those previously in place. Specifically, the following minimum capital requirements now apply to the Company and the Bank:

- a new common equity Tier 1 risk-based capital ratio of 4.5%;
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement);
- a total risk-based capital ratio of 8% (unchanged from the former requirement); and
- a leverage ratio of 4% (also unchanged from the former requirement).

Under the rules, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as noncumulative perpetual preferred stock. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rule has disqualified from Tier 1 capital treatment. Cumulative perpetual preferred stock, formerly includable in Tier 1 capital, is now included only in Tier 2 capital. Although accumulated other comprehensive income (AOCI) is presumptively included in Common Equity Tier 1 capital, the rule provided a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI. The Company and Bank made this opt-out election and, as a result, will retain the pre-existing regulatory capital treatment for AOCI.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. This buffer must consist solely of Tier 1 Common Equity, but the buffer applies to all three measurements (Common Equity Tier 1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, becoming fully effective on January 1, 2019, and when fully-phased in, will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets. As of January 1, 2016, the Company and the Bank are required to hold a capital conservation buffer of 0.625%, increasing by that amount each successive year until 2019. Failure to maintain the required buffer would result in limitations on permissible shareholder distributions and discretionary bonus payments.

In general, the rules have had the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, certain loans past due 90 days or more or in nonaccrual status, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

The Company's capital ratios exceeded all applicable regulatory requirements at December 31, 2016. (See Note 20 to the Company's consolidated financial statements included in Part II, Item 8 of this report for additional information about the Company's and the Bank's regulatory capital ratios.) In addition, management has modeled the capital conservation buffer requirement on a fully-phased basis and believes that, as of December 31, 2016, the Company and the Bank would satisfy that requirement if it had been fully-phased in as of such date.

The Basel III capital standards also revised the FDIC's "prompt corrective action" requirements (see "Prompt Corrective Action" below).

Sarbanes-Oxley Act. The Sarbanes-Oxley Act of 2002 (SOX) was enacted to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. SOX and the SEC's implementing regulations include provisions addressing, among other matters, the duties, functions and qualifications of audit committees for all public companies; certification of financial statements by the chief executive officer and the chief financial officer; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; disclosure of off-balance sheet transactions; a prohibition on personal loans to directors and officers, except (in the case of banking companies) loans in the normal course of business; expedited filing requirements for reports of beneficial ownership of company stock by insiders; disclosure of a code of ethics for senior officers, and of any change or waiver of such code; the formation of a public accounting oversight board; auditor independence; disclosure of fees paid to the company's auditors for non-audit services and limitations on the provision of such services; attestation requirements for company management and external auditors, relating to internal controls and procedures; and various increased criminal penalties for violations of federal securities laws.

Since 2007 Section 404 of SOX has required management of the Company to undertake a periodic assessment of the adequacy and effectiveness of the Company's internal control over financial reporting. Management's report on internal control over financial reporting for 2015 is contained in Item 9A of this Report. The Company has incurred, and expects to continue to incur, costs in connection with its on-going compliance with Section 404.

As enacted in 2002 and implemented by the SEC, SOX provided that, beginning with annual financial statements for 2010, the Company's external auditors would be required to attest to, and report on, management's assessment of the Company's internal controls and the operating effectiveness of these controls. As noted above, however, the Dodd-Frank Act included permanent relief from this requirement for smaller reporting companies such as the Company.

Information on the Company's corporate governance practices, including committee charters, is available on the Company's website at www.communitybancorpvt.com.

SEC Regulatory Relief for Smaller Reporting Companies. In December 2007, the SEC adopted amendments to its disclosure and reporting rules to extend to more public companies the benefits of the simplified and less rigorous disclosure requirements previously applicable only to "small business issuers." The amendments established a new category of "smaller reporting companies" with a public float of less than $75 million. The Company continues to qualify as a smaller reporting company as of its last measurement date (June 30, 2016). Under the amendments, smaller reporting companies are able to elect whether to comply with specified financial and nonfinancial disclosure requirements on an item by item basis. The amendments were effective February 4, 2008 and the Company has elected to avail itself of some of the relief provided in the amendments in connection with preparation of the Company's annual meeting proxy statement and its periodic reports, including this annual report on Form 10-K.

Dividends. The Company derives funds for payment of dividends to its shareholders primarily from dividends received from its subsidiary, Community National Bank. Under the National Bank Act, prior approval from the OCC is required if the total of all dividends declared by a national bank in any calendar year will exceed the sum of such bank's net profits for that last year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. Federal law also prohibits national banks from paying dividends greater than the bank's undivided profits after deducting statutory bad debt in excess of the bank's allowance for loan losses.

The Company and the Bank are also subject to various general regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The appropriate federal or state banking agency is authorized to determine under certain circumstances relating to the financial condition of a bank or bank holding company that the payment of dividends would be an unsafe or unsound practice and to prohibit such payment. In addition, under the Basel III capital requirements, failure to maintain the required capital conservation buffer would result in additional limitations on permissible shareholder distributions.

The Federal Reserve has issued supervisory guidance on the payment of dividends and redemption and repurchases of stock by bank holding companies reflecting the expectation that a bank holding company will inform and consult with Federal Reserve supervisory staff in advance of declaring and paying any dividend that could raise safety and soundness concerns. Examples of actions that might raise such concerns include declaration of a dividend exceeding current period earnings; redeeming or repurchasing regulatory capital instruments when the bank holding company is experiencing financial weaknesses; or redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred. The guidance provides that a bank holding company should eliminate, defer or severely limit dividends if net income for the past four quarters is not sufficient to fully fund dividends; the prospective rate of earnings retention is not consistent with the holding company's capital needs and overall current and prospective financial condition; or the holding company will not meet, or is in danger of not meeting, its minimum regulatory capital ratios. The Company would be required in future periods to consult with, and obtain the approval of, the Federal Reserve for payment of any dividends, including regular quarterly cash dividends, that are in excess of earnings for the applicable quarterly period.

OCC Supervision. The Bank is a national banking association and subject to the provisions of the National Bank Act and federal and state statutes and rules and regulations applicable to national banks. The primary supervisory authority for the Bank is the OCC. The OCC's examinations are designed for the protection of the Bank's depositors and not its shareholders. The Bank is subject to periodic examination by the OCC and must file periodic reports with the OCC containing a complete statement of its financial condition and results of operations.

The CFPB created by the Dodd-Frank Act took over responsibility for enforcing the principal federal consumer protection laws, such as the Truth in Lending Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act and the Truth in Saving Act, among others, in 2011. Institutions that have assets of $10 billion or less, such as our Bank subsidiary, will continue to be supervised and examined in this area by their primary federal regulators (in the case of our Bank subsidiary, the OCC). However, the Dodd-Frank Act gives the CFPB expanded data collecting powers for fair lending purposes for both small business and mortgage loans, as well as expanded authority to prevent unfair, deceptive and abusive practices.

Prompt Corrective Action. The Bank is subject to regulatory capital requirements established under the Federal Deposit Insurance Company Improvement Act of 1991 (FDICIA). Among other things, FDICIA identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the respective U.S. federal regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements within such categories. 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 regulatory agencies to prescribe certain non-capital 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 federal bank regulatory agencies, including the OCC, have adopted substantially similar regulations that define the five capital categories identified by FDICIA. These regulations establish various degrees of corrective action to be taken when an FDIC-insured depository institution is considered undercapitalized. Effective January 1, 2015, the FDIC's Prompt Corrective Action regulations were revised in accordance with the Basel III capital standards. The enhanced requirements (i) introduce a Common Equity Tier 1 ratio requirement at each capital category (other than critically undercapitalized), and set the required Common Equity Tier 1 ratio at 6.5% for well-capitalized status; (ii) increase the minimum Tier 1 capital ratio requirement for each category (other than critically undercapitalized), and set the minimum Tier 1 capital ratio for well-capitalized status at 8.0% (as compared to 6.0% under the prior rule); and (iii) eliminate the provision that permitted a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be considered adequately capitalized. The Basel III capital standards do not change the total risk-based capital requirement for any prompt corrective action category.

As of December 31, 2016, the Bank was considered "well capitalized" under FDICIA's Prompt Corrective Action capital requirements. (See Note 20 to the Company's consolidated financial statements included in Part II, Item 8 of this report for additional information about the Bank's regulatory capital ratios.)

Deposit Insurance. The deposits of the Bank are insured by the Deposit Insurance Fund (DIF) of the FDIC up to the limits set forth under applicable law and are subject to the deposit insurance premium assessments of the DIF. The FDIC imposes a risk-based deposit premium assessments system, which was amended pursuant to the Federal Deposit Insurance Reform Act of 2005 and further amended by the Dodd-Frank Act. Under this system, as amended, the assessment rates for an insured depository institution vary according to the level of risk incurred in its activities. To arrive at an assessment rate for a banking institution, the FDIC places it in one of four risk categories determined by reference to its capital levels and supervisory ratings. In addition, in the case of those institutions in the lowest risk category, the FDIC further determines its assessment rate based on certain specified financial ratios or, if applicable, its long-term debt ratings. The assessment rate schedule can change from time to time, at the discretion of the FDIC, subject to certain limits. In addition, all FDIC insured depository institutions are required to pay a pro rata portion of the interest due on the obligations issued by the Financing Corporation (FICO) to fund the closing and disposal of failed thrift institutions by the Resolution Trust Corporation.

The Dodd-Frank Act changed the assessment formula for determining deposit insurance premiums and modified certain insurance coverage provisions of the FDIA. The FDIC's implementing rules, which redefined the base for FDIC insurance assessments from the amount of insured deposits to average consolidated total assets less average tangible equity, became effective April 1, 2011. The Bank's total FDIC insurance assessment for 2016 was $306,249.

The Dodd-Frank Act also permanently increased from $100,000 to $250,000 the maximum per depositor FDIC insurance amount.

Brokered Deposits. Under FDICIA, an FDIC-insured bank is prohibited from accepting brokered deposits without prior approval of the FDIC unless it is well capitalized under the FDICIA's prompt corrective actions guidelines. The Company participates in the Certificate of Deposit Account Registry Service (CDARS) of the Promontory Interfinancial Network, which uses a deposit-matching engine to match CDARS deposits in other participating banks, dollar- for-dollar. This product is designed to provide deposit insurance in excess of FDIC limits and thereby enhance customer attraction and retention, build deposits and improve net interest margins. CDARS also permits the "one-way" purchase of deposits, which the Company utilizes from time to time for liquidity management purposes. CDARS are considered brokered deposits for certain purposes under the Federal Deposit Insurance Act and FDIC regulations. As of December 31, 2016 the Company had CDARS deposits totaling $3,141,773 in exchanged funds and $0 in one-way funds. The Company also relies from time to time on purchased wholesale deposit funding, which is a form of brokered deposits. The Company had $14.0 million in purchased wholesale deposits outstanding at December 31, 2016. The Company's Asset, Liability and Funds Management Policy limits the use of brokered deposits to 5% of total assets.

USA Patriot Act. The USA PATRIOT Act is intended to strengthen the ability of U.S. law enforcement and the intelligence community to work cooperatively to combat terrorism on a variety of fronts. The Act contains sweeping anti-money laundering and financial transparency provisions and imposes various requirements, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. The Secretary of the Treasury and federal banking regulators have adopted several regulations to implement these provisions. The Act also amended the federal Bank Holding Company Act and the Bank Merger Act to require the federal banking regulatory authorities to consider the effectiveness of a bank holding company or a financial institution's anti-money laundering activities when reviewing an application to expand operations. As required by law, Community National Bank has in place a Bank Secrecy Act and Anti-Money Laundering compliance program, as well as a customer identification program.

Financial Privacy. Under the federal Gramm-Leach-Bliley Financial Modernization Act of 1999 all financial institutions, including the Company, are required to adopt privacy policies, restrict the sharing of nonpublic consumer customer data with nonaffiliated parties, and establish procedures and practices to protect customer data from unauthorized access. The Company is also subject to similar, but more stringent, requirements under state law, including the Vermont Financial Privacy Act. In addition, the Company is subject to the federal Fair Credit Reporting Act, including the amendments adopted in the federal Fair and Accurate Credit Transactions Act of 2003 (FACT Act). The FACT Act includes many provisions concerning national credit reporting standards and permits consumers to opt out of information sharing among affiliated companies for marketing purposes. It also requires financial institutions to notify their customers if they report negative information about them to a credit bureau or if they are granted credit terms less favorable than those generally available. The Federal Reserve and the OCC have extensive rulemaking authority under the FACT Act and have promulgated rules implementing the Act, including rules limiting information sharing for affiliate marketing and rules requiring programs to identify, detect and mitigate certain identity theft red flags. The Company is also subject to the requirements of the Vermont Fair Credit Reporting Act, which generally requires an individual's consent in order to obtain a credit report, and to data security standards and data breach notice requirements.

Qualified Mortgage Rules. Pursuant to the Dodd-Frank Act, the CFPB adopted significant amendments to the regulations that implement the Truth in Lending Act. These amendments, which became effective January 10, 2014, address mortgage origination practices by certain housing creditors, including the Bank, and generally require mortgage lenders to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider eight underwriting factors when making the credit decision. Alternatively, the mortgage lender can originate so-called "qualified mortgages (QMs)," which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a residential mortgage loan that does not have certain high risk features, such as negative amortization, interest-only payments, balloon payments, or a term exceeding 30 years. In addition, to be a qualified mortgage, the points and fees paid by a consumer cannot exceed 3% of the total loan amount and the borrower's total debt-to-income ratio must be no higher than 43% (subject to certain limited exceptions for loans eligible for purchase, guarantee or insurance by a government sponsored entity or a federal agency).

A lender originating a QM is protected against a legal claim that the lender failed to comply with the ability-to-repay requirement. A lender originating a mortgage that is not a QM is exposed to the risk of a potential claim that the lender did not comply with the ability-to-repay rules, which could require the lender to pay damages to the borrower, and could impair the lender's ability to enforce the loan terms or foreclose on the real estate collateral. The ability-to-repay requirement creates a new basis for after-the-fact challenge of QM status by regulators and by consumers and its future interpretation by the courts may create substantial legal uncertainty. The CFPB's mission is consumer protection, not lender safety and soundness, and for that reason the CFPB wrote the ability-to-repay rule with the goal of preventing consumers from being steered by lenders into expensive and unsustainable borrowing, rather than with the goal of assuring loan repayment. Accordingly, typical credit-quality features such as loan-to-value standards are not elements of the ability-to-repay rule, and it will not necessarily be the case that QMs have a higher probability or history of repayment than other mortgages. Compliance with the ability-to-repay/QM requirements have increased the Company's compliance costs, and may adversely affect the profitability of our routine residential mortgage lending operations. In addition, for the mortgage lending industry the ability-to-repay rule creates a bias in favor of QMs, which because of factors such as a minimum 43% debt-to-income ratio, could have unintended adverse effects, such as reducing community bank lending to low- and moderate-income borrowers and communities.

Integrated TILA/RESPA (TRID) Disclosures. As required by the Dodd-Frank Act, the CFPB issued final rules in 2013 revising and integrating previously separate disclosures required under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) in connection with certain closed-end consumer mortgage loans. These final rules became effective in October 2015 and require lenders to provide a new Loan Estimate (which combines content from the former Good Faith Estimate required under RESPA and the initial disclosures required under TILA) not later than the third business day after submission of a loan application, and a new Closing Disclosure (which combines content of the former HUD-1 Settlement Statement required under RESPA and the final disclosures required under TILA) at least three days prior to the loan closing. Other significant changes included in the TRID rules include: (1) expansion of the scope of loans that require RESPA early disclosures, including bridge loans, vacant land loans, and construction loans; (2) changes and additions to "waiting period" requirements to close a loan; (3) reduced tolerances for estimated fees and (4) the lender, rather than the closing agent, is responsible for providing final disclosures. As with the CFPB's ability-to-repay/QM rules, compliance with the TRID rules has increased the Company's compliance costs and may adversely affect the profitability of our routine residential mortgage lending operations.

Community Reinvestment Act. The Federal Community Reinvestment Act (CRA) requires banks to define the communities they serve, identify the credit needs of those communities, collect and maintain data for each small business or small farm loan originated or purchased by the Bank, and maintain a Public File at each location. The federal banking regulators examine the institutions they regulate for compliance with the CRA and assign one of the following four ratings: “outstanding,” “satisfactory,” “needs to improve” or “substantial noncompliance”. The rating assigned reflects the bank’s record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank. As of the Bank’s last CRA examination, completed during 2014, it received a rating of “Outstanding”.

Home Mortgage Disclosure Act. The federal Home Mortgage Disclosure Act (HMDA), which is implemented by Federal Reserve Board Regulation C, requires mortgage lenders that maintain offices within Metropolitan Statistical Areas (MSAs) to report and make available to the public specified information regarding their residential mortgage lending activities, such as the pricing of home mortgage loans, including the “rate spread” between the interest rate on loans and certain treasury securities and other benchmarks. In July 2015, the CFPB implemented and expanded new HMDA rules. The final rule adopts a dwelling-secured standard for all loans or lines of credit that are for personal, family, or household purposes. Thus, many consumer-purpose transactions, including closed-end home-equity loans, home-equity lines of credit, and reverse mortgages, are subject to the regulation. Most commercial-purpose transactions (i.e., loans or lines of credit not for personal, family, or household purposes) are subject to the regulation only if they are for the purpose of home purchase, home improvement, or refinancing. The final rule excludes from coverage home improvement loans that are not secured by a dwelling (i.e., home improvement loans that are unsecured or that are secured by some other type of collateral) and all agricultural-purpose loans and lines of credit. Community National Bank became subject to HMDA reporting requirements as a result of its merger with LyndonBank in 2007, as the former LyndonBank branch in Enosburg Falls in Franklin County is included within the Burlington, Vermont MSA.

Flood Insurance Reform. The Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters Act), as amended by the Homeowner Flood Insurance Affordability Act of 2014, modified the National Flood Insurance Program by: (i) increasing the maximum civil penalty for Flood Disaster Protection Act violations to $2,000 and eliminating the annual penalty cap; (ii) requiring certain lenders to escrow premiums and fees for flood insurance on residential improved real estate; (iii) directing lenders to accept private flood insurance and to notify borrowers of its availability; (iv) amending the force placement requirement provisions; and (v) permitting lenders to charge borrowers costs for lapses in or insufficient coverage. The civil penalty and force placed insurance provisions were effective immediately.

In July 2015, certain federal agencies issued a joint final rule exempting: (1) detached structures that are not used as a residence from the mandatory flood insurance purchase requirements and (2) HELOCs, business purpose loans, nonperforming loans, loans with terms of less than one year, loans for co-ops and condominiums, and subordinate loans on the same property from the mandatory escrow of flood insurance premium requirements. Additionally, the final rule requires certain lenders to escrow flood insurance payments and offer the option to escrow flood insurance premiums on residential improved real estate securing a loan, effective January 1, 2016. During 2016, the federal banking agencies issued proposed rules for comment that address the private flood insurance provisions of the Biggert-Waters Act.

Reserve Requirements. Federal Reserve Board Regulation D 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) or non-personal time deposits (generally, money market deposit accounts or other savings deposits held by corporations or other depositors that are not natural persons, and certain other types of time deposits), subject to certain exemptions. Because required reserves must be maintained in the form of either vault cash, a non-interest bearing account at the Federal Reserve Bank of Boston or a pass through account (as defined by the Federal Reserve Board), the effect of these reserve requirements is to reduce the amount of the Company's interest-bearing assets.

Federal Home Loan Bank System. Community National Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. Member institutions are required to purchase and hold shares of capital stock in the applicable regional Federal Home Loan Bank (the Federal Home Loan Bank of Boston, in the case of Community National Bank), in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year and 4.5% of its advances (borrowings) from the Federal Home Loan Bank. Community National Bank was in compliance with this requirement with an investment in FHLBB stock at December 31, 2016 of approximately $2.2 million. During 2009, the FHLBB experienced significant net operating losses, and as a result temporarily ceased paying dividends on its stock and instituted a moratorium on stock repurchases and redemptions. In 2011, the FHLBB resumed paying dividends, but at a more modest rate than previous years and in February 2012 it lifted the moratorium on stock redemptions. As a member, the Bank is subject to future capital calls by the FHLBB in order to maintain compliance with its capital plan.

Executive Compensation Guidelines. In 2009, the Federal Reserve issued comprehensive guidance on executive compensation policies, intended to ensure that the incentive compensation practices of banking organizations do not undermine their safety and soundness by encouraging excessive risk-taking. The guidance covers all employees that have the ability to affect materially an institution's risk profile, either individually or as part of a group, and establishes that incentive compensation arrangements should (1) provide incentives that do not encourage risk-taking beyond the institution's ability to identify and manage effectively; (2) be compatible with effective internal controls and risk management; and (3) be supported by strong corporate governance, including active and effective oversight by the board of directors. The guidance instructed institutions to begin an immediate review of their incentive compensation policies to ensure that they do not encourage excessive risk-taking and implement corrective programs as needed. Where deficiencies in incentive compensation arrangements exist, they must be immediately addressed. For institutions such as the Company that are not "large, complex banking organizations" as defined in the guidance, the Federal Reserve will review the incentive compensation arrangements as part of its regular, risk-focused examination process and not in a separate examination. These examinations will be tailored to the scope and complexity of the institution's activity and compensation arrangements. The findings will be included in the Federal Reserve's examination report and deficiencies will be incorporated into the institution's supervisory ratings. Enforcement actions may be taken against an institution if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the institution's safety and soundness and the institution fails to take prompt and effective measures to correct the deficiencies.

Other Legislative and Regulatory Initiatives. In addition to the statutes, regulations and regulatory initiatives described above, new legislation and regulations affecting financial institutions are frequently proposed. If enacted or adopted, these measures could change banking statutes and the Company's operating environment in substantial and unpredictable ways and could further increase reporting and compliance requirements, governance structures and costs of doing business. The Company cannot predict whether any such additional legislation or other regulatory initiatives will be adopted or the effect they may have on the Company's business, results of operations or financial condition.

Effects of Government Monetary Policy

The earnings of the Company are affected by general and local economic conditions and by the policies of various governmental regulatory authorities. In particular, the Federal Reserve Board regulates money supply, credit conditions and interest rates in order to influence general economic conditions, primarily through open market operations in United States Government Securities, varying the discount rate on member bank borrowings, setting reserve requirements against member and nonmember bank deposits, regulating interest rates payable by member banks on time and savings deposits and expanding or contracting the money supply. Federal Reserve Board monetary policies have had a significant effect on the operating results of commercial banks, including the Company, in the past and are expected to continue to do so in the future.

Other Available Information

This annual report on Form 10-K is on file with SEC. The Company also files with the SEC quarterly reports on Form 10-Q and current reports on Form 8-K, as well as proxy materials for its annual meetings of shareholders. You may obtain copies of these documents by visiting the SEC’s Public Reference Room at 100F Street, NE, Washington, DC 20549-0213, by calling the SEC at 1-800-SEC-0330 or by accessing the SEC’s website at http://www.sec.gov. The Company's SEC-filed reports and proxy statements are also available through a link on the Company's website at www.communitybancorpvt.com. The Company has also posted on its website the Company’s Code of Ethics for Senior Financial Officers and the Principal Executive Officer, the Insider Trading Policy and the charters of the Audit, Compensation and Nominating Committees. The information and documents contained on the Company's website do not constitute part of this report. Copies of the Company's reports filed with the SEC (other than exhibits) can also be obtained by contacting Melissa Tinker, Assistant Corporate Secretary, at our principal offices, which are located at 4811 U.S. Route 5, Derby, Vermont 05829 or by calling (802) 334-7915.

Item 1A. Risk Factors

Before deciding to invest in the Company or deciding to maintain or increase an investment, investors should carefully consider the material risks described below, in addition to the other information contained in this report and in the Company’s other filings with the SEC. The risks and uncertainties described below and in the Company’s other filings are not the only ones the Company faces. Additional risks and uncertainties not presently known to management or that are currently deemed immaterial may also affect the Company’s business. If any of these known or unknown risks or uncertainties actually occurs, the Company’s business, financial condition and results of operations could be adversely affected, which in turn could result in a decline in the value of the Company’s capital stock.

Our common stock is not exchange-listed and our trading volume is less than that of larger public companies, which can contribute to volatility in our stock price and adversely affect the price and liquidity of an investment in our common stock.

Our common stock is included in the OTC QX market tier maintained by the OTC Markets Group, Inc under the trading symbol CMTV, but is not traded on any securities exchange. Bid and ask quotations and trades in our stock made by certain brokerage firms are reported through the OTC Link® Alternative Trading System (ATS) maintained by a subsidiary of the OTC Markets Group, Inc. However, trading in our stock is sporadic. A public trading market for a particular class of stock having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of numerous buyers and sellers of that stock at any given time, which in turn depends on the individual decisions of investors and general economic and market conditions over which issuers have no control. The trading market in our stock does not exhibit these characteristics. The trading history of our common stock has been characterized by relatively low trading volume. This lack of an active public market means that the value of a shareholder's investment in our common stock may be subject to sudden fluctuations, as individual trades have a greater effect on our reported trading price than would be the case in a broad public market with significant daily trading volume.

The market price of our common stock may also be subject to fluctuations in response to numerous other factors, including the factors discussed below, regardless of our actual operating performance. The possibility of such fluctuations occurring is increased due to the illiquid nature of the trading market in our common stock. Therefore, a shareholder may be unable to sell our common stock at or above the price at which it was purchased, or at or above the current market price or at the time of his or her choosing.

Our ability to pay dividends on our capital stock and to service our debt depends primarily on dividends from our subsidiary and may be subject to regulatory limitations.

As a holding company, our cash flow typically comes from dividends that our bank subsidiary, Community National Bank, pays to us. Therefore, our ability to pay dividends on our common and preferred stock and to service our subordinated debentures, depends on the dividends we receive from the Bank. Dividend payments from the Bank are subject to federal statutory and regulatory limitations, generally based on net profits and retained earnings and may be subject to additional prudential considerations, such as capital planning needs. In addition, Federal Reserve policy, which applies to us as a registered bank holding company, provides that dividends by bank holding companies should generally be paid out of current earnings looking back over a one-year period and should not be paid if regulatory capital levels are deemed insufficient. Further, regulatory capital requirements could curtail our ability to pay dividends in some cases if we do not maintain a required capital conservation buffer. Our failure to pay dividends on our common or preferred stock or our failure to service our debt could have a material adverse effect on the market price of our common stock. Moreover, if sufficient dividend funding from the Bank is not available to cover all our requirements, we would be obligated first to pay interest and, if applicable, principal on our debentures and then to pay dividends on our preferred stock before making any dividend payments on our common stock.

Although we have generally paid quarterly cash dividends on our common stock, we cannot provide any assurance that dividends will continue to be paid in the future or that the dividend rate will not be reduced in future periods.

Securities issued by us, including our common stock, are not FDIC insured.

Securities issued by us, including our common stock, are not savings or deposit accounts or other obligations of any bank and are not insured by the FDIC, the Deposit Insurance Fund or any other governmental agency or instrumentality, or any private insurer, and are subject to investment risk, including the possible loss of principal.

Changes in interest rates could adversely affect our business, results of operations and financial condition.

Our results of operations depend substantially on our net interest income, which is the difference between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits and borrowings. These rates are highly sensitive to many factors beyond our control, including general economic conditions, inflation, recession, unemployment, money supply and the monetary policies of the Federal Reserve. If the interest rate we pay on deposits and other borrowings increases at a faster rate than the interest rate we earn on loans and other investments, our net interest income and therefore earnings, could be adversely affected. Conversely, our earnings could be adversely affected if the interest rate we earn on loans and other investments falls more quickly than the interest rate we pay on deposits and borrowings. While we have taken measures intended to manage the risks of operating in a changing interest rate environment, we cannot provide assurance that these measures will be effective in avoiding undue interest rate risk.

Increases in interest rates also can affect the value of loans and other assets, such as investment securities, and may affect our ability to realize gains on the sale of assets. For example, we originate loans for sale to secondary market investors, and increasing interest rates may reduce the volume of loans originated for sale, resulting in a reduction in the fee income we earn on such sales. Further, increasing interest rates may adversely affect the ability of borrowers to pay the principal or interest on loans, resulting in an increase in our non-performing assets and a reduction in our income.

In addition, increases in interest rates will increase the dividend rate on our Series A preferred stock, which is tied to the prime rate, and the interest rate on our debentures, which is tied to the London Interbank Offered Rate (LIBOR). Higher preferred stock dividend payments and debenture interest costs would decrease the amount of funds available for payment of dividends on our common stock.

We are subject to liquidity risk because we rely primarily on deposit-gathering to satisfy our funding needs.

Our primary source of liquidity is through the growth of deposits, which provide low cost funding for our operations. If we are unable to attract enough deposits in our market area to fund loan growth and our other funding needs, then we may be forced to purchase deposits or to borrow through the FHLBB or in the capital markets. Purchased deposits and borrowings would tend to be more expensive than funding through core deposits and therefore could have a negative impact on our results of operations, cash flow, liquidity and regulatory capital levels.

