

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2008

OR

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

Commission File Number: 0-20293

UNION BANKSHARES CORPORATION

(Exact name of registrant as specified in its charter)

VIRGINIA
(State or other jurisdiction of
incorporation or organization)

54-1598552
(I.R.S. Employer
Identification No.)

211 North Main Street
P.O. Box 446
Bowling Green, Virginia 22427
(Address of principal executive offices) (Zip Code)

(804) 633-5031
(Registrant's telephone number, including area code)

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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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

The number of shares of common stock outstanding as of October 31, 2008 was 13,523,135.

[Table of Contents](#)

UNION BANKSHARES CORPORATION
FORM 10-Q
INDEX

<u>ITEM</u>		<u>PAGE</u>
	<u>PART I – FINANCIAL INFORMATION</u>	
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets as of September 30, 2008, December 31, 2007 and September 30, 2007	1
	Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2008 and 2007	2
	Condensed Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2008 and 2007	3
	Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2008 and 2007	4
	Notes to Condensed Consolidated Financial Statements	5
	Report of Independent Registered Public Accounting Firm	18
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	34
Item 4.	Controls and Procedures	36
	<u>PART II – OTHER INFORMATION</u>	
Item 1.	Legal Proceedings	36
Item 1A.	Risk Factors	36
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	37
Item 6.	Exhibits	37
	Signatures	38

PART I – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

UNION BANKSHARES CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share amounts)

	September 30, 2008 <i>(Unaudited)</i>	December 31, 2007 <i>(Audited)</i>	September 30, 2007 <i>(Unaudited)</i>
ASSETS			
Cash and cash equivalents:			
Cash and due from banks	\$ 49,848	\$ 54,716	\$ 45,712
Interest-bearing deposits in other banks	960	662	1,238
Money market investments	180	303	192
Other interest-bearing deposits	2,598	2,598	2,598
Federal funds sold	30,937	—	732
Total cash and cash equivalents	84,523	58,279	50,472
Securities available for sale, at fair value	290,357	282,699	276,672
Loans held for sale	22,983	25,248	20,717
Loans, net of unearned income	1,865,667	1,747,820	1,683,742
Less allowance for loan losses	24,420	19,336	18,556
Net loans	1,841,247	1,728,484	1,665,186
Bank premises and equipment, net	77,127	75,741	75,398
Other real estate owned	1,293	694	217
Core deposit intangibles, net	10,094	11,550	12,407
Goodwill	56,474	56,474	56,075
Other assets	64,067	62,228	61,888
Total assets	\$ 2,448,165	\$ 2,301,397	\$ 2,219,032
LIABILITIES			
Noninterest-bearing demand deposits	\$ 284,940	\$ 281,405	\$ 286,675
Interest-bearing deposits:			
NOW accounts	217,223	217,809	205,063
Money market accounts	272,830	156,576	162,183
Savings accounts	99,897	100,885	107,232
Time deposits of \$100,000 and over	410,035	453,243	446,401
Brokered certificates of deposit	81,729	—	—
Other time deposits	447,506	449,660	454,787
Total interest-bearing deposits	1,529,220	1,378,173	1,375,666
Total deposits	1,814,160	1,659,578	1,662,341
Securities sold under agreements to repurchase	66,966	82,049	70,493
Other short-term borrowings	70,000	200,837	129,700
Trust preferred capital notes	60,310	60,310	60,310
Long-term borrowings	204,500	69,500	69,500
Other liabilities	18,280	17,041	18,437
Total liabilities	2,234,216	2,089,315	2,010,781
Commitments and contingencies			
STOCKHOLDERS' EQUITY			
Common stock, \$1.33 par value, shares authorized 36,000,000; issued and outstanding, 13,523,135 shares, 13,438,334 shares, and 13,388,789 shares, respectively	17,988	17,879	17,813
Surplus	42,297	40,758	39,693
Retained earnings	155,387	152,238	151,104
Accumulated other comprehensive income (loss)	(1,723)	1,207	(359)
Total stockholders' equity	213,949	212,082	208,251
Total liabilities and stockholders' equity	\$ 2,448,165	\$ 2,301,397	\$ 2,219,032

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

UNION BANKSHARES CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Interest and dividend income:				
Interest and fees on loans	\$30,437	\$32,530	\$ 91,426	\$ 94,022
Interest on Federal funds sold	5	221	34	606
Interest on deposits in other banks	8	20	22	47
Interest on money market investments	—	1	1	3
Interest on other interest-bearing deposits	7	34	47	103
Interest and dividends on securities:				
Taxable	2,220	2,230	6,797	6,735
Nontaxable	1,335	1,215	3,863	3,491
Total interest and dividend income	34,012	36,251	102,190	105,007
Interest expense:				
Interest on deposits	10,685	12,078	33,096	35,977
Interest on Federal funds purchased	114	432	378	1,000
Interest on short-term borrowings	661	2,256	3,698	4,223
Interest on long-term borrowings	2,298	2,137	5,811	7,078
Total interest expense	13,758	16,903	42,983	48,278
Net interest income	20,254	19,348	59,207	56,729
Provision for (recapture of) loan losses	3,667	432	6,943	(113)
Net interest income after provision for loan losses	16,587	18,916	52,264	56,842
Noninterest income:				
Service charges on deposit accounts	2,405	1,947	6,854	5,590
Other service charges, commissions and fees	1,804	1,525	4,985	4,526
Gains on securities transactions, net	1	93	29	601
Gains on sales of loans	2,790	2,024	8,967	6,500
Gains on sales of other real estate and bank premises, net	1,737	317	1,872	308
Other operating income	376	376	1,410	1,178
Total noninterest income	9,113	6,282	24,117	18,703
Noninterest expenses:				
Salaries and benefits	11,046	9,230	33,385	28,787
Occupancy expenses	1,755	1,560	5,182	4,373
Furniture and equipment expenses	1,242	1,213	3,739	3,510
Other operating expenses	6,066	5,975	17,770	16,933
Total noninterest expenses	20,109	17,978	60,076	53,603
Income before income taxes	5,591	7,220	16,305	21,942
Income tax expense	1,336	1,863	4,065	5,796
Net income	\$ 4,255	\$ 5,357	\$ 12,240	\$ 16,146
Earnings per share, basic	\$ 0.32	\$ 0.40	\$ 0.91	\$ 1.21
Earnings per share, diluted	\$ 0.31	\$ 0.40	\$ 0.91	\$ 1.20

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

UNION BANKSHARES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(Dollars in thousands, except share amounts)

(Unaudited)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Total
Balance – December 31, 2006	<u>\$17,716</u>	<u>\$38,047</u>	<u>\$142,168</u>	<u>\$ 1,485</u>		<u>\$199,416</u>
Comprehensive income:						
Net income			16,146		\$ 16,146	16,146
Unrealized holding losses arising during the period (net of taxes, \$783)					(1,453)	
Reclassification adjustment for gains included in net income (net of taxes, \$210)					(391)	
Other comprehensive loss (net of taxes, \$993)				(1,844)	(1,844)	(1,844)
Total comprehensive income					<u>\$ 14,302</u>	
Cash dividends (\$.54 per share)			(7,210)			(7,210)
Issuance of common stock under Dividend Reinvestment Plan (34,306 shares)	45	741				786
Issuance of common stock under Incentive Stock Option Plan (38,973 shares)	51	491				542
Issuance of common stock for services rendered (470 shares)	1	13				14
Stock-based compensation expense		401				401
Balance – September 30, 2007	<u>\$17,813</u>	<u>\$39,693</u>	<u>\$151,104</u>	<u>\$ (359)</u>		<u>\$208,251</u>
Balance – December 31, 2007	<u>\$17,879</u>	<u>\$40,758</u>	<u>\$152,238</u>	<u>\$ 1,207</u>		<u>\$212,082</u>
Comprehensive income:						
Net income			12,240		\$ 12,240	12,240
Unrealized holding losses arising during the period (net of taxes, \$1,567)					(2,911)	
Reclassification adjustment for gains included in net income (net of taxes, \$10)					(19)	
Other comprehensive loss (net of taxes, \$1,577)				(2,930)	(2,930)	(2,930)
Total comprehensive income					<u>\$ 9,310</u>	
Cash dividends (\$.55 per share)			(7,487)			(7,487)
Tax benefit from exercise of stock awards		46				46
Cumulative-effect of a change in accounting principle			(1,604)			(1,604)
Stock purchased under stock repurchase plan	(20)	(234)				(254)
Issuance of common stock under Dividend Reinvestment Plan (43,279 shares)	58	755				813
Issuance of common stock under Incentive Stock Option Plan (50,198 shares)	71	577				648
Stock-based compensation expense		395				395
Balance – September 30, 2008	<u>\$17,988</u>	<u>\$42,297</u>	<u>\$155,387</u>	<u>\$ (1,723)</u>		<u>\$213,949</u>

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

UNION BANKSHARES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(Dollars in thousands)
(Unaudited)

	2008	2007
Operating activities:		
Net income	\$ 12,240	\$ 16,146
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization of bank premises and equipment	3,983	3,391
Amortization, net	1,900	1,834
Provision for (recapture of) loan losses	6,943	(113)
Decrease (increase) in loans held for sale, net	2,265	(633)
Gains on the sale of investment securities	(29)	(601)
Gains on sales of other real estate owned and premises, net	(1,872)	(308)
Stock-based compensation expense	395	401
Tax benefit from the exercise of equity-based awards	46	—
Increase in other assets	(1,319)	(5,642)
(Decrease) increase in other liabilities	(365)	2,726
Net cash and cash equivalents provided by operating activities	24,187	17,201
Investing activities:		
Purchases of securities available for sale	(41,347)	(38,481)
Proceeds from sales of securities available for sale	881	146
Proceeds from maturities, calls and paydowns of securities available for sale	28,344	42,276
Net increase in loans	(119,706)	(134,776)
Purchases of bank premises and equipment, net	(3,497)	(12,810)
Cash received in bank acquisitions	—	35,636
Net cash and cash equivalents used in investing activities	(135,325)	(108,009)
Financing activities:		
Net increase (decrease) in noninterest-bearing deposits	3,535	(14,173)
Net increase (decrease) in interest-bearing deposits	151,047	(32,702)
Net increase (decrease) in short-term borrowings	(145,920)	137,497
Net increase (decrease) in long-term borrowings	135,000	(19,350)
Cash dividends paid	(7,487)	(7,210)
Issuance of common stock	1,461	1,328
Stock repurchased under stock repurchase plan	(254)	—
Net cash and cash equivalents provided by financing activities	137,382	65,390
Increase (decrease) in cash and cash equivalents	26,244	(25,418)
Cash and cash equivalents at beginning of the period	58,279	75,890
Cash and cash equivalents at end of the period	\$ 84,523	\$ 50,472
Supplemental Disclosure of Cash Flow Information		
Cash payments for:		
Interest	\$ 43,397	\$ 48,133
Income taxes	4,771	6,090
Supplemental schedule of noncash investing and financing activities		
Unrealized losses on securities available for sale	\$ (4,507)	\$ (2,837)
Transfer of loans to other real estate owned	1,587	217
Cumulative effect of a change in accounting principle	(1,604)	—
Transactions related to bank acquisitions		
Increase in assets and liabilities:		
Other Assets	\$ —	\$ 7,672
Noninterest bearing deposits	—	8,586
Interest bearing deposits	—	34,722

See accompanying notes to condensed consolidated financial statements.