We are subject to credit risk and if our allowance for loan losses is not adequate to cover actual losses, our earnings could decrease.

We are exposed to the risk that our borrowers may default on their obligations. A borrower's default on its obligations under one or more loans may result in lost principal and interest income and increased operating expenses as a result of the allocation of management time and resources to the collection and work-out of the credit. In certain situations, where collection efforts are unsuccessful or acceptable work-out arrangements cannot be reached, we may have to write off the loan in whole or in part. In loan default situations, we may acquire real estate or other assets, if any, that secure the loan, through foreclosure or other similar available remedies, and the amount owed under the defaulted loan could exceed the value of the collateral acquired.

We periodically make a determination of the adequacy of our allowance for loan losses based on available information, including, but not limited to, the quality of the loan portfolio as indicated by loan risk ratings, economic conditions, the value of the underlying collateral and the level of non-accruing and criticized loans. Management relies on its loan officers and credit quality reviews, its experience and its evaluation of economic conditions, among other factors, in determining the amount of the provision required for the allowance. Provisions to this allowance result in an expense for the period. If, as a result of general economic conditions, previously incorrect assumptions, an increase in defaulted loans, or other pertinent factors, we determine that additional increases in the allowance for loan losses are necessary, additional expenses may be incurred.

Determining the amount of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and trends, all of which may undergo material changes. At any time, we are likely to have loans in our portfolio that will result in losses but that have not been identified as nonperforming or potential problem credits. We cannot be certain that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit or correctly estimate losses on those loans that are identified. The OCC, our subsidiary Bank’s primary federal regulator, reviews the loan portfolio from time to time as part of its regulatory examination and may request that we increase the allowance for loan losses. Changes in economic conditions or individual business or personal circumstances affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need to make additional provisions to restore the allowance. Any provisions to increase or restore the allowance for loan losses would decrease our net income and, possibly, our capital, and could have an adverse effect on our results of operations and financial condition.

Prepayments of loans may negatively impact our business.

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

Our loans and deposits are geographically concentrated and adverse local economic conditions could negatively affect our business.

Unlike many larger banking institutions, our banking operations are not geographically diversified. Substantially all of our loans, deposits and fee income are generated in northeastern and central Vermont. As a result, poor economic conditions in northeastern and central Vermont could adversely impact the demand for loans and our other financial products and services and may cause us to incur losses associated with higher default rates and decreased collateral values in our loan portfolio. Much of our market area is located in the poorest region of the state. Economic conditions in northeastern and central Vermont are subject to various uncertainties, to a greater degree than other regions of the state. If economic conditions in our market area decline, we expect that our level of problem assets would increase and our prospects for growth would be impaired.

Our banking business is highly regulated, and we may be adversely affected by changes in law and regulation.

We are subject to regulation and supervision by the Federal Reserve, and the Bank is subject to regulation and supervision by the OCC and the FDIC. Federal laws and regulations govern numerous matters affecting us, including changes in the ownership or control of banks and bank holding companies, maintenance of adequate capital, the permissible types, amounts and terms of loans and investments, permissible nonbanking activities, the level of reserves against deposits and restrictions on dividend payments. The OCC possesses the power to issue cease and desist orders to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulation, and the Federal Reserve possesses similar powers with respect to bank holding companies. We are also subject to certain state laws, including certain Vermont laws designed to protect consumers of banking products and services. These and other federal and state laws and restrictions limit the manner in which we may conduct business and obtain financing.

Our business is highly regulated and the various federal and state laws, rules, regulations, and supervisory guidance, policies and interpretations applicable to us are subject to regular modification and change. It is impossible to predict the nature of such changes or their competitive impact on the banking and financial services industry in general or on our banking operations in particular. Such changes may, among other things, increase our cost of doing business, limit our permissible activities, or affect the competitive balance between banks and other financial institutions. In addition, failure to comply with applicable laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties, litigation by private parties, and/or reputational damage, which could have a material adverse effect on our business, results of operations and financial condition.

The requirement to record certain assets and liabilities at fair value may adversely affect our financial results.

We report certain assets, including investment securities, at fair value. Generally, for assets that are reported at fair value we use quoted market prices or valuation models that utilize market data inputs to estimate fair value. Because we carry these assets on our books at their estimated fair value, we may incur losses even if the asset in question presents minimal credit risk. For example, we could be required to recognize other-than-temporary impairments in future periods with respect to investment securities in our portfolio. The amount and timing of any impairment recognized will depend on the severity and duration of the decline in fair value of our investment securities and our estimation of the anticipated recovery period.

Market changes in delivery of financial services may adversely affect demand for our services.

Channels for delivering financial products and services to our customers are evolving rapidly, with less reliance on traditional branch facilities and more use of online and mobile banking. We compete with larger providers that have significant resources to dedicate to improved technology and delivery channels. We periodically evaluate the profitability of our branch system and other office and operational facilities to improve efficiencies. However, identification and closure of unprofitable operations and facilities can lead to restructuring charges and introduce the risk of disruptions to revenues and customer relationships.

Substantial competition could adversely affect us.

Banking is a highly competitive business. We compete actively for loan, deposit, and other financial services business in northeastern and central Vermont. Our competitors include a number of state and national banks and tax-advantaged credit unions, as well as financial and nonfinancial firms that offer services similar to those that we offer. Some of our competitors are community or regional banks that have strong local market positions. Our large bank competitors, in particular, have substantial capital, technology and marketing resources that are well in excess of ours. These larger financial institutions may have greater access to capital at a lower cost and have a higher per-borrower lending limit than our Company, which may adversely affect our ability to compete with them effectively.

In addition, technology and other changes increasingly allow parties to complete financial transactions electronically, without the need for a physical presence in a market area. We are therefore likely to face increasing competition from out-of-market competitors, including national firms. Moreover, in many cases transactions may now be completed without the involvement of banks. For example, consumers can pay bills and transfer funds over the Internet and by telephone without banks. Many non-bank financial service providers have lower overhead costs and are subject to fewer regulatory constraints. If consumers do not use banks to complete their financial transactions, we could potentially lose fee income, deposits and income generated from those deposits.

Systems failures, interruptions or breaches of security could disrupt our business and have an adverse effect on our business, results of operations and financial condition.

We depend upon data processing, software, communication, and information access and exchange on a variety of computing platforms and networks and over the internet, and we rely on the services of a variety of third party vendors to meet our data processing and communication needs. Consequently, we are subject to certain related operational risks, both in our operations and through those of our service providers. These risks include, but are not limited to, data processing system failures and errors, inadequate or failed internal processes, customer or employee fraud, cyberattacks and catastrophic failures resulting from terrorist acts or natural disasters. Despite the safeguards we maintain, we cannot be certain that all of our systems are entirely free from vulnerability to attack or other technological difficulties or failures. Information security risks have increased significantly due to the use of online, telephone and mobile banking channels by customers and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties. Our technologies, systems and networks and those of certain of our service providers as well as our customers' devices, may be the target of cyberattacks, computer viruses, malicious code, phishing attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our or our customers' confidential, proprietary and other information, the theft of customer assets through fraudulent transactions or disruption of our or our customers' or other third parties' business operations. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and we could be exposed to claims from customers. While we have instituted safeguards and controls, we cannot provide assurance that they will be effective in all cases, and their failure in some circumstances could have a material adverse effect on our business, financial condition or results of operations.

We depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions with customers and counterparties, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements and other financial information. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors if made available. If this information is inaccurate, we may suffer financial or reputational harm or other adverse effects with respect to the operation of our business, our financial condition and our results of operations.

New products and services are essential to remain competitive but may subject us to additional risks.

We consistently attempt to offer new products and services to our customers to remain competitive. There can be risks and uncertainties associated with these new products and services especially if they are dependent on new technologies. We may spend significant time and resources in development of new products and services to market to customers. Through our development and implementation process we may incur risks associated with delivery timetables, pricing and profitability, compliance with regulations, technology failures and shifting customer preferences. Failure to successfully manage these risks could have a material effect on our financial condition, result of operations and business.

Changes in accounting standards could materially affect our financial statements.

From time to time the Financial Accounting Standards Board and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements and applicable disclosures in our SEC filings. These changes can be very difficult to predict and can materially affect how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements. Implementation of accounting changes, with associated professional consultation and advice, can be costly, even if the change will not have any material effect on our financial statements.

Our internal controls and procedures may fail or be circumvented.

Management periodically reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. However, any system of controls, no matter how well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurance that the objectives of the system are met. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have a material adverse effect on our business, results of operations and financial condition.

Changes in our tax rates could affect our future results.

Our future effective tax rates and tax liabilities could be unfavorably affected by increases in applicable tax rates and changes in federal or state tax laws, regulations and agency interpretations. Our effective tax rates could also be affected by changes in the valuation of our deferred tax assets and liabilities or by the outcomes of any examinations of our income tax returns by the Internal Revenue Service or our state income, franchise, sales and use or other tax returns by the Vermont Department of Taxes.

Our business could suffer if we fail to attract and retain skilled personnel.

Our success depends, in large part, on our ability to attract and retain key personnel, including executives. Any of our current employees, including our senior management, may terminate their employment with us at any time. Competition for qualified personnel in our industry can be intense and our geographic market area might not be favorably perceived by potential executive management candidates. We may not be successful in attracting and retaining sufficient qualified personnel. We may also incur increased expenses and be required to divert the attention of other senior executives to recruit replacements for the loss of any key personnel.

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

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

We have become subject to more stringent capital requirements.

As of January 1, 2015, we were required to comply with new capital rules issued by the federal banking agencies that implemented the Basel III capital standards and established the minimum capital levels required under the Dodd-Frank Act. These new capital rules require banks and bank holding companies to maintain a minimum common equity Tier I capital ratio of 4.5% of risk-weighted assets, a minimum Tier I capital ratio of 6.0% of risk-weighted assets, a minimum total capital ratio of 8.0% of risk-weighted assets, and a minimum leverage ratio of 4.0%. Subject to a transition period, the new capital rules require banks and bank holding companies to maintain a 2.5% common equity Tier I capital conservation buffer above the minimum risk-based capital requirements for adequately capitalized institutions to avoid restrictions on the ability to pay dividends, discretionary bonuses, and to engage in share repurchases. The Company and the Bank met these requirements as of December 31, 2016. The new rules permanently grandfathered trust preferred securities issued before May 19, 2010 for institutions with less than $15.0 billion in total assets as of December 31, 2009, subject to a limit of 25% of Tier I capital. Our trust preferred securities qualify for this grandfather treatment. The new rules increased the required capital for certain categories of assets, including high volatility construction real estate loans and certain exposures related to securitizations, but retained the previous capital treatment of residential mortgages. Under the new rules, we were permitted to make, and did make, a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital.

Continued implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

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

When we acquire a business, a portion of the purchase price of the acquisition may be allocated to goodwill and other identifiable intangible assets. The excess of the purchase price over the fair value of the net identifiable tangible and intangible assets acquired determines the amount of the purchase price that is allocated to goodwill acquired. At December 31, 2016, our goodwill and other identifiable intangible assets totaled approximately $11.9 million, which included goodwill and remaining unamortized core deposit intangible asset created in connection with the LyndonBank acquisition in 2007 of approximately $11.6 million and $273 thousand, respectively. Under current accounting standards, if we determine goodwill or intangible assets are impaired, we would be required to write down the value of these assets to fair value. We conduct a review each year, or more frequently if events or circumstances warrant such, to determine whether goodwill is impaired. We last completed a goodwill impairment analysis as of December 31, 2016, and concluded goodwill was not impaired. We conduct a review of our other intangible assets for impairment should events or circumstances warrant such. There were no triggers for such review for impairment for other intangible assets for the year ended December 31, 2016. We cannot provide assurance that we will not be required to take an impairment charge in the future. Any impairment charge would have a negative effect on our shareholders' equity and financial results and may cause a decline in our stock price.

We are not able to offer all of the financial services and products of a financial holding company.

Banks, securities firms, and insurance companies can now combine under a "financial holding company" umbrella. Financial holding companies can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting), and merchant banking. Some of our competitors have elected to become financial holding companies. We offer only traditional banking products and, trust and investment management services indirectly through, Community Financial Services Group, LLC,.

Our organizational documents may have the effect of discouraging a third party from acquiring us.

Our Amended and Restated Articles of Association and By-Laws contain provisions, including a staggered board of directors and a supermajority vote requirement, that make it more difficult for a third party to gain control or acquire us without the consent of the board of directors. These provisions could also discourage proxy contests and may make it more difficult for dissident shareholders to elect representatives as directors and take other corporate actions.

Item 1B. Unresolved Staff Comments

Not Applicable

Item 2. Properties

Although Community Bancorp. does not itself own or lease real property, Community National Bank owns and leases various properties for its banking operations. All of the Bank's offices are located in Vermont. In July, 2015, the Company closed two of its banking offices in Caledonia County in an effort to reduce overhead costs by consolidating those offices with other Bank branches in close proximity.

The Company's administrative offices are located at the main offices of the Bank on U.S. Route 5 in Derby, Vermont, with total office space of approximately 34,000 square feet, including retail banking offices, an operations center as well as a community room used by the Bank for meetings and various functions. This community room has a secure outside access making it possible for the Bank to offer it to non-profit organizations after banking hours free of charge. This office is equipped with a remote drive-up facility and a drive-up ATM as well as an inside lobby ATM.

In addition to its main office, the Company currently owns or leases the following premises in six Vermont counties:

Office Location[1]	Owned	Leased	CFSG Office[2]
Caledonia County			
St. Johnsbury (Railroad Street)		X[3]	
St. Johnsbury (Route 5)		X	
Lyndon (Memorial Drive)		X[4]	X
Chittenden County			
South Burlington (Shelburne Road)[5]		X	
Franklin County			
Enosburg Falls (Sampsonville Road)	X		
Lamoille County			
Morrisville (Route 15 West)		X	
Orleans County			
Barton (Church Street)	X		
Derby Line (Main Street)	X		
Island Pond (Route 105)		X	
Newport (Main Street)	X		X
Troy (Route 101)	X		
Washington County			
Barre (North Main Street)	X		X
Montpelier (State Street)		X	

[1] All listed locations are operating bank branch offices, except as otherwise noted in footnotes 3 and 5.

[2]The Bank leases space at some of its branch locations to its affiliated trust and investment management affiliate, CFSG, including premises in Newport, Vermont used as CFSG's main office.

[3] These premises consist of approximately 1,600 square feet on the southern end of Railroad Street and were formerly used as a branch office, now closed and currently vacant.

[4] This branch consists of a building on Memorial Drive comprising approximately 2,600 square feet in the town of Lyndon and is leased on market terms from a neighboring business, 48 Broad Street, LLC, owned by David Stahler who is a member of the Bank's Caledonia County advisory board.

[5] Loan production office (LPO), opened in the first quarter of 2017.

In addition to ATMs at the main office and all branch locations, the Company maintains cash machines at nine third party locations throughout its market area. A complete listing of the Company's banking offices and off-premises cash machine locations is contained on the Bank's website at www.communitynationalbank.com.

All of the Company's owned premises are free and clear of any mortgages or encumbrances and, in management's view, all locations are suitable for conducting the Bank's business.

Item 3. Legal Proceedings

There are no pending legal proceedings to which the Company or the Bank is a party or of which any of its property is the subject, other than routine litigation incidental to its banking business, none of which, in the opinion of management, is material to the Company's consolidated operations or financial condition.

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

Information on the trading market in, market price of, and dividends paid on, the Company's common stock is incorporated by reference to the section of the 2016 Annual Report under the caption "Common Stock Performance by Quarter" immediately following the "Management's Discussion and Analysis of Financial Condition and Results of Operations", filed as Exhibit 13 to this report. The balance of the information required by item 201 of Regulation S-K is omitted in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective February 4, 2008).

During the fourth quarter ended December 31, 2016, purchases of the Company's common stock by the Company or by any affiliated purchaser (as defined in SEC Rule 10b-18) were as follows:

For the period:	Total Number of Shares Purchased(1)(2)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan at the End of the Period
October 1 - October 31	0	$ 0.00	N/A	N/A
November 1 - November 30	6,000	14.85	N/A	N/A
December 1 - December 31	0	0.00	N/A	N/A
Total	6,000	$ 14.85	N/A	N/A

(1) All 6,000 shares were purchased for the account of participants invested in the Company Stock Fund under the Company's Retirement Savings Plan by or on behalf of the Plan Trustee, the Human Resources Committee of Community National Bank. Such share purchases were facilitated through CFSG, which provides certain investment advisory services to the Plan. Both the Plan Trustee and CFSG may be considered affiliates of the Company under Rule 10b-18.

(2) Shares purchased during the period do not include fractional shares repurchased from time to time in connection with the participant's election to discontinue participation in the Company's Dividend Reinvestment Plan.

Item 6. Selected Financial Data

Omitted, in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective Feb. 4, 2008).

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

Incorporated by reference to the section of the 2016 Annual Report under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," immediately following the "Notes to Consolidated Financial Statements", filed as Exhibit 13 to this report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Incorporated by reference to the subsection labeled "Risk Management" of Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the 2016 Annual Report, filed as Exhibit 13 to this report.

Item 8. Financial Statements and Supplementary Data

The audited consolidated financial statements and related notes of Community Bancorp. and Subsidiary and the report thereon of the independent registered accounting firm of Berry Dunn McNeil & Parker, LLC are incorporated herein by reference from the 2016 Annual Report, filed as Exhibit 13 to this report.

In accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective Feb. 4, 2008), the Company has elected to present audited statements of income, comprehensive income, cash flows and changes in shareholders' equity for each of the preceding two, rather than three, fiscal years.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

Management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). As of December 31, 2016, an evaluation was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures. Based on that evaluation, management concluded that its disclosure controls and procedures as of December 31, 2016 were effective in ensuring that material information required to be disclosed in the reports it files with the Commission under the Exchange Act was recorded, processed, summarized, and reported on a timely basis.

Management’s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. As of December 31, 2016, an evaluation was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company’s internal control over financial reporting. Management assessed the Company’s system of internal control over financial reporting as of December 31, 2016, in relation to criteria for effective internal control over financial reporting as described in “Internal Control – Integrated Framework,” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2016, its system of internal control over financial reporting met those criteria and is effective.

This Annual Report does not include an attestation report of the Company’s independent registered public accounting firm regarding internal control over financial reporting. Management’s report is not subject to attestation by the Company’s independent registered public accounting firm pursuant to permanent relief accorded to smaller reporting companies in the Dodd-Frank Act.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company’s internal control over financial reporting that occurred during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Item 9B. Other Information

None

PART III.

Item 10. Directors, Executive Officers and Corporate Governance

The following is incorporated by reference to the Company's Proxy Statement for the 2017 Annual Meeting.

Listing of the names, ages, principal occupations, business experience and specific qualifications of the incumbent directors and nominees under the caption "PROPOSAL I - ELECTION OF DIRECTORS."

Listing of the names, ages, titles and business experience of the executive officers under the caption EXECUTIVE OFFICERS."

Information regarding compliance with Section 16(a) of the Securities Exchange Act of 1934 under the caption "SHARE OWNERSHIP INFORMATION - Section 16(a) Beneficial Ownership Reporting Compliance."

Information regarding changes in the Company’s procedures for submission of director nominations by shareholders under the caption “SHAREHOLDER NOMINATIONS AND OTHER PROPOSALS.”

Information regarding whether a member of the Audit Committee qualifies as an audit committee financial expert under applicable SEC rules, under the caption "CORPORATE GOVERNANCE - Board Committees."

The Code of Ethics for Senior Financial Officers and the Principal Executive Officer is available on the Company's website at www.communitybancorpvt.com. The Code is also listed as Exhibit 14 to this report and incorporated by reference to a prior filing with the SEC. There were no waivers of any provision of the Code during 2016.

Item 11. Executive Compensation

The following is incorporated by reference to the Company's Proxy Statement for the 2017 Annual Meeting:

Information regarding compensation of directors under the captions "PROPOSAL I - ELECTION OF DIRECTORS - Directors' Fees and Other Compensation" and "-Directors' Deferred Compensation Plan."
Information regarding executive compensation and benefit plans under the caption "EXECUTIVE COMPENSATION."
Information regarding management interlocks and certain transactions under the caption "CORPORATE GOVERNANCE - Compensation Committee Interlocks and Insider Participation."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following is incorporated by reference to the Company's Proxy Statement for the 2017 Annual Meeting:

Information regarding the share ownership of management and principal shareholders under the caption "SHARE OWNERSHIP INFORMATION."

The Company does not maintain any equity compensation plans for which disclosure is required under Item 201(d) of SEC Regulation S-K.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The following is incorporated by reference to the Company's Proxy Statement for the 2017 Annual Meeting:

Information regarding transactions with management under the caption "CORPORATE GOVERNANCE -Transactions with Management."
Information regarding the independence of directors under the caption “CORPORATE GOVERNANCE – Director Independence.”

Item 14. Principal Accounting Fees and Services

The following is incorporated by reference to the Company's Proxy Statement for the 2017 Annual Meeting under the caption "PROPOSAL 2 - RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS - Fees Paid to Independent Auditors":

Fees paid to the principal accountant for various audit functions including, but not limited to, the audit of the annual financial statements in the Company's Form 10-K Report and review of the financial statements in the Company's Form 10-Q Reports.
Description of the audit committee's pre-approval policies and procedures required by paragraph (c) (7)(I) of rule 2-01of Regulation S-X.

PART IV.

Item 15. Exhibits and Financial Statement Schedules

(a) Financial Statements

The following are included in this report and are incorporated by reference to the 2016 Annual Report, filed as Exhibit 13 to this report:

Consolidated Balance Sheets at December 31, 2016 and 2015
Consolidated Statements of Income for the years ended December 31, 2016 and 2015
Consolidated Statements of Comprehensive Income for the years ended December 31, 2016 and 2015
Consolidated Statements of Changes in Shareholders’ Equity for the years ended December 31, 2016 and 2015
Consolidated Statements of Cash Flows for the years ended December 31, 2016 and 2015
Notes to Consolidated Financial Statements
Report of Berry Dunn McNeil & Parker, LLC, independent registered public accountants

(b) Exhibits

The following exhibits, previously filed with the Commission, are incorporated by reference:

Exhibit 3(i) - Amended and Restated Articles of Association, filed as Exhibit 3.1 to the Company's Form 10-Q Report filed on August 12, 2014.
Exhibit 3(ii) – Certificate of Creation, Designation, Powers, Preferences, Rights, Privileges, Qualifications, Limitations, Restrictions, Terms and Conditions of the Series A Fixed-to-Floating Non-Cumulative Perpetual Preferred Stock, filed as Exhibit 3(i) to the Company's Form 8-K Report filed on December 31, 2007.
Exhibit 3(iii) - Amended and Restated By-laws of Community Bancorp. as amended and restated through March 12, 2013, filed as Exhibit 3.1 in the Company's Form 8-K Report filed on March 14, 2013.
Exhibit 4(i) – Indenture dated as of October 31, 2007 between Community Bancorp., as issuer and Wilmington Trust Company, as indenture trustee, filed as Exhibit 4.1 to the Company's Form 8-K Report filed on November 2, 2007.
Exhibit 4(ii) – Amended and Restated Declaration of Trust dated as of October 31, 2007 among Community Bancorp., as sponsor, Wilmington Trust Company, as Delaware and institutional Trustee, and the administrators named therein, filed as Exhibit 4.2 to the Company's Form 8-K Report filed on November 2, 2007.
Exhibit 10(i) – Guarantee Agreement dated as of October 31, 2007 between Community Bancorp., as guarantor and Wilmington Trust Company, as guarantee trustee, filed as Exhibit 10.1 to the Company's Form 8-K Report filed on November 2, 2007.
Exhibit 10(ii)* - Amended and Restated Deferred Compensation Plan for Directors, filed as Exhibit 10.2 to the Company's Form 8-K Report filed on December 15, 2008.
Exhibit 10(iii)* - Amended and Restated Supplemental Retirement Plan, filed as Exhibit 10.1 to the Company's Form 8-K Report filed on December 15, 2008.
Exhibit 10(iv)* - Amended and Restated Officer Incentive Plan, filed as Exhibit 10.1 to the Company's Form 8-K Report filed on March 13, 2015.
Exhibit 10(v)* - Description of the Directors Retirement Plan, filed as Exhibit 10(iv) to the Company's Form 10-K Report filed on March 30, 2005; plan terminated in 2005 with respect to future accruals, as disclosed in the Company's Form 8-K Report filed on December 19, 2005.
Exhibit 10(vi)* - Change in Control Agreement for Executive Vice President (Company), Chief Operating Officer (Bank), filed as Exhibit 10.1 to the Company's Form 8-K Report filed on June 23, 2015.
Exhibit 10(vii)* - Change in Control Agreement for Treasurer (Company), Senior Vice President and Chief Financial Officer (Bank), filed as Exhibit 10.2 to the Company's Form 8-K Report filed on June 23, 2015.
Exhibit 10(viii) * - Change in Control Agreement for Vice President (Company), Senior Vice President and Chief Credit Officer (Bank), filed as Exhibit 10.3 to the Company's Form 8-K Report filed on June 23, 2015.
Exhibit 14 – Amended Code of Ethics for Senior Financial Officers and the Principal Executive Officer, filed as Exhibit 14 to the Company's Form 8-K Report on July 12, 2010.

The following exhibits are filed as part of this report:**
Exhibit 13 - Portions of the 2016 Annual Report, specifically incorporated by reference into this report.
Exhibit 21 - Subsidiaries of Community Bancorp.
Exhibit 23 - Consent of Berry Dunn McNeil & Parker, LLC
Exhibit 31(i) - Certification from the Chief Executive Officer (Principal Executive Officer) of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31(ii) - Certification from the Treasurer (Principal Financial Officer) of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32(i) - Certification from the Chief Executive Officer (Principal Executive Officer) of the Company pursuant to section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32(ii) - Certification from the Treasurer (Principal Financial Officer) of the Company pursuant to section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101--The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2016 formatted in eXtensible Business Reporting Language (XBRL): (i) the audited consolidated balance sheets, (ii) the audited consolidated statements of income, (iii) the audited consolidated statements of comprehensive income; (iv) the audited consolidated statements of changes in shareholders' equity, (v) the audited consolidated statements of cash flows and (vi) related notes, for the years ended December 31, 2016 and 2015.

* Denotes compensatory plan or arrangement.
** Exhibit 12 (Statement re Computation of Ratios) is omitted in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective February 4, 2008).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COMMUNITY BANCORP.

BY: /s/ Kathryn M. Austin — Date: March 20, 2017
Kathryn M. Austin, President and Chief
Executive Officer (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

BY: /s/ Kathryn M. Austin — Date: March 20, 2017
Kathryn M. Austin, President and Chief
Executive Officer (Principal Executive Officer)

BY: /s/ Louise M. Bonvechio — Date: March 20, 2017
Louise M. Bonvechio, Corporate Secretary and
Treasurer (Principal Financial Officer)

BY: /s/ Candace A. Patenaude — Date: March 20, 2017
Candace A. Patenaude
(Principal Accounting Officer)

COMMUNITY BANCORP. DIRECTORS

/s/ Thomas E. Adams — Date: March 20, 2017
Thomas E. Adams

/s/ Kathryn M. Austin — Date: March 20, 2017
Kathryn M. Austin

/s/ David M. Bouffard — Date: March 20, 2017
David M. Bouffard

/s/ Charles W. Bucknam, Jr. — Date: March 20, 2017
Charles W. Buckman, Jr.

/s/ Aminta K. Conant — Date: March 20, 2017
Aminta K. Conant

/s/ Jacques R. Couture — Date: March 20, 2017
Jacques R. Couture

/s/ Rosemary M. Lalime — Date: March 20, 2017
Rosemary M. Lalime

/s/ Patrick M. Malone — Date: March 20, 2017
Patrick Malone

/s/ Stephen P. Marsh — Date: March 20, 2017
Stephen P. Marsh, Board Chair

/s/ Dorothy R. Mitchell — Date: March 20, 2017
Dorothy R. Mitchell

/s/ Fredric Oeschger — Date: March 20, 2017
Fredric Oeschger

/s/James G. Wheeler, Jr. — Date: March 20, 2017
James G. Wheeler, Jr.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Community Bancorp. and Subsidiary

We have audited the accompanying consolidated balance sheets of Community Bancorp. and Subsidiary as of December 31, 2016 and 2015 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Community Bancorp. and Subsidiary as of December 31, 2016 and 2015, and the consolidated results of their operations and their consolidated cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
March 20, 2017
Vermont Registration No. 92-0000278

Portland, ME ● Bangor, ME ● Manchester, NH
WWW.BERRYDUNN.COM

Community Bancorp. and Subsidiary
Consolidated Balance Sheets

	December 31, 2016	December 31, 2015
Assets		
Cash and due from banks	$ 10,943,344	$ 9,479,353
Federal funds sold and overnight deposits	18,670,942	19,372,537
Total cash and cash equivalents	29,614,286	28,851,890
Securities held-to-maturity (fair value $51,035,000 at December 31, 2016 and $44,143,000 at December 31, 2015)	49,886,631	43,354,419
Securities available-for-sale	33,715,051	26,470,400
Restricted equity securities, at cost	2,755,850	2,441,650
Loans held-for-sale	0	1,199,400
Loans	487,249,226	458,119,429
Allowance for loan losses	(5,278,445)	(5,011,878)
Deferred net loan costs	310,130	316,491
Net loans	482,280,911	453,424,042
Bank premises and equipment, net	10,830,556	11,460,207
Accrued interest receivable	1,818,510	1,633,213
Bank owned life insurance (BOLI)	4,625,406	4,520,486
Core deposit intangible	272,691	545,386
Goodwill	11,574,269	11,574,269
Other real estate owned (OREO)	394,000	262,000
Other assets	9,885,504	10,397,347
Total assets	$ 637,653,665	$ 596,134,709
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Demand, non-interest bearing	$ 104,472,268	$ 93,525,762
Interest-bearing transaction accounts	118,053,360	130,735,094
Money market funds	79,042,619	81,930,888
Savings	86,776,856	81,731,290
Time deposits, $250,000 and over	19,274,880	9,431,437
Other time deposits	97,115,049	98,131,091
Total deposits	504,735,032	495,485,562
Borrowed funds	31,550,000	10,000,000
Repurchase agreements	30,423,195	22,073,238
Capital lease obligations	483,161	558,365
Junior subordinated debentures	12,887,000	12,887,000
Accrued interest and other liabilities	3,123,760	3,715,888
Total liabilities	583,202,148	544,720,053
Shareholders' Equity		
Preferred stock, 1,000,000 shares authorized, 25 shares issued and outstanding ($100,000 liquidation value)	2,500,000	2,500,000
Common stock - $2.50 par value; 15,000,000 shares authorized, 5,269,053 and 5,204,517 shares issued at December 31, 2016 and 2015, respectively (including 15,022 and 15,430 shares issued February 1, 2017 and 2016, respectively)	13,172,633	13,011,293
Additional paid-in capital	30,825,658	30,089,438
Retained earnings	10,666,782	8,482,096
Accumulated other comprehensive loss	(90,779)	(45,394)
Less: treasury stock, at cost; 210,101 shares at December 31, 2016 and 2015	(2,622,777)	(2,622,777)
Total shareholders' equity	54,451,517	51,414,656
Total liabilities and shareholders' equity	$ 637,653,665	$ 596,134,709
Book value per common share outstanding	$ 10.27	$ 9.79

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary
Consolidated Statements of Income

	Years Ended December 31, 2016	2015
Interest income		
Interest and fees on loans	$ 22,293,558	$ 21,717,394
Interest on debt securities		
Taxable	511,339	441,808
Tax-exempt	1,283,021	1,113,250
Dividends	138,362	116,943
Interest on federal funds sold and overnight deposits	21,834	17,294
Total interest income	24,248,114	23,406,689
Interest expense		
Interest on deposits	2,025,713	2,078,239
Interest on federal funds purchased and other borrowed funds	136,987	88,483
Interest on repurchase agreements	76,457	69,496
Interest on junior subordinated debentures	460,142	409,432
Total interest expense	2,699,299	2,645,650
Net interest income	21,548,815	20,761,039
Provision for loan losses	500,000	510,000
Net interest income after provision for loan losses	21,048,815	20,251,039
Non-interest income		
Service fees	2,741,692	2,565,079
Income from sold loans	891,538	947,325
Other income from loans	839,269	738,454
Net realized gain on sale of securities available-for-sale	0	17,502
Other income	1,029,400	881,795
Total non-interest income	5,501,899	5,150,155
Non-interest expense		
Salaries and wages	7,051,820	6,888,352
Employee benefits	2,838,726	2,576,772
Occupancy expenses, net	2,466,628	2,576,496
Other expenses	6,785,350	6,769,353
Total non-interest expense	19,142,524	18,810,973
Income before income taxes	7,408,190	6,590,221
Income tax expense	1,923,912	1,764,630
Net income	$ 5,484,278	$ 4,825,591
Earnings per common share	$ 1.07	$ 0.96
Weighted average number of common shares used in computing earnings per share	5,024,270	4,961,972
Dividends declared per common share	$ 0.64	$ 0.64

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary
Consolidated Statements of Comprehensive Income

	Years Ended December 31,	
	2016	**2015**
Net income	$ 5,484,278	$ 4,825,591
Other comprehensive loss, net of tax:		
Unrealized holding loss on available-for-sale securities		
arising during the period	(68,765)	(40,000)
Reclassification adjustment for gain realized in income	0	(17,502)
Unrealized loss during the year	(68,765)	(57,502)
Tax effect	23,380	19,551
Other comprehensive loss, net of tax	(45,385)	(37,951)
Total comprehensive income	$ 5,438,893	$ 4,787,640

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2016 and 2015

	Common stock		Preferred stock	
	Shares	**Amount**	**Shares**	**Amount**
Balances, December 31, 2014	5,142,475	$ 12,856,188	25	$ 2,500,000
Comprehensive income				
Net income	0	0	0	0
Other comprehensive loss	0	0	0	0
Total comprehensive income				
Cash dividends declared - common stock	0	0	0	0
Cash dividends declared - preferred stock	0	0	0	0
Issuance of common stock	62,042	155,105	0	0
Balances, December 31, 2015	5,204,517	13,011,293	25	2,500,000
Comprehensive income				
Net income	0	0	0	0
Other comprehensive loss	0	0	0	0
Total comprehensive income				
Cash dividends declared - common stock	0	0	0	0
Cash dividends declared - preferred stock	0	0	0	0
Issuance of common stock	64,536	161,340	0	0
Balances, December 31, 2016	5,269,053	$ 13,172,633	25	$ 2,500,000

The accompanying notes are an integral part of these consolidated financial statements.

Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Treasury stock	Total shareholders' equity
$ 29,359,300	$ 6,909,934	$ (7,443)	$ (2,622,777)	$ 48,995,202
0	4,825,591	0	0	4,825,591
0	0	(37,951)	0	(37,951)
				4,787,640
0	(3,172,179)	0	0	(3,172,179)
0	(81,250)	0	0	(81,250)
730,138	0	0	0	885,243
30,089,438	8,482,096	(45,394)	(2,622,777)	51,414,656
0	5,484,278	0	0	5,484,278
0	0	(45,385)	0	(45,385)
				5,438,893
0	(3,212,092)	0	0	(3,212,092)
0	(87,500)	0	0	(87,500)
736,220	0	0	0	897,560
$ 30,825,658	$ 10,666,782	$ (90,779)	$ (2,622,777)	$ 54,451,517

Community Bancorp. and Subsidiary
Consolidated Statements of Cash Flows

	Years Ended December 31, 2016	Years Ended December 31, 2015
Cash Flows from Operating Activities:		
Net income	$ 5,484,278	$ 4,825,591
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, bank premises and equipment	1,041,985	969,661
Provision for loan losses	500,000	510,000
Deferred income tax	(172,562)	(172,374)
Gain on sale of securities available-for-sale	0	(17,502)
Gain on sale of loans	(429,480)	(424,240)
Loss on sale of bank premises and equipment	39,644	130,603
Loss on sale of OREO	4,965	20,058
Income from Trust LLC	(429,008)	(361,044)
Amortization of bond premium, net	117,821	148,526
Write down of OREO	41,000	75,820
Proceeds from sales of loans held for sale	21,691,034	24,397,411
Originations of loans held for sale	(20,062,154)	(25,146,321)
(Decrease) increase in taxes payable	(187,908)	54,669
(Increase) decrease in interest receivable	(185,297)	65,235
Decrease in mortgage servicing rights	82,384	18,886
Decrease (increase) in other assets	332,930	(309,552)
Increase in cash surrender value of BOLI	(104,920)	(106,912)
Amortization of core deposit intangible	272,695	272,695
Amortization of limited partnerships	909,386	565,335
Decrease (increase) in unamortized loan costs	6,361	(13,097)
Increase (decrease) in interest payable	19,930	(11,038)
Increase in accrued expenses	142,323	23,407
Increase in other liabilities	193,055	76,798
Net cash provided by operating activities	9,308,462	5,592,615
Cash Flows from Investing Activities:		
Investments - held-to-maturity		
Maturities and pay downs	44,317,216	40,831,786
Purchases	(50,849,428)	(42,375,260)
Investments - available-for-sale		
Maturities, calls, pay downs and sales	6,166,383	15,522,796
Purchases	(13,597,620)	(9,234,828)
Proceeds from redemption of restricted equity securities	1,866,400	890,800
Purchases of restricted equity securities	(2,180,600)	0
(Decrease) increase in limited partnership contributions payable	(948,000)	975,000
Investments in limited partnerships	0	(975,500)
Increase in loans, net	(29,833,467)	(10,903,013)
Capital expenditures for bank premises and equipment	(451,978)	(1,071,523)
Proceeds from sales of OREO	217,143	966,615
Recoveries of loans charged off	75,129	98,370
Net cash used in investing activities	(45,218,822)	(5,274,757)

	2016	2015
Cash Flows from Financing Activities:		
Net (decrease) increase in demand and interest-bearing transaction accounts	(1,735,228)	10,113,515
Net increase (decrease) in money market and savings accounts	2,157,297	(2,187,668)
Net increase (decrease) in time deposits	8,827,401	(5,459,748)
Net increase (decrease) in repurchase agreements	8,349,957	(6,469,723)
Net increase in short-term borrowings	20,000,000	10,000,000
Proceeds from long-term borrowings	1,550,000	0
Decrease in capital lease obligations	(75,204)	(81,179)
Dividends paid on preferred stock	(87,500)	(81,250)
Dividends paid on common stock	(2,313,967)	(2,262,089)
Net cash provided by financing activities	36,672,756	3,571,858
Net increase in cash and cash equivalents	762,396	3,889,716
Cash and cash equivalents:		
Beginning	28,851,890	24,962,174
Ending	$ 29,614,286	$ 28,851,890
Supplemental Schedule of Cash Paid During the Period:		
Interest	$ 2,679,369	$ 2,656,688
Income taxes, net of refunds	$ 1,375,000	$ 1,317,000
Supplemental Schedule of Noncash Investing and Financing Activities:		
Change in unrealized loss on securities available-for-sale	$ (68,765)	$ (57,502)
Loans transferred to OREO	$ 395,108	$ 86,173
Investment in limited partnerships, not yet paid	$ 0	$ 975,000
Common Shares Dividends Paid:		
Dividends declared	$ 3,212,092	$ 3,172,179
Increase in dividends payable attributable to dividends declared	(565)	(24,847)
Dividends reinvested	(897,560)	(885,243)
	$ 2,313,967	$ 2,262,089

The accompanying notes are an integral part of these consolidated financial statements.

Note 1. Significant Accounting Policies

The accounting policies of Community Bancorp. and Subsidiary (Company) are in conformity, in all material respects, with accounting principles generally accepted in the United States of America (US GAAP) and general practices within the banking industry. The following is a description of the Company's significant accounting policies.

Basis of presentation and consolidation

The consolidated financial statements include the accounts of Community Bancorp. and its wholly-owned subsidiary, Community National Bank (Bank). All significant intercompany accounts and transactions have been eliminated. The Company is considered a "smaller reporting company" under applicable disclosure rules of the Securities and Exchange Commission and accordingly, has elected to provide its audited statements of income, comprehensive income, cash flows and changes in shareholders' equity for a two year, rather than a three year, period.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810, "Consolidation", in part, addresses limited purpose trusts formed to issue trust preferred securities. It also establishes the criteria used to identify variable interest entities (VIE) and to determine whether or not to consolidate a VIE. In general, ASC Topic 810 provides that the enterprise with the controlling financial interest, known as the primary beneficiary, consolidates the VIE. In 2007, the Company formed CMTV Statutory Trust I for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The Company is not the primary beneficiary of CMTV Statutory Trust I; accordingly, the trust is not consolidated with the Company for financial reporting purposes. CMTV Statutory Trust I is considered an affiliate of the Company (see Note 10).

In December 2011, the Company formed a limited liability company (LLC) to facilitate its purchase of federal New Markets Tax Credits (NMTC) under an investment structure designed by a local community development entity. Management has evaluated the Company's interest in the LLC under the ASC guidance relating to VIEs in light of the overall structure and purpose of the NMTC financing transaction and has concluded that the LLC should not be consolidated in the Company's financial statements for financial reporting purposes, as the Company is not the primary beneficiary of the NMTC structure, does not exercise control within the overall structure and is not obligated to absorb a majority of any losses of the NMTC structure (see Note 7).

Nature of operations

The Company provides a variety of deposit and lending services to individuals, municipalities, and business customers through its branches, ATMs and telephone and internet banking capabilities in northern and central Vermont, which is primarily a small business and agricultural area. The Company's primary deposit products are checking and savings accounts and certificates of deposit. Its primary lending products are commercial, real estate, municipal and consumer loans.

Concentration of risk

The Company's operations are affected by various risk factors, including interest rate risk, credit risk, and risk from geographic concentration of its deposit taking and lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities and repricing of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to creditworthy borrowers, although credit losses are expected to occur because of subjective factors and factors beyond the control of the Company. While the Company has a diversified loan portfolio by loan type, most of its lending activities are conducted within the geographic area where its banking offices are located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy in northern and central Vermont. In addition, a substantial portion of the Company's loans are secured by real estate, which is susceptible to a decline in value, especially during times of adverse economic conditions.

Use of estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions involve inherent uncertainties. Accordingly, actual results could differ from those estimates and those differences could be material.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses (ALL) and the valuation of OREO. In connection with evaluating loans for impairment or assigning the carrying value of OREO, management generally obtains independent evaluations or appraisals for significant properties. While the ALL and the carrying value of OREO are determined using management's best estimate of probable loan and OREO losses, respectively, as of the balance sheet date, the ultimate collectibility of a substantial portion of the Company's loan portfolio and the recovery of a substantial portion of the fair value of OREO are susceptible to uncertainties and changes in a number of factors, especially local real estate market conditions. The amount of the change that is reasonably possible cannot be estimated.

While management uses available information to recognize losses on loans and OREO, future additions to the allowance or write-downs of OREO may be necessary based on changes in local economic conditions or other relevant factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for losses on loans and the carrying value of OREO. Such agencies may require the Company to recognize additions to the allowance or write-downs of OREO based on their judgment about information available to them at the time of their examination.

Mortgage servicing rights (MRSs) associated with loans originated and sold in the secondary market, where servicing is retained, are capitalized and included in other assets in the consolidated balance sheets. MSRs are amortized against non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying loans. The value of capitalized servicing rights represents the present estimated value of the future servicing fees arising from the right to service loans for third parties. The carrying value of the MSRs is periodically reviewed for impairment based on a determination of estimated fair value as compared to amortized cost, and impairment, if any, is recognized through a valuation allowance and is recorded as a write down. Critical accounting policies for MSRs relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of MSRs requires the development and use of estimates, including anticipated principal amortization and prepayments. Events that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. Management uses a third party consultant to assist in analyzing the fair value of the Company's MSRs.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to various factors, including the length of time and the extent to which the fair value has been less than cost; the nature of the issuer and its financial condition and near-term prospects; and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The evaluation of these factors is a subjective process and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

Accounting for a business combination that was completed prior to 2009 requires the application of the purchase method of accounting. Under the purchase method, the Company was required to record the assets and liabilities acquired through the LyndonBank merger in 2007 at fair market value, with the excess of the purchase price over the fair value of the net assets recorded as goodwill and evaluated annually for impairment. Management uses various assumptions in evaluating goodwill for impairment.

Management utilizes numerous techniques to estimate the carrying value of various other assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. Management acknowledges that the use of different estimates or assumptions could produce different estimates of carrying values.

Presentation of cash flows

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

Investment securities

Securities the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity (HTM) and reported at amortized cost. Debt and equity securities not classified as HTM are classified as available-for-sale (AFS). Investments classified as AFS are carried at fair value, with unrealized gains and losses, net of tax and reclassification adjustments, reflected as a net amount in the shareholders' equity section of the consolidated balance sheets and in the statements of changes in shareholders' equity. Investment securities transactions are accounted for on a trade date basis. The specific identification method is used to determine realized gains and losses on sales of securities AFS. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or call date. The Company does not hold any securities purchased for the purpose of selling in the near term and classified as trading.

Declines in the fair value of individual equity securities that are deemed to be other than temporary are reflected in earnings when identified. For individual debt securities that the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to (1) credit loss is recognized in earnings and (2) other factors is recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the interest rates at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

Other investments

In December 2011, the Company made an equity investment in a NMTC financing structure (see Note 7). The Company's investment in the NMTC is amortized using the effective yield method.

From time to time, the Company acquires partnership interests in limited partnerships for low income housing projects. New investments in limited partnerships are amortized using the proportional amortization method. All investments made before January 1, 2015 are amortized using the effective yield method.

The Company has a one-third ownership interest in Community Financial Services Group, LLC (CFSG), a non-depository trust company (see Note 7). The Company's investment in CFSG is accounted for under the equity method of accounting.

Restricted equity securities

Restricted equity securities comprise Federal Reserve Bank stock and Federal Home Loan Bank stock. These securities are carried at cost. As a member of the Federal Reserve Bank of Boston (FRBB), the Company is required to invest in FRBB stock in an amount equal to 6% of the Bank's capital stock and surplus.

As a member of the Federal Home Loan Bank of Boston (FHLBB), the Company is required to invest in $100 par value stock of the FHLBB in an amount that approximates 1% of unpaid principal balances on qualifying loans, plus an additional amount to satisfy an activity based requirement. The stock is nonmarketable and redeemable at par value, subject to the FHLBB's right to temporarily suspend such redemptions. Members are subject to capital calls in some circumstances to ensure compliance with the FHLBB's capital plan.

Loans held-for-sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balance, adjusted for any charge-offs, the ALL, loan premiums or discounts for acquired loans and any unearned fees or costs on originated loans.

Loan interest income is accrued daily on the outstanding balances. For all loan segments, the accrual of interest is discontinued when a loan is specifically determined to be impaired or when the loan is delinquent 90 days and management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is generally not recognized on specific impaired loans unless the likelihood of further loss is considered by management to be remote. Interest payments received on impaired loans are generally applied as a reduction of the loan principal balance. Loans are returned to accrual status when principal and interest payments are brought current and the customer has demonstrated the intent and ability to make future payments on a timely basis. Loans are written down or charged off when collection of principal is considered doubtful.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount is amortized as an adjustment of the related loan's yield. The Company generally amortizes these amounts over the contractual life of the loans.

Loan premiums and discounts on loans acquired in the merger with LyndonBank are amortized as an adjustment to yield over the life of the loans.

Allowance for loan losses

The ALL is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

Unsecured loans, primarily consumer loans, are charged off when they become uncollectible and no later than 120 days past due. Unsecured loans to customers who subsequently file bankruptcy are charged off within 30 days of receipt of the notification of filing or by the end of the month in which the loans become 120 days past due, whichever occurs first. For secured loans, both residential and commercial, the potential loss on impaired loans is carried as a loan loss reserve specific allocation; the loss portion is charged off when collection of the full loan appears unlikely. The unsecured portion of a real estate loan is that portion of the loan exceeding the "fair value" of the collateral less the estimated cost to sell. Value of the collateral is determined in accordance with the Company’s appraisal policy. The unsecured portion of an impaired real estate secured loan is charged off by the end of the month in which the loan becomes 180 days past due.

As described below, the allowance consists of general, specific and unallocated components. However, the entire allowance is available to absorb losses in the loan portfolio, regardless of specific, general and unallocated components considered in determining the amount of the allowance.

General component

The general component of the ALL is based on historical loss experience, adjusted for qualitative factors and stratified by the following loan segments: commercial and industrial, commercial real estate, residential real estate first (1^{st}) lien, residential real estate junior (Jr) lien and consumer loans. The Company does not disaggregate its portfolio segments further into classes. Loss ratios are calculated by loan segment for one year, two year, three year, four year and five year look back periods. The highest loss ratio among these look-back periods is then applied against the respective segment. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels of and trends in delinquencies and non-performing loans, levels of and trends in loan risk groups, trends in volumes and terms of loans, effects of any changes in loan related policies, experience, ability and the depth of management, documentation and credit data exception levels, national and local economic trends, external factors such as competition and regulation and lastly, concentrations of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interests, loans to industry segments, and the geographic distribution of commercial real estate loans. This evaluation is inherently subjective as it requires estimates that are susceptible to revision as more information becomes available.

The reserve methodology was modified during the quarter ended June 30, 2015 to eliminate using the higher of the 1999-2001 losses or current losses, by eliminating the use of the 1999-2001 periods. The 1999-2001 information had become dated and the Bank’s credit portfolio management had evolved since that period. The revised methodology now considers the highest annual loss rates for the most recent one to five year look back periods for each segment of the portfolio. This change in methodology resulted in a reduction to required reserves of $529,234 at June 30, 2015. However, that reduction was partially offset by adjustments made to the commercial & industrial and commercial real estate qualitative factors for the impact of the change in methodology, principally in the areas of loan growth, loan policy, and delinquency factors. As a result, the commercial & industrial and commercial real estate factors were each increased a total of 10 basis points, amounting to increases of $171,000 and $70,000, respectively at June 30, 2015.

The qualitative factors are determined based on the various risk characteristics of each loan segment. The Company has policies, procedures and internal controls that management believes are commensurate with the risk profile of each of these segments. Major risk characteristics relevant to each portfolio segment are as follows:

Commercial & Industrial – Loans in this segment include commercial and industrial loans and to a lesser extent loans to finance agricultural production. Commercial loans are made to businesses and are generally secured by assets of the business, including trade assets and equipment. While not the primary collateral, in many cases these loans may also be secured by the real estate of the business. Repayment is expected from the cash flows of the business. A weakened economy, soft consumer spending, unfavorable foreign trade conditions and the rising cost of labor or raw materials are examples of issues that can impact the credit quality in this segment.

Commercial Real Estate – Loans in this segment are principally made to businesses and are generally secured by either owner-occupied, or non-owner occupied commercial real estate. A relatively small portion of this segment includes farm loans secured by farm land and buildings. As with commercial and industrial loans, repayment of owner-occupied commercial real estate loans is expected from the cash flows of the business and the segment would be impacted by the same risk factors as commercial and industrial loans. The non-owner occupied commercial real estate portion includes both residential and commercial construction loans, vacant land and real estate development loans, multi-family dwelling loans and commercial rental property loans. Repayment of construction loans is expected from permanent financing takeout; the Company generally requires a commitment or eligibility for the take-out financing prior to construction loan origination. Real estate development loans are generally repaid from the sale of the subject real property as the project progresses. Construction and development lending entail additional risks, including the project exceeding budget, not being constructed according to plans, not receiving permits, or the pre-leasing or occupancy rate not meeting expectations. Repayment of multi-family loans and commercial rental property loans is expected from the cash flow generated by rental payments received from the individuals or businesses occupying the real estate. Commercial real estate loans are impacted by factors such as competitive market forces, vacancy rates, cap rates, net operating incomes, lease renewals and overall economic demand. In addition, loans in the recreational and tourism sector can be affected by weather conditions, such as unseasonably low winter snowfalls. Commercial real estate lending also carries a higher degree of environmental risk than other real estate lending.

Residential Real Estate - 1st Lien – All loans in this segment are collateralized by first mortgages on 1 – 4 family owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Residential Real Estate – Jr Lien – All loans in this segment are collateralized by junior lien mortgages on 1 – 4 family residential real estate and repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Consumer – Loans in this segment are made to individuals for consumer and household purposes. This segment includes both loans secured by automobiles and other consumer goods, as well as loans that are unsecured. This segment also includes overdrafts, which are extensions of credit made to both individuals and businesses to cover temporary shortages in their deposit accounts and are generally unsecured. The Company maintains policies restricting the size and term of these extensions of credit. The overall health of the economy, including unemployment rates, has an impact on the credit quality of this segment.

Specific component

The specific component of the ALL relates to loans that are impaired. Impaired loans are loan(s) to a borrower that in the aggregate are greater than $100,000 and that are in non-accrual status or are troubled debt restructurings (TDR) regardless of amount. A specific allowance is established for an impaired loan when its estimated impaired basis is less than the carrying value of the loan. For all loan segments, except consumer loans, a loan is considered impaired when, based on current information and events, in management's estimation it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant or temporary payment delays and payment shortfalls generally are not classified as impaired. Management evaluates the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and frequency of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis, by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Impaired loans also include troubled loans that are restructured. A TDR occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. TDRs may include the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms, or a combination of the two.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, unless such loans are subject to a restructuring agreement.

Unallocated component

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

Bank premises and equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally by the straight-line method over the estimated useful lives of the assets. The cost of assets sold or otherwise disposed of, and the related accumulated depreciation, are eliminated from the accounts and the resulting gains or losses are reflected in the consolidated statements of income. Maintenance and repairs are charged to current expense as incurred and the cost of major renewals and betterments is capitalized.

Other real estate owned

Real estate properties acquired through or in lieu of loan foreclosure or properties no longer used for bank operations are initially recorded at fair value less estimated selling cost at the date of acquisition, foreclosure or transfer. Fair value is determined, as appropriate, either by obtaining a current appraisal or evaluation prepared by an independent, qualified appraiser, by obtaining a broker's market value analysis, and finally, if the Company has limited exposure and limited risk of loss, by the opinion of management as supported by an inspection of the property and its most recent tax valuation. During periods of declining market values, the Company will generally obtain a new appraisal or evaluation. Any write-down based on the asset's fair value at the date of acquisition or institution of foreclosure is charged to the ALL. After acquisition through or in lieu of foreclosure, these assets are carried at the lower of their new cost basis or fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed as incurred. Appraisals by an independent, qualified appraiser are performed periodically on properties that management deems significant, or evaluations may be performed by management or a qualified third party on properties in the portfolio that are deemed less significant or less vulnerable to market conditions. Subsequent write-downs are recorded as a charge to other expense. Gains or losses on the sale of such properties are included in income when the properties are sold.

Intangible assets

Intangible assets include the excess of the purchase price over the fair value of net assets acquired (goodwill) in the 2007 acquisition of LyndonBank, as well as a core deposit intangible related to the deposits acquired from LyndonBank (see Note 6). The core deposit intangible is amortized on an accelerated basis over 10 years to approximate the pattern of economic benefit to the Company. The Company evaluates the valuation and amortization of the core deposit intangible asset if events occur that could result in possible impairment. Goodwill is reviewed for impairment annually, or more frequently as events or circumstances warrant.

Income taxes

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting bases and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgments relating to the realizability of such asset.

Mortgage servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or retained upon the sale of loans. Capitalized servicing rights are reported in other assets and initially recorded at fair value, and are amortized against non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing rights are periodically evaluated for impairment, based upon the estimated fair value of the rights as compared to amortized cost. Impairment is determined by stratifying the rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance and is recorded as amortization of other assets, to the extent that estimated fair value is less than the capitalized amount at the valuation date. Subsequent improvement, if any, in the estimated fair value of impaired MSRs is reflected in a positive valuation adjustment and is recognized in other income up to (but not in excess of) the amount of the prior impairment.

Pension costs

Pension costs are charged to salaries and employee benefits expense and accrued over the active service period.

Advertising costs

The Company expenses advertising costs as incurred.

Comprehensive income

US GAAP generally requires recognized revenue, expenses, gains and losses to be included in net income. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on available-for-sale securities, are not reflected in the consolidated statement of income, but the cumulative effect of such items from period-to-period is reflected as a separate component of the shareholders' equity section of the consolidated balance sheet (accumulated other comprehensive income or loss). Other comprehensive income or loss, along with net income, comprises the Company's total comprehensive income.

Preferred stock

The Company has outstanding 25 shares of fixed-to-floating rate non-cumulative perpetual preferred stock, without par value and with a liquidation preference of $100,000 per share, issued in December 2007. Under the terms of the preferred stock, the Company pays non-cumulative cash dividends quarterly, when, as and if declared by the Board of Directors. Dividends are payable at a variable dividend rate equal to the Wall Street Journal Prime Rate in effect on the first business day of each quarterly dividend period. A variable rate of 3.25% and 3.50% was in effect during 2015 and 2016, respectively. The variable rate then increased by 25 basis points for the dividend payment due in the first quarter of 2017.