UNION BANKSHARES CORPORATION AND SUBSIDIARIES

**Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008**

1. ACCOUNTING POLICIES

The consolidated financial statements include the accounts of Union Bankshares Corporation and its subsidiaries (the "Company"). Significant inter-company accounts and transactions have been eliminated in consolidation.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and follow general practice within the banking industry. Accordingly, the unaudited condensed consolidated financial statements do not include all the information and footnotes required by GAAP for complete financial statements. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of the interim periods presented have been made. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2007 Annual Report on Form 10-K. If needed, certain previously reported amounts have been reclassified to conform to current period presentation.

2. MERGERS AND ACQUISITIONS

On March 14, 2008, the Company completed the previously announced merger of its Prosperity Bank & Trust Company ("Prosperity") affiliate into Union Bank and Trust Company ("Union Bank").

On May 28, 2008, the Company announced that its affiliate Bay Community Bank would merge into its largest bank affiliate, Union Bank. The completion date of the merger is expected to be October 31, 2008.

On September 7, 2007, the Company completed the previously announced acquisition of six Virginia branches of Provident Bank ("Acquired Bank Branches"), a subsidiary of Provident Bankshares Corporation. These six branches are located in Charlottesville, Middleburg, Warrenton (2) and Winchester (2). Deposits assumed in this branch acquisition totaled approximately \$44 million. There were no loans included in the transaction. The Acquired Bank Branches were accounted for as a purchase which required the Company to allocate the total purchase price of the acquisition to the assets acquired and liabilities assumed, based on their respective fair values at the acquisition date, with any remaining acquisition costs being recorded as goodwill. Operating results for the Acquired Bank Branches have been included in the Company's consolidated results since September 7, 2007.

3. STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard ("SFAS") *Share-Based Payment* ("SFAS No. 123R"), which replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires the costs resulting from all share-based payments to employees be recognized in the financial statements.

The Company's 2003 Stock Incentive Plan provides for the granting of incentive stock options, non-statutory stock options, and nonvested stock awards to key employees of the Company. The stock incentive plan makes available 525,000 shares which may be

Table of Contents

awarded to employees of the Company in the form of incentive stock options intended to comply with the requirements of Section 422 of the Internal Revenue Code of 1986 (“incentive stock options”), non-statutory stock options, and nonvested stock. Under the plan, the option price cannot be less than the fair market value of the stock on the grant date. The stock option’s maximum term is ten years from the date of grant and vests in equal annual installments of twenty percent over a five year vesting schedule. The Company issues new shares to satisfy share-based awards. As of September 30, 2008, approximately 302,488 shares were available for issuance under the Company’s 2003 Stock Incentive Plan.

For the three and nine month periods ended September 30, 2008, the Company recognized stock-based compensation expense of approximately \$110 thousand and \$292 thousand, net of tax, or approximately \$.01 per share and \$.02 per share, per period respectively, in accordance with SFAS No. 123R.

Stock Options

The following table summarizes the stock option activity for the nine months ended September 30, 2008:

	Number of Stock Options	Weighted Average Exercise Price
Options outstanding, December 31, 2007	277,363	\$ 19.58
Granted	4,750	20.41
Exercised	(51,011)	13.07
Forfeited	(6,960)	22.91
Options outstanding, September 30, 2008	224,142	21.00
Options exercisable, September 30, 2008	183,367	19.55

The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table for the nine months ended September 30, 2008:

	Nine Months Ended September 30,	
	2008	2007
Dividend yield (1)	2.29%	1.99%
Expected life in years (2)	7.8	7.5
Expected volatility (3)	29.89%	25.23%
Risk-free interest rate (4)	3.68%	4.68%
Weighted average fair value per option granted	\$ 6.15	\$ 8.07

(1) Calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant.

(2) Based on the average of the contractual life and vesting schedule for the respective option.

(3) Based on the monthly historical volatility of the Company’s stock price over the expected life of the options.

(4) Based upon the U.S. Treasury bill yield curve, for periods within the contractual life of the option, in effect at the time of grant.

Table of Contents

The following table summarizes information concerning stock options issued to the Company's employees that are vested or are expected to vest and stock options exercisable as of September 30, 2008 (dollars in thousands, except share and per share amounts):

	Stock Options Vested or Expected to Vest	Exercisable
Stock options	217,157	183,367
Weighted average remaining contractual life in years	5.28	5.03
Weighted average exercise price on shares above water	\$ 21.00	\$ 19.55
Aggregate intrinsic value	\$ 960	\$ 939

The total intrinsic value for stock options exercised during the three and nine months ended September 30, 2008 was approximately \$72 thousand and \$361 thousand, respectively. The fair value of stock options vested during the nine months ended September 30, 2008 was approximately \$238 thousand. Cash received from the exercise of stock options for the three and nine months ended September 30, 2008 was approximately \$84 thousand and \$667 thousand, respectively. The tax benefit realized from disqualifying dispositions during the nine months ended September 30, 2008 was \$46 thousand.

Nonvested Stock

The 2003 plan permits the granting of nonvested stock, but is limited to one-third of the aggregate number of total awards granted. This equity component of compensation is divided between restricted (time-based) stock grants and performance-based stock grants. The restricted stock vests fifty percent on each of the third and fourth anniversaries of the date of the grant. The performance-based stock is subject to vesting on the fourth anniversary of the date of the grant based on the performance of the Company's stock price. The value of the nonvested stock awards was calculated by multiplying the fair market value of the Company's common stock on grant date by the number of shares awarded. Employees have the right to vote the shares and to receive cash or stock dividends (restricted stock), if any, except for the nonvested stock under the performance-based component (performance stock).

The following table summarizes the nonvested stock activity for the nine months ended September 30, 2008:

	Restricted Stock	Weighted Average Grant-Date Fair Value
Balance, December 31, 2007	58,625	\$ 27.84
Granted	8,356	19.83
Vested	(3,486)	23.97
Forfeited	(2,457)	27.16
Balance, September 30, 2008	61,038	26.99

Table of Contents

The estimated unamortized compensation expense, net of estimated forfeitures, related to nonvested stock and stock options issued and outstanding as of September 30, 2008 will be recognized in future periods is as follows (dollars in thousands):

	<u>Stock Options</u>	<u>Restricted Stock</u>	<u>Total</u>
For the remaining three months of 2008	\$ 34	\$ 120	\$ 154
For year ended December 31, 2009	96	322	418
For year ended December 31, 2010	93	214	307
For year ended December 31, 2011	56	54	110
For year ended December 31, 2012	17	9	26
For year ended December 31, 2013	2	—	2
Total	<u>\$ 298</u>	<u>\$ 719</u>	<u>\$1,017</u>

4. ALLOWANCE FOR LOAN LOSSES

The following summarizes activity in the allowance for loan losses for the nine months ended September 30, 2008 and 2007 (dollars in thousands):

	<u>September 30, 2008</u>	<u>September 30, 2007</u>
Beginning balance	\$ 19,336	\$ 19,148
Recoveries credited to allowance	227	282
Loans charged off	(2,086)	(761)
Provision for (recapture of) loan losses	6,943	(113)
Ending balance	<u>\$ 24,420</u>	<u>\$ 18,556</u>

5. EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares outstanding attributable to stock awards. There were 132,144 and 96,689 anti-dilutive awards as of September 30, 2008 and 2007, respectively.

Table of Contents

The following is a reconciliation of the denominators of the basic and diluted EPS computations for the three and nine months ended September 30, 2008 and 2007 (dollars and shares in thousands, except per share amounts):

	Income (Numerator)	Weighted Average Shares (Denominator)	Per Share Amount
For the Three Months ended September 30, 2008			
Basic EPS	\$ 4,255	13,482	\$ 0.32
Effect of dilutive stock awards	—	55	(0.01)
Diluted EPS	<u>\$ 4,255</u>	<u>13,537</u>	<u>\$ 0.31</u>
For the Three Months ended September 30, 2007			
Basic EPS	\$ 5,357	13,350	\$ 0.40
Effect of dilutive stock awards	—	70	—
Diluted EPS	<u>\$ 5,357</u>	<u>13,420</u>	<u>\$ 0.40</u>
For the Nine Months ended September 30, 2008			
Basic EPS	\$ 12,240	13,466	\$ 0.91
Effect of dilutive stock awards	—	45	—
Diluted EPS	<u>\$ 12,240</u>	<u>13,511</u>	<u>\$ 0.91</u>
For the Nine Months ended September 30, 2007			
Basic EPS	\$ 16,146	13,330	\$ 1.21
Effect of dilutive stock awards	—	86	(0.01)
Diluted EPS	<u>\$ 16,146</u>	<u>13,416</u>	<u>\$ 1.20</u>

6. TRUST PREFERRED CAPITAL NOTES

On March 30, 2006, the Company formed Statutory Trust II, a wholly owned subsidiary, for the purpose of issuing redeemable capital securities in connection with the acquisition of Prosperity that was completed on April 1, 2006. A Trust Preferred Capital Note of \$36.0 million was issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate (three month LIBOR plus 1.40%) which adjusts and is payable quarterly. The interest rate for the period ending September 30, 2008 was 4.22%. The redeemable capital securities may be called at par after five years on March 31, 2011 and each quarterly anniversary of such date until the securities mature in 30 years on March 31, 2036. The principal asset of the Statutory Trust II is \$37.1 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the capital notes, of which \$1.1 million is reflected as the Company's investment in Statutory Trust II reported as "Other assets" within the financial statements.

During the first quarter of 2004, the Company's Statutory Trust I, a wholly owned subsidiary, was formed for the purpose of issuing redeemable capital securities in connection with the acquisition of Guaranty Financial Corporation ("Guaranty"). A Trust Preferred Capital Note of \$22.5 million was issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate (three month LIBOR plus 2.75%) which adjusts and is payable quarterly. The interest rate for the period ending September 30, 2008 was 5.57%. The redeemable capital securities may be redeemed at par beginning on June 17, 2009 and each quarterly anniversary of such date until the securities mature on June 17, 2034. The principal asset of the Statutory Trust I is \$23.2 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the capital notes, of which \$696 thousand is reflected as the Company's investment in Statutory Trust I reported as "Other assets" within the financial statements.

7. SEGMENT REPORTING DISCLOSURES

The Company has two reportable segments: traditional full service community banks and a mortgage loan origination business. The community bank business includes four banks, which provide loan, deposit, investment, and other banking services to retail and commercial customers through their 58 branch offices located in Virginia. The mortgage segment provides a variety of mortgage loan products principally in Virginia and Maryland. These loans are originated and sold primarily in the secondary market through purchase commitments from investors, which subject the Company to only *de minimis* risk.