Earnings per common share

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

The following table illustrates the calculation of earnings per common share for the periods presented, as adjusted for the cash dividend declared on the preferred stock:

Years Ended December 31,	2016	2015
Net income, as reported	$ 5,484,278	$ 4,825,591
Less: dividends to preferred shareholders	87,500	81,250
Net income available to common shareholders	$ 5,396,778	$ 4,744,341
Weighted average number of common shares used in calculating earnings per share	5,024,270	4,961,972
Earnings per common share	$ 1.07	$ 0.96

Off-balance-sheet financial instruments

In the ordinary course of business, the Company is a party to off-balance-sheet financial instruments consisting of commitments to extend credit, commercial and municipal letters of credit, standby letters of credit, and risk-sharing commitments on residential mortgage loans sold through the FHLBB's Mortgage Partnership Finance (MPF) program. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Impact of recently issued accounting standards

In January 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. This guidance also changes certain disclosure requirements and other aspects of current US GAAP. Public businesses must use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of ASU No. 2016-01 on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842). The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in the ASU is permitted for all entities. The Company is currently evaluating the impact of the adoption of the ASU on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* . Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model, requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available for sale, which will require that credit losses on those securities be recorded through an allowance for credit losses rather than a write-down. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within such years. The Company is evaluating the impact of the adoption of the ASU on its consolidated financial statements. The ASU may have a material impact on the Company's consolidated financial statements upon adoption as it will require a change in the Company's assessment of its ALL and allowance on unused commitments as it will transition from an incurred loss model to an expected loss model, which will likely result in an increase in the ALL upon adoption and may negatively impact the Company and Bank's regulatory capital ratios. Additionally, ASU No. 2016-13 may reduce the carrying value of the Company's HTM investment securities as it will require an allowance on the expected losses over the life of these securities to be recorded upon adoption.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles - *Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* . The ASU was issued to reduce the cost and complexity of the goodwill impairment test. To simplify the subsequent measurement of goodwill, step two of the goodwill impairment test was eliminated. Instead, a Company will recognize an impairment of goodwill should the carrying value of a reporting unit exceed its fair value (i.e. step one). The ASU will be effective for the Company on January 1, 2020 and will be applied prospectively.

The Company has goodwill from its acquisition of LyndonBank in 2007 and performs an impairment test annually or more frequently if circumstances warrant (see Note 6). The Company is currently evaluating the impact of the adoption of the ASU on its consolidated financial statements, but does not anticipate any material impact at this time.

Note 2. Investment Securities

Securities available-for-sale (AFS) and held-to-maturity (HTM) consist of the following:

Securities AFS	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2016				
U.S. Government sponsored enterprise (GSE) debt securities	$ 17,365,805	$ 24,854	$ 73,331	$ 17,317,328
Agency mortgage-backed securities (Agency MBS)	13,265,790	3,896	115,458	13,154,228
Other investments	3,221,000	24,947	2,452	3,243,495
	$ 33,852,595	$ 53,697	$ 191,241	$ 33,715,051

Securities AFS	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2015				
U.S. GSE debt securities	$ 12,832,059	$ 22,523	$ 22,139	$ 12,832,443
Agency MBS	10,734,121	0	69,637	10,664,484
Other investments	2,973,000	5,046	4,573	2,973,473
	$ 26,539,180	$ 27,569	$ 96,349	$ 26,470,400

Securities HTM	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value*
December 31, 2016				
States and political subdivisions	$ 49,886,631	$ 1,148,369	$ 0	$ 51,035,000
December 31, 2015				
States and political subdivisions	$ 43,354,419	$ 788,581	$ 0	$ 44,143,000

*Method used to determine fair value rounds values to nearest thousand.

The entire balance under "Securities HTM - States and political subdivisions" consists of securities of local municipalities which are attributable to municipal financing transactions directly with the Company. The reported fair value of these securities is an estimate based on an analysis that takes into account future maturities and scheduled future repricing. The Company anticipates no losses on these securities and expects to hold them until their maturity.

Securities AFS with a book value of $33,604,595 and $23,566,180 and a fair value of $33,469,254 and $23,496,927 at December 31, 2016 and 2015, respectively, were pledged as collateral for larger dollar repurchase agreement accounts and for other purposes as required or permitted by law.

There were no sales of securities AFS during 2016. Proceeds from sales of securities AFS were $7,019,450 in 2015 with gains of $22,802 and losses of $5,300.

The carrying amount and estimated fair value of securities by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may call or prepay obligations with or without call or prepayment penalties, pursuant to contractual terms. Because the actual maturities of Agency MBS usually differ from their contractual maturities due to the right of borrowers to prepay the underlying mortgage loans, usually without penalty, those securities are not presented in the table by contractual maturity date.

The scheduled maturities of debt securities AFS at December 31, 2016 were as follows:

	Amortized Cost	Fair Value
Due in one year or less	$ 2,006,027	$ 2,010,287
Due from one to five years	17,335,778	17,329,503
Due from five to ten years	1,245,000	1,221,033
Mortgage-backed securities	13,265,790	13,154,228
	$ 33,852,595	$ 33,715,051

The scheduled maturities of debt securities HTM at December 31, 2016 were as follows:

	Amortized Cost	Fair Value*
Due in one year or less	$ 25,368,725	$ 25,369,000
Due from one to five years	4,030,900	4,318,000
Due from five to ten years	4,013,242	4,300,000
Due after ten years	16,473,764	17,048,000
	$ 49,886,631	$ 51,035,000

*Method used to determine fair value rounds values to nearest thousand.

Debt securities AFS with unrealized losses as of the balance sheet dates are presented in the tables below. There were no debt securities with unrealized losses of 12 months or more as of the balance sheet dates presented.

	Less than 12 months		
	Number of Debt Securities	Fair Value	Unrealized Loss
December 31, 2016			
U.S. GSE debt securities	4	$ 5,176,669	$ 73,331
Agency MBS	15	10,704,717	115,458
Other investments	2	493,548	2,452
	21	$ 16,374,934	$ 191,241
December 31, 2015			
U.S. GSE debt securities	6	$ 6,243,373	$ 22,139
Agency MBS	12	10,664,484	69,637
Other investments	6	1,483,427	4,573
	24	$ 18,391,284	$ 96,349

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions, or adverse developments relating to the issuer, warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

As the Company has the ability to hold its debt securities until maturity, or for the foreseeable future if classified as AFS, and it is more likely than not that the Company will not have to sell such securities before recovery of their cost basis, no declines in such securities were deemed to be other-than-temporary at December 31, 2016 and 2015.

The Bank is a member of the FHLBB. The FHLBB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. The Company obtains much of its wholesale funding from the FHLBB. As a requirement of membership in the FHLBB, the Bank must own a minimum required amount of FHLBB stock, calculated periodically based primarily on the Bank's level of borrowings from the FHLBB. As a result of the Bank's level of borrowings during 2016, the Bank was required to purchase additional FHLBB stock which in aggregate totaled $2,180,600. No purchases of additional FHLBB stock were required during 2015. As a member of the FHLBB, the Company is also subject to future capital calls by the FHLBB in order to maintain compliance with its capital plan. During 2016 and 2015, FHLBB exercised capital call options totaling $1,866,400 and $890,800, respectively, on the Company's portfolio of FHLBB stock. As of December 31, 2016 and 2015, the Company's investment in FHLBB stock was $2,167,700 and $1,853,500, respectively.

The Company periodically evaluates its investment in FHLBB stock for impairment based on, among other factors, the capital adequacy of the FHLBB and its overall financial condition. No impairment losses have been recorded through December 31, 2016.

The Company's investment in FRBB Stock was $588,150 at December 31, 2016 and 2015.

Note 3. Loans, Allowance for Loan Losses and Credit Quality

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

	2016	2015
Commercial & industrial	$ 68,730,573	$ 65,191,124
Commercial real estate	201,728,280	178,206,542
Residential real estate - 1st lien	166,691,962	162,760,273
Residential real estate - Junior (Jr) lien	42,927,335	44,720,266
Consumer	7,171,076	7,241,224
Gross Loans	487,249,226	458,119,429
Deduct (add):		
Allowance for loan losses	5,278,445	5,011,878
Deferred net loan costs	(310,130)	(316,491)
Net Loans	$ 482,280,911	$ 453,424,042

The following is an age analysis of past due loans (including non-accrual), by portfolio segment:

December 31, 2016	30-89 Days	90 Days or More	Total Past Due	Current	Total Loans	Non-Accrual Loans	90 Days or More and Accruing
Commercial & industrial	$ 328,684	$ 26,042	$ 354,726	$ 68,375,847	$ 68,730,573	$ 143,128	$ 26,042
Commercial real estate	824,836	222,738	1,047,574	200,680,706	201,728,280	765,584	0
Residential real estate							
- 1st lien	4,881,496	1,723,688	6,605,184	160,086,778	166,691,962	1,227,220	1,068,083
- Jr lien	984,849	116,849	1,101,698	41,825,637	42,927,335	338,602	27,905
Consumer	53,972	2,176	56,148	7,114,928	7,171,076	0	2,176
Total	$ 7,073,837	$ 2,091,493	$ 9,165,330	$478,083,896	$487,249,226	$ 2,474,534	$ 1,124,206

December 31, 2015	30-89 Days	90 Days or More	Total Past Due	Current	Total Loans	Non-Accrual Loans	90 Days or More and Accruing
Commercial & industrial	$ 224,997	$ 168,244	$ 393,241	$ 64,797,883	$ 65,191,124	$ 441,103	$ 13,556
Commercial real estate	888,994	560,439	1,449,433	176,757,109	178,206,542	2,400,757	45,356
Residential real estate							
- 1st lien	2,875,768	1,408,551	4,284,319	158,475,954	162,760,273	2,009,079	801,241
- Jr lien	521,373	63,031	584,404	44,135,862	44,720,266	386,132	63,031
Consumer	83,343	0	83,343	7,157,881	7,241,224	0	0
Total	$ 4,594,475	$ 2,200,265	$ 6,794,740	$451,324,689	$458,119,429	$ 5,237,071	$ 923,184

For all loan segments, loans over 30 days are considered delinquent.

As of the balance sheet dates presented, residential mortgage loans in process of foreclosure consisted of the following:

	Number of loans	Current Balance
December 31, 2016	8	$ 322,663
December 31, 2015	5	400,905

The following summarizes changes in the ALL and select loan information, by portfolio segment:

As of or for the year ended December 31, 2016

	Commercial & Industrial	Commercial Real Estate	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Unallocated	Total
Allowance for loan losses							
Beginning balance	$ 712,902	$ 2,152,678	$ 1,368,028	$ 422,822	$ 75,689	$ 279,759	$ 5,011,878
Charge-offs	(49,009)	0	(244,149)	0	(15,404)	0	(308,562)
Recoveries	36,032	0	23,712	240	15,145	0	75,129
Provision (credit)	26,923	343,407	222,166	(51,886)	8,543	(49,153)	500,000
Ending balance	$ 726,848	$ 2,496,085	$ 1,369,757	$ 371,176	$ 83,973	$ 230,606	$ 5,278,445
Allowance for loan losses							
Evaluated for impairment							
Individually	$ 0	$ 86,400	$ 6,200	$ 114,800	$ 0	$ 0	$ 207,400
Collectively	726,848	2,409,685	1,363,557	256,376	83,973	230,606	5,071,045
Total	$ 726,848	$ 2,496,085	$ 1,369,757	$ 371,176	$ 83,973	$ 230,606	$ 5,278,445
Loans evaluated for impairment							
Individually	$ 48,385	$ 687,495	$ 946,809	$ 224,053	$ 0		$ 1,906,742
Collectively	68,682,188	201,040,785	165,745,153	42,703,282	7,171,076		485,342,484
Total	$ 68,730,573	$201,728,280	$166,691,962	$ 42,927,335	$ 7,171,076		$487,249,226

As of or for the year ended December 31, 2015

	Commercial & Industrial	Commercial Real Estate	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Unallocated	Total
Allowance for loan losses							
Beginning balance	$ 646,719	$ 2,311,936	$ 1,270,766	$ 321,099	$ 118,819	$ 236,535	$ 4,905,874
Charge-offs	(200,900)	(14,783)	(150,947)	(66,104)	(69,632)	0	(502,366)
Recoveries	59,264	0	6,042	240	32,824	0	98,370
Provision (credit)	207,819	(144,475)	242,167	167,587	(6,322)	43,224	510,000
Ending balance	$ 712,902	$ 2,152,678	$ 1,368,028	$ 422,822	$ 75,689	$ 279,759	$ 5,011,878
Allowance for loan losses							
Evaluated for impairment							
Individually	$ 0	$ 0	$ 25,100	$ 114,600	$ 0	$ 0	$ 139,700
Collectively	712,902	2,152,678	1,342,928	308,222	75,689	279,759	4,872,178
Total	$ 712,902	$ 2,152,678	$ 1,368,028	$ 422,822	$ 75,689	$ 279,759	$ 5,011,878
Loans evaluated for impairment							
Individually	$ 286,436	$ 2,551,748	$ 1,419,808	$ 234,004	$ 0		$ 4,491,996
Collectively	64,904,688	175,654,794	161,340,465	44,486,262	7,241,224		453,627,433
Total	$ 65,191,124	$178,206,542	$162,760,273	$ 44,720,266	$ 7,241,224		$458,119,429

Impaired loans by portfolio segment were as follows:

	As of December 31, 2016			2016
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
With an allowance recorded				
Commercial real estate	$ 220,257	$ 232,073	$ 86,400	$ 89,664
Residential real estate - 1st lien	271,962	275,118	6,200	350,709
Residential real estate - Jr lien	224,053	284,342	114,800	241,965
	716,272	791,533	207,400	682,338
With no related allowance recorded				
Commercial & industrial	48,385	62,498		183,925
Commercial real estate	467,238	521,991		1,059,542
Residential real estate - 1st lien	674,847	893,741		877,237
Residential real estate - Jr lien	0	0		15,888
	1,190,470	1,478,230		2,136,592
Total	$ 1,906,742	$ 2,269,763	$ 207,400	$ 2,818,930

	As of December 31, 2015			2015
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
With an allowance recorded				
Commercial & industrial	$ 0	$ 0	$ 0	$ 37,359
Commercial real estate	0	0	0	40,902
Residential real estate - 1st lien	173,788	182,251	25,100	228,273
Residential real estate - Jr lien	234,004	284,227	114,600	155,207
	407,792	466,478	139,700	461,741
With no related allowance recorded				
Commercial & industrial	286,436	366,387		446,817
Commercial real estate	2,551,748	2,776,729		2,151,713
Residential real estate - 1st lien	1,246,020	1,460,402		973,572
Residential real estate - Jr lien	0	0		113,964
	4,084,204	4,603,518		3,686,066
Total	$ 4,491,996	$ 5,069,996	$ 139,700	$ 4,147,807

Interest income recognized on impaired loans is immaterial for all periods presented.

Credit Quality Grouping

In developing the ALL, management uses credit quality grouping to help evaluate trends in credit quality. The Company groups credit risk into Groups A, B and C. The manner the Company utilizes to assign risk grouping is driven by loan purpose. Commercial purpose loans are individually risk graded while the retail portion of the portfolio is generally grouped by delinquency pool.

Group A loans - Acceptable Risk – are loans that are expected to perform as agreed under their respective terms. Such loans carry a normal level of risk that does not require management attention beyond that warranted by the loan or loan relationship characteristics, such as loan size or relationship size. Group A loans include commercial purpose loans that are individually risk rated and retail loans that are rated by pool. Group A retail loans include both performing consumer and residential real estate loans. Residential real estate loans are loans to individuals secured by 1-4 family homes, including first mortgages, home equity and home improvement loans. Loan balances fully secured by deposit accounts or that are fully guaranteed by the Federal Government are considered acceptable risk.

Group B loans – Management Involved - are loans that require greater attention than the acceptable loans in Group A. Characteristics of such loans may include, but are not limited to, borrowers that are experiencing negative operating trends such as reduced sales or margins, borrowers that have exposure to adverse market conditions such as increased competition or regulatory burden, or borrowers that have had unexpected or adverse changes in management. These loans have a greater likelihood of migrating to an unacceptable risk level if these characteristics are left unchecked. Group B is limited to commercial purpose loans that are individually risk rated.

Group C loans – Unacceptable Risk – are loans that have distinct shortcomings that require a greater degree of management attention. Examples of these shortcomings include a borrower's inadequate capacity to service debt, poor operating performance, or insolvency. These loans are more likely to result in repayment through collateral liquidation. Group C loans range from those that are likely to sustain some loss if the shortcomings are not corrected, to those for which loss is imminent and non-accrual treatment is warranted. Group C loans include individually rated commercial purpose loans and retail loans adversely rated in accordance with the Federal Financial Institutions Examination Council’s Uniform Retail Credit Classification Policy. Group C retail loans include 1-4 family residential real estate loans and home equity loans past due 90 days or more with loan-to-value ratios greater than 60%, home equity loans 90 days or more past due where the bank does not hold first mortgage, irrespective of loan-to-value, loans in bankruptcy where repayment is likely but not yet established, and lastly consumer loans that are 90 days or more past due.

Commercial purpose loan ratings are assigned by the commercial account officer; for larger and more complex commercial loans, the credit rating is a collaborative assignment by the lender and the credit analyst. The credit risk rating is based on the borrower's expected performance, i.e., the likelihood that the borrower will be able to service its obligations in accordance with the loan terms. Credit risk ratings are meant to measure risk versus simply record history. Assessment of expected future payment performance requires consideration of numerous factors. While past performance is part of the overall evaluation, expected performance is based on an analysis of the borrower's financial strength, and historical and projected factors such as size and financing alternatives, capacity and cash flow, balance sheet and income statement trends, the quality and timeliness of financial reporting, and the quality of the borrower’s management. Other factors influencing the credit risk rating to a lesser degree include collateral coverage and control, guarantor strength and commitment, documentation, structure and covenants and industry conditions. There are uncertainties inherent in this process.

Credit risk ratings are dynamic and require updating whenever relevant information is received. The risk ratings of larger or more complex loans, and Group B and C rated loans, are assessed at the time of their respective annual reviews, during quarterly updates, in action plans or at any other time that relevant information warrants update. Lenders are required to make immediate disclosure to the Chief Credit Officer of any known increase in loan risk, even if considered temporary in nature.

The risk ratings within the loan portfolio by segments as of the balance sheet dates were as follows:

As of December 31, 2016

	Commercial & Industrial	Commercial Real Estate	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Total
Group A	$ 67,297,983	$ 191,755,393	$ 164,708,778	$ 42,289,062	$ 7,168,901	$ 473,220,117
Group B	512,329	2,971,364	0	169,054	0	3,652,747
Group C	920,261	7,001,523	1,983,184	469,219	2,175	10,376,362
Total	$ 68,730,573	$ 201,728,280	$ 166,691,962	$ 42,927,335	$ 7,171,076	$ 487,249,226

As of December 31, 2015

	Commercial & Industrial	Commercial Real Estate	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Total
Group A	$ 59,764,081	$ 168,326,527	$ 158,834,849	$ 44,041,594	$ 7,241,224	$ 438,208,275
Group B	4,724,729	4,529,493	599,516	212,508	0	10,066,246
Group C	702,314	5,350,522	3,325,908	466,164	0	9,844,908
Total	$ 65,191,124	$ 178,206,542	$ 162,760,273	$ 44,720,266	$ 7,241,224	$ 458,119,429

Modifications of Loans and TDRs

A loan is classified as a TDR if, for economic or legal reasons related to a borrower’s financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider.

The Company is deemed to have granted such a concession if it has modified a troubled loan in any of the following ways:

- Reduced accrued interest;
- Reduced the original contractual interest rate to a rate that is below the current market rate for the borrower;
- Converted a variable-rate loan to a fixed-rate loan;
- Extended the term of the loan beyond an insignificant delay;
- Deferred or forgiven principal in an amount greater than three months of payments; or
- Performed a refinancing and deferred or forgiven principal on the original loan.

An insignificant delay or insignificant shortfall in the amount of payments typically would not require the loan to be accounted for as a TDR. However, pursuant to regulatory guidance, any payment delay longer than three months is generally not considered insignificant. Management's assessment of whether a concession has been granted also takes into account payments expected to be received from third parties, including third-party guarantors, provided that the third party has the ability to perform on the guarantee.

The Company's TDRs are principally a result of extending loan repayment terms to relieve cash flow difficulties. The Company has only, on a limited basis, reduced interest rates for borrowers below the current market rate for the borrower. The Company has not forgiven principal or reduced accrued interest within the terms of original restructurings, nor has it converted variable rate terms to fixed rate terms. However, the Company evaluates each TDR situation on its own merits and does not foreclose the granting of any particular type of concession.

TDRs by segment for the periods presented were as follows:

	Year ended December 31, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential real estate - 1st lien	8	$ 572,418	$ 598,030
Residential real estate - Jr lien	2	62,819	64,977
Total	10	$ 635,237	$ 663,007

	Year ended December 31, 2015		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial & industrial	2	$ 199,134	$ 204,142
Commercial real estate	3	581,431	616,438
Residential real estate - 1st lien	12	1,229,100	1,303,228
Residential real estate - Jr lien	2	117,746	121,672
Total	19	$ 2,127,411	$ 2,245,480

The TDRs for which there was a payment default during the twelve month periods presented were as follows:

Year ended December 31, 2016

	Number of Contracts	Recorded Investment
Residential real estate - 1st lien	2	$ 93,230
Residential real estate - Jr lien	1	54,557
Total	3	$ 147,787

Year ended December 31, 2015

	Number of Contracts	Recorded Investment
Commercial real estate	1	$ 149,514
Residential real estate - 1st lien	4	286,803
Residential real estate - Jr lien	1	69,828
Total	6	$ 506,145

TDRs are treated as other impaired loans and carry individual specific reserves with respect to the calculation of the ALL. These loans are categorized as non-performing, may be past due, and are generally adversely risk rated. The TDRs that have defaulted under their restructured terms are generally in collection status and their reserve is typically calculated using the fair value of collateral method.

The specific allowances related to TDRs as of the balance sheet dates presented were as follows:

	2016	2015
Specific Allowance	$ 92,600	$ 25,100

As of December 31, 2016, the Company was not contractually committed to lend additional funds to debtors with impaired or non-accrual loans. The Company is contractually committed to lend on one Small Business Administration guaranteed line of credit to a borrower whose lending relationship was previously restructured, but is no longer considered impaired for disclosure purposes.

Note 4. Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $193,858,201 and $193,994,081 at December 31, 2016 and 2015, respectively. Net gain realized on the sale of loans was $429,480 and $424,240 for the years ended December 31, 2016 and 2015, respectively.

The following table summarizes changes in MSRs for the years ended December 31,

	2016	2015
Balance at beginning of year	$ 1,293,079	$ 1,311,965
MSRs capitalized	176,705	230,818
MSRs amortized	(266,603)	(257,921)
Change in valuation allowance	7,514	8,217
Balance at end of year	$ 1,210,695	$ 1,293,079

Note 5. Bank Premises and Equipment

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

	2016	2015
Buildings and improvements	$ 11,213,737	$ 11,176,189
Land and land improvements	2,433,971	2,377,703
Furniture and equipment	9,277,592	8,752,908
Leasehold improvements	1,117,085	1,048,409
Capital lease	991,014	976,907
Other prepaid assets	125,584	514,476
	25,158,983	24,846,592
Less accumulated depreciation and amortization	(14,328,427)	(13,386,385)
	$ 10,830,556	$ 11,460,207

The Company is obligated under non-cancelable operating leases for bank premises expiring in various years through 2026, with options to renew. Minimum future rental payments for these leases with original terms in excess of one year as of December 31, 2016 for each of the next five years and in aggregate are:

2017	$ 230,563
2018	233,706
2019	206,470
2020	179,581
2021	97,800
Subsequent to 2021	330,000
	$ 1,278,120

Total rental expense amounted to $204,324 and $204,991 for the years ended December 31, 2016 and 2015, respectively.

Capital lease obligations

The following is a schedule by years of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of December 31, 2016:

2017	$ 136,560
2018	141,460
2019	141,460
2020	110,460
2021	39,117
Total minimum lease payments	569,057
Less amount representing interest	(85,896)
Present value of net minimum lease payments	$ 483,161

Note 6. Goodwill and Other Intangible Asset

As a result of the acquisition of LyndonBank on December 31, 2007, the Company recorded goodwill amounting to $11,574,269. The goodwill is not amortizable and is not deductible for tax purposes. Management evaluated goodwill for impairment at December 31, 2016 and 2015 and concluded that no impairment existed as of such dates.

The Company also recorded $4,161,000 of acquired identified intangible assets representing the core deposit intangible, which is subject to amortization as a non-interest expense over a ten year period. The accumulated amortization expense was $3,888,309 and $3,615,614 as of December 31, 2016 and 2015, respectively. The future amortization expense related to the remaining core deposit intangible at December 31, 2016 is $272,691 and will be fully expensed in 2017.

Note 7. Other Investments

In 2011, the Company established a single-member LLC to facilitate the purchase of federal NMTC through an investment structure designed by a local community development entity. The LLC does not conduct any business apart from its role in the NMTC financing structure. The NMTC equity investment generated tax credits of $204,900 for each of the years ended December 31, 2016 and 2015, with an amortization expense of $177,938 and $161,890, respectively. The carrying value of the NMTC equity investment was $196,572 and $374,510 at December 31, 2016 and 2015, respectively, and is included in other assets in the consolidated balance sheets.

The Company purchases from time to time interests in various limited partnerships established to acquire, own and rent residential housing for low and moderate income Vermonters located in northeastern and central Vermont. The tax credits from these investments were $448,290 and $431,715 for the years ended December 31, 2016 and 2015, respectively. Additionally, the Company recognized a one-time rehabilitation credit on one limited partnership amounting to $273,843 for 2016. Expenses related to amortization of the investments in the limited partnerships are recognized as a component of income tax expense, and were $731,448 and $403,445 for 2016 and 2015, respectively. The carrying values of the limited partnership investments were $1,731,484 and $2,462,932 at December 31, 2016 and 2015, respectively, and are included in other assets.

The Bank has a one-third ownership interest in a non-depository trust company, CFSG, based in Newport, Vermont, which is held indirectly through Community Financial Services Partners, LLC (CFSG Partners), a Vermont LLC that owns 100% of the LLC equity interests of CFSG. The Bank accounts for its investment in CFSG Partners under the equity method of accounting. The Company's investment in CFSG Partners, included in other assets, amounted to $2,016,785 and $1,587,777 as of December 31, 2016 and 2015, respectively. The Company recognized income of $429,008 and $361,044 for 2016 and 2015, respectively, through CFSG Partners from the operations of CFSG.

Note 8. Deposits

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

2017	$ 65,384,502
2018	17,229,272
2019	14,568,044
2020	7,898,848
2021	11,309,263
Total time certificates of deposit	$ 116,389,929

Total deposits in excess of the Federal Deposit Insurance Corporation (FDIC) insurance level amounted to $139,897,460 as of December 31, 2016.

Note 9. Borrowed Funds

Outstanding advances for the Company as of the balance sheet dates presented were as follows:

	2016	2015
Long-Term Advances(1)		
FHLBB term advance, 0.00%, due February 26, 2021	$ 350,000	$ 0
FHLBB term advance, 0.00%, due September 22, 2023	200,000	0
FHLBB term advance, 0.00%, due November 22, 2021	1,000,000	0
	1,550,000	0
Short-Term Advances		
FHLBB term advances, 0.77% and 0.48% fixed rate, due February 08, 2017 and February 26, 2016, respectively	10,000,000	10,000,000
FHLBB term advance 0.77% fixed rate, due February 24, 2017	10,000,000	0
FHLBB term advance 0.92% fixed rate, due June 14, 2017	10,000,000	0
	30,000,000	10,000,000
Total Advances	$ 31,550,000	$ 10,000,000

(1) The Company has borrowed a total of $1,550,000 under the FHLBB's Jobs for New England (JNE) program, a program dedicated to supporting job growth and economic development throughout New England. The FHLBB is providing a subsidy, funded by the FHLBB's earnings, to write down interest rates to zero percent on JNE advances that finance qualifying loans to small businesses. JNE advances must support lending to small businesses in New England that create and/or retain jobs, or otherwise contribute to overall economic development activities.

Borrowings from the FHLBB are secured by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by 1-4 family residential properties. Qualified collateral for these borrowings totaled $94,744,189 and $100,361,793 as of December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, the Company's gross potential borrowing capacity under this arrangement was $68,163,543 and $72,091,633, respectively, before reduction for outstanding advances and collateral pledges.

Under a separate agreement with the FHLBB, the Company has the authority to collateralize public unit deposits, up to its available borrowing capacity, with letters of credit issued by the FHLBB. At December 31, 2016, $21,225,000 in FHLBB letters of credit was utilized as collateral for these deposits compared to $14,900,000 at December 31, 2015. Total fees paid by the Company in connection with issuance of these letters of credit were $25,967 for 2016 and $29,535 for 2015.

The Company also maintained a $500,000 IDEAL Way Line of Credit with the FHLBB at December 31, 2016 and 2015, with no outstanding advances under this line at either year-end date. Interest on these borrowings is at a rate determined daily by the FHLBB and payable monthly.

The Company also has a line of credit with the FRBB, which is intended to be used as a contingency funding source. For this Borrower-in-Custody arrangement, the Company pledged eligible commercial and industrial loans, commercial real estate loans and home equity loans, resulting in an available line of $77,862,708 and $72,345,479 as of December 31, 2016 and 2015, respectively. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), which was 125 basis points as of December 31, 2016. As of December 31, 2016 and 2015, the Company had no outstanding advances against this line.

The Company has an unsecured line of credit with two correspondent banks with available borrowing capacity totaling $7,500,000 at December 31, 2015 and unsecured lines of credit with three correspondent banks with available borrowing capacity totaling $12,500,000 at December 31, 2016. The Company had no outstanding advances against these lines for the periods presented.

Note 10. Junior Subordinated Debentures

As of December 31, 2016 and 2015, the Company had outstanding $12,887,000 principal amount of Junior Subordinated Debentures due in 2037 (the Debentures). The Debentures bear a floating rate equal to the 3-month London Interbank Offered Rate plus 2.85%. During 2016, the floating rate approximated 3.51% per quarter compared to 3.13% for 2015. The Debentures mature on December 15, 2037 and are subordinated and junior in right of payment to all senior indebtedness of the Company, as defined in the Indenture dated as of October 31, 2007 between the Company and Wilmington Trust Company, as Trustee. The Debentures first became redeemable, in whole or in part, by the Company on December 15, 2012. Interest paid on the Debentures for 2016 and 2015 was $460,142 and $409,432, respectively, and is deductible for tax purposes.

The Debentures were issued and sold to CMTV Statutory Trust I (the Trust). The Trust is a special purpose trust funded by a capital contribution of $387,000 from the Company, in exchange for 100% of the Trust's common equity. The Trust was formed for the purpose of issuing corporation-obligated mandatorily redeemable Capital Securities (Capital Securities) in the principal amount of $12.5 million to third-party investors and using the proceeds from the sale of such Capital Securities and the Company's initial capital contribution to purchase the Debentures. The Debentures are the sole asset of the Trust. Distributions on the Capital Securities issued by the Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Trust on the Debentures. The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the Debentures. The Company has entered into an agreement which, taken collectively, fully and unconditionally guarantees the payments on the Capital Securities, subject to the terms of the guarantee.

The Debentures are currently includable in the Company's Tier 1 capital up to 25% of core capital elements (see Note 20).

Note 11. Repurchase Agreements

Securities sold under agreements to repurchase amounted to $30,423,195 and $22,073,238 as of December 31, 2016 and 2015, respectively. These agreements were collateralized by U.S. GSE securities, Agency MBS securities and certificates of deposit with a book value of $33,604,595 and a fair value of $33,469,254 at December 31, 2016 and by U.S. GSE securities and Agency MBS securities with a book value of $23,566,180 and a fair value of $23,496,927 at December 31, 2015.

The average daily balance of these repurchase agreements was $25,888,496 and $24,332,366 during 2016 and 2015, respectively. The maximum borrowings outstanding on these agreements at any month-end of the Company were $30,423,195 and $28,229,636 during 2016 and 2015, respectively. These repurchase agreements mature daily and carried a weighted average interest rate of 0.30% during 2016 and 0.29% during 2015.

Note 12. Income Taxes

The Company prepares its federal income tax return on a consolidated basis. Federal income taxes are allocated to members of the consolidated group based on taxable income.

Federal income tax expense for the years ended December 31 was as follows:

	2016	2015
Currently paid or payable	$ 2,096,474	$ 1,937,004
Deferred tax benefit	(172,562)	(172,374)
Total income tax expense	$ 1,923,912	$ 1,764,630

Total income tax expense differed from the amounts computed at the statutory federal income tax rate of 34 percent primarily due to the following for the years ended December 31:

	2016	2015
Computed expense at statutory rates	$ 2,518,785	$ 2,240,669
Tax exempt interest and BOLI	(471,900)	(414,855)
Disallowed interest	13,053	11,523
Partnership tax credits	(857,359)	(566,949)
Low income housing investment amortization expense	482,756	266,280
NMTC amortization expense	117,439	106,847
Other	121,138	121,116
	$ 1,923,912	$ 1,764,630

The deferred income tax benefit consisted of the following items for the years ended December 31:

	2016	2015
Depreciation	$ 64,758	$ (82,902)
MSRs	(28,011)	(6,421)
Deferred compensation	(58,194)	(26,169)
Bad debts	(90,633)	(36,042)
Non-accrual loan interest	0	13,731
Limited partnership amortization	7,865	56,890
Investment in CFSG Partners	13,187	20,182
Core deposit intangible	(92,716)	(92,716)
Loan fair value	(7,514)	(9,951)
OREO write down	6,460	(10,370)
Other	12,236	1,394
Deferred tax benefit	$ (172,562)	$ (172,374)

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

	2016	2015
Components of the deferred tax asset:		
Bad debts	$ 1,794,672	$ 1,704,039
Deferred compensation	302,166	243,972
Contingent liability - MPF program	45,042	45,042
OREO write down	13,940	20,400
Capital lease	63,228	69,567
Unrealized loss on securities available-for-sale	46,765	23,385
Other	22,837	28,733
Total deferred tax asset	$ 2,288,650	$ 2,135,138

	2016	2015
Components of the deferred tax liability:		
Depreciation	219,304	154,546
Limited partnerships	52,109	44,244
MSRs	411,636	439,647
Investment in CFSG Partners	115,035	101,848
Core deposit intangible	92,715	185,431
Fair value adjustment on acquired loans	21,930	29,444
Total deferred tax liability	912,729	955,160
Net deferred tax asset	$ 1,375,921	$ 1,179,978

US GAAP provides for the recognition and measurement of deductible temporary differences (including general valuation allowances) to the extent that it is more likely than not that the deferred tax asset will be realized.

The net deferred tax asset is included in other assets in the consolidated balance sheets.

ASC Topic 740, *Income Taxes*, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the consolidated financial statements. The Company has adopted these provisions and there was no material effect on the consolidated financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2013 through 2016.

Note 13. 401(k) and Profit-Sharing Plan

The Company has a defined contribution plan covering all employees who meet certain age and service requirements. The pension expense was $652,078 and $610,631 for 2016 and 2015, respectively. These amounts represent discretionary matching contributions of a portion of the voluntary employee salary deferrals under the 401(k) plan and discretionary profit-sharing contributions under the plan.

Note 14. Deferred Compensation and Supplemental Employee Retirement Plans

The Company maintains a directors' deferred compensation plan and, prior to 2005, maintained a retirement plan for its directors. Participants are general unsecured creditors of the Company with respect to these benefits. The benefits accrued under these plans were $114,014 and $141,857 at December 31, 2016 and 2015, respectively. Expenses associated with these plans were $723 and $779 for the years ended December 31, 2016 and 2015, respectively.

The Company also maintains a supplemental employee retirement plan (SERP) for certain key employees of the Company. Benefits accrued under this plan were $774,713 and $575,709 at December 31, 2016 and 2015, respectively. The expense associated with this plan was $199,004 and $114,190 for the years ended December 31, 2016 and 2015, respectively.

Note 15. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees, commitments to sell loans and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the maximum extent of involvement the Company has in particular classes of financial instruments.

The Company's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments. The Company applies the same credit policies and underwriting criteria in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company generally requires collateral or other security to support financial instruments with credit risk. At December 31, the following off-balance-sheet financial instruments representing credit risk were outstanding:

	Contract or Notional Amount	
	2016	2015
Unused portions of home equity lines of credit	$ 25,535,104	$ 25,074,972
Residential construction lines of credit	3,676,176	3,658,037
Commercial real estate and other construction lines of credit	25,951,345	15,586,595
Commercial and industrial commitments	36,227,213	46,197,882
Other commitments to extend credit	42,459,454	19,991,513
Standby letters of credit and commercial letters of credit	2,009,788	1,859,059
Recourse on sale of credit card portfolio	258,555	262,625
MPF credit enhancement obligation, net of liability recorded	748,239	1,051,601

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. At December 31, 2016 and 2015, the Company had binding loan commitments to sell residential mortgages at fixed rates totaling $832,000 and $3,655,547, respectively (see Note 16). The recourse provision under the terms of the sale of the Company's credit card portfolio in 2007 is based on total lines, not balances outstanding. Based on historical losses, the Company does not expect any significant losses from this commitment.

The Company evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit, or a commitment to extend credit, is based on management's credit evaluation of the counter-party. Collateral or other security held varies but may include real estate, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The fair value of standby letters of credit has not been included in the balance sheets as the fair value is immaterial.

In connection with its 2007 trust preferred securities financing, the Company guaranteed the payment obligations under the $12,500,000 of capital securities of its subsidiary, the Trust. The source of funds for payments by the Trust on its capital trust securities is payments made by the Company on its debentures issued to the Trust. The Company's obligation under those debentures is fully reflected in the Company's consolidated balance sheet, in the gross amount of $12,887,000 as of the dates presented, of which $12,500,000 represents external financing through the issuance to investors of capital securities by the Trust (see Note 10).

Note 16. Contingent Liability

The Company sells first lien 1-4 family residential mortgage loans under the MPF program with the FHLBB. Under this program the Company shares in the credit risk of each mortgage loan, while receiving fee income in return. The Company is responsible for a Credit Enhancement Obligation (CEO) based on the credit quality of these loans. FHLBB funds a First Loss Account (FLA) based on the Company's outstanding MPF mortgage balances. This creates a laddered approach to sharing in any losses. In the event of default, homeowner's equity and private mortgage insurance, if any, are the first sources of repayment; the FHLBB's FLA funds are then utilized, followed by the participant's CEO, with the balance of losses absorbed by FHLBB. These loans must meet specific underwriting standards of the FHLBB. As of December 31, 2016 and 2015, the Company had $48,058,235 and $50,374,657, respectively, in loans sold through the MPF program and on which the Company had a CEO. As of December 31, 2016, the notional amount of the maximum CEO related to this program was $870,664 compared to $1,171,787 as of December 31, 2015. The Company had accrued a contingent liability for this CEO in the amount of $122,425 and $120,186 as of December 31, 2016 and 2015, respectively, which is calculated by management based on the methodology used in calculating the ALL, adjusted to reflect the risk sharing arrangements with the FHLBB.

Note 17. Legal Proceedings

In the normal course of business, the Company is involved in various claims and legal proceedings. In the opinion of the Company's management, any liabilities resulting from such proceedings are not expected to be material to the Company's consolidated financial condition or results of operations.

Note 18. Transactions with Related Parties

Aggregate loan transactions of the Company with directors, principal officers, their immediate families and affiliated companies in which they are principal owners (commonly referred to as related parties) as of December 31 were as follows:

	2016	2015
Balance, beginning of year	$ 14,017,551	$ 8,593,273
Loans - New Directors	0	7,225,328
New loans to existing Officers/Directors	11,862,375	14,587,380
Retirement/Resignation of Director	0	(1,824,495)
Repayment*	(11,758,440)	(14,563,935)
Balance, end of year	$ 14,121,486	$ 14,017,551

*Includes loans sold to the secondary market.

Total funds of related parties on deposit with the Company were $7,938,810 and $5,713,210 at December 31, 2016 and 2015, respectively.

The Company leases 2,253 square feet of condominium space in the state office building on Main Street in Newport, Vermont to its trust company affiliate, CFSG, for its principal offices. CFSG also leases offices in the Company’s Barre and Lyndonville branches. The amount of rental income received from CFSG for the years ended December 31, 2016 and 2015 was $60,660 and $59,343, respectively.

The Company utilizes the services of CFSG as an investment advisor for the Company’s 401(k) plan. The Human Resources committee of the Board of Directors is the Trustee of the plan, and CFSG provides investment advice for the plan. CFSG also acts as custodian of the retirement funds and makes investments on behalf of the plan and its participants. In addition, CFSG serves as investment advisor and custodian of funds under the Company’s SERP. The Company pays monthly management fees to CFSG for its services to the 401(k) plan and the SERP based on the market value of the total assets under management. The amount paid to CFSG for the years ended December 31, 2016 and 2015 was $44,065 and $47,448, respectively, for the 401(k) plan and $2,442 and $2,065, respectively, for the SERP.

Note 19. Restrictions on Cash and Due From Banks

In the ordinary course of business, the Company may, from time to time, maintain amounts due from correspondent banks that exceed federally insured limits. However, no losses have occurred in these accounts and the Company believes it is not exposed to any significant risk with respect to such accounts. The Company was required to maintain contracted balances with other correspondent banks of $462,500 at December 31, 2016 and 2015. Of the $462,500 balance, $262,500 was a separate agreed upon “impressed” balance to avoid monthly charges on the Company’s current federal funds liquidity line.

Note 20. Regulatory Capital Requirements

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Additional prompt corrective action capital requirements are applicable to banks, but not to bank holding companies.

The Company and the Bank are required to maintain minimum amounts and ratios (set forth in the table below) of Common equity tier 1, Tier 1 and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). The Company's non-cumulative Series A preferred stock ($2.5 million liquidation preference) is includable without limitation in its Common equity tier 1 and Tier 1 capital. The Company is allowed to include in Common equity tier 1 and Tier 1 capital an amount of trust preferred securities equal to no more than 25% of the sum of all core capital elements, which is generally defined as shareholders' equity, less certain intangibles, including goodwill and the core deposit intangible, net of any related deferred income tax liability, with the balance includable in Tier 2 capital. Management believes that, as of December 31, 2016, the Company and the Bank met all capital adequacy requirements to which they are currently subject.

Beginning in 2016, an additional capital conservation buffer has been added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer will be fully phased-in on January 1, 2019 at 2.5% of risk-weighted assets. A banking organization with a conservation buffer of less than 2.5% (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The Company's and the Bank's capital conservation buffer was 5.52% and 5.42%, respectively, at December 31, 2016. As of December 31, 2016, both the Company and the Bank exceed the required capital conservation buffer of 0.0625% and on a pro forma basis would be compliant with the fully phased-in capital conservation buffer requirement.

As of December 31, 2016, the Bank was considered well capitalized under the regulatory capital framework for Prompt Corrective Action and the Company exceeded applicable consolidated regulatory guidelines for capital adequacy.

The following table shows the regulatory capital ratios for the Company and the Bank as of December 31:

	Actual		Minimum For Capital Adequacy Purposes:		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions(1):	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in Thousands)			
December 31, 2016						
Common equity tier 1 capital (to risk-weighted assets)						
Company	$ 55,690	12.34%	$ 20,304	4.50%	N/A	N/A
Bank	$ 55,120	12.23%	$ 20,274	4.50%	$ 29,285	6.50%
Tier 1 capital (to risk-weighted assets)						
Company	$ 55,690	12.34%	$ 27,072	6.00%	N/A	N/A
Bank	$ 55,120	12.23%	$ 27,032	6.00%	$ 36,043	8.00%
Total capital (to risk-weighted assets)						
Company	$ 61,012	13.52%	$ 36,096	8.00%	N/A	N/A
Bank	$ 60,443	13.42%	$ 36,043	8.00%	$ 45,054	10.00%
Tier 1 capital (to average assets)						
Company	$ 55,690	9.17%	$ 24,305	4.00%	N/A	N/A
Bank	$ 55,120	9.08%	$ 24,281	4.00%	$ 30,351	5.00%
December 31, 2015						
Common equity tier 1 capital (to risk-weighted assets)						
Company	$ 52,555	12.38%	$ 19,100	4.50%	N/A	N/A
Bank	$ 52,000	12.27%	$ 19,072	4.50%	$ 27,549	6.50%
Tier 1 capital (to risk-weighted assets)						
Company	$ 52,555	12.38%	$ 25,467	6.00%	N/A	N/A
Bank	$ 52,000	12.27%	$ 25,430	6.00%	$ 33,906	8.00%
Total capital (to risk-weighted assets)						
Company	$ 57,610	13.57%	$ 33,956	8.00%	N/A	N/A
Bank	$ 57,056	13.46%	$ 33,906	8.00%	$ 42,383	10.00%
Tier 1 capital (to average assets)						
Company	$ 52,555	9.01%	$ 23,324	4.00%	N/A	N/A
Bank	$ 52,000	8.93%	$ 23,301	4.00%	$ 29,126	5.00%

The Company's ability to pay dividends to its shareholders is largely dependent on the Bank's ability to pay dividends to the Company. The Bank is restricted by law as to the amount of dividends that can be paid. Dividends declared by national banks that exceed net income for the current and preceding two years must be approved by the Bank’s primary banking regulator, the Office of the Comptroller of the Currency. Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above.

Note 21. Fair Value

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. The fair values of some of these assets and liabilities are measured on a recurring basis while others are measured on a non-recurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available-for-sale are recorded at fair value on a recurring basis. Other assets, such as MSRs, loans held-for-sale, impaired loans, and OREO are recorded at fair value on a non-recurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with Level 1 considered highest and Level 3 considered lowest). A brief description of each level follows.

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes MSRs, impaired loans and OREO.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following methods and assumptions were used by the Company in estimating its fair value measurements and disclosures:

Cash and cash equivalents: The carrying amounts reported in the balance sheet for cash and cash equivalents approximate their fair values. As such, the Company classifies these financial instruments as Level 1.

Securities available-for-sale and held-to-maturity: Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds and default rates. Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include federal agency securities and securities of local municipalities.

Restricted equity securities: Restricted equity securities are comprised of FRBB stock and FHLBB stock. These securities are carried at cost, which is believed to approximate fair value, based on the redemption provisions of the FRBB and the FHLBB. The stock is nonmarketable, and redeemable at par value, subject to certain conditions. The Company classifies these securities as Level 2.

Loans and loans held-for-sale: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate residential, commercial real estate, and rental property mortgage loans, and commercial and industrial loans) are estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Loan impairment is deemed to exist when full repayment of principal and interest according to the contractual terms of the loan is no longer probable. Impaired loans are reported based on one of three measures: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. If the fair value is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the ALL. Accordingly, certain impaired loans may be subject to measurement at fair value on a non-recurring basis. Management has estimated the fair values of these assets using Level 2 inputs, such as the fair value of collateral based on independent third-party appraisals for collateral-dependent loans. All other loans are valued using Level 3 inputs.

The fair value of loans held-for-sale is based upon an actual purchase and sale agreement between the Company and an independent market participant. The sale is executed within a reasonable period following quarter end at the stated fair value.

MSRs: MSRs represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method and compared to fair value for impairment. In evaluating the carrying values of MSRs, the Company obtains third party valuations based on loan level data including note rate, and the type and term of the underlying loans. The Company classifies MSRs as non-recurring Level 2.

OREO: Real estate acquired through or in lieu of foreclosure and bank properties no longer used as bank premises are initially recorded at fair value. The fair value of OREO is based on property appraisals and an analysis of similar properties currently available. The Company records OREO as non-recurring Level 2.

Deposits, federal funds purchased and borrowed funds: The fair values disclosed for demand deposits (for example, checking accounts, savings accounts and repurchase agreements) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit and borrowed funds are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates and indebtedness to a schedule of aggregated contractual maturities on such time deposits and indebtedness. The Company classifies deposits, federal funds purchased and borrowed funds as Level 2.

Capital lease obligations: Fair value is determined using a discounted cash flow calculation using current rates. Based on current rates, carrying value approximates fair value. The Company classifies these obligations as Level 2.

Junior subordinated debentures: Fair value is estimated using current rates for debentures of similar maturity. The Company classifies these instruments as Level 2.

Accrued interest: The carrying amounts of accrued interest approximate their fair values. The Company classifies accrued interest as Level 2.

Off-balance-sheet credit related instruments: Commitments to extend credit are evaluated and fair value is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

FASB ASC Topic 825 “Financial Instruments”, requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company’s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

Assets Recorded at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis and reflected in the consolidated balance sheets at the dates presented, segregated by fair value hierarchy, are summarized below:

December 31, 2016	**Level 2**
Assets: (market approach)	
U.S. GSE debt securities	$ 17,317,328
Agency MBS	13,154,228
Other investments	3,243,495
Total	$ 33,715,051

December 31, 2015	Level 2
Assets: (market approach)	
U.S. GSE debt securities	$ 12,832,443
Agency MBS	10,664,484
Other investments	2,973,473
	$ 26,470,400

There were no Level 1 or Level 3 assets or liabilities measured on a recurring basis as of the balance sheet dates presented.

Assets Recorded at Fair Value on a Non-Recurring Basis

The following table includes assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. Impaired loans measured at fair value only include impaired loans with a related specific ALL and are presented net of specific allowances as disclosed in Note 3.

Assets measured at fair value on a nonrecurring basis and reflected in the consolidated balance sheets at the dates presented, segregated by fair value hierarchy, are summarized below:

December 31, 2016	Level 2
Assets: (market approach)	
MSRs(1)	$ 1,210,695
Impaired loans, net of related allowance	508,872
OREO	394,000
December 31, 2015	
Assets: (market approach)	
MSRs(1)	$ 1,293,079
Impaired loans, net of related allowance	268,092
OREO	262,000

(1) Represents MSRs at lower of cost or fair value, including MSRs deemed to be impaired and for which a valuation allowance was established to carry at fair value at December 31, 2016 and 2015.

There were no Level 1 or Level 3 assets or liabilities measured on a non-recurring basis as of the balance sheet dates presented.

The carrying amounts and estimated fair values of the Company's financial instruments were as follows:

December 31, 2016	**Carrying Amount**	**Fair Value Level 1**	**Fair Value Level 2**	**Fair Value Level 3**	**Fair Value Total**
			(Dollars in Thousands)		
Financial assets:					
Cash and cash equivalents	$ 29,614	$ 29,614	$ 0	$ 0	$ 29,614
Securities held-to-maturity	49,887	0	51,035	0	51,035
Securities available-for-sale	33,715	0	33,715	0	33,715
Restricted equity securities	2,756	0	2,756	0	2,756
Loans and loans held-for-sale					
Commercial & industrial	67,972	0	48	68,727	68,775
Commercial real estate	199,136	0	601	201,560	202,161
Residential real estate - 1st lien	165,243	0	941	166,858	167,799
Residential real estate - Jr lien	42,536	0	109	42,948	43,057
Consumer	7,084	0	0	7,371	7,371
MSRs(1)	1,211	0	1,302	0	1,302
Accrued interest receivable	1,819	0	1,819	0	1,819
Financial liabilities:					
Deposits					
Other deposits	470,002	0	469,323	0	469,323
Brokered deposits	34,733	0	34,745	0	34,745
Short-term borrowings	30,000	0	30,000	0	30,000
Long-term borrowings	1,550	0	1,376	0	1,376
Repurchase agreements	30,423	0	30,423	0	30,423
Capital lease obligations	483	0	483	0	483
Subordinated debentures	12,887	0	12,849	0	12,849
Accrued interest payable	73	0	73	0	73

(1) Reported fair value represents all MSRs serviced by the Company at December 31, 2016, regardless of carrying amount

December 31, 2015	Carrying Amount	Fair Value Level 1	Fair Value Level 2	Fair Value Level 3	Fair Value Total
	(Dollars in Thousands)				
Financial assets:					
Cash and cash equivalents	$ 28,852	$ 28,852	$ 0	$ 0	$ 28,852
Securities held-to-maturity	43,354	0	44,143	0	44,143
Securities available-for-sale	26,470	0	26,470	0	26,470
Restricted equity securities	2,442	0	2,442	0	2,442
Loans and loans held-for-sale					
Commercial & industrial	64,438	0	286	65,399	65,685
Commercial real estate	175,945	0	2,552	178,502	181,054
Residential real estate - 1st lien	162,492	0	1,395	164,959	166,354
Residential real estate - Jr lien	44,270	0	119	44,939	45,058
Consumer	7,161	0	0	7,482	7,482
MSRs(1)	1,293	0	1,497	0	1,497
Accrued interest receivable	1,633	0	1,633	0	1,633
Financial liabilities:					
Deposits					
Other deposits	466,859	0	466,524	0	466,524
Brokered deposits	28,627	0	28,630	0	28,630
Short-term borrowings	10,000	0	10,000	0	10,000
Repurchase agreements	22,073	0	22,073	0	22,073
Capital lease obligations	558	0	558	0	558
Subordinated debentures	12,887	0	12,851	0	12,851
Accrued interest payable	53	0	53	0	53

(1) Reported fair value represents all MSRs serviced by the Company at December 31, 2015, regardless of carrying amount

The estimated fair values of commitments to extend credit and letters of credit were immaterial at December 31, 2016 and 2015.

Note 22. Condensed Financial Information (Parent Company Only)

The following condensed financial statements are for Community Bancorp. (Parent Company Only), and should be read in conjunction with the consolidated financial statements of Community Bancorp. and Subsidiary.

Community Bancorp. (Parent Company Only) Condensed Balance Sheets	December 31, 2016	December 31, 2015
Assets		
Cash	$ 494,086	$ 508,325
Investment in subsidiary - Community National Bank	66,769,241	63,747,517
Investment in Capital Trust	387,000	387,000
Income taxes receivable	269,335	239,394
Total assets	$ 67,919,662	$ 64,882,236
Liabilities and Shareholders' Equity		
Liabilities		
Junior subordinated debentures	$ 12,887,000	$ 12,887,000
Dividends payable	581,145	580,580
Total liabilities	13,468,145	13,467,580
Shareholders' Equity		
Preferred stock, 1,000,000 shares authorized, 25 shares issued and outstanding ($100,000 liquidation value)	2,500,000	2,500,000
Common stock - $2.50 par value; 15,000,000 shares authorized, and 5,269,053 and 5,204,517 shares issued at December 31, 2016 and 2015, respectively (including 15,022 and 15,430 shares issued February 1, 2017 and 2016, respectively)	13,172,633	13,011,293
Additional paid-in capital	30,825,658	30,089,438
Retained earnings	10,666,782	8,482,096
Accumulated other comprehensive loss	(90,779)	(45,394)
Less: treasury stock, at cost; 210,101 shares at December 31, 2016 and 2015	(2,622,777)	(2,622,777)
Total shareholders' equity	54,451,517	51,414,656
Total liabilities and shareholders' equity	$ 67,919,662	$ 64,882,236

The investment in the subsidiary bank is carried under the equity method of accounting. The investment and cash, which is on deposit with the Bank, have been eliminated in consolidation.

Community Bancorp. (Parent Company Only) Condensed Statements of Income	Years Ended December 31, 2016	2015
Income		
Bank subsidiary distributions	$ 2,940,000	$ 2,842,000
Dividends on Capital Trust	13,818	12,295
Total income	2,953,818	2,854,295
Expense		
Interest on junior subordinated debentures	460,142	409,432
Administrative and other	345,842	306,962
Total expense	805,984	716,394
Income before applicable income tax benefit and equity in undistributed net income of subsidiary	2,147,834	2,137,901
Income tax benefit	269,335	239,394
Income before equity in undistributed net income of subsidiary	2,417,169	2,377,295
Equity in undistributed net income of subsidiary	3,067,109	2,448,296
Net income	$ 5,484,278	$ 4,825,591

Community Bancorp. (Parent Company Only) Condensed Statements of Cash Flows	Years Ended December 31, 2016	2015
Cash Flows from Operating Activities		
Net income	$ 5,484,278	$ 4,825,591
Adjustments to reconcile net income to net cash provided by operating activities		
Equity in undistributed net income of subsidiary	(3,067,109)	(2,448,296)
Increase in income taxes receivable	(29,941)	(5,443)
Net cash provided by operating activities	2,387,228	2,371,852
Cash Flows from Financing Activities		
Dividends paid on preferred stock	(87,500)	(81,250)
Dividends paid on common stock	(2,313,967)	(2,262,089)
Net cash used in financing activities	(2,401,467)	(2,343,339)
Net (decrease) increase in cash	(14,239)	28,513
Cash		
Beginning	508,325	479,812
Ending	$ 494,086	$ 508,325
Cash Received for Income Taxes	$ 239,394	$ 233,952
Cash Paid for Interest	$ 460,142	$ 409,432
Dividends paid:		
Dividends declared	$ 3,212,092	$ 3,172,179
Increase in dividends payable attributable to dividends declared	(565)	(24,847)
Dividends reinvested	(897,560)	(885,243)
	$ 2,313,967	$ 2,262,089

Note 23. Quarterly Financial Data (Unaudited)

A summary of financial data for the four quarters of 2016 and 2015 is presented below:

	Quarters in 2016 ended			
	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	$ 5,818,254	$ 5,963,378	$ 6,254,098	$ 6,212,384
Interest expense	663,262	676,995	691,743	667,299
Provision for loan losses	100,000	150,000	150,000	100,000
Non-interest income	1,237,851	1,318,699	1,483,520	1,461,829
Non-interest expense	4,682,291	4,675,180	4,790,503	4,994,550
Net income	1,169,494	1,295,199	1,515,900	1,503,685
Earnings per common share	0.23	0.25	0.30	0.29

	Quarters in 2015 ended			
	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	$ 5,866,800	$ 5,751,184	$ 5,939,735	$ 5,848,970
Interest expense	727,514	672,304	632,470	613,362
Provision for loan losses	150,000	150,000	75,000	135,000
Non-interest income	1,212,787	1,304,481	1,299,995	1,332,892
Non-interest expense	4,696,729	4,779,840	4,531,874	4,802,530
Net income	1,109,841	1,077,704	1,439,822	1,198,224
Earnings per common share	0.22	0.21	0.29	0.24

Note 24. Other Income and Other Expenses

The components of other income and other expenses which are in excess of one percent of total revenues in either of the two years disclosed are as follows:

	2016	2015
Income		
Income from investment in CFSG Partners	$ 429,008	$ 361,044
Expenses		
Outsourcing expense	$ 509,345	$ 516,197
Service contracts - administration	389,971	330,563
Marketing	380,753	307,841
State deposit tax	568,549	562,271
ATM fees	382,227	372,609
Telephone	318,059	312,043
FDIC insurance	306,249	365,804

Note 25. Subsequent Events

Declaration of Cash Dividend

On December 14, 2016, the Company declared a cash dividend of $0.16 per share payable February 1, 2017 to shareholders of record as of January 15, 2017. On March 8, 2017, the Company declared a cash dividend of $0.17 per share payable May 1, 2017 to shareholders of record as of April 15, 2017. These dividends have been recorded as of each declaration date, including shares issuable under the DRIP.