Table of Contents

Profit and loss is measured by net income after taxes including realized gains and losses on the Company's investment portfolio. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Inter-segment transactions are recorded at cost and eliminated as part of the consolidation process.

Both of the Company's reportable segments are service-based. The mortgage business is a fee-based business while the banks are driven principally by net interest income. The banks provide a distribution and referral network through their customers for the mortgage loan origination business. The mortgage segment offers a more limited referral network for the banks, due largely to the minimal degree of overlapping geographic markets.

The community bank segment provides the mortgage segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest at the three month LIBOR rate plus 25 basis points. These transactions are eliminated in the consolidation process. A management fee for operations and administrative support services is charged to all subsidiaries and eliminated in the consolidated totals.

Table of Contents

Information about reportable segments and reconciliation of such information to the consolidated financial statements for three and nine months ended September 30, 2008 and 2007 is as follows (dollars in thousands):

	Community Banks	Mortgage	Eliminations	Consolidated
Three Months Ended September, 2008				
Net interest income	\$ 20,072	\$ 182	\$ —	\$ 20,254
Provision for loan losses	3,667	—	—	3,667
Net interest income after provision for loan losses	16,405	182	—	16,587
Noninterest income	6,414	2,779	(80)	9,113
Noninterest expenses	17,354	2,835	(80)	20,109
Income before income taxes	5,465	126	—	5,591
Income tax expense	1,285	51	—	1,336
Net income	\$ 4,180	\$ 75	\$ —	\$ 4,255
Total assets	\$2,445,578	\$27,920	\$ (25,333)	\$2,448,165
Three Months Ended September 30, 2007				
Net interest income	\$ 19,289	\$ 59	\$ —	\$ 19,348
Provision for loan losses	432	—	—	432
Net interest income after provision for loan losses	18,857	59	—	18,916
Noninterest income	4,329	2,024	(71)	6,282
Noninterest expenses	15,683	2,366	(71)	17,978
Income (loss) before income taxes	7,503	(283)	—	7,220
Income tax expense (benefit)	1,975	(112)	—	1,863
Net income (loss)	\$ 5,528	\$ (171)	\$ —	\$ 5,357
Total assets	\$2,216,376	\$23,359	\$ (20,703)	\$2,219,032
Nine Months Ended September, 2008				
Net interest income	\$ 58,710	\$ 497	\$ —	\$ 59,207
Provision for loan losses	6,943	—	—	6,943
Net interest income after provision for loan losses	51,767	497	—	52,264
Noninterest income	15,392	8,968	(243)	24,117
Noninterest expenses	51,090	9,229	(243)	60,076
Income before income taxes	16,069	236	—	16,305
Income tax expense	3,961	104	—	4,065
Net income	\$ 12,108	\$ 132	\$ —	\$ 12,240
Total assets	\$2,445,578	\$27,920	\$ (25,333)	\$2,448,165
Nine Months Ended September 30, 2007				
Net interest income	\$ 56,546	\$ 183	\$ —	\$ 56,729
Provision for (recapture of) loan losses	(113)	—	—	(113)
Net interest income after provision for (recapture of) loan losses	56,659	183	—	56,842
Noninterest income	12,430	6,482	(209)	18,703
Noninterest expenses	46,356	7,456	(209)	53,603
Income (loss) before income taxes	22,733	(791)	—	21,942
Income tax expense (benefit)	6,114	(318)	—	5,796
Net income (loss)	\$ 16,619	\$ (473)	\$ —	\$ 16,146
Total assets	\$2,216,376	\$23,359	\$ (20,703)	\$2,219,032

8. STOCK REPURCHASE

The Board of Directors has authorized management of the Company to buy up to 150,000 shares of its outstanding common stock in the open market at prices that management determines to be prudent. This authorization expires May 31, 2009. The Company considers current market conditions and the Company's current capital level, in addition to other factors, when deciding whether to repurchase stock. It is anticipated that any repurchased shares will be used primarily for general corporate purposes, including the dividend reinvestment and stock purchase plan, the 2003 Stock Incentive Plan, and other employee benefit plans. In March 2008, management repurchased 15,000 shares at a price of \$16.87 per share. No shares were repurchased during the second or third quarters of 2008.

9. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141(R), 'Business Combinations' ("SFAS 141(R)"). The standard will significantly change the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes the criteria for how an acquiring entity in a business

Table of Contents

combination recognizes the assets acquired and liabilities assumed in the transaction; establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. Acquisition related costs, including finder's fees, advisory, legal, accounting valuation and other professional and consulting fees are required to be expensed as incurred. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008 and early implementation is not permitted. The adoption of this statement will impact the Company's accounting for and reporting of any acquisitions completed after January 1, 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No.160, *'Noncontrolling Interests in Consolidated Financial Statements'* ("SFAS 160"). SFAS 160 requires an entity to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The Company does not expect the implementation of SFAS 160 to have a material impact on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2, *'Effective Date of FASB Statement No. 157'* ("FSP 157-2"). FSP FAS 157-2 delays the effective date of SFAS 157, *'Fair Value Measurements,'* for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the FASB and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of Statement 157. FSP 157-2 defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, for items within the scope of this FSP. Examples of items to which the deferral would and would not apply are listed in the FSP. The Company does not expect the implementation of FSP 157-2 to have a material impact on its consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *'Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133'* ("SFAS 161"). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The Company does not expect the implementation of SFAS 161 to have a material impact on its consolidated financial statements.

In April 2008, the FASB issued FSP 142-3, *'Determination of the Useful Life of Intangible Assets'* ("FSP 142-3"). This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, *'Goodwill and Other Intangible Assets.'* The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company does not expect the implementation of FSP 142-3 to have a material impact on its consolidated financial statements.

Table of Contents

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, *'The Hierarchy of Generally Accepted Accounting Principles'* ("SFAS 162"). This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 becomes effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411. The Company does not expect the implementation of SFAS 162 to have a material impact on its consolidated financial statements.

In October 2008, the FASB issued FSP 157-3, *'Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active'* ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS 157, "Fair Value Measurements," in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP was effective upon issuance, including prior periods for which financial statements have not been issued. The provisions of FSP 157-3 did not have a material impact on the Company's consolidated financial statements.

10. GOODWILL AND INTANGIBLE ASSETS

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), which prescribes the accounting for goodwill and intangible assets subsequent to initial recognition. The provisions of SFAS 142 discontinue the amortization of goodwill and intangible assets with indefinite lives, but require at least an annual impairment review and more frequently if certain impairment indicators are in evidence. Based on the annual testing for impairment of goodwill and intangible assets, there have been no impairment charges to date.

Core deposit intangible assets are being amortized over the period of expected benefit, which ranges from 5 to 15 years. As part of the purchase price allocation for the acquisition of deposits related to the Acquired Bank Branches in September 2007, the Company recorded \$1.1 million in core deposit intangible assets and \$4.3 million in goodwill. The core deposit intangible assets recorded for the Acquired Bank Branches are being amortized over an average of 7.9 years. As part of the purchase price allocation for the acquisition of Prosperity in 2006, the Company recorded \$5.5 million in core deposit intangible assets and \$20.6 million in goodwill. The core deposit intangible assets recorded for the Prosperity acquisition are being amortized over an average of 9.1 years.

Table of Contents

Information concerning goodwill and intangible assets is presented in the following table (in thousands):

	<u>Gross Carrying Value</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Value</u>
September 30, 2008			
Amortizable core deposit intangibles	\$ 20,215	\$ 10,121	\$ 10,094
Unamortizable goodwill	56,816	342	56,474
December 31, 2007			
Amortizable core deposit intangibles	\$ 20,215	\$ 8,665	\$ 11,550
Unamortizable goodwill	56,816	342	56,474
September 30, 2007			
Amortizable core deposit intangibles	\$ 20,589	\$ 8,182	\$ 12,407
Unamortizable goodwill	56,416	341	56,075

11. COMMITMENTS AND CONTINGENCIES

Commitments to extend credit are agreements to lend to customers as long as there are no violations of any conditions established in the contracts. Commitments generally have fixed expiration dates or other termination clauses and may require payments of fees. Because many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. At September 30, 2008 and 2007, the Company had outstanding loan commitments approximating \$627.3 million and \$709.7 million, respectively.

Letters of credit written are conditional commitments issued by the Company to guarantee the performance of customers to third parties. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The amount of standby letters of credit whose contract amounts represent credit risk totaled approximately \$29.9 million and \$28.4 million at September 30, 2008 and 2007, respectively.

At September 30, 2008, Union Mortgage Group, Inc. ("Union Mortgage"), a wholly owned subsidiary of Union Bank, had rate lock commitments to originate mortgage loans amounting to \$59.0 million and loans held for sale of \$23.0 million. Union Mortgage has entered into corresponding commitments on a best-efforts basis to sell loans on a servicing released basis totaling approximately \$82.0 million. These commitments to sell loans are designed to mitigate the mortgage company's exposure to fluctuations in interest rates in connection with rate lock commitments and loans held for sale.

[Table of Contents](#)

12. SECURITIES

The amortized cost, gross unrealized gains and losses and estimated fair values of investment securities as of September 30, 2008 and December 31, 2007 are summarized as follows (in thousands):

	Amortized Cost	Gross Unrealized		Estimated Fair Value
		Gains	(Losses)	
September 30, 2008				
Obligations of states and political subdivisions	\$ 119,535	\$ 1,177	\$ (4,041)	\$ 116,671
Corporate and other bonds	14,365	54	(766)	13,653
Mortgage-backed securities	139,048	1,371	(321)	140,098
Federal Reserve Bank stock – restricted	3,383	—	—	3,383
Federal Home Loan Bank stock – restricted	16,298	—	—	16,298
Other securities	254	—	—	254
Total securities	\$ 292,883	\$ 2,602	\$ (5,128)	\$ 290,357
December 31, 2007				
Obligations of states and political subdivisions	\$ 111,439	\$ 1,840	\$ (683)	\$ 112,596
Corporate and other bonds	15,435	653	(92)	15,996
Mortgage-backed securities	135,962	930	(672)	136,220
Federal Reserve Bank stock – restricted	3,337	—	—	3,337
Federal Home Loan Bank stock – restricted	13,800	—	—	13,800
Other securities	743	7	—	750
Total securities	\$ 280,716	\$ 3,430	\$ (1,447)	\$ 282,699

The following table shows the gross unrealized losses and fair value (in thousands) of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired. These are aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position and are as follows:

	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized Losses	Fair value	Unrealized Losses	Fair value	Unrealized Losses
As of September 30, 2008						
Obligations of states and political subdivisions	\$ 55,375	\$ (3,503)	\$ 5,193	\$ (538)	\$ 60,568	\$ (4,041)
Mortgage-backed securities	33,463	(237)	3,349	(84)	36,812	(321)
Corporate and other bonds	8,330	(672)	1,756	(94)	10,086	(766)
	\$ 97,168	\$ (4,412)	\$ 10,298	\$ (716)	\$ 107,466	\$ (5,128)
As of December 31, 2007						
Obligations of states and political subdivisions	\$ 26,227	\$ (564)	\$ 4,055	\$ (119)	\$ 30,282	\$ (683)
Mortgage-backed securities	10,891	(16)	48,785	(656)	59,676	(672)
Corporate and other bonds	—	—	4,513	(92)	4,513	(92)
	\$ 37,118	\$ (580)	\$ 57,353	\$ (867)	\$ 94,471	\$ (1,447)

As of September 30, 2008, there were \$10.3 million of individual securities that had been in a continuous loss position for more than 12 months. Additionally, these securities had an unrealized loss of \$716 thousand and consisted primarily of municipal obligations. Management has evaluated the investment portfolio by security and determined the declines in fair value were primarily attributable to changes in market interest rates, not in estimated cash flows or credit quality. Management has the positive ability and intent to hold these securities to maturity or until value is recovered. Therefore, no other-than-temporary impairment was recorded at the end of the reporting period.