For purposes of accrual or disclosure in these financial statements, the Company has evaluated subsequent events through the date of issuance of these financial statements.

For the Years Ended December 31, 2016 and 2015

The following discussion analyzes the consolidated financial condition of Community Bancorp. (the Company) and its wholly-owned subsidiary, Community National Bank, as of December 31, 2016 and 2015, and its consolidated results of operations for the years then ended. The Company is considered a “smaller reporting company” under applicable regulations of the Securities and Exchange Commission (SEC) and is therefore eligible for relief from certain disclosure requirements. In accordance with such provisions, the Company has elected to provide its audited consolidated statements of income, comprehensive income, cash flows and changes in shareholders’ equity for two, rather than three, years.

The following discussion should be read in conjunction with the Company’s audited consolidated financial statements and related notes.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements about the results of operations, financial condition and business of the Company and its subsidiary. Words used in the discussion below such as "believes," "expects," "anticipates," "intends," "estimates," "plans," "predicts," or similar expressions, indicate that management of the Company is making forward-looking statements.

Forward-looking statements are not guarantees of future performance. They necessarily involve risks, uncertainties and assumptions. Future results of the Company may differ materially from those expressed in these forward-looking statements. Examples of forward looking statements included in this discussion include, but are not limited to, estimated contingent liability related to assumptions made within the asset/liability management process, management's expectations as to the future interest rate environment and the Company's related liquidity level, credit risk expectations relating to the Company's loan portfolio and its participation in the Federal Home Loan Bank of Boston (FHLBB) Mortgage Partnership Finance (MPF) program, and management's general outlook for the future performance of the Company or the local or national economy. Although forward-looking statements are based on management's current expectations and estimates, many of the factors that could influence or determine actual results are unpredictable and not within the Company's control. Readers are cautioned not to place undue reliance on such statements as they speak only as of the date they are made. The Company does not undertake, and disclaims any obligation, to revise or update any forward-looking statements to reflect the occurrence or anticipated occurrence of events or circumstances after the date of this Report, except as required by applicable law. The Company claims the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995.

Factors that may cause actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities: (1) general economic conditions, either nationally, regionally or locally deteriorate, resulting in a decline in credit quality or a diminished demand for the Company's products and services; (2) competitive pressures increase among financial service providers in the Company's northern New England market area or in the financial services industry generally, including competitive pressures from non-bank financial service providers, 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 as to negatively affect the Company's net income, asset valuations or margins; (4) changes in laws or government rules, including the rules of the federal Consumer Financial Protection Bureau, or the way in which courts or government agencies interpret or implement those laws or rules, increase our costs of doing business, causing us to limit or change our product offerings or pricing, 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) reductions in deposit levels, which necessitate increased borrowings to fund loans and investments; (10) the geographic concentration of the Company’s loan portfolio and deposit base; (11) losses due to the fraudulent or negligent conduct of third parties, including the Company’s service providers, customers and employees; (12) the effect of changes to the calculation of the Company’s regulatory capital ratios which began in 2015 under the Basel III capital framework and which, among other things, requires additional regulatory capital, and changes the framework for risk-weighting of certain assets; (13) the effect of and changes in the United States monetary and fiscal policies, including the interest rate policies of the Federal Reserve Board (FRB) and its regulation of the money supply; and (14) adverse changes in the credit rating of U.S. government debt.

NON-GAAP FINANCIAL MEASURES

Under SEC Regulation G, public companies making disclosures containing financial measures that are not in accordance with generally accepted accounting principles in the United States (US GAAP or GAAP) must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure, as well as a statement of the company's reasons for utilizing the non-GAAP financial measure. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. However, three non-GAAP financial measures commonly used by financial institutions, namely tax-equivalent net interest income and tax-equivalent net interest margin (as presented in the tables in the section labeled Interest Income Versus Interest Expense (Net Interest Income)) and core earnings (as defined and discussed in the Results of Operations section), have not been specifically exempted by the SEC, and may therefore constitute non-GAAP financial measures under Regulation G. We are unable to state with certainty whether the SEC would regard those measures as subject to Regulation G.

Management believes that these non-GAAP financial measures are useful in evaluating the Company's financial performance and facilitate comparisons with the performance of other financial institutions. However, that information should be considered supplemental in nature and not as a substitute for related financial information prepared in accordance with GAAP.

OVERVIEW

The Company's consolidated assets at year-end 2016 were $637.7 million compared to $596.1 million at year-end 2015, an increase of 7.0%. Total loans increased 6.4% to $487.2 million, driven primarily by an increase in commercial loans of $27.1 million, to $270.5 million year over year, and a marginal increase in residential mortgage loans of $2.1 million to end the year at $209.6 million. The Company's investment portfolio increased 19.7% year over year with increases of $7.2 million in the available-for-sale portfolio and $6.5 million in the held-to-maturity portfolio. Funding for these increases was provided by a $9.2 million net increase in deposits, a $20.0 million increase in short-term advances, a $1.5 million increase in long-term advances, and an $8.3 million increase in repurchase agreements. Capital grew to $54.5 million with a book value of $10.27 per common share on December 31, 2016, compared with $51.4 million in capital and a book value of $9.79 per common share on December 31, 2015.

The Company's net income of $5.5 million, or $1.07 per common share, for 2016 was up 13.7%, compared with net income of just over $4.8 million, or $0.96 per common share, in 2015. The improvement is primarily due to the growth in earning assets, as the yield and margins remain under pressure in the current rate environment. Average earning assets increased $18.7 million, or 3.5%, in 2016, and tax-equivalent interest income increased by $928,883, or 3.9%, resulting in a slight increase in average yield on interest-earning assets of two basis points. Management was able to maintain the average yield on interest earning assets for 2016, with an increase of 1 basis point due to the growth in the higher yielding commercial loan portfolio. Average interest-bearing liabilities increased $5.4 million, or 1.2% during the year, and the average rate paid on interest-bearing liabilities virtually remained unchanged, with an increase of 1 basis point, creating a slight increase in interest expense of $53,936. The shift of customer funds out of higher yielding certificates of deposit (CDs) to lower yielding demand and savings accounts seen in prior years slowed considerably in 2016, as the balances saw less of a decline during the year. Non-interest bearing deposit balances increased steadily throughout the year, which helped to offset the cost associated with the increased use of short term borrowings and brokered deposits needed to fund loan growth. The combined effect of these changes resulted in an increase of $875,234 in tax-equivalent net interest income, and a slight improvement in net interest margin from 3.95% to 3.98% year over year.

Continued improvement in asset quality and lower levels of charge-off activity during 2016 allowed the Company to reduce the provision for loan losses by $10,000 compared to 2015 despite the significant growth in the loan portfolio.

More locally, according to the State of Vermont Department of Labor, Vermont's unemployment rate for December, 2016 was 3.1%, compared to 3.5% in December, 2015, and remains well below the national average of 4.7%. However, certain industries, most notably construction, have yet to recover from the last recession. In addition, regions outside the Northwestern part of the state have not mirrored the robust growth seen in and around the Burlington area. Of the Company's primary market areas, Orleans, Caledonia, and Essex Counties continue to have the highest unemployment rates in the state, while Washington and Franklin Counties are at or near the state average.

The regulatory environment continues to increase operating costs and place extensive burdens on personnel resources to comply with myriad legal requirements, including those under the Dodd-Frank Act of 2010, and the numerous rulemakings it has spawned, the Sarbanes-Oxley Act of 2002, the USA Patriot Act, the Bank Secrecy Act, the Real Estate Settlement Procedures Act and the Truth in Lending Act, as well as the new Basel III capital framework. It is possible that these administrative costs and burdens will moderate in the future with the new presidential administration, but this remains to be seen.

The Company declared dividends of $0.64 per common share in 2016 and 2015. As of December 31, 2016, the Company reported retained earnings of $10.7 million, compared to $8.5 million as of December 31, 2015 and total shareholders' equity of $54.5 million and $51.4 million, respectively. The Company is committed to remaining a well-capitalized community bank, working to meet the needs of our customers while providing a fair return to our shareholders.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared according to US GAAP. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities in the consolidated financial statements and related notes. The SEC has defined a company's critical accounting policies as those that are most important to the portrayal of the Company's financial condition and results of operations, and which require the Company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Because of the significance of these estimates and assumptions, there is a high likelihood that materially different amounts would be reported for the Company under different conditions or using different assumptions or estimates. Management evaluates on an ongoing basis its judgment as to which policies are considered to be critical.

Allowance for Loan Losses - Management believes that the calculation of the allowance for loan losses (ALL) is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. In estimating the ALL, management considers historical experience as well as other qualitative factors, including the effect of current economic indicators and their probable impact on borrowers and collateral, trends in delinquent and non-performing loans, trends in criticized and classified assets, levels of exceptions, the impact of competition in the market, concentrations of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interests, loans to industry segments and the geographic distribution of commercial real estate loans. Management's estimates used in calculating the ALL may increase or decrease based on changes in these factors, which in turn will affect the amount of the Company's provision for loan losses charged against current period income. This evaluation is inherently subjective and actual results could differ significantly from these estimates under different assumptions, judgments or conditions.

Other Real Estate Owned (OREO) – Real estate properties acquired through or in lieu of foreclosure or properties no longer used for bank operations, are initially recorded at fair value less estimated selling cost at the date of acquisition, foreclosure or transfer. Fair value is determined, as appropriate, either by obtaining a current appraisal or evaluation prepared by an independent, qualified appraiser, by obtaining a broker's market value analysis, and finally, if the Company has limited exposure and limited risk of loss, by the opinion of management as supported by an inspection of the property and its most recent tax valuation. During periods of declining market values, the Company will generally obtain a new appraisal or evaluation. The amount, if any, by which the recorded amount of the loan exceeds the fair value, less estimated cost to sell, is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. The recorded amount of the loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest. After acquisition through or in lieu of foreclosure, these assets are carried at the lower of their new cost basis or fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed as incurred. Appraisals by an independent, qualified appraiser are performed periodically on properties that management deems significant, or evaluations may be performed by management or a qualified third party on properties in the portfolio that are deemed less significant or less vulnerable to market conditions. Subsequent write-downs are recorded as a charge to other expense. Gains or losses on the sale of such properties are included in income when the properties are sold.

Investment Securities - Management performs quarterly reviews of individual debt and equity securities in the investment portfolio to determine whether a decline in the fair value of a security is other than temporary. A review of other-than-temporary impairment requires management to make certain judgments regarding the materiality of the decline and the probability, extent and timing of a valuation recovery, the Company's intent to continue to hold the security and, in the case of debt securities, the likelihood that the Company will not have to sell the security before recovery of its cost basis. Management assesses fair value declines to determine the extent to which such changes are attributable to fundamental factors specific to the issuer, such as financial condition and business prospects, or to market-related or other external factors, such as interest rates, and in the case of debt securities, the extent to which the impairment relates to credit losses of the issuer, as compared to other factors. Declines in the fair value of securities below their cost that are deemed to be other than temporary, and declines in fair value of debt securities below their cost that are related to credit losses, are recorded in earnings as realized losses, net of tax effect. The non-credit loss portion of an other than temporary decline in the fair value of debt securities below their cost basis (generally, the difference between the fair value and the estimated net present value of expected future cash flows from the debt security) is recognized in other comprehensive income as an unrealized loss, provided that the Company does not intend to sell the security and it is more likely than not that the Company will not have to sell the security before recovery of its reduced basis.

Mortgage Servicing Rights - Mortgage servicing rights associated with loans originated and sold, where servicing is retained, are required to be capitalized and initially recorded at fair value on the acquisition date and are subsequently accounted for using the “amortization method”. Mortgage servicing rights are amortized against non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying financial assets. The value of capitalized servicing rights represents the estimated present value of the future servicing fees arising from the right to service loans for third parties. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of estimated fair value compared to amortized cost, and impairment, if any, is recognized through a valuation allowance and is recorded as a reduction of non-interest income. Subsequent improvement (if any) in the estimated fair value of impaired mortgage servicing rights is reflected in a positive valuation adjustment and is recognized in non-interest income up to (but not in excess of) the amount of the prior impairment. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and prepayments. Factors that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. The Company analyzes and accounts for the value of its servicing rights with the assistance of a third party consultant.

Goodwill - Goodwill from an acquisition accounted for under the purchase accounting method, such as the Company’s 2007 acquisition of LyndonBank, is subject to ongoing periodic impairment evaluation, which includes an analysis of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions. This evaluation is inherently subjective.

Other - Management utilizes numerous techniques to estimate the carrying value of various assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. The use of different estimates or assumptions could produce different estimates of carrying values and those differences could be material in some circumstances.

RESULTS OF OPERATIONS

The Company’s net income increased $658,687, or 13.7%, from 2015 to 2016, resulting in earnings per common share of $1.07 for 2016 and $0.96 for 2015. Net interest income (core earnings) increased $787,776, or 3.9%, for 2016 compared to 2015. This substantial increase in core earnings reflected the combined effect of a substantial increase of $841,425, or 3.6% in interest income versus a slight increase of $53,649, or 2.0%, in interest expense, year over year.

Non-interest income increased $351,744, or 6.8%. The largest component of non-interest income for 2016 was service fee income, with an increase of $176,613, or 6.9%, primarily from an increase in overdraft fees attributable to an overdraft privilege program implemented in June of 2016. Other components were derived from loan activity, both from loans sold in the secondary market and loans held in portfolio. Income from sold loans decreased $55,787, or 5.9% due to a decrease in originations of residential mortgages sold.

Originations of residential mortgages sold in the secondary market totaled $20.1 million in 2016, a 13.0% decrease compared to originations totaling $25.1 million in 2015. Despite the lower volume, the Company reported net gains from the sales of these mortgages of $429,480 in 2016, compared to $424,240 in 2015. Mortgage rates remained historically low through the majority of 2016, but flat compared to prior periods, causing the refinancing activity to slow compared to the periods of falling rates. The volume of financing activity for home sales has not entirely filled the void created by this decrease in refinancing activity. Income from fees related to other loan activity increased $100,815, or 13.7%, due predominately to an increase in commercial loan documentation fees of $104,847, or 32.4%. This increase is directly related to the higher volume of commercial loan originations during 2016 compared to 2015.

The final category of non-interest income is made up of other ancillary revenue and saw an increase of $147,605, or 16.7%. Contributing to the increase was an increase of $67,964, or 18.8%, in trust income, an increase of $85,945, or 531.3%, in market value of the Company's investments related to the Supplemental Employee Retirement Program (SERP), and a one-time, non-recurring liquidating membership distribution from the New England Mortgage Insurance Exchange which resulted in income of $88,646. It should also be noted that the income from the trust company affiliate reflects a one-time market value adjustment of approximately $85,000 to a fund that was recorded through current year profits, of which the Company's portion was approximately $28,000.

Most components of non-interest expense increased, year over year, for an aggregate increase of $331,551, or 1.8%. Salary and benefits increased $425,422, or 4.5%, compared to the prior year, including an increase in salaries of $158,648, or 2.3%, and an increase in employee benefits of $261,954, or 10.2%, due primarily to an increase in contributions to the SERP and pension expense of $126,261, or 17.4%, and an increase in the health benefit expense of $97,564, or 7.6%. Occupancy expense reported the only decrease totaling $109,868, or 4.3%, year over year due to lower heating and utility cost during a warmer than normal winter and lower cost of building maintenance and capital losses on equipment. Please refer to the non-interest income and non-interest expense section of this report for more detail.

Return on average assets (ROA), which is net income divided by average total assets, measures how effectively a corporation uses its assets to produce earnings. Return on average equity (ROE), which is net income divided by average shareholders' equity, measures how effectively a corporation uses its equity capital to produce earnings.

The following table shows these ratios, as well as other equity ratios, for each of the last three fiscal years:

	December 31,		
	2016	**2015**	**2014**
Return on Average Assets	0.91%	0.82%	0.89%
Return on Average Equity	10.36%	9.60%	10.81%
Dividend Payout Ratio (1)	59.81%	66.67%	62.14%
Average Equity to Average Assets Ratio	8.77%	8.57%	8.22%

(1) Dividends declared per common share divided by earnings per common share.

The following table summarizes the earnings performance and certain balance sheet and per share data of the Company during each of the last five fiscal years:

SELECTED FINANCIAL DATA

As of December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
Balance Sheet Data					
Net loans	$482,280,911	$453,424,042	$443,202,475	$435,354,440	$412,232,869
Total assets	637,653,665	596,134,709	586,711,044	573,667,404	575,738,245
Total deposits	504,735,032	495,485,562	493,019,463	481,552,569	475,496,859
Borrowed funds	31,550,000	10,000,000	0	0	6,000,000
Total liabilities	583,202,148	544,720,053	537,715,842	527,531,427	532,385,670
Total shareholders' equity	54,451,517	51,414,656	48,995,202	46,135,977	43,352,575
Years Ended December 31,					
Operating Data					
Total interest income	$ 24,248,114	$ 23,406,689	$ 22,950,277	$ 22,639,782	$ 22,821,331
Total interest expense	2,699,299	2,645,650	3,055,744	3,442,134	4,882,319
Net interest income	21,548,815	20,761,039	19,894,533	19,197,648	17,939,012
Provision for loan losses	500,000	510,000	540,000	670,000	1,000,000
Net interest income after provision for loan losses	21,048,815	20,251,039	19,354,533	18,527,648	16,939,012
Non-interest income	5,501,899	5,150,155	5,141,751	5,982,568	6,188,960
Non-interest expense	19,142,524	18,810,973	17,585,980	17,818,632	17,691,593
Income before income taxes	7,408,190	6,590,221	6,910,304	6,691,584	5,436,379
Applicable income tax expense (1)	1,923,912	1,764,630	1,785,396	1,604,929	1,035,689
Net income	$ 5,484,278	$ 4,825,591	$ 5,124,908	$ 5,086,655	$ 4,400,690
Per Share Data					
Earnings per common share (2)	$ 1.07	$ 0.96	$ 1.03	$ 1.01	$ 0.88
Dividends declared per common share	$ 0.64	$ 0.64	$ 0.64	$ 0.56	$ 0.56
Book value per common share outstanding	$ 10.27	$ 9.79	$ 9.43	$ 8.96	$ 8.49
Weighted average number of common shares outstanding	5,024,270	4,961,972	4,897,281	4,838,185	4,769,645
Number of common shares outstanding, period end	5,058,952	4,994,416	4,932,374	4,868,606	4,812,925

(1) Applicable income tax expense assumes a 34% tax rate.
(2) Computed based on the weighted average number of common shares outstanding during the periods presented.

INTEREST INCOME VERSUS INTEREST EXPENSE (NET INTEREST INCOME)

The largest component of the Company's operating income is net interest income, which is the difference between interest earned on loans and investments versus the interest paid on deposits and other sources of funds (i.e. other borrowings). The Company's level of net interest income can fluctuate over time due to changes in the level and mix of earning assets, and sources of funds (volume) and from changes in the yield earned and costs of funds (rate paid). A portion of the Company's income from municipal investments is not subject to income taxes. Because the proportion of tax-exempt items in the Company's portfolio varies from year-to-year, to improve comparability of information across years, the non-taxable income shown in the tables below has been converted to a tax equivalent basis. Because the Company's corporate tax rate is 34%, to equalize tax-free and taxable income in the comparison, we divide the tax-free income by 66%, with the result that every tax-free dollar is equivalent to $1.52 in taxable income.

Tax-exempt income is derived from municipal investments, which comprised the entire held-to-maturity portfolio of $49.9 million, $43.4 million and $41.8 million, at December 31, 2016, 2015 and 2014, respectively.

The following table provides the reconciliation between net interest income presented in the consolidated statements of income and the non-GAAP tax equivalent net interest income presented in the table immediately following for each of the last three years.

Years Ended December 31,	**2016**	**2015**	**2014**
	(Dollars in Thousands)		
Net interest income as presented	$ 21,549	$ 20,761	$ 19,895
Effect of tax-exempt income	661	573	555
Net interest income, tax equivalent	$ 22,210	$ 21,334	$ 20,450

The following table presents average earning assets and average interest-bearing liabilities supporting earning assets for each of the last three fiscal years. Interest income (excluding interest on non-accrual loans) and interest expense are both expressed on a tax equivalent basis, both in dollars and as a rate/yield.

	Years Ended December 31,								
	2016			2015			2014		
	Average Balance	Income/ Expense	Average Rate/ Yield	Average Balance	Income/ Expense	Average Rate/ Yield	Average Balance	Income/ Expense	Average Rate/ Yield
	(Dollars in Thousands)								
Interest-Earning Assets									
Loans (1)	$ 470,229	$ 22,294	4.74%	$ 454,793	$ 21,717	4.78%	$ 447,133	$ 21,423	4.79%
Taxable investment securities	29,383	511	1.74%	30,725	442	1.44%	30,990	344	1.11%
Tax-exempt investment securities	51,744	1,944	3.76%	44,516	1,687	3.79%	42,654	1,635	3.83%
Sweep and interest-earning accounts	4,481	22	0.49%	6,337	17	0.27%	5,079	13	0.26%
Other investments (2)	2,690	138	5.13%	3,495	117	3.35%	3,819	91	2.38%
Total	$ 558,527	$ 24,909	4.46%	$ 539,866	$ 23,980	4.44%	$ 529,675	$ 23,506	4.44%
Interest-Bearing Liabilities									
Interest-bearing transaction accounts	$ 116,081	$ 223	0.19%	$ 117,867	$ 229	0.19%	$ 115,209	$ 241	0.21%
Money market accounts	82,254	803	0.98%	87,390	826	0.95%	83,168	821	0.99%
Savings deposits	85,896	106	0.12%	80,530	98	0.12%	75,042	94	0.13%
Time deposits	109,347	894	0.82%	107,100	925	0.86%	123,209	1,360	1.10%
Borrowed funds	17,426	95	0.55%	14,217	40	0.28%	9,440	21	0.22%
Repurchase agreements	25,888	76	0.29%	24,314	70	0.29%	25,263	62	0.25%
Capital lease obligations	511	42	8.22%	596	49	8.22%	674	55	8.16%
Junior subordinated debentures	12,887	460	3.57%	12,887	409	3.17%	12,887	402	3.12%
Total	$ 450,290	$ 2,699	0.60%	$ 444,901	$ 2,646	0.59%	$ 444,892	$ 3,056	0.69%
Net interest income		$ 22,210			$ 21,334			$ 20,450	
Net interest spread (3)			3.86%			3.85%			3.75%
Net interest margin (4)			3.98%			3.95%			3.86%

(1) Included in gross loans are non-accrual loans with an average balance of $3.2 million, $5.2 million and $4.9 million for the years ended December 31, 2016, 2015 and 2014, respectively. Loans are stated before deduction of unearned discount and allowance for loan losses.

(2) Included in other investments is the Company's FHLBB Stock with an average balance of $1.7 million, $2.5 million and $2.8 million, respectively, for 2016, 2015 and 2014 and a dividend rate of approximately 4.67%, 1.75% and 1.53%, respectively.

(3) Net interest spread is the difference between the average yield on average earning assets and the average rate paid on average interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average earning assets.

The average volume of interest-earning assets for 2016 increased 3.5% compared to 2015, and for 2015 increased 1.9% compared to 2014. Similarly, the average volume of loans for 2016 increased over 2015 by 3.4%, and for 2015 increased by 1.7% compared to 2014. Average yield on interest-earning assets for 2016 increased two basis points, to 4.46%, compared to 4.44% for both 2015 and 2014, while the average yield on loans decreased four basis points from 2015 to 2016 and one basis point from 2014 to 2015. The two basis point increase in the average yield for 2016 compared to 2015 and 2014, as well as the slight increases noted below in the net interest spread and margin for the respective periods, are due primarily to the yield improvement in the taxable investment portfolio. Interest earned on the loan portfolio as a percentage of total interest income remained fairly steady, comprising approximately 89.5%, 90.6% and 91.1%, respectively, for 2016, 2015, and 2014. The average volume of the taxable investment portfolio (classified as available for sale) decreased 4.4% from 2015 to 2016 and 0.9% from 2014 to 2015 as primarily all maturities in 2016 and 2015 were used to fund loan growth. Average yields on the taxable investment portfolio increased 30 basis points from 2015 to 2016 and 33 basis points from 2014 to 2015. These increases are due primarily to the shift in the taxable investment portfolio to higher yielding mortgage-backed securities and certificates of deposit, both of which had very favorable spreads to similar term treasury and agency bonds, while exhibiting similar risk profiles. The average volume of the tax exempt portfolio (classified as held to maturity and consisting of municipal securities) increased 16.2% from 2015 to 2016, due in part to the Company’s $6.3 million participation in a local hospital bond financing, and increased 4.4% from 2014 to 2015. The average tax-equivalent yield on the tax exempt portfolio decreased by three basis points from 2015 to 2016 and four basis points from 2014 to 2015. This is reflective of the continued low rate environment as well competitive pressures for municipal investments. The average volume of sweep and interest-earning accounts, which consists primarily of an interest-bearing account at the Federal Reserve Bank of Boston (FRBB), decreased 29.3% during 2016, while an increase of 24.8% is noted from 2014 to 2015. Throughout 2016, excess cash has been used to fund loan and tax exempt securities growth.

In comparison, the average volume of interest-bearing liabilities for 2016 increased by 1.2% compared to 2015, while little change is noted for 2015 compared to 2014. The average rate paid on interest-bearing liabilities increased by one basis point from 2015 to 2016, while a decrease of ten basis points is noted for 2014 to 2015. The average volume of interest-bearing transaction accounts decreased by 1.5% for 2016 compared to 2015, while an increase of 2.3% is noted from 2014 to 2015, and the average rate paid on these accounts remained relatively unchanged during the three year comparison periods. The average volume of money market accounts decreased during 2016 by 5.9% compared to 2015, but increased 5.1% for 2015 compared to 2014, while the average rate paid on these deposits increased three basis points during 2016 and decreased four basis points from 2014 to 2015. The decrease in money market accounts in 2016 is due primarily to the run off, as anticipated, of approximately $8,000,000 in construction-related escrow funds deposited during the fourth quarter of 2014. The average volume of savings accounts increased by 6.7% from 2015 to 2016, and 7.3% from 2014 to 2015, as customers tended to favor savings accounts to CDs, possibly anticipating higher rates in the near future. Compared to 2015, the average volume of retail time deposits decreased 4.5% during 2016, and 10.5% from 2014 to 2015, while the average volume of wholesale time deposits increased 280.9% from 2015 to 2016 but decreased 60.5% from 2014 to 2015. Wholesale time deposits, which are large dollar purchased deposits, have been an increasingly beneficial source of funding in 2016 as they have provided large blocks of funding without the need to disrupt pricing in the Company’s local markets. These funds can be obtained relatively quickly on an as-needed basis and for the desired duration, making them a valuable alternative to traditional term borrowings from the FHLBB. The average volume of federal funds purchased and other borrowed funds increased 22.6% from 2015 to 2016 and 50.6% from 2014 to 2015, and the average rate paid on these accounts increased 27 basis points and six basis points, respectively. The increase in the average rate paid in 2016 is reflective of the increase in the federal funds rate by the Federal Reserve in December 2015. The average volume of repurchase agreements increased 6.5% from 2015 to 2016, but decreased 3.8% from 2014 to 2015, while the average rate paid on repurchase agreements remained flat from 2015 to 2016, and increased four basis points from 2014 to 2015.

After years of this low interest rate environment which put pressure on the Company’s net interest spread and margin due to the Company’s earning assets being both replaced with, and repricing to, lower interest rate instruments, and due to limited opportunity to reduce rates further on non-maturing interest-bearing deposits, the asset growth and changes to the mix of the balance sheet, combined with low cost of funds, is starting to have a positive effect on both the net interest spread and margin. In addition, the 25 basis point increase in the prime rate in December 2015 provided some benefit to the Company’s variable rate loan portfolio during 2016, and further benefit is expected going forward from the 25 basis point increase in December 2016. Net interest spread for 2016 was 3.86%, an increase of one basis point from 3.85% for 2015, compared to an increase of 10 basis points from 3.75% for 2014. Net interest margin was 3.98% for 2016, which increased three basis points from a net interest margin of 3.95% for 2015, compared to an increase of nine basis points from a net interest margin of 3.86% for 2014.

The following table summarizes the variances in income for the years 2016, 2015 and 2014 resulting from volume changes in assets and liabilities and fluctuations in rates earned and paid compared to the prior year.

Changes in Interest Income and Interest Expense

	2016 vs. 2015			2015 vs. 2014		
	Variance Due to Rate (1)	Variance Due to Volume (1)	Total Variance	Variance Due to Rate (1)	Variance Due to Volume (1)	Total Variance
	(Dollars in Thousands)					
Average Interest-Earning Assets						
Loans	$ (161)	$ 738	$ 577	$ (73)	$ 367	$ 294
Taxable investment securities	92	(23)	69	102	(4)	98
Tax-exempt investment securities	(17)	274	257	(19)	71	52
Sweep and interest-earning accounts	14	(9)	5	1	3	4
Other investments	62	(41)	21	37	(11)	26
Total	$ (10)	$ 939	$ 929	$ 48	$ 426	$ 474
Average Interest-Bearing Liabilities						
Interest-bearing transaction accounts	$ (3)	$ (3)	$ (6)	$ (18)	$ 6	$ (12)
Money market accounts	27	(50)	(23)	(37)	42	5
Savings deposits	2	6	8	(3)	7	4
Time deposits	(50)	19	(31)	(296)	(139)	(435)
Federal funds purchased and other borrowed funds	46	9	55	8	11	19
Repurchase agreements	1	5	6	11	(3)	8
Capital lease obligations	0	(7)	(7)	0	(6)	(6)
Junior subordinated debentures	51	0	51	7	0	7
Total	$ 74	$ (21)	$ 53	$ (328)	$ (82)	$ (410)
Changes in net interest income	$ (84)	$ 960	$ 876	$ 376	$ 508	$ 884

(1) Items which have shown a year-to-year increase in volume have variances allocated as follows:
Variance due to rate = Change in rate x new volume
Variance due to volume = Change in volume x old rate
Items which have shown a year-to-year decrease in volume have variances allocated as follows:
Variance due to rate = Change in rate x old volume
Variances due to volume = Change in volume x new rate

NON-INTEREST INCOME AND NON-INTEREST EXPENSE

Non-interest Income

The components of non-interest income for the annual periods presented are as follows:

	Years Ended December 31,		Change	
	2016	2015	Income	Percent
Service fees	$ 2,741,692	$ 2,565,079	$ 176,613	6.89%
Income from sold loans	891,538	947,325	(55,787)	-5.89%
Other income from loans	839,269	738,454	100,815	13.65%
Net realized gain on sale of securities available-for-sale	0	17,502	(17,502)	-100.00%
Income from CFSG Partners	429,008	361,044	67,964	18.82%
Rental income on OREO properties	0	44,800	(44,800)	-100.00%
Income from insurance exchange	94,333	39,246	55,087	140.36%
SERP fair value adjustment	69,768	(16,177)	85,945	-531.28%
Other income	436,291	452,882	(16,591)	-3.66%
Total non-interest income	$ 5,501,899	$ 5,150,155	$ 351,744	6.83%

Total non-interest income increased by $351,744 for the year ended December 31, 2016 compared to the same period 2015, with significant changes noted in the following:

- Service fees increased $176,613, or 6.9%, year over year, due primarily to an increase in overdraft charges driven by a courtesy overdraft program put into place in the second quarter of 2016.

- Income from sold loans decreased $55,787, or 5.9%. An increase in mortgage rates in 2016 resulted in a decrease in refinance activity and a related decrease in volume of loans originated and sold in the secondary market drove the decrease in income.

- Other income from loans increased $100,815, or 13.7%, year over year due primarily to an increase in commercial loan documentation fees. These fees increased $104,848, or 32.4%, due to the increase in originations of commercial loans.

- Unlike prior years, the Company sold none of its available-for-sale investments, resulting in no realized gain or loss during 2016.

- Income from the Company's trust and investment management affiliate, Community Financial Services Group, LLC (CFSG), increased $67,964, or 18.8%, for the year. Approximately $28,000 of this increase was due to the effect of a one-time mark-to-market adjustment to CFSG's investment portfolio resulting from its adoption of an accounting principle to eliminate the income statement impact of future changes to market values of its nonqualified tax deferred accounts to their income statement.

- The Company sold an OREO property in 2015 that had generated rental income, accounting for the absence of this revenue during 2016.

- The Company received a liquidity membership distribution from an insurance exchange resulting in one-time income of $88,646 in the fourth quarter of 2016.

- The SERP fair value adjustment increased $85,945 during 2016 due to changes in the equity markets.

Non-interest Expense

The components of non-interest expense for the annual periods presented are as follows:

	Years Ended December 31,		Change	
	2016	2015	Expense	Percent
Salaries and wages	$ 7,051,820	$ 6,888,352	$ 163,468	2.37%
Employee benefits	2,838,726	2,576,772	261,954	10.17%
Occupancy expenses, net	2,466,628	2,576,496	(109,868)	-4.26%
Other expenses				
Computer outsourcing	509,345	516,197	(6,852)	-1.33%
Service contracts - administrative	389,971	330,563	59,408	17.97%
Telephone expense	318,059	312,043	6,016	1.93%
Collection & non-accruing loan expense	122,176	74,716	47,460	63.52%
OREO expense	60,965	188,584	(127,619)	-67.67%
ATM fees	382,227	372,609	9,618	2.58%
State deposit tax	568,549	562,271	6,278	1.12%
Other miscellaneous expenses	4,434,058	4,412,370	21,688	0.49%
Total non-interest expense	$ 19,142,524	$ 18,810,973	$ 331,551	1.76%

Total non-interest expense increased $331,551 for the full year 2016 compared to the same period in 2015, with significant changes noted in the following:

- Salaries and wages increased $163,468, or 2.4%, due to normal salary increases.
- The increase in employee benefits of $261,954, or 10.2%, is due primarily to an increase of $126,261, or 17.4%, in SERP contributions and pension expense, and an increase of $97,564, or 7.6%, in health insurance premiums.
- Occupancy expenses decreased $109,868, or 4.3%, year over year. Lower heating and maintenance costs due to a milder than usual winter season, as well as lower operating costs due to the closing of two branches during the third quarter of 2015 are the primary reasons for this decrease. The closing of the branches also contributed to a higher level of capital losses on equipment in 2015 compared to 2016 in the amount of $90,959.
- Service contracts – administrative increased $59,408, or 18.0%, year over year . A new service contract for our upgraded phone system is the primary reason for this increase.
- Collections & non-accruing loan expense increased $47,460, or 63.5%, year over year mostly due to the increased length of time that properties are staying in the foreclosure process, particularly those involving bankruptcy, resulting in increased maintenance costs associated with properties in foreclosure.
- OREO expense decreased $127,619, or 67.7%, year over year, due in part to reimbursed condo fees associated with a property the Company sold in December of 2015 as well as lower costs associated with the properties remaining in OREO.

APPLICABLE INCOME TAXES

The provision for income taxes increased $159,282, or 9.0%, from $1,764,630 in 2015 to $1,923,912 in 2016. Income before taxes increased $817,969, or 12.4% for 2016 compared to 2015. Tax credits from affordable housing investments increased $290,410, or 67.3% from $431,715 in 2015 to $722,125 in 2016, while New Market Tax Credits (NMTC) of $135,234 were the same for both 2015 and 2016.

Amortization expense related to limited partnership investments, is included as a component of tax expense and amounted to $731,448 and $403,445 for 2016 and 2015, respectively. These investments provide tax benefits, including tax credits, and are designed to provide an effective yield between 8% and 10%. The Company entered into a new limited partnership investment in 2015 that began amortizing during 2016 and had significant rehabilitation tax credits, accounting for the increase in amortization expense as well as the increase in tax credits.

The increase in income before taxes, partially offset by the overall increase in tax credits, accounts for the increase in income tax expense in 2016.

CHANGES IN FINANCIAL CONDITION

The following discussion refers to the volume of average assets, liabilities and shareholders' equity in the table labeled "Distribution of Assets, Liabilities and Shareholders' Equity" on the following page.

Average assets increased $9.5 million, or 1.7%, from the year ended December 31, 2014 to the year ended December 31, 2015, and $17.0 million, or 2.9%, from 2015 to 2016. The average volume of loans increased $7.9 million, or 1.8%, from 2014 to 2015 and $15.3 million, or 3.4%, from 2015 to 2016, due in part to strong commercial loan demand. The Company used maturities, sales and calls within the taxable investment portfolio and short-term borrowings to help fund loan growth during 2014 through 2016, accounting for the combined decrease of $1.6 million in the average volume of taxable investments from 2014 through 2016. The average volume of the tax-exempt portfolio increased $1.9 million, or 4.4%, from 2014 to 2015 and $7.2 million, or 16.2%, from 2015 to 2016 and is made up of local municipal obligations.

Average liabilities increased $6.6 million, or 1.3%, from the year ended December 31, 2014 to the year ended December 31, 2015 and $14.3 million, or 2.7%, from 2015 to 2016. The average volume of demand deposits increased $6.4 million, or 7.8%, from 2014 to 2015 and $8.4 million, or 9.5%, from 2015 to 2016. These increases reflected average volume increases of $4.1 million increase in business checking accounts and a $1.8 million increase in personal checking accounts during 2015, and average volume increases of $5.4 million in business checking accounts and $3.4 million in consumer accounts during 2016. The average volume of interest-bearing transaction accounts increased $2.7 million, or 2.3%, from 2014 to 2015 but decreased $1.8 million, or 1.5%, from 2015 to 2016. The average volume of money market accounts followed a similar pattern as the interest-bearing transaction accounts, increasing $4.2 million, or 5.1%, from 2014 to 2015 and then decreasing $5.1 million, or 5.9%, from 2015 to 2016. The insured cash sweep account (ICS) offered through Promontory Interfinancial Network, has worked very well as a means of attracting new customers and retaining current customers who are looking for alternatives to time deposits and to maximize FDIC insurance coverage. In 2015, the Company began offering an ICS interest-bearing demand deposit product which was well received with an average volume in 2015 of $4.6 million, which increased 26.2% to an average volume of $5.8 million in 2016. The average volume of the ICS money market accounts decreased from $17.7 million in 2014 to $13.4 million in 2015 and $11.9 million in 2016. The average volume of savings accounts increased $5.5 million, or 7.3%, from 2014 to 2015 and $5.4 million, or 6.7%, from 2015 to 2016 due in part to a continued shift from time deposits. The average volume of total retail time deposits decreased $12.3 million, or 10.5%, from 2014 to 2015, and decreased $4.7 million, or 4.5% from 2015 to 2016 which largely reflects a continued shift to savings or money market accounts, or customer rate shopping at other financial institutions. The Company strives to keep its core deposit customers but is not placing much emphasis on attracting rate shoppers as it has sufficient liquidity to meet reasonably foreseeable loan demand and other requirements. The trend away from retail time deposits slowed in 2016 as rates have stayed at the bottom through a full maturity cycle and are not resetting to a lower base, indicating that most customers that did not leave CD funds in the previous maturity are not as rate sensitive and are more likely to stay in the product. The Company has used wholesale time deposits to offset the decrease in retail deposits as needed. Average wholesale time deposits decreased by $3.8 million, or 60.4%, from 2014 to 2015 and increased by $6.9 million, or 281.4% from 2015 to 2016. The average volume of federal funds purchased and other borrowed funds increased $4.8 million, or 50.6%, from 2014 to 2015 and $3.2 million, or 22.6%, from 2015 to 2016, which was attributable to the growth in loans outpacing deposit growth. The Company continues to utilize overnight funds, wholesale deposits and other short-term borrowings to meet cash needs during the seasonal outflows of municipal deposits and to fund loan growth.

The following table provides a visual comparison of the breakdown of average assets and average liabilities as well as average shareholders' equity for the comparison periods.

Distribution of Assets, Liabilities and Shareholders' Equity

	Years Ended December 31,					
	2016		2015		2014	
	Balance	%	Balance	%	Balance	%
	(Dollars in Thousands)					
Average Assets						
Cash and due from banks						
Non-interest bearing	$ 9,514	1.58%	$ 9,868	1.68%	$ 9,934	1.72%
Federal funds sold and overnight deposits	4,481	0.74%	6,337	1.08%	5,079	0.88%
Taxable investment securities	29,383	4.87%	30,725	5.24%	30,990	5.37%
Tax-exempt investment securities	51,744	8.58%	44,516	7.59%	42,654	7.40%
Other securities	2,303	0.38%	3,108	0.53%	3,432	0.60%
Total investment securities	83,430	13.83%	78,349	13.36%	77,076	13.37%
Gross loans	470,856	78.06%	455,571	77.71%	447,716	77.63%
Reserve for loan losses and deferred costs	(4,831)	-0.80%	(4,737)	-0.81%	(4,609)	-0.80%
Premises and equipment	11,082	1.84%	11,622	1.98%	11,635	2.02%
Other real estate owned	417	0.07%	1,127	0.19%	979	0.17%
Investment in Capital Trust	387	0.06%	387	0.07%	387	0.07%
Bank owned life insurance	4,569	0.76%	4,463	0.76%	4,354	0.75%
Core deposit intangible	401	0.06%	675	0.12%	948	0.16%
Goodwill	11,574	1.92%	11,574	1.98%	11,574	2.01%
Other assets	11,343	1.88%	11,013	1.88%	11,664	2.02%
Total average assets	$ 603,223	100%	$ 586,249	100%	$ 576,737	100%
Average Liabilities						
Demand deposits	$ 96,618	16.02%	$ 88,225	15.05%	$ 81,847	14.19%
Interest-bearing transaction accounts	116,081	19.24%	117,867	20.11%	115,209	19.98%
Money market funds	82,254	13.64%	87,390	14.91%	83,168	14.42%
Savings accounts	85,896	14.24%	80,530	13.73%	75,042	13.01%
Time deposits	109,347	18.13%	107,100	18.27%	123,209	21.36%
Total average deposits	490,196	81.27%	481,112	82.07%	478,475	82.96%
Other borrowed funds	17,426	2.89%	14,217	2.42%	9,440	1.64%
Repurchase agreements	25,888	4.29%	24,314	4.15%	25,263	4.38%
Junior subordinated debentures	12,887	2.14%	12,887	2.20%	12,887	2.23%
Other liabilities	3,878	0.64%	3,449	0.59%	3,273	0.57%
Total average liabilities	550,275	91.23%	535,979	91.43%	529,338	91.78%
Average Shareholders' Equity						
Preferred stock	2,500	0.41%	2,500	0.42%	2,500	0.43%
Common stock	13,074	2.17%	12,943	2.21%	12,715	2.20%
Additional paid-in capital	30,361	5.03%	29,608	5.05%	28,853	5.00%
Retained earnings	9,502	1.57%	7,787	1.33%	5,963	1.03%
Less: Treasury stock	(2,623)	-0.43%	(2,623)	-0.45%	(2,623)	-0.45%
Accumulated other comprehensive income(loss)	134	0.02%	55	0.01%	(9)	0.00%
Total average shareholders' equity	52,948	8.77%	50,270	8.57%	47,399	8.22%
Total average liabilities and shareholders' equity	$ 603,223	100%	$ 586,249	100%	$ 576,737	100%

CERTAIN TIME DEPOSITS

Increments of maturity of time certificates of deposit of $100,000 or more outstanding on December 31, 2016 are summarized as follows:

3 months or less	$ 6,686,327
Over 3 through 6 months	12,946,304
Over 6 through 12 months	15,235,572
Over 12 months	24,126,833
Total	$ 58,995,036

RISK MANAGEMENT

Interest Rate Risk and Asset and Liability Management - Management actively monitors and manages the Company's interest rate risk exposure and attempts to structure the balance sheet to maximize net interest income while controlling its exposure to interest rate risk. The Company's Asset/Liability Management Committee (ALCO) is made up of the Executive Officers and certain Vice Presidents of the Bank representing major business lines. The ALCO formulates strategies to manage interest rate risk by evaluating the impact on earnings and capital of such factors as current interest rate forecasts and economic indicators, potential changes in such forecasts and indicators, liquidity and various business strategies. The ALCO meets at least quarterly to review financial statements, liquidity levels, yields and spreads to better understand, measure, monitor and control the Company's interest rate risk. In the ALCO process, the committee members apply policy limits set forth in the Asset Liability, Liquidity and Investment policies approved and periodically reviewed by the Company's Board of Directors. The ALCO's methods for evaluating interest rate risk include an analysis of the effects of interest rate changes on net interest income and an analysis of the Company's interest rate sensitivity "gap", which provides a static analysis of the maturity and repricing characteristics of the entire balance sheet. The ALCO Policy also includes a contingency funding plan to help management prepare for unforeseen liquidity restrictions, including hypothetical severe liquidity crises.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company's financial instruments also change, thereby impacting net interest income (NII), the primary component of the Company's earnings. Fluctuations in interest rates can also have an impact on liquidity. The ALCO uses an outside consultant to perform rate shock simulations to the Company's net interest income, as well as a variety of other analyses. It is the ALCO's function to provide the assumptions used in the modeling process. Assumptions used in prior period simulation models are regularly tested by comparing projected NII with actual NII. The ALCO utilizes the results of the simulation model to quantify the estimated exposure of NII and liquidity to sustained interest rate changes. The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. The model also simulates the balance sheet's sensitivity to a prolonged flat rate environment. All rate scenarios are simulated assuming a parallel shift of the yield curve; however further simulations are performed utilizing non-parallel changes in the yield curve. The results of this sensitivity analysis are compared to the ALCO policy limits which specify a maximum tolerance level for NII exposure over a 1-year horizon, assuming no balance sheet growth, given a 200 basis point (bp) shift upward and a 100 bp shift downward in interest rates.

Under the Company's interest rate sensitivity modeling, with the continued asset sensitive balance sheet, in a rising rate environment NII is expected to trend upward as the short-term asset base (cash and adjustable rate loans) quickly cycle upward while the retail funding base (deposits) lags the market. If rates paid on deposits have to be increased more and/or more quickly than projected, the expected benefit to rising rates would be reduced. In a falling rate environment, NII is expected to trend slightly downward compared with the current rate environment scenario for the first year of the simulation as asset yield erosion is not fully offset by decreasing funding costs. Thereafter, net interest income is projected to experience sustained downward pressure as funding costs reach their assumed floors and asset yields continue to reprice into the lower rate environment. The recent increase in the federal funds rate, the second in the past two years, will generate a positive impact to the Company's NII in 2017 as variable rate loans reprice in the first quarter of the year. This, coupled with the steepening of the yield curve in the fourth quarter of 2016, should help to maintain asset yields in the face of increased competition for quality loans.

The following table summarizes the estimated impact on the Company's NII over a twelve month period, assuming a gradual parallel shift of the yield curve beginning December 31, 2016:

One Year Horizon		Two Year Horizon	
Rate Change	Percent Change in NII	Rate Change	Percent Change in NII
Down 100 basis points	-2.40%	Down 100 basis points	-6.70%
Up 200 basis points	4.50%	Up 200 basis points	12.60%

The amounts shown in the table are well within the ALCO Policy limits. However, those amounts do not represent a forecast and should not be relied upon as indicative of future results. While assumptions used in the ALCO process, including the interest rate simulation analyses, are developed based upon current economic and local market conditions, and expected future conditions, the Company cannot provide any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

Credit Risk - As a financial institution, one of the primary risks the Company manages is credit risk, the risk of loss stemming from borrowers' failure to repay loans or inability to meet other contractual obligations. The Company's Board of Directors prescribes policies for managing credit risk, including Loan, Appraisal and Environmental policies. These policies are supplemented by comprehensive underwriting standards and procedures. The Company maintains a Credit Administration department whose function includes credit analysis and monitoring of and reporting on the status of the loan portfolio, including delinquent and non-performing loan trends. The Company also monitors concentration of credit risk in a variety of areas, including portfolio mix, the level of loans to individual borrowers and their related interest, loans to industry segments, and the geographic distribution of commercial real estate loans. Loans are reviewed periodically by an independent loan review firm to help ensure accuracy of the Company's internal risk ratings and compliance with various internal policies, procedures and regulatory guidance.

Residential mortgages represent approximately half of the Company's loan balances; that level has been on a gradual decline in recent years, with a strategic shift to commercial lending. The Company originates traditional mortgage products and does not offer higher risk loans such as option adjustable rate mortgage products, high loan-to-value products, interest only mortgages, subprime loans and products with deeply discounted teaser rates. The Company has comprehensive origination, underwriting and servicing guidelines to support compliance with the various mortgage rules, and to enable sound underwriting decisions. Residential mortgages with loan-to-values exceeding 80% are generally covered by private mortgage insurance (PMI). A 90% loan-to-value residential mortgage product without PMI is only available to borrowers with excellent credit and low debt-to-income ratios and has not been widely originated. Junior lien home equity products make up approximately 21% of the residential mortgage portfolio with maximum loan-to-value ratios (including prior liens) of 80%.

The Company's strategy is to continue growing the commercial and commercial real estate portfolios. Consistent with the strategic focus on commercial lending, both segments saw solid growth during 2016, particularly in commercial real estate loans. The commercial real estate growth included several large relationships that converted from construction financing to permanent financing. Residential mortgage loan demand, which had fallen off sharply during 2014 in response to an increase in interest rates late in 2013, picked up during 2015 and continued through 2016, with increased purchase activity causing the portfolio's sharp decline to taper off. During the last quarter of 2016, the Company held most originations in portfolio, resulting in an increase in the 1st lien residential mortgage portfolio.

The following table reflects the composition of the Company's loan portfolio as of December 31,

Composition of Loan Portfolio

	2016		2015		2014		2013		2012	
	Total Loans	% of Total	Total Loans	% of Total	Total Loans	% of Total	Total Loans	% of Total	Total Loans	% of Total
	(Dollars in Thousands)									
Real estate loans										
Construction & land development	$ 14,991	3.08%	$ 21,445	4.68%	$ 12,574	2.81%	$ 19,098	4.34%	$ 12,751	3.06%
Farm land	13,011	2.67%	12,570	2.74%	13,105	2.93%	10,453	2.38%	9,321	2.24%
1-4 Family residential -										
1st lien	166,692	34.21%	162,760	35.53%	163,966	36.62%	172,847	39.29%	169,613	40.74%
Jr lien	42,927	8.81%	44,720	9.76%	44,801	10.00%	45,687	10.39%	47,029	11.29%
Commercial real estate	173,727	35.66%	144,192	31.48%	140,934	31.47%	127,385	28.96%	117,736	28.28%
Loans to finance agricultural production	996	0.20%	2,508	0.55%	2,017	0.45%	1,720	0.39%	2,590	0.62%
Commercial & industrial	67,734	13.90%	62,683	13.68%	62,373	13.93%	53,900	12.25%	46,694	11.21%
Consumer	7,171	1.47%	7,241	1.58%	8,035	1.79%	8,819	2.00%	10,642	2.56%
Gross loans	487,249	100%	458,119	100%	447,805	100%	439,909	100%	416,376	100%
Less:										
Allowance for loan losses and deferred net loan costs	(4,968)		(4,695)		(4,602)		(4,554)		(4,143)	
Net loans	$ 482,281		$ 453,424		$ 443,203		$ 435,355		$ 412,233	

The following table shows the estimated maturity of the Company's commercial loan portfolio as of December 31, 2016.

	Fixed Rate Loans				Variable Rate Loans			
	Within 1 Year	2 - 5 Years	After 5 Years	Total	Within 1 Year	2 - 5 Years	After 5 Years	Total
	(Dollars in Thousands)							
Real estate								
Construction & land development	$ 1,411	$ 227	$ 2,164	$ 3,802	$ 4,145	$ 171	$ 6,873	$ 11,189
Secured by farm land	6	0	381	387	397	219	12,008	12,624
Commercial real estate	830	1,440	12,136	14,406	4,626	4,102	150,593	159,321
Loans to finance agricultural production	14	337	0	351	100	545	0	645
Commercial & industrial	438	12,417	3,080	15,935	21,819	15,857	14,123	51,799
Total	$ 2,699	$ 14,421	$ 17,761	$ 34,881	$ 31,087	$ 20,894	$ 183,597	$ 235,578

Risk in the Company’s commercial and commercial real estate loan portfolios is mitigated in part by government guarantees issued by federal agencies such as the U.S. Small Business Administration (SBA) and USDA Rural Development. At December 31, 2016, the Company had $23.9 million in guaranteed loans with guaranteed balances of $18.1 million, compared to $21.8 million in guaranteed loans with guaranteed balances of $16.9 million at December 31, 2015.

The Company works actively with customers early in the delinquency process to help them to avoid default and foreclosure. Commercial and commercial real estate loans are generally placed on non-accrual status when there is deterioration in the financial position of the borrower, payment in full of principal and interest is not expected, and/or principal or interest has been in default for 90 days or more. However, such a loan need not be placed on non-accrual status if it is both well secured and in the process of collection. Residential mortgages and home equity loans are considered for non-accrual status at 90 days past due and are evaluated on a case-by-case basis. The Company obtains current property appraisals or market value analyses and considers the cost to sell collateral in order to assess the level of specific allocations required. Consumer loans are generally not placed in non-accrual but are charged off by the time they reach 120 days past due. When a loan is placed in non-accrual status, the Company's policy is to reverse the accrued interest against current period income and to discontinue the accrual of interest until the borrower clearly demonstrates the ability and intention to resume normal payments, typically demonstrated by regular timely payments for a period of not less than six months. Interest payments received on non-accrual or impaired loans are generally applied as a reduction of the loan principal balance.

The level of non-performing assets remained comparatively stable from 2012 through 2015, with a substantial decrease in 2016 in large part due to the restoration to accrual status of one large commercial real estate relationship and another commercial relationship secured by multiple residential properties. Other reductions occurred through the foreclosure process or through borrower initiated payments and payoffs.

Non-performing assets at the end of each of the last five fiscal years consisted of the following:

Non-Performing Assets

December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
	(Dollars in Thousands)				
Accruing loans past due 90 days or more:					
Commercial & industrial	$ 26	$ 14	$ 24	$ 22	$ 0
Commercial real estate	0	45	5	5	54
Residential real estate - 1st lien	1,068	801	980	817	282
Residential real estate - Jr lien	28	63	116	56	42
Consumer	2	0	0	8	1
Total past due 90 days or more	1,124	923	1,125	908	379
Non-accrual loans:					
Commercial & industrial	143	441	553	527	597
Commercial real estate	766	2,401	1,934	1,404	1,892
Residential real estate - 1st lien	1,227	2,009	1,263	2,203	1,928
Residential real estate - Jr lien	339	386	404	593	338
Total non-accrual loans	2,475	5,237	4,154	4,727	4,755
Total non-accrual and past due loans	3,599	6,160	5,279	5,635	5,134
Other real estate owned	394	262	1,238	1,106	1,075
Total non-performing assets	$ 3,993	$ 6,422	$ 6,517	$ 6,741	$ 6,209
Percent of gross loans	0.82%	1.40%	1.46%	1.53%	1.49%
Reserve coverage of non-performing assets	132.18%	78.04%	75.28%	72.03%	69.45%
Yearly (decrease) increase in non-performing assets	$ (2,429)	$ (95)	$ (224)	$ 532	
Percent of change in non-performing assets	-37.83%	-1.45%	-3.31%	8.56%	

Non-performing loans as of December 31, 2016 consisted of, by dollar volume, approximately 49% residential first mortgages, 14% junior lien home equity loans, 31% commercial real estate and 6% in commercial loans not secured by real estate, compared to 38%, 7%, 46%, and 9%, respectively, at December 31, 2015.

As of the balance sheet dates, the Company was not contractually committed to lend additional funds to debtors with impaired, non-accrual or modified loans. The Company is contractually committed to lend on one SBA guaranteed line of credit to a borrower whose lending relationship was previously restructured, but is no longer considered impaired for disclosure purposes.

The Company’s troubled debt restructurings (TDR) are principally a result of extending loan repayment terms to relieve cash flow difficulties. The Company has only infrequently reduced interest rates for borrowers below the current market rates. The Company has not forgiven principal or reduced accrued interest within the terms of original restructurings. Management evaluates each TDR situation on its own merits and does not foreclose the granting of any particular type of concession.

The Non-Performing Assets in the table above include the following TDRs that were past due 90 days or more or in non-accrual status as of the dates presented:

	December 31, 2016		December 31, 2015	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance
Commercial	2	$ 143,127	4	$ 298,115
Commercial real estate	2	354,811	5	1,414,380
Residential real estate - 1st lien	9	516,886	11	967,324
Residential real estate - Jr lien	2	117,158	1	55,633
Total	15	$ 1,131,982	21	$ 2,735,452

The remainder of the Company’s TDRs were performing in accordance with their modified terms as of the date presented and consisted of the following:

	December 31, 2016		December 31, 2015	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance
Commercial real estate	5	$ 1,350,480	2	$ 429,170
Residential real estate - 1st lien	28	2,722,973	21	1,958,699
Residential real estate - Jr lien	2	63,971	1	69,828
Total	35	$ 4,137,424	24	$ 2,457,697

The Company’s OREO portfolio at December 31, 2015 consisted of one commercial and one residential property acquired through the normal foreclosure process. During 2016, the Company moved two additional properties into OREO totaling $395,108, and sold one of those properties and one of the properties held at December 31, 2015. With total sales, net of closing costs, of $217,143 during 2016, and subsequent write-downs totaling $41,000 on two properties, 2016 ended with an OREO balance of $394,000, representing two residential properties.