Table of Contents

13. FAIR VALUE MEASUREMENTS

SFAS No. 157, "*Fair Value Measurements*" ("SFAS 157"), defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three Levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Securities

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company's securities are considered to be Level 2 securities.

Loans held for sale

Loans held for sale are required to be measured at lower of cost or fair value. Under SFAS 157, market value is to represent fair value. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions. Premiums received or to be received on the quotes or bids are indicative of the fact that cost is lower than fair value.

Impaired loans

SFAS 157 applies to loans measured for impairment using the practical expedients permitted by SFAS 114, "*Accounting by Creditors for Impairment of a Loan*," including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

Intangibles and Goodwill

Goodwill and intangible assets require an impairment review at least annually and more frequently if certain impairment indicators are evident. Based on the annual testing for impairment of goodwill and intangible assets, there have been no impairment charges to date.

[Table of Contents](#)

Other Real Estate Owned

Real estate owned is measured at the lower of fair value or cost less cost to sell. The Company believes that the fair value component in its valuation follows the provisions of SFAS 157.

14. CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE

During the first quarter of 2008, Emerging Issues Task Force 06-4 "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*" became effective. This statement requires the Company to recognize a liability (offset as a reduction to capital) and related compensation costs for endorsement split-dollar life insurance arrangements that provide benefits to employees during post-retirement periods. The Company recorded a reduction to retained earnings and corresponding increase to liabilities of \$1.6 million. This reduction to retained earnings has been reflected in the Company's Condensed Consolidated Statements of Changes in Stockholders' Equity.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Union Bankshares Corporation
Bowling Green, Virginia

We have reviewed the accompanying condensed consolidated balance sheets of Union Bankshares Corporation and subsidiaries as of September 30, 2008 and 2007, and the related condensed consolidated statements of income for the three and nine month periods ended September 30, 2008 and 2007 and the related condensed consolidated statements of changes in stockholders' equity and cash flows for the nine month periods ended September 30, 2008 and 2007. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board, the consolidated balance sheet of Union Bankshares Corporation and subsidiaries as of December 31, 2007, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated February 28, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Yount, Hyde & Barbours, P.C.

Winchester, Virginia
November 10, 2008

[Table of Contents](#)

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management’s discussion and analysis is presented to aid the reader in understanding and evaluating the financial condition and results of operations of Union Bankshares and its subsidiaries (the “Company”). This discussion and analysis should be read with the consolidated financial statements, the footnotes thereto, and the other financial data included in this report, as well as the Company’s Annual Report on Form 10-K and management’s discussion and analysis for the year ended December 31, 2007. Highlighted in the discussion are material changes from prior reporting periods and any identifiable trends affecting the Company. Results of operations for the three month and nine month periods ended September 30, 2008 and 2007 are not necessarily indicative of results that may be attained for any other period. Amounts are rounded for presentation purposes, while some of the percentages presented are computed based on unrounded amounts.

FORWARD-LOOKING STATEMENTS

Certain statements in this report may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualified words (and their derivatives) such as “expect,” “believe,” “estimate,” “plan,” “project,” “anticipate” or other statements concerning opinions or judgment of the Company and its management about future events. Although the Company believes that its expectations with respect to forward-looking statements are based upon reasonable assumptions within the bounds of its existing knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual future results and trends may differ materially from historical results or those anticipated depending on a variety of factors, including, but not limited to, the effects of and changes in: general economic conditions, the interest rate environment, legislative and regulatory requirements, competitive pressures, new products and delivery systems, inflation, changes in the stock and bond markets, technology, and consumer spending and savings habits. The Company does not update any forward-looking statements that may be made from time to time by or on behalf of the Company.

CRITICAL ACCOUNTING POLICIES

General

The accounting and reporting policies of the Company and its subsidiaries are in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and conform to general practices within the banking industry. The Company’s financial position and results of operations are affected by management’s application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities, and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company’s consolidated financial position and/or results of operations.

The more critical accounting and reporting policies include the Company’s accounting for the allowance for loan losses and mergers and acquisitions. The Company’s accounting policies are fundamental to understanding the Company’s consolidated financial position and consolidated results of operations. Accordingly, the Company’s significant accounting policies are discussed in detail in Note 1 “Summary of Significant Accounting Policies” in the “Notes to the Consolidated Financial Statements” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2007.

Table of Contents

The following is a summary of the Company's critical accounting policies that are highly dependent on estimates, assumptions and judgments.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) Statement of Financial Accounting Standard ("SFAS") No. 5, *Accounting for Contingencies* ("SFAS No. 5"), which requires that losses be accrued when occurrence is probable and can be reasonably estimated and (ii) SFAS No. 114, *Accounting by Creditors for Impairment of a Loan* ("SFAS No. 114"), as amended, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The Company's allowance for loan losses is the accumulation of various components that are calculated based on independent methodologies. All components of the allowance represent an estimation performed pursuant to either SFAS No. 5 or SFAS No. 114. Management's estimate of each SFAS No. 5 component is based on certain observable data that management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; loan volumes; geographic, borrower and industry concentrations; seasoning of the loan portfolio; the findings of internal credit quality assessments and results from external bank regulatory examinations. These factors, as well as historical losses and current economic and business conditions, are used in developing estimated loss factors used in the calculations.

The Company adopted SFAS No. 114, which has been amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures* ("SFAS No. 118"). SFAS No. 114, as amended, requires that the impairment of loans that have been separately identified for evaluation is to be measured based on the present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral-dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment is to be based on the net realizable value of the collateral. SFAS No. 114, as amended, also requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans.

Reserves for commercial loans are determined by applying estimated loss factors to the portfolio based on management's evaluation and "risk grading" of the commercial loan portfolio. Reserves are provided for noncommercial loan categories using historical loss factors applied to the total outstanding loan balance of each loan category. Additionally, environmental factors based on national and local economic activity, as well as portfolio specific attributes, are considered in the allowance for loan losses. Specific reserves are determined on a loan-by-loan basis based on management's evaluation of the Company's exposure for each credit, given the current payment status of the loan and the net realizable value of any underlying collateral.

While management uses the best information available to establish the allowance for loan and lease losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or, if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Table of Contents

Mergers and Acquisitions

The Company's mergers and acquisition strategy focuses on high growth areas with strong market demographics and targets organizations that have a comparable corporate culture, strong performance and good asset quality, among other factors.

The Company accounts for acquisitions under the purchase method of accounting and accordingly is required to record the assets acquired, including identified intangible assets and liabilities assumed at their fair value, which often involves estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques, which are inherently subjective. The amortization of identified intangible assets is based upon the estimated economic benefits to be received, which is also subjective. These estimates also include the establishment of various accruals and allowances based on planned facility dispositions and employee severance considerations, among other acquisition-related items. In addition, purchase acquisitions typically result in goodwill, which is subject to at least annual impairment testing, or more frequently if certain indicators are in evidence, based on the fair value of net assets acquired compared to the carrying value of goodwill.

The Company and the acquired entity also incur merger-related costs during an acquisition. The Company capitalizes direct costs of the acquisition, such as investment banker and attorneys' fees and includes them as part of the purchase price. Other merger-related internal costs associated with acquisitions are expensed as incurred. Some examples of these merger-related costs include, but are not limited to, systems conversions, integration planning consultants and advertising fees. These merger-related costs are reflected in "Other operating expenses" within the Condensed Consolidated Statements of Income classified within the noninterest expense line. The acquired entity records merger-related costs that result from a plan to exit an activity, involuntarily terminate or relocate employees, and are recognized as liabilities assumed as of the consummation date of the acquisition.

BUSINESS OVERVIEW

Union Bankshares Corporation is one of the largest community banking organizations based in Virginia, providing full service banking to the Northern, Central, Rappahannock, Tidewater and Northern Neck regions of Virginia in 58 locations through its bank subsidiaries, Union Bank and Trust Company (38 locations in the counties of Albemarle, Caroline, Chesterfield, Fairfax, Fluvanna, Hanover, Henrico, King George, King William, Nelson, Spotsylvania, Stafford, Westmoreland and the cities of Fredericksburg and Charlottesville); Northern Neck State Bank (9 locations in the counties of Richmond, Westmoreland, Essex, Northumberland and Lancaster); Rappahannock National Bank (7 locations in Washington, Front Royal, Middleburg, Warrenton, and Winchester) and Bay Community Bank (4 locations in Williamsburg, Newport News and Grafton). Union Bank and Trust Company also operates a loan production office in Manassas. Union Investment Services, Inc. provides full brokerage services; Union Mortgage Group, Inc. provides a full line of mortgage products; and Union Insurance Group, LLC offers various lines of insurance products. Bay Community Bank also owns a non-controlling interest in Johnson Mortgage Company, LLC.

On March 14, 2008, the Company completed the previously announced merger of its Prosperity Bank & Trust Company affiliate into Union Bank and Trust Company ("Union Bank").

On May 28, 2008, the Company announced that its affiliate Bay Community Bank would merge into its largest bank affiliate, Union Bank. The merger is expected to be completed on October 31, 2008.

Table of Contents

In May 2007, the Company completed construction of a new 70,000 square foot operations center in Caroline County, Virginia at a cost of approximately \$13 million. The facility is located just west of Interstate 95 near the intersection U.S. Route 1 and State Route 207 and is approximately twelve miles west of the Company's corporate offices in Bowling Green, Virginia. The new facility will accommodate the Company's anticipated growth and provides improved access to the Greater Richmond and Fredericksburg workforce. The Company sold its former operations center during the third quarter of 2007.

Additional information is available on the Company's website at www.ubsh.com. The shares of the Company are traded on the NASDAQ Global Select Market under the symbol "UBSH."

RESULTS OF OPERATIONS

Net Income

Net income for the quarter ended September 30, 2008 was \$4.3 million, down \$78 thousand, or 1.8%, as compared to the most recent quarter ending June 30, 2008. Earnings per share, on a diluted basis, declined \$.01 from \$.32 to \$.31, representing a decline of 3.1%. Return on average assets and return on average equity were .71% and 7.87%, respectively. These results were largely attributable to increased provisions for loan losses partially offset by lower funding costs, gains from the sale of other real estate owned and other increases in noninterest income.

For the three months ended September 30, 2008, net income was \$4.3 million, down 20.6% from \$5.4 million for the same quarter in 2007. Earnings per share, on a diluted basis, decreased \$.09, or 22.5%, to \$.31 from \$.40 for the same quarter a year ago. Return on average equity for the quarter ended September 30, 2008 was 7.87%, while return on average assets for the same period was 0.71%, compared to 10.32% and .97%, respectively, for the prior year's same quarter.

This year to year decline was largely the result of increased provisions for loan losses, the costs associated with the purchase of six bank branches, effective September 7, 2007, the opening of one de novo branch and nonrecurring expenses related to merging affiliate banks. These increased expenses were partially offset by gains from the sale of other real estate owned, increased profitability in the mortgage segment and growth in service charge income on deposit accounts. The six purchased branches and the de novo branch are referred to collectively herein as the "new branches."

For the nine months ended September 30, 2008, net income was \$12.2 million down \$3.9 million, or 24.2%, from \$16.1 million compared to the same period a year ago. This decline represents a decrease in earnings per share, on a diluted basis, of \$.29, or 24.2%, from \$1.20 to \$.91. Return on average equity for the nine months ended September 30, 2008 was 7.61%, while return on average assets was .70%, compared to 10.59% and 1.01%, respectively, for the same period in 2007. The decrease was partially related to increased provisions for loan losses, noninterest expenses associated with the purchase of new branches, partially offset by gains from the sale of other real estate owned, increased profitability in the mortgage segment and growth in service charge income on deposit accounts.

As a supplement to U.S. generally accepted accounting principles ("GAAP"), the Company also uses certain alternate financial measures to review its operating performance. Diluted earnings per share on a cash basis for the quarter ended September 30, 2008 were \$.34 as compared to \$.42 for the same quarter a year ago and \$.35 for the quarter ended June 30, 2008. Additionally, cash basis return on average tangible equity for the quarter ended September 30, 2008 was 12.26% as compared to 15.90% in the prior year's third quarter and 12.64% for the quarter ended June 30, 2008.

Table of Contents

Net Interest Income

The Federal Open Market Committee (“FOMC”) of the Federal Reserve Board of Governors, maintained the targeted Federal funds rate at 2.00% from April 30, 2008 through September 30, 2008. The economic events and financial turmoil of the last several months have placed stress on deposit pricing and competition for those deposits, both having an impact on the Company’s net interest margin.

On a linked quarter basis, net interest income, on a tax-equivalent basis, increased \$497 thousand, or 2.4%, to \$21.1 million. The tax-equivalent net interest margin declined 3 basis points to 3.89% from 3.92% over the most recent quarter. Contributing to this decline was a slight decrease in earning asset yields as compared to costs associated with the funding of those assets. Additionally, increased volumes in money market savings accounts amid a decline in checking accounts and demand deposits put pressure on the net interest margin. Total average interest-bearing liabilities increased \$50.2 million and the related cost declined 5 basis points to 2.91%. Total average interest-earning asset yields declined 6 basis points to 6.42% on increased total average earning-asset volumes of \$44.9 million.

For the three months ended September 30, 2008, net interest income, on a tax-equivalent basis, increased \$1.0 million, or 5.1%, to \$21.1 million compared to the same period last year. This increase in net interest income was achieved despite a decline in the net interest margin of 18 basis points, from 4.07% to 3.89%. This net interest margin decline was partially attributable to lower loan yields on increased loan volumes despite a reduction in the cost of funds during this period. Yields on average earning-assets declined 107 basis points and the cost of interest-bearing liabilities declined 108 basis points. The increase in net interest income was primarily driven by increased loan volume and lower cost of borrowings and certificates of deposit greater than \$100 thousand. Of the increase in funding sources, average money market volumes increased \$114.8 million, certificates of deposit less than \$100 thousand increased \$50.3 million (principally brokered certificates of deposit) and other borrowings increased \$50.6 million partially offset by lower demand deposit volumes of \$10.5 million.

For the nine months ended September 30, 2008, net interest income, on a tax-equivalent basis, increased by \$2.8 million, or 4.7%, to \$61.7 million compared to the same period last year. This increase in net interest income was achieved despite a decline in the net interest margin of 23 basis points, from 4.12% to 3.89%. This net interest margin decline was partially attributable to the decline in yields on earning-assets as compared to costs of interest-bearing liabilities. Yields on earning-assets declined 89 basis points and the cost of interest-bearing liabilities declined 83 basis points. Additional pressure on the net interest margin related to lower yields on earning assets had a greater impact than the increase in loan volumes despite lower costs to fund those loans during this period. The increase in net interest income was principally due to favorable loan volumes, lower costs of certificates of deposit greater than \$100 thousand and lower costs associated with borrowings.

A variety of investment and funding activity occurred during 2007 and is stated herein for comparative purposes. For the nine months ended September 30, 2007, approximately \$8.0 million (\$6.2 million during the first quarter and \$1.8 million during the second quarter) of investment securities were called by the issuers resulting in gains of \$508 thousand (\$301 thousand during the first quarter and \$207 thousand during the second quarter). The proceeds from these calls combined with additional funds were used to pay off approximately \$15.0 million of higher cost (6.3%) Federal Home Loan Bank (“FHLB”) advances. Penalties of approximately \$513 thousand (\$316 thousand during the first quarter and \$197 thousand during the second quarter) associated with the early payoff of these advances have been reflected as an interest expense adjustment in the net interest income for the nine months ended September 30, 2007. Absent this interest expense adjustment, the net interest margin would have been 4.16%, instead of 4.12%, for the nine months ending September 30, 2007.

[Table of Contents](#)

AVERAGE BALANCES, INCOME AND EXPENSES, YIELDS AND RATES (TAXABLE EQUIVALENT BASIS)

	For the Three Months Ended September 30,								
	2008			2007			2006		
	Average Balance	Interest Income / Expense	Yield / Rate (1)	Average Balance	Interest Income / Expense	Yield / Rate (1)	Average Balance	Interest Income / Expense	Yield / Rate (1)
<i>(Dollars in thousands)</i>									
Assets:									
Securities:									
Taxable	\$ 176,959	\$ 2,220	4.99%	\$ 171,600	\$ 2,230	5.16%	\$ 196,351	\$ 2,619	5.29%
Tax-exempt	<u>112,825</u>	<u>2,053</u>	7.24%	<u>104,937</u>	<u>1,869</u>	7.07%	<u>94,966</u>	<u>1,725</u>	7.21%
Total securities	289,784	4,273	5.87%	276,537	4,099	5.88%	291,317	4,344	5.92%
Loans, net (2) (3)	1,840,979	30,231	6.53%	1,657,002	32,292	7.73%	1,519,694	29,171	7.62%
Loans held for sale	24,682	379	6.10%	21,350	352	6.53%	25,531	430	6.68%
Federal funds sold	1,661	5	1.20%	1,674	221	5.59%	8,288	520	5.61%
Money market investments	124	—	0.01%	216	1	2.17%	203	2	3.67%
Interest-bearing deposits in other banks	1,738	8	1.88%	1,459	21	5.61%	1,722	25	5.81%
Other interest-bearing deposits	2,598	7	1.01%	2,598	34	5.26%	2,598	34	5.24%
Total earning assets	2,161,566	34,903	6.42%	1,960,836	37,020	7.49%	1,849,353	34,526	7.41%
Allowance for loan losses	(22,125)			(18,361)			(18,815)		
Total non-earning assets	251,569			247,691			223,063		
Total assets	<u>\$2,391,010</u>			<u>\$2,190,166</u>			<u>\$2,053,601</u>		
Liabilities and Stockholders' Equity:									
Interest-bearing deposits:									
Checking	\$ 215,675	341	0.63%	\$ 201,803	330	0.65%	\$ 200,591	211	0.42%
Money market savings	272,513	1,701	2.48%	157,729	935	2.35%	166,633	942	2.24%
Regular savings	102,181	143	0.56%	104,899	201	0.76%	117,297	271	0.92%
Certificates of deposit:									
\$100,000 and over	419,448	3,895	3.69%	443,292	5,537	4.96%	402,793	4,770	4.70%
Under \$100,000	495,901	4,605	3.69%	445,570	5,076	4.52%	412,867	4,308	4.14%
Total interest-bearing deposits	1,505,718	10,685	2.82%	1,353,293	12,079	3.54%	1,300,181	10,502	3.20%
Other borrowings	378,126	3,074	3.23%	327,515	4,825	5.84%	251,470	3,902	6.16%
Total interest-bearing liabilities	1,883,844	13,759	2.91%	1,680,808	16,904	3.99%	1,551,651	14,404	3.68%
Noninterest-bearing liabilities:									
Demand deposits	273,696			284,160			296,715		
Other liabilities	18,430			19,350			13,907		
Total liabilities	2,175,970			1,984,318			1,862,273		
Stockholders' equity	215,040			205,848			191,328		
Total liabilities and stockholders' equity	<u>\$2,391,010</u>			<u>\$2,190,166</u>			<u>\$2,053,601</u>		
Net interest income		<u>\$21,144</u>			<u>\$20,116</u>			<u>\$20,122</u>	
Interest rate spread (4)			3.51%			3.50%			3.73%
Interest expense as a percent of average earning assets			2.53%			3.42%			3.09%
Net interest margin			3.89%			4.07%			4.32%

- (1) Rates and yields are annualized and calculated from actual, not rounded amounts in thousands, which appear above.
- (2) Nonaccrual loans are included in average loans outstanding.
- (3) Foregone interest on previously charged off credits of \$350 thousand has been excluded for 2006.
- (4) Income and yields are reported on a taxable equivalent basis using the statutory federal corporate tax rate of 35%.

[Table of Contents](#)

AVERAGE BALANCES, INCOME AND EXPENSES, YIELDS AND RATES (TAXABLE EQUIVALENT BASIS)

	For the Nine Months Ended September 30,								
	2008			2007			2006		
	Average Balance	Interest Income / Expense	Yield / Rate (1)	Average Balance	Interest Income / Expense	Yield / Rate (1)	Average Balance	Interest Income / Expense	Yield / Rate (1)
<i>(Dollars in thousands)</i>									
Assets:									
Securities:									
Taxable	\$ 177,184	\$ 6,797	5.12%	\$ 174,069	\$ 6,735	5.17%	\$ 186,806	\$ 7,337	5.25%
Tax-exempt	<u>109,750</u>	<u>5,943</u>	7.23%	<u>99,363</u>	<u>5,370</u>	7.23%	<u>87,196</u>	<u>4,789</u>	7.34%
Total securities	286,934	12,740	5.93%	273,432	12,105	5.92%	274,002	12,126	5.92%
Loans, net (2) (3)	1,801,561	90,751	6.73%	1,612,018	93,351	7.74%	1,467,932	81,935	7.46%
Loans held for sale	26,398	1,104	5.59%	21,774	1,012	6.21%	26,272	1,287	6.55%
Federal funds sold	1,615	34	2.81%	2,017	606	5.53%	8,167	838	5.19%
Money market investments	170	1	0.47%	209	3	2.04%	136	3	3.07%
Interest-bearing deposits in other banks	1,259	22	2.31%	1,166	47	5.41%	1,146	44	5.09%
Other interest-bearing deposits	2,598	47	2.41%	2,598	103	5.33%	2,598	93	4.85%
Total earning assets	<u>2,120,535</u>	<u>104,699</u>	6.60%	<u>1,913,214</u>	<u>107,227</u>	7.49%	<u>1,780,253</u>	<u>96,326</u>	7.23%
Allowance for loan losses	(20,833)			(18,589)			(18,232)		
Total non-earning assets	<u>249,887</u>			<u>241,212</u>			<u>205,659</u>		
Total assets	<u>\$2,349,589</u>			<u>\$2,135,837</u>			<u>\$1,967,680</u>		
Liabilities and Stockholders' Equity:									
Interest-bearing deposits:									
Checking	\$ 220,627	1,077	0.65%	\$ 205,340	982	0.64%	\$ 202,286	593	0.39%
Money market savings	216,255	3,776	2.33%	157,913	2,737	2.32%	175,772	2,948	2.24%
Regular savings	102,295	451	0.59%	104,981	626	0.80%	119,266	821	0.92%
Certificates of deposit:									
\$100,000 and over	436,229	13,315	4.08%	445,762	16,477	4.94%	371,957	12,304	4.42%
Under \$100,000	<u>486,581</u>	<u>14,477</u>	3.97%	<u>450,008</u>	<u>15,154</u>	4.50%	<u>395,218</u>	<u>11,369</u>	3.85%
Total interest-bearing deposits	1,461,987	33,096	3.02%	1,364,004	35,976	3.53%	1,264,499	28,035	2.96%
Other borrowings	380,220	9,888	3.47%	268,436	12,300	6.13%	220,022	8,988	5.46%
Total interest-bearing liabilities	<u>1,842,207</u>	<u>42,984</u>	3.12%	<u>1,632,440</u>	<u>48,276</u>	3.95%	<u>1,484,521</u>	<u>37,023</u>	3.33%
Noninterest-bearing liabilities:									
Demand deposits	272,616			281,686			281,310		
Other liabilities	<u>19,862</u>			<u>17,915</u>			<u>13,332</u>		
Total liabilities	2,134,685			1,932,041			1,779,163		
Stockholders' equity	214,904			203,796			188,517		
Total liabilities and stockholders' equity	<u>\$2,349,589</u>			<u>\$2,135,837</u>			<u>\$1,967,680</u>		
Net interest income		<u>\$ 61,715</u>			<u>\$ 58,951</u>			<u>\$59,303</u>	
Interest rate spread (4)			3.48%			3.54%			3.90%
Interest expense as a percent of average earning assets			2.71%			3.37%			2.78%
Net interest margin			3.89%			4.12%			4.45%

- (1) Rates and yields are annualized and calculated from actual, not rounded amounts in thousands, which appear above.
- (2) Nonaccrual loans are included in average loans outstanding.
- (3) Foregone interest on previously charged off credits of \$464 thousand has been excluded for 2006.
- (4) Income and yields are reported on a taxable equivalent basis using the statutory federal corporate tax rate of 35%.

Table of Contents

Provision for Loan Losses

For the quarter ended September 30, 2008, the provision for loan losses increased \$3.2 million from September 30, 2007. On a linked quarter basis, the provision for loan losses increased \$2.0 million. The provision for loan losses increased \$7.1 million for the nine months ending September 30, 2008 compared to the same period a year ago. During the first quarter of 2007, the Company recaptured \$750 thousand in provision for loan losses due to the reduction in the estimated loss exposure on a non-performing loan to a single credit relationship. Absent this recapture, the increase in the provision for loan losses was \$6.3 million. The increases in the provision for loan losses and the current levels in the allowance for loan losses reflect continued loan growth, charge-off and delinquency trends and uncertainty with regard to general economic and other credit risk factors that the Company considers in assessing the adequacy of the allowance for loan losses.

Noninterest Income

For the three months ended September 30, 2008, noninterest income increased \$2.8 million, or 45.1%, from \$6.3 million to \$9.1 million compared to last year's same quarter. This increase includes increased gains on the sales of two parcels of other real estate owned totaling approximately \$1.4 million. Additionally, this increase also reflects an increase in mortgage segment revenue of approximately \$766 thousand and an increase of \$458 thousand in revenue from service charges on deposit accounts, primarily overdraft and returned check fees, from the same quarter a year ago. For comparative purposes during the three months ended September 30, 2007, the Company recorded a gain of \$324 thousand from the sale of its former operations center.

On a linked quarter basis, noninterest income increased \$1.5 million, or 19.0%, to \$9.1 million from \$7.7 million for the quarter ended June 30, 2008. This increase includes increased gains on the aforementioned gains on the sales of two parcels of other real estate owned totaling approximately \$1.7 million. Additionally, the Company had lower mortgage segment revenue as gains on sales of loans decreased by approximately \$389 thousand from the prior quarter. Absent this third quarter real estate gain and gains on mortgage loan sales, noninterest income increased approximately \$76 thousand, or 1.7%, from the quarter ended June 30, 2008.

For the nine months ended September 30, 2008, noninterest income increased \$5.4 million, or 28.9%, to \$24.1 million from \$18.7 million for the same period in 2007. This increase included gains from the sale of mortgage loans of approximately \$2.5 million, increased revenue of \$1.3 million from service charges on deposit accounts and gains from sales of other real estate owned totaling approximately \$1.6 million over the same period a year ago.

During the first nine months of 2008, the Commonwealth of Virginia, exercising its eminent domain rights, acquired other real estate owned (adjacent to a bank branch) for a public easement, which resulted in a gain of \$127 thousand. The initial public offering of Visa, Inc. common stock during March 2008 resulted in the mandatory redemption of certain classes of common stock to financial institution members of Visa U.S.A. The Company recorded a gain of \$198 thousand relating to this redemption of its member banks' Visa, Inc. common stock. Additionally during the third quarter of 2008, the Company sold two parcels of other real estate owned resulting in gains of approximately \$1.8 million. For comparative purposes during the same period in 2007, the Company recorded a gain of \$508 thousand on sales of trust preferred securities called by the issuer and a gain of \$324 thousand from the sale of its former operations center. Absent these real estate and securities gain transactions and mortgage segment revenue during the nine month period ended September 30, 2008 and 2007, noninterest income increased \$1.7 million, or 14.5%, compared to the same period in 2007.

For comparative purposes, noninterest income for the nine months ended September 30, 2008 and 2007 included income associated with the purchase of six bank branches since their September 2007 purchase date. It also includes the opening of one de novo bank branch in December 2007. The purchased six bank branches contributed approximately \$16 thousand of noninterest income during

Table of Contents

the year and for the quarter ending September 30, 2007. During the first nine months of 2008, these new branches contributed \$309 thousand toward the increase in noninterest income. Absent the noninterest income associated with the new branches, real estate and securities gain transactions and mortgage operations during the nine month period ended September 30, 2008 and 2007, noninterest income increased approximately \$1.4 million, or 11.9% compared to the same nine month period ended September 30, 2007.

Noninterest Expense

For the three months ended September 30, 2008, noninterest expense increased \$2.1 million, or 11.9%, to \$20.1 million over the same quarter a year ago, primarily related to increases in salaries and benefits, the new branches and mortgage segment operations. Salaries and benefits increased \$1.8 million for the three months ended September 30, 2008 as compared to the same quarter a year ago. Of the \$1.8 million increase, \$1.1 million related to normal compensation increases and profit sharing expenses, \$397 thousand was incurred at the mortgage segment related to commissions on increased loan production, and \$296 thousand related to employees at the new branches. Occupancy expenses increased \$195 thousand, of which \$109 thousand related to the new branches. Other operating expenses and furniture and equipment expenses increased \$91 thousand and \$29 thousand, respectively. Excluding the new branches and mortgage segment operations, the increase in noninterest expense was approximately \$1.2 million, or 8.0%, from the same quarter a year ago.

On a linked quarter basis, noninterest expense increased by \$75 thousand, or 0.4%, to \$20.1 million for the three months ended September 30, 2008. Salaries and benefits expenses declined \$233 thousand, or 2.1%, primarily attributable to lower mortgage segment commissions, but were offset by increased other operating expenses of \$262 thousand, including \$143 thousand related to exhausting Federal Deposit Insurance Corporation ("FDIC") insurance assessment credits during the quarter. Occupancy expenses and furniture and equipment expenses increased \$36 thousand and \$10 thousand, respectively. Without the expenses associated with the new branches and mortgage segment operations, noninterest expenses increased \$503 thousand, or 3.1%, over the prior quarter.

For the nine months ended September 30, 2008, noninterest expense increased by \$6.5 million, or 12.1 %, to \$60.1 million compared to the nine months ended September 30, 2007. Increases in salaries and benefits of \$4.6 million, or 16.0%, were primarily attributable to increased mortgage segment commissions of \$1.5 million as well as additional personnel in the new branches and normal compensation increases. Occupancy expenses increased \$809 thousand, or 18.5%, and were principally attributable to increased facilities costs associated with the Company's new operations center and the new branches. Some of these increased costs included depreciation, rental expenses and, to a lesser extent, utility costs. Operating expenses increased \$837 thousand, or 4.9%, and principally related to ongoing infrastructure enhancements to support the Company's continued growth as well as higher FDIC insurance costs due to exhausting assessment credits. Infrastructure enhancements included such things as Voice-over Internet Protocol and the associated hardware and software to support this technology. Approximately \$269 thousand of operating expenses related to conversion costs incurred to merge an affiliate bank. Furniture and equipment expenses increased \$229 thousand, or 6.5%, and were attributable to the related depreciation of the new branches and the new operations center.

For comparative purposes, noninterest expense for the nine months ended September 30, 2008 and 2007 includes expense associated with the purchase of six bank branches acquired in September 2007 and the opening of one de novo bank branch in December 2007. These new branches contributed approximately \$192 thousand of noninterest expense during the month of September in 2007. During the first nine months of 2008, these new branches contributed \$928 thousand toward the increase in salaries and benefits, \$392 thousand in occupancy expenses, \$256 thousand in other operating expenses and \$171 thousand in furniture and equipments expenses. Absent the noninterest expense associated with the new branches, merger-related costs, and mortgage segment expenses, noninterest expense increased approximately \$2.6 million, or 5.7%, over the same nine month period ended September 30, 2007.

Table of Contents

Income Taxes

The provision for income taxes is based upon the results of operations, adjusted for the effect of certain tax-exempt income and non-deductible expenses. In addition, certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

The Company must also evaluate the likelihood that deferred tax assets will be recovered from future taxable income. If any such assets are not likely to be recovered, a valuation allowance must be recognized. The Company has determined that a valuation allowance is not required for deferred tax assets as of September 30, 2008. The assessment of the carrying value of deferred tax assets is based on certain assumptions, changes in which could have a material impact on the Company's financial statements.

The effective tax rates for the three and nine months ended September 30, 2008 was 23.9% and 24.9%, compared to 25.8% and 26.4%, respectively, for the same period in 2007.

SEGMENT INFORMATION

Community Banking Segment

For the three months ended September 30, 2008, net income for the community banking segment decreased \$1.3 million, or 24.4%, from \$5.5 million, for the same quarter last year. This decline was largely attributable to increased provisions for loan losses, costs related to new branches, and costs associated with merging affiliate banks, partially offset by increased gains on the sales of two parcels of other real estate owned totaling approximately \$1.4 million. Noninterest income increased \$2.1 million, or 48.2%, in the third quarter of 2008 from the same period a year earlier primarily due to gains on the sales of other real estate owned and increased revenue of \$737 thousand principally from service charges on deposit accounts and other fees. Noninterest expense increased \$1.7 million, or 10.7%, and primarily related to higher salaries and benefits expenses and occupancy costs related to new branches as well as normal compensation increases as compared to the same period a year ago.

On a linked quarter basis, community bank segment net income decreased \$64 thousand, or 1.5%, for the period ended September 30, 2008. The decrease was largely attributable to additional provision for loan losses partially offset by gains on sales of two parcels of other real estate owned. Noninterest income increased \$1.9 million, or 41.1%, largely due to the gains on sales of real estate mentioned previously. Absent these prior period gains, noninterest income increased \$76 thousand, or 1.7%, from the most recent quarter. Noninterest expense increase \$502 thousand, or 3.0%, primarily due to \$221 thousand in salaries and wages and \$220 thousand in other operating expenses.

For the nine months ended September 30, 2008, net income for the community banking segment decreased \$4.5 million, or 27.1%, from \$16.6 million the same period a year ago. This decline was largely attributable to increased provisions for loan losses, costs related to the purchase of six bank branches, the opening of one de novo bank branch as well as costs associated with merging affiliate banks. Noninterest income increased \$3.0 million, or 23.8%, from the same period a year earlier primarily due to gains on sales of two parcels of other real estate owned and increased revenue from service charges on deposit accounts and other fees. During the first nine months of 2008, the Company recorded a gain on sales of other real estate owned of \$1.8 million, gain related to the sale of property to the Commonwealth of Virginia, exercising its public domain easement rights, of \$127 thousand and a gain related to the redemption of Visa Inc. common stock of \$198 thousand. During the first nine months of 2007, the Company recorded a gain on

[Table of Contents](#)

called investment securities totaling \$508 thousand and a gain on the sale of its former operations center of \$324 thousand. Absent these gain transactions, noninterest income increased \$1.7 million, or 14.5%, from the same period a year ago. Noninterest expense increased \$4.7 million, or 10.2%, from the same period a year ago. During the first nine months of 2008, the Company incurred costs related to the new branches as well as costs associated with merging affiliate banks. Absent the new branches and merger costs, noninterest expense increased \$2.6 million, or 5.7%, from the same period in 2007.

Mortgage Segment

For the three months ended September 30, 2008, the mortgage segment reported net income of \$75 thousand, a \$246 thousand increase from \$171 thousand net loss for the same quarter in 2007. Originations increased 18.3% from the same period last year, resulting in an increase in loan revenue of \$768 thousand driven by loan origination growth within core market areas. Total noninterest expenses increased \$469 thousand. Of this increase, \$397 thousand related to salaries and benefits, a function of increased commission expense resulting from higher loan originations. Other operating expenses increased \$44 thousand principally as a result of other costs related to increased loan growth and the addition of new branch offices.

On a linked quarter basis, mortgage segment net income declined by \$13 thousand from net income of \$88 thousand in the second quarter of 2008 to net income of \$75 thousand. Revenue from the sale of loans declined \$396 thousand, or 12.4%, while originations fell 18.1%. Salaries and benefits declined \$455 thousand reflecting the decrease in originations. Operating expenses and furniture and equipment expenses each increased \$41 thousand and \$8 thousand, respectively, from the prior quarter. Occupancy expenses declined \$23 thousand, principally due to lower maintenance costs and rental expense.

For the nine months ended September 30, 2008, mortgage segment net income increased by \$605 thousand from a net loss of \$473 thousand to net income of \$132 thousand. Revenue from the sale of loans increased \$2.5 million, or 38.1%, as a result of revised fee schedules, consumer demand for loans, and 21.1% higher originations at increased margins. Salaries and benefits increased \$1.5 million, principally due to commissions and other expenses related to increased loan originations. Operating and occupancy costs increased \$119 thousand and \$93 thousand, respectively, while furniture and equipment costs increased \$36 thousand. These costs were largely driven by origination growth and additions to the branch office network.

BALANCE SHEET

Balance Sheet Overview

At September 30, 2008, total assets were approximately \$2.4 billion compared to \$2.2 billion and \$2.3 billion at September 30, 2007 and December 31, 2007, respectively. Net loans increased \$176.1 million, or 10.6%, from September 30, 2007, and increased \$112.8 million, or 6.5% from December 31, 2007. The year over year increase in loan growth was spread among consumer and commercial loan portfolios. Total cash and cash equivalents increased \$34.1 million to \$84.5 million at September 30, 2008 from \$50.5 million a year ago, and increased \$26.2 million from \$58.3 million at December 31, 2007. This increase was in Federal funds sold and represented excess liquidity from an FHLB advance. Deposits increased \$151.8 million, or 9.1%, and \$154.6 million, or 9.3%, from September 30, 2007 and December 31, 2007, respectively, primarily due to increases in money market accounts and the issuance of approximately \$81.7 million in brokered certificates of deposit. Total borrowings (including repurchase agreements) increased \$71.8 million from September 30, 2007, but decreased by \$10.9 million from December 31, 2007 to \$401.8 million at September 30, 2008. The Company's equity to assets ratio was 8.74% at September 30, 2008.

Table of Contents

While not immune from the effects of weakening economic conditions, the Company remains focused on maintaining adequate levels of liquidity and capital during this challenging environment, and believes its sound risk management practices in underwriting and lending will enable it to successfully weather this period of economic uncertainty.

Liquidity

Liquidity represents an institution's ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Management monitors liquidity levels on a daily basis. Liquid assets include cash, interest-bearing deposits with banks, money market investments, Federal funds sold, securities available for sale, loans held for sale and loans maturing or re-pricing within one year. Additional sources of liquidity available to the Company include its capacity to borrow additional funds when necessary through Federal funds lines with several correspondent banks, a line of credit with the Federal Home Loan Bank of Atlanta ("FHLB") and a corporate line of credit with a large correspondent bank. Management considers the Company's overall liquidity to be sufficient to satisfy its depositors' requirements and to meet its customers' credit needs.

As of September 30, 2008, cash, interest-bearing deposits in other banks, money market investments, Federal funds sold, securities available for sale, loans available for sale and loans that mature or reprice in one year totaled \$1.7 billion, or 74.9% of total earning assets. As of September 30, 2008, approximately \$1.3 billion, or 67.52%, of total loans, are scheduled to mature or reprice within the next year. In addition to deposits, the Company utilizes Federal funds purchased, FHLB advances, securities sold under agreements to repurchase and customer repurchase agreements, to fund the growth in its loan portfolio, securities purchases, and periodically, wholesale leverage transactions.

During the first quarter of 2008, the Company issued \$40 million of brokered certificates of deposit with an average cost of 3.90%. During the third quarter of 2008, the Company issued an additional \$41.7 million in brokered certificates of deposit with an average cost of 3.04%. These brokered certificates were issued at rates below the then-current prevailing local market rates. Both deposit issues remained outstanding as of September 30, 2008.

Loan Portfolio

The following table presents the Company's composition of loans, net of unearned income in dollar amounts and as a percentage of total gross loans (dollars in thousands) as of:

	September 30, 2008	% of Total Loans	December 31, 2007	% of Total Loans	September 30, 2007	% of Total Loans
Mortgage loans on real estate:						
Residential 1-4 family	\$ 289,022	15.5%	\$ 281,847	16.1%	\$ 270,366	16.1%
Commercial	539,590	28.8%	500,118	28.6%	495,789	29.4%
Construction	416,668	22.3%	396,928	22.7%	380,259	22.6%
Second mortgages	36,484	2.0%	37,875	2.2%	38,177	2.3%
Equity lines of credit	159,586	8.6%	128,897	7.4%	125,431	7.4%
Multifamily	42,051	2.3%	32,970	1.9%	31,129	1.8%
Agriculture	27,705	1.5%	18,958	1.1%	16,161	1.0%
Total real estate loans	1,511,106	81.0%	1,397,593	80.0%	1,357,312	80.6%
Commercial Loans	139,873	7.5%	136,317	7.8%	124,731	7.4%
Consumer installment loans						
Personal	160,933	8.6%	173,650	9.9%	166,194	9.9%
Credit cards	14,853	0.8%	13,108	0.7%	14,186	0.8%
Total consumer installment loans	175,786	9.4%	186,758	10.6%	180,380	10.7%
All other loans	38,902	2.1%	27,152	1.6%	21,319	1.3%
Gross loans	\$ 1,865,667	100.0%	\$ 1,747,820	100.0%	\$ 1,683,742	100.0%

Table of Contents

As reflected in the loan table, at September 30, 2008, the largest component of the Company's loan portfolio consisted of real estate loans, concentrated in residential 1-4 family, commercial and construction. The risks attributable to these concentrations are mitigated by the Company's credit underwriting and monitoring process, including oversight by a centralized credit administration function and credit risk and policy management committee, as well as seasoned bankers focusing their lending to borrowers with proven track records in markets with which the Company is familiar.

Approximately 29% of the Company's loan portfolio is comprised of amortizing commercial real estate loans of which approximately 50% is owner-occupied real estate. In addition, 22% of the loan portfolio is concentrated in real estate construction loans including raw land, land development, builder lots (spec and pre-sold) and residential and commercial construction loans. These loans are originated and underwritten by the Company's lending staff and are generally secured by real estate located within the Company's various trade areas, principally Fredericksburg, Richmond and Charlottesville. There is not a significant concentration of real estate loans in the Company's Northern Virginia trade area. Softening in residential real estate has impacted the housing absorption rate and pricing. Any prolonging of this current real estate slump will have a greater negative impact on these portfolios.

Asset Quality

Industry concerns over asset quality, precipitated by issues related to subprime mortgage lending, declining real estate activity and general economic conditions, continued to increase during the third quarter. The impact of these concerns has begun to be reflected in the economic markets in which the Company operates, principally through slowing real estate activity. The Company has a significant concentration in real estate loans and has experienced reduced activity in that sector. The Company has experienced some deterioration in asset quality and anticipates there may be additional softening in the near-term. Despite this, the markets in which the Company operates remain relatively stable and overall asset quality remains very competitive relative to peer banks and to the industry as a whole. The Company's loan portfolio does not include exposure to subprime mortgage loans. Residential acquisition and development lending and builder/construction lending have been scaled back as housing activity across our markets has declined. Several new nonperforming loans have come out of those portfolios and are being worked vigorously. Management will continue to monitor delinquencies, risk rating changes, charge-offs, market trends and other indicators of risk in the Company's portfolio, particularly those tied to residential real estate, and adjust the allowance for loan losses accordingly.

Despite increasing industry concerns over credit issues and an increase in loan losses, the Company's asset quality remains strong. Net charge-offs were \$897 thousand, or 0.19% of loans, for the quarter ended September 30, 2008, compared to net charge-offs of \$229 thousand, or 0.05%, in the same quarter last year and \$478 thousand, or 0.11 %, for the quarter ended June 30, 2008. These charge-offs in the current quarter principally related to indirect auto lending of \$303 thousand and residential real estate of \$208 thousand. As of September 30, 2008, total past due loans were \$12.1 million, or 0.65%, of total gross loans, up from 0.46% at September 30, 2007. At September 30, 2008, nonperforming assets totaled \$17.1 million, including a single credit relationship totaling \$7.0 million. Excluding this single credit relationship, total nonperforming assets increased \$9.0 million since September 30, 2007 and \$7.3 million since December 31, 2007. Net nonperforming assets increased \$4.3 million during the third quarter of 2008. This third quarter increase was related to one acquisition and development relationship and one residential home building relationship. The second quarter increase was \$2.2 million and primarily related to one commercial relationship operating in a construction-related industry. The remaining increase of \$748 thousand occurred during the first quarter of 2008. The Company continues to closely monitor exposure in its loan portfolio, particularly in acquisition and development and residential construction relationships.

The Company entered into a workout agreement with the borrower in the aforementioned \$7.0 million single credit relationship during March 2004. Under the terms of the agreement, the Company extended further credit secured by additional property with

Table of Contents

significant equity. During the first quarter of 2007, such equity was extracted from this relationship, reducing nonperforming assets totals on this relationship from \$10.6 million as of December 31, 2006 to \$7.9 million, and resulting in the recapture of \$750 thousand in specific reserves. In the second quarter of 2007, approximately \$400 thousand of this relationship returned to accrual status, further reducing the nonperforming balance to \$7.5 million as of the end of June 30, 2007. This balance has been further reduced, due to payments from the borrower, to \$7.0 million at September 30, 2008. Despite the lengthy nature of this workout, the Company continues to work with the borrower toward a resolution of the affiliated loans and anticipates this workout will result in further reductions of the Company's overall exposure to the borrower. The loans to this relationship continue to be secured by real estate (two assisted living facilities).

The following table sets forth selected asset quality data and ratios (dollars in thousands) for the quarter ending:

	September 30, 2008	December 31, 2007	September 30, 2007
Nonaccrual loans	\$ 15,848	\$ 9,436	\$ 8,307
Foreclosed properties	817	217	217
Other real estate owned	476	476	—
Total nonperforming assets	\$ 17,141	\$ 10,129	\$ 8,524
Balances			
Allowance for loan losses	\$ 24,420	\$ 19,336	\$ 18,556
Average loans, net of unearned income	1,801,561	1,713,402	1,612,018
Loans, net of unearned income	1,865,667	1,747,820	1,683,742
Ratios			
Allowance for loan losses to loans	1.31%	1.11%	1.10%
Allowance for loan losses to NPLs	142.47%	190.90%	217.69%
Nonperforming assets to loans & other real estate	0.92%	0.58%	0.51%
Net charge-offs to average loans	0.20%	0.09%	0.06%

Capital Resources

Capital resources represent funds, earned or obtained, over which financial institutions can exercise greater or longer control in comparison with deposits and borrowed funds. The adequacy of the Company's capital is reviewed by management on an ongoing basis with reference to size, composition, and quality of the Company's resources and consistency with regulatory requirements and industry standards. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses, yet allow management to effectively leverage its capital to maximize return to shareholders.

The Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, have adopted capital guidelines to supplement the existing definitions of capital for regulatory purposes and to establish minimum capital standards. Specifically, the guidelines categorize assets and off-balance sheet items into four risk-weighted categories. The minimum ratio of qualifying total assets is 8.0%, of which 4.0% must be Tier 1 capital, consisting of common equity, retained earnings and a limited amount of perpetual preferred stock, less certain intangible items. The Company had a total risk-based capital ratio of 11.64% and a Tier 1 risk-based capital ratio of 10.42% as of September 30, 2008. In addition, each of the Company's subsidiary banks had risk-based capital ratios exceeding the minimum requirements of "well-capitalized" as established by the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. The Company's equity to asset ratio was 8.74% at September 30, 2008.

While the subsidiary banks' risk-based capital levels are considered "well-capitalized" by regulatory definition, a prolonged period of earnings at current levels and dividend payouts could negatively impact capital ratios. The Company has a capital planning and monitoring process in place as it strives to maintain its historical strong capital levels and remain "well-capitalized."

Table of Contents

In connection with its acquisitions of Prosperity and Guaranty, the Company issued trust preferred capital notes to fund the cash portion of those acquisitions, collectively totaling \$58.5 million. The total of the trust preferred capital notes currently qualify for Tier 1 capital of the Company for regulatory purposes.

During the first quarter of 2008, Emerging Issues Task Force 06-4 "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" became effective. This statement requires the Company to recognize a liability (offset as a reduction to capital) and related compensation costs for endorsement split-dollar life insurance arrangements that provide benefits to employees during postretirement periods. The Company recorded a reduction to retained earnings and corresponding increase to liabilities of \$1.6 million. This reduction to retained earnings has been reflected in the Company's Condensed Consolidated Statements of Changes in Stockholders' Equity.

The following summarizes the Company's regulatory capital and related ratios (dollars in thousands):

	September 30, 2008	December 31, 2007	September 30, 2007
Tier 1 capital	\$ 207,604	\$ 201,351	\$ 198,628
Tier 2 capital	24,420	19,336	18,556
Total risk-based capital	232,024	220,687	217,184
Risk-weighted assets	1,992,824	1,890,569	1,837,361
Capital ratios:			
Tier 1 risk-based capital ratio	10.42%	10.65%	10.81%
Total risk-based capital ratio	11.64%	11.67%	11.82%
Leverage ratio (Tier 1 capital to average adjusted assets)	8.94%	9.20%	9.36%
Stockholders' equity to assets	8.74%	9.22%	9.38%
Tangible equity to tangible assets	6.47%	6.70%	6.77%

NON-GAAP MEASURES

In reporting the results as of September 30, 2008, the Company has provided supplemental performance measures on an operating or tangible basis. Such measures exclude amortization expense related to intangible assets, such as core deposit intangibles. The Company believes these measures are useful to investors as they exclude non-operating adjustments resulting from acquisition activity and allow investors to see the combined economic results of the organization. For the three and nine months ended September 30, 2008, cash basis operating earnings per share were \$0.34 and \$0.98 per share as compared to \$0.42 and \$1.27 per share for the same period in 2007. Annualized cash basis returns on average tangible assets for the three and nine months ended September 30, 2008 were 0.78% and 0.77%, respectively, compared to 1.06% and 1.10%, respectively, for the same period in 2007. Annualized cash basis returns on average tangible equity for the three and nine months ended September 30, 2008 were 12.26% and 11.93%, respectively, compared to 15.90% and 16.24%, respectively, for the same period in 2007.

These measures are a supplement to GAAP used to prepare the Company's financial statements and should not be viewed as a substitute for GAAP measures. In addition, the Company's non-GAAP measures may not be comparable to non-GAAP measures of other companies.

Table of Contents

A reconciliation of these non-GAAP measures from their respective GAAP basis measures is presented in the following table (dollars in thousands, except share and per share amounts):

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Net income	\$ 4,255	\$ 5,357	\$ 12,240	\$ 16,146
Plus: core deposit intangible amortization, net of tax	314	306	946	901
Cash basis operating earnings	<u>4,569</u>	<u>5,663</u>	<u>13,186</u>	<u>17,047</u>
Average assets	2,391,010	2,190,166	2,349,589	2,135,837
Less: average goodwill	56,474	52,975	56,474	51,659
Less: average core deposit intangibles	10,331	11,566	10,810	11,772
Average tangible assets	<u>2,324,205</u>	<u>2,125,625</u>	<u>2,282,305</u>	<u>2,072,406</u>
Average equity	215,040	205,848	214,904	203,796
Less: average goodwill	56,474	52,975	56,474	51,659
Less: average core deposit intangibles	10,331	11,566	10,810	11,772
Average tangible equity	<u>148,235</u>	<u>141,307</u>	<u>147,620</u>	<u>140,365</u>
Weighted average shares outstanding, diluted	13,536,670	13,420,199	13,511,178	13,415,537
Cash basis earnings per share, diluted	\$ 0.34	\$ 0.42	\$ 0.98	\$ 1.27
Cash basis return on average tangible assets	0.78%	1.06%	0.77%	1.10%
Cash basis return on average tangible equity	12.26%	15.90%	11.93%	16.24%

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. The Company's market risk is composed primarily of interest rate risk. The Asset and Liability Management Committee ("ALCO") of the Company is responsible for reviewing the interest rate sensitivity position of the Company and establishing policies to monitor and limit exposure to this risk. The Company's Board of Directors reviews and approves the guidelines established by ALCO.

Interest rate risk is monitored through the use of three complementary modeling tools: static gap analysis, earnings simulation modeling and economic value simulation (net present value estimation). Each of these models measures changes in a variety of interest rate scenarios. While each of the interest rate risk models has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company, the distribution of risk along the yield curve, the level of risk through time, and the amount of exposure to changes in certain interest rate relationships. Static gap, which measures aggregate re-pricing values, is less utilized because it does not effectively measure the options risk impact on the Company and is not addressed here. Earnings simulation and economic value models, which more effectively measure the cash flow and optionality impacts, are utilized by management on a regular basis and are explained below.

EARNINGS SIMULATION ANALYSIS

Management uses simulation analysis to measure the sensitivity of net interest income to changes in interest rates. The model calculates an earnings estimate based on current and projected balances and rates. This method is subject to the accuracy of the assumptions that underlie the process, but it provides a better analysis of the sensitivity of earnings to changes in interest rates than other analyses, such as the static gap analysis discussed above.

Table of Contents

Assumptions used in the model are derived from historical trends and management's outlook and include loan and deposit growth rates and projected yields and rates. Such assumptions are monitored and periodically adjusted