Allowance for loan losses and provisions - The Company maintains an allowance for loan losses (allowance) at a level that management believes is appropriate to absorb losses inherent in the loan portfolio as of the measurement date (See Critical Accounting Policies). Although the Company, in establishing the allowance, considers the inherent losses in individual loans and pools of loans, the allowance is a general reserve available to absorb all credit losses in the loan portfolio. No part of the allowance is segregated to absorb losses from any particular loan or segment of loans.

When establishing the allowance each quarter, the Company applies a combination of historical loss factors and qualitative factors to loan segments, including residential first and junior lien mortgages, commercial real estate, commercial & industrial, and consumer loan portfolios. No changes were made to the allowance methodology during 2016. The Company will shorten or lengthen its look back period for determining average portfolio historical loss rates as the economy either contracts or expands; during a period of economic contraction, a shortening of the look back period may more conservatively reflect the current economic climate. The highest loss rates experienced for the look back period are applied to the various segments in establishing the allowance.

The Company applies numerous qualitative factors to each segment of the loan portfolio. Those factors include the levels of and trends in delinquencies and non-accrual loans, criticized and classified assets, volumes and terms of loans, and the impact of any loan policy changes. Experience, ability and depth of lending personnel, levels of policy and documentation exceptions, national and local economic trends, the competitive environment, and concentrations of credit are also factors considered.

The adequacy of the allowance is reviewed quarterly by the risk management committee of the Board of Directors and then presented to the full Board of Directors for approval.

The following table summarizes the Company's loan loss experience for each of the last five years.

As of or Years Ended December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
			(Dollars in Thousands)		
Loans outstanding, end of year	$ 487,249	$ 458,119	$ 447,805	$ 439,909	$ 416,376
Average loans outstanding during year	$ 470,229	$ 454,793	$ 447,133	$ 425,482	$ 402,023
Non-accruing loans, end of year	$ 2,475	$ 5,237	$ 4,154	$ 4,727	$ 4,755
Non-accruing loans, net of government guarantees	$ 2,328	$ 4,551	$ 3,378	$ 4,368	$ 3,537
Allowance, beginning of year	$ 5,012	$ 4,906	$ 4,855	$ 4,312	$ 3,887
Loans charged off:					
Commercial & industrial	(49)	(201)	(153)	(83)	(159)
Commercial real estate	0	(15)	(168)	(125)	(58)
Residential real estate - 1st lien	(244)	(151)	(59)	(56)	(246)
Residential real estate - Jr lien	0	(66)	(52)	(57)	(136)
Consumer	(16)	(69)	(112)	(67)	(97)
Total	(309)	(502)	(544)	(388)	(696)
Recoveries:					
Commercial & industrial	25	59	6	3	29
Commercial real estate	0	0	0	186	52
Residential real estate - 1st lien	24	6	15	16	6
Residential real estate - Jr lien	0	0	0	21	2
Consumer	26	33	34	35	32
Total	75	98	55	261	121
Net loans charged off	(234)	(404)	(489)	(127)	(575)
Provision charged to income	500	510	540	670	1,000
Allowance, end of year	$ 5,278	$ 5,012	$ 4,906	$ 4,855	$ 4,312
Net charge offs to average loans outstanding	0.05%	0.09%	0.11%	0.03%	0.14%
Provision charged to income as a percent of average loans	0.11%	0.11%	0.12%	0.16%	0.25%
Allowance to average loans outstanding	1.12%	1.10%	1.10%	1.14%	1.07%
Allowance to non-accruing loans	213.25%	95.70%	118.10%	102.71%	90.68%
Allowance to non-accruing loans net of government guarantees	226.72%	110.13%	145.23%	111.15%	121.91%

Improving loan portfolio trends throughout 2012 and 2013, and several recoveries resulted in a $330,000, or 33.0%, decrease to the provision for loan losses for 2013; with a total 2013 provision of $670,000, compared to a provision of $1 million for 2012. While the Company’s allowance coverage of non-accruing loans increased during 2013, the coverage of non-accruing loans net of government guarantees decreased. The decrease was the result of new non-accruing loans that were not guaranteed, replacing one large government guaranteed loan that was fully liquidated during the second quarter of 2013. Both the increase in the reserve balance and lower levels of non-accruing loans during 2014 led to the strengthened reserve coverage of non-accruing loans at year-end 2014, including the coverage of non-accruing loans net of government guarantees. Despite lower net losses in 2015 than in 2014, the 2015 provision was maintained at a level consistent with portfolio growth and higher levels of non-performing loans. Similarly, despite lower net losses during 2016 and sharply lower non-performing loans, the 2016 provision held steady at $500,000 to support the strong loan growth, particularly in the commercial real estate portfolio. The Company has an experienced collections department that continues to work actively with borrowers to resolve problem loans and manage the OREO portfolio, and management continues to monitor the loan portfolio closely.

Specific allocations to the allowance are made for certain impaired loans. Impaired loans include loans to a borrower that in aggregate are greater than $100,000 and that are in non-accrual status or are troubled debt restructurings. A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due, including interest and principal, according to the contractual terms of the loan agreement. The Company will review all the facts and circumstances surrounding non-accrual loans and on a case-by-case basis may consider loans below the threshold as impaired when such treatment is material to the financial statements. See Note 3 to the accompanying audited consolidated financial statements for information on the recorded investment in impaired loans and their related allocations.

The portion of the allowance termed "unallocated" is established to absorb inherent losses that exist as of the valuation date although not specifically identified through management's process for estimating credit losses. While the allowance is described as consisting of separate allocated portions, the entire allowance is available to support loan losses, regardless of category.

The following table shows the allocation of the allowance for loan losses, as well as the percent of each loan category to the total loan portfolio for each of the last five years:

Allocation of Allowance for Loan Losses

December 31,	2016	%	2015	%	2014	%	2013	%	2012	%
	(Dollars in Thousands)									
Domestic										
Commercial & industrial	$ 726	14%	$ 713	14%	$ 647	14%	$ 516	12%	$ 428	12%
Commercial real estate	2,496	41%	2,152	39%	2,312	37%	2,144	36%	1,537	33%
Residential real estate -										
1st lien	1,370	35%	1,368	35%	1,271	37%	1,453	39%	1,563	41%
Jr lien	371	9%	423	10%	321	10%	366	11%	333	11%
Consumer	84	1%	76	2%	119	2%	105	2%	139	3%
Unallocated	231	0%	280	0%	236	0%	271	0%	312	0%
Total	$ 5,278	100%	$ 5,012	100%	$ 4,906	100%	$ 4,855	100%	$ 4,312	100%

Market Risk - In addition to credit risk in the Company's loan portfolio and liquidity risk in its loan and deposit-taking operations, the Company's business activities also generate market risk. Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Declining capital markets can result in fair value adjustments necessary to record decreases in the value of the investment portfolio for other-than-temporary-impairment. The Company does not have any market risk sensitive instruments acquired for trading purposes. The Company's market risk arises primarily from interest rate risk inherent in its lending and deposit taking activities. During recessionary periods, a declining housing market can result in an increase in loan loss reserves or ultimately an increase in foreclosures. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to loan prepayment risks, early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes vary by product. The prolonged weak economy and disruption in the financial markets in recent years may heighten the Company's market risk. As discussed above under "Interest Rate Risk and Asset and Liability Management", the Company actively monitors and manages its interest rate risk through the ALCO process.

INVESTMENT SECURITIES

The Company maintains an investment portfolio of various securities to diversify its revenue sources, as well as to provide interest rate risk and credit risk diversification and to provide for its liquidity and funding needs. The Company's portfolio of available-for-sale securities increased $7.2 million, or 27.4%, in 2016, from $26.5 million at December 31, 2015 to $33.7 million at December 31, 2016. The Company's held-to-maturity portfolio consisted entirely of tax-exempt obligations of state and political subdivisions with a book value of $49.9 million as of December 31, 2016 compared to $43.4 million at December 31, 2015. The increase in the held-to-maturity investment portfolio is due to a $4.9 million increase in municipal term obligations compared with the prior year, while non-arbitrage and tax anticipation lending declined $2.2 million, or 9.5%, and $1.2 million, or 32.7%, respectively, from December 31, 2015. The non-arbitrage and tax anticipation loans to municipalities are issued annually on a competitive bid basis; as a result the portfolio can fluctuate considerably from year to year based on changes in competitive pressures.

Accounting standards require banks to recognize all appreciation or depreciation of investments classified as either trading securities or available-for-sale, either through the income statement or on the balance sheet even though a gain or loss has not been realized. Securities classified as trading securities are marked to market with any gain or loss net of tax effect, charged to income. The Company's investment policy does not permit the holding of trading securities. Securities classified as held-to-maturity are recorded at book value, subject to adjustment for other-than-temporary impairment. Securities classified as available-for-sale are marked to market with any gain or loss after taxes charged to shareholders' equity in the consolidated balance sheets. These adjustments in the available-for-sale portfolio resulted in an accumulated unrealized loss net of taxes of $90,779 at December 31, 2016, compared to an unrealized loss net of taxes of $45,394 at December 31, 2015. The fluctuations in unrealized gains and losses are due solely to market interest rate changes, and are not based on any deterioration in credit quality of the underlying issuers. The Company added FNMA and FHLMC issued mortgage-backed securities (Agency MBS) as an approved asset class in 2014 in order to realize a more favorable yield in the portfolio and diversify the holdings. This strategy has performed well with the continued flattening of the yield curve. Although classified as available-for-sale, these securities are short term and we anticipate keeping them until maturity. The unrealized loss positions within the investment portfolio as of the balance sheet dates presented are considered by management to be temporary.

The restricted equity securities comprise the Company's membership stock in the FRBB and FHLBB. On December 31, 2016 and 2015, the Company held $588,150 in FRBB stock and $2.2 million and $1.9 million, respectively, in FHLBB stock. Membership in the FRBB and FHLBB requires the purchase of their stock in specified amounts. The stock is typically held for an extended period of time and can only be sold back to the issuer, or in the case of FHLBB, a member institution. Restricted equity stock is sold and redeemed at par. Due to the unique nature of the restricted equity stock, including the non-investment purpose for owning it, the ownership structure and restrictions and the absence of a trading market for the stock, these securities are not marked to market, but carried at par.

Some of the Company's investment securities have a call feature, meaning that the issuer may call in the investment before maturity, at predetermined call dates and prices. In 2016, there was one call feature exercised by the issuer, compared to no calls exercised during 2015.

The Company's investment portfolios as of December 31 in each of the last three fiscal years were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in Thousands)			
December 31, 2016				
Available-for-Sale				
U.S. GSE debt securities	$ 17,366	$ 24	$ 73	$ 17,317
Agency MBS	13,266	4	116	13,154
Other investments	3,221	25	2	3,244
	$ 33,853	$ 53	$ 191	$ 33,715
Held-to-Maturity				
States and political subdivisions	$ 49,887	$ 1,148	$ 0	$ 51,035
Restricted Equity Securities (1)	$ 2,756	$ 0	$ 0	$ 2,756
Total	$ 86,495	$ 267	$ 191	$ 86,571

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in Thousands)			
December 31, 2015				
Available-for-Sale				
U.S. GSE debt securities	$ 12,832	$ 22	$ 22	$ 12,832
Agency MBS	10,734	0	70	10,664
Other investments	2,973	5	4	2,974
	$ 26,539	$ 27	$ 96	$ 26,470
Held-to-Maturity				
States and political subdivisions	$ 43,354	$ 789	$ 0	$ 44,143
Restricted Equity Securities (1)	$ 2,442	$ 0	$ 0	$ 2,442
Total	$ 72,335	$ 816	$ 96	$ 73,055

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in Thousands)			
December 31, 2014				
Available-for-Sale				
U.S. GSE debt securities	$ 19,929	$ 50	$ 72	$ 19,907
U.S. Government securities	3,997	4	0	4,001
Agency MBS	9,032	19	12	9,039
	$ 32,958	$ 73	$ 84	$ 32,947
Held-to-Maturity				
States and political subdivisions	$ 41,811	$ 423	$ 0	$ 42,234
Restricted Equity Securities (1)	$ 3,332	$ 0	$ 0	$ 3,332
Total	$ 78,101	$ 496	$ 84	$ 78,513

(1) Required equity purchases for membership in the Federal Reserve System and Federal Home Loan Bank System.

The Company did not have investments totaling more than 10% of Shareholders' equity in any one issuer during any of the periods presented.

In 2016, there were no sales from the investment portfolio, accounting for the absence of realized gains or losses, compared to realized gains of $14,779 from the sale of investments in U.S. Government securities and realized gains of $8,023 and realized losses of $5,300 from the sale of investments in U.S. GSE debt securities in 2015, and realized gains of $27,838 from the sale of investments in U.S. GSE debt securities in 2014.

The following is an analysis of the maturities and yields of the debt securities in the Company's investment portfolio for each of the last three fiscal years:

Maturities and Yields of Investment Portfolio

December 31,	**2016**		**2015**		**2014**	
	Fair Value(1)	**Weighted Average Yield(2)**	**Fair Value(1)**	**Weighted Average Yield(2)**	**Fair Value(1)**	**Weighted Average Yield(2)**
			(Dollars in Thousands)			
Available-for-Sale						
U.S. Treasury & Agency Obligations						
Due in one year or less	$ 2,010	1.17%	$ 3,086	1.19%	$ 5,034	0.59%
Due from one to five years	14,331	1.44%	9,746	1.32%	18,874	1.09%
Due from five to ten years	976	2.60%	0	0.00%	0	0.00%
Total	$ 17,317	1.47%	$ 12,832	1.29%	$ 23,908	0.99%
Other Investments						
Due from one to five years	$ 2,998	2.12%	$ 2,728	2.13%	$ 0	0.00%
Due from five to ten years	245	2.50%	245	2.50%	0	0.00%
Total	$ 3,243	2.15%	$ 2,973	2.16%	$ 0	0.00%
Agency MBS (3)	$ 13,154	2.01%	$ 10,664	1.69%	$ 9,039	2.13%
FRBB Stock (4)	$ 588	6.00%	$ 588	6.00%	$ 588	6.00%
FHLBB Stock (4)	$ 2,168	3.70%	$ 1,854	3.74%	$ 2,744	1.58%
Held-to-Maturity						
Obligations of State & Political Subdivisions						
Due in one year or less	$ 25,369	3.67%	$ 27,731	3.41%	$ 28,159	3.70%
Due from one to five years	4,031	2.97%	4,016	2.81%	4,638	2.98%
Due from five to ten years	4,013	4.36%	3,022	4.34%	2,305	4.83%
Due after ten years	16,474	3.79%	8,585	4.57%	6,709	4.14%
Total	$ 49,887	3.72%	$ 43,354	3.65%	$ 41,811	3.75%

(1) Investments classified as available-for-sale are presented at fair value, and investments classified as held-to-maturity are presented at book value.
(2) The yield on obligations of state and political subdivisions is calculated on a tax equivalent basis assuming a 34 percent tax rate.
(3) Because the actual maturities of Agency MBS usually differ from their contractual maturities due to the right of borrowers to prepay the underlying mortgage loans, usually without penalty, those securities are not presented by contractual maturity date.
(4) Required equity purchases for membership in the Federal Reserve System and Federal Home Loan Bank System.

COMMITMENTS, CONTINGENCIES AND OFF-BALANCE-SHEET ARRANGEMENTS

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. During 2016, the Company did not engage in any activity that created any additional types of off-balance-sheet risk.

The Company generally requires collateral or other security to support financial instruments with credit risk. The Company's financial instruments whose contract amount represents credit risk are disclosed in Note 15 to the consolidated financial statements.

EFFECTS OF INFLATION

Rates of inflation affect the reported financial condition and results of operations of all industries, including the banking industry. The effect of monetary inflation is generally magnified in bank financial and operating statements because most of a bank's assets and liabilities are monetary in nature and, as costs and prices rise, cash and credit demands of individuals and businesses increase, while the purchasing power of net monetary assets declines. During the economic downturn that began in 2008, the capital and credit markets experienced significant volatility and disruption, with the federal government taking unprecedented steps to deal with the economic situation. These measures have included significant deficit spending as well as quantitative easing of the money supply by the FRB, which could result in inflation in future periods.

The impact of inflation on the Company's financial results is affected by management's ability to react to changes in interest rates in order to reduce inflationary effect on performance. Interest rates do not necessarily move in conjunction with changes in the prices of other goods and services. As discussed above, management seeks to manage the relationship between interest-sensitive assets and liabilities in order to protect against significant interest rate fluctuations, including those resulting from inflation. Inflation remains below the Federal Reserve's implied target of 2% and is not believed to present any challenge in the near term. An inflationary environment could develop with the large spending packages presented to improve the country's aging infrastructure.

LIQUIDITY AND CAPITAL RESOURCES

Managing liquidity risk is essential to maintaining both depositor confidence and stability in earnings. Liquidity management refers to the ability of the Company to adequately cover fluctuations in assets and liabilities. Meeting loan demand (assets) and covering the withdrawal of deposit funds (liabilities) are two key components of the liquidity management process. The Company's principal sources of funds are deposits, amortization and prepayment of loans and securities, maturities of investment securities, sales of loans available-for-sale, and earnings and funds provided from operations. Maintaining a relatively stable funding base, which is achieved by diversifying funding sources, competitively pricing deposit products, and extending the contractual maturity of liabilities, reduces the Company's exposure to roll over risk on deposits and limits reliance on volatile short-term borrowed funds. Short-term funding needs arise from declines in deposits or other funding sources and funding requirements for loan commitments. The Company's strategy is to fund assets to the maximum extent possible with core deposits that provide a sizable source of relatively stable and low-cost funds.

The Company recognizes that, at times, when loan demand exceeds deposit growth it may be desirable to utilize alternative sources of deposit funding to augment retail deposits and borrowings. One-way deposits purchased through the Certificate of Deposit Account Registry Service (CDARS), maintained by the Promontory Interfinancial Network provide an alternative funding source when needed. Such deposits are generally considered a form of brokered deposits. The Company had no one-way deposits at December 31, 2016 compared to $4.2 million at December 31, 2015. In addition, two-way CDARS deposits allow the Company to provide FDIC deposit insurance to its customers in excess of account coverage limits by exchanging deposits with other CDARS members. At December 31, 2016 and 2015, the Company reported $3.1 million and $2.8 million, respectively, in CDARS deposits representing exchanged deposits with other CDARS participating banks.

During 2016 the Company also increased its use of brokered deposits outside of the CDARS program, establishing a relationship with a prominent broker of public and institutional funds from across the country. These are typically short term certificates of deposit with maturity less than one year. This relationship has provided another avenue for short term funding that is easily accessible without any detrimental effect on the pricing of the core deposit base. The company had $14.0 million and $1.0 million of these brokered CDs outstanding at December 31, 2016 and December 31, 2015, respectively.

At December 31, 2016 and 2015, gross borrowing capacity of approximately $68.2 million and $72.1 million, respectively, was available through the FHLBB secured by the Company's qualifying loan portfolio (generally, residential mortgages), reduced by outstanding advances and collateral pledges. The Company also has an unsecured Federal Funds line with the FHLBB with an available balance of $500,000 and no advances against it at December 31, 2016 and 2015. Interest is chargeable at a rate determined daily approximately 25 basis points higher than the rate paid on federal funds sold.

Under a separate agreement with the FHLBB, the Company has the authority to collateralize public unit deposits up to its FHLBB borrowing capacity ($68.2 million and $72.1 million at December 31, 2016 and 2015, respectively, less outstanding advances and collateral pledges) with letters of credit issued by the FHLBB. The Company offers a Government Agency Account to its municipal customers collateralized with these FHLBB letters of credit. At December 31, 2016 and 2015, approximately $21.2 million and $14.9 million, respectively, of qualifying residential real estate loans were pledged as collateral to the FHLBB for these collateralized governmental unit deposits, which reduced dollar-for-dollar the available borrowing capacity under the FHLBB line of credit. Total fees paid by the Company to the FHLBB in connection with these letters of credit were $25,967 for 2016 and $29,535 for 2015.

The Company has a Borrower-in-Custody arrangement with the FRBB secured by eligible commercial loans, commercial real estate loans and home equity loans, resulting in an available line of $77.9 million and $72.3 million, respectively, at December 31, 2016 and 2015. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), which was 125 basis points at December 31, 2016. At December 31, 2016 and 2015, the Company had no outstanding advances against this line.

The Company has unsecured lines of credit with two correspondent banks with available borrowing capacity totaling $7.5 million at December 31, 2015 and unsecured lines of credit with three correspondent banks with available borrowing capacity totaling $12.5 million at December 31, 2016. The Company had no outstanding advances against these lines for the periods presented.

Securities sold under agreements to repurchase amounted to $30.4 million, $22.1 million and $28.5 million as of December 31, 2016, 2015 and 2014, respectively. The average daily balance of these repurchase agreements was $25.9 million, $24.3 million and $25.3 million during 2016, 2015, and 2014, respectively. The maximum borrowings outstanding on these agreements at any month-end reporting period of the Company were $30.4 million, $28.2 million and $28.5 million during 2016, 2015 and 2014, respectively. These repurchase agreements mature daily and carried a weighted average interest rate of 0.30% during 2016, 0.29% during 2015 and 0.25% during 2014.

The following table illustrates the changes in shareholders' equity from December 31, 2015 to December 31, 2016:

Balance at December 31, 2015 (book value $9.79 per common share)	$ 51,414,656
Net income	5,484,278
Issuance of stock through the Dividend Reinvestment Plan	897,560
Dividends declared on common stock	(3,212,092)
Dividends declared on preferred stock	(87,500)
Change in unrealized loss on available-for-sale securities, net of tax	(45,385)
Balance at December 31, 2016 (book value $10.27 per common share)	$ 54,451,517

In December, 2016, the Company declared a $0.16 per common share cash dividend, payable February 1, 2017 to shareholders of record as of January 15, 2017, requiring the Company to accrue a liability of $581,145 for this dividend in the fourth quarter of 2016. In March, 2017, the Board of Directors of the Company approved a cash dividend of $0.17 per common share, payable on May 1, 2017 to shareholders of record as of April 15, 2017. This dividend represented an increase of $0.01 per common share from the cash dividend paid during recent quarterly periods. The declaration of this dividend required the Company to accrue a liability of $638,026 in the first quarter of 2017.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Additional Prompt Corrective Action capital requirements are applicable to banks, but not bank holding companies.

Beginning in 2016, an additional capital conservation buffer has been added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer will be fully phased-in on January 1, 2019 at 2.5 percent. A banking organization with a conservation buffer of less than 2.5 percent (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The Company’s and the Bank’s capital conservation buffer was 5.52% and 5.42%, respectively, at December 31, 2016. As of December 31, 2016, both the Company and the Bank exceed the required capital conservation buffer of 0.625% and, on a pro forma basis, would be compliant with the fully phased-in capital conservation buffer requirement.

On December 31, 2016, the Company’s tier 1 leverage ratio was 9.17%, common equity tier 1 and tier 1 risk-based capital ratios were both 12.34%, and total risk-based capital ratio was 13.52% and exceeded all applicable regulatory capital adequacy requirements as of such date. Similarly, on December 31, 2016, the Bank’s tier 1 leverage ratio was 9.08%, common equity tier 1 and tier 1 risk-based capital ratios were both 12.23%, and total risk-based capital ratio was 13.42%, and exceeded all applicable regulatory capital adequacy guidelines as of such date. In addition, as of December 31, 2016, the Bank was considered well capitalized under the regulatory capital framework for Prompt Corrective Action, the highest regulatory capital category. (See Note 20 to the consolidated financial statements.)

Common Stock Performance by Quarter*

	2016				2015			
Trade Price	**First**	**Second**	**Third**	**Fourth**	**First**	**Second**	**Third**	**Fourth**
High	$ 14.40	$ 14.50	$ 14.50	$ 16.00	$ 14.50	$ 14.50	$ 14.75	$ 14.75
Low	$ 13.15	$ 13.75	$ 13.77	$ 14.00	$ 14.00	$ 14.00	$ 14.15	$ 13.60
				2016				2015
Bid Price	**First**	**Second**	**Third**	**Fourth**	**First**	**Second**	**Third**	**Fourth**
High	$ 14.25	$ 14.25	$ 14.30	$ 15.75	$ 14.40	$ 14.40	$ 14.50	$ 14.25
Low	$ 13.30	$ 13.76	$ 13.77	$ 13.86	$ 14.00	$ 14.00	$ 14.15	$ 14.00
Cash Dividends Declared	$ 0.16	$ 0.16	$ 0.16	$ 0.16	$ 0.16	$ 0.16	$ 0.16	$ 0.16

*The Company's common stock is not traded on any exchange. However, the Company’s common stock is included in the OTCQX® marketplace tier maintained by the OTC Markets Group Inc. Trade and bid information for the stock appears in the OTC’s interdealer quotation system, OTC Link ATS®. The trade price and bid information in the table above is based on information reported by participating FINRA-registered brokers in the OTC Link ATS® system and may not represent all trades or high and low bids during the relevant periods. Such price quotations reflect inter-dealer prices without retail mark-up, mark-down or commission and bid prices do not necessarily represent actual transactions. The OTC trading symbol for the Company’s common stock is CMTV.

As of February 1, 2017, there were 5,057,954 shares of the Corporation's common stock ($2.50 par value) outstanding, owned by 845 shareholders of record.

Form 10-K

A copy of the Form 10-K Report filed with the Securities and Exchange Commission may be obtained without charge upon written request to:

Kathryn M. Austin, President & CEO
Community Bancorp.
4811 US Route 5
Newport, Vermont 05855

Shareholder Services

For shareholder services or information contact:

Melissa Tinker, Assistant Corporate Secretary
Community Bancorp.
4811 US Route 5
Newport, Vermont 05855
(802) 334-7915

Transfer Agent:

Computershare Investor Services
PO Box 43078
Providence, RI 02940-3078
www.computershare.com

Annual Shareholders' Meeting

The 2017 Annual Shareholders' Meeting will be held at 5:30 p.m., May 16, 2017, at the Elks Club in Derby. We hope to see many of our shareholders there.

Exhibit 21

Subsidiaries of the Company

The wholly-owned subsidiary of Community Bancorp. is Community National Bank, a national banking association incorporated under the Banking Laws of The United States. Community National Bank is considered to be a "significant subsidiary" of Community Bancorp., within the meaning of Rule 1-02(w) of SEC Regulation S-X.

The unconsolidated subsidiary of Community Bancorp. is CMTV Statutory Trust I, a Delaware statutory business trust.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the inclusion in this Annual Report (Form 10-K) of Community Bancorp. of our report dated March 20, 2017 with respect to the consolidated financial statements included in the 2016 Annual Report to Shareholders of Community Bancorp.

We also consent to the incorporation by reference in the Registration Statement (Form S-3 No. 333-160875 and No. 333-214340) pertaining to the Community Bancorp Dividend Reinvestment Plan and in the Registration Statement (Form S-8 No. 333-133631 and No. 333-212977) pertaining to the Community Bancorp Retirement Savings Plan of our report dated March 20, 2017, with respect to the consolidated financial statements, incorporated therein by reference, of Community Bancorp. included in the Annual Report (Form 10-K) for the year ended December 31, 2016.

Portland, Maine
March 20, 2017
Vermont Registration No. 92-0000278

Exhibit 31.1

CERTIFICATION

I, Kathryn M. Austin, President and Chief Executive Officer (Principal Executive Officer), certify that:

1. I have reviewed this annual report on Form 10-K of Community Bancorp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Community Bancorp.

March 20, 2017

By: /s/ Kathryn M. Austin

Name: Kathryn M. Austin,
Title: President & Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION

I, Louise M. Bonvechio, Corporate Secretary and Treasurer (Principal Financial Officer), certify that:

1. I have reviewed this annual report on Form 10-K of Community Bancorp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Community Bancorp.

March 20, 2017

By: /s/ Louise M. Bonvechio

Name: Louise M. Bonvechio
Title: Corporate Secretary and Treasurer
(Principal Financial Officer)

CERTIFICATION PURSUANT TO 18 U. S. C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Community Bancorp. (the "Company") on Form 10-K for the period ended December 31, 2016, filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Principal Executive Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that: 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

A signed original of this written statement required by Section 906 has been provided to Community Bancorp. and will be retained by Community Bancorp. and furnished to the Securities and Exchange Commission or its staff upon request.

Community Bancorp.

March 20, 2017

By: /s/ Kathryn M. Austin
Name: Kathryn M. Austin,
Title: President & Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

CERTIFICATION PURSUANT TO 18 U. S. C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Community Bancorp. (the "Company") on Form 10-K for the period ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Principal Financial Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that: 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

A signed original of this written statement required by Section 906 has been provided to Community Bancorp. and will be retained by Community Bancorp. and furnished to the Securities and Exchange Commission or its staff upon request.

Community Bancorp.

March 20, 2017

By: /s/ Louise M. Bonvechio

Name: Louise M. Bonvechio
Title: Corporate Secretary and Treasurer
(Principal Financial Officer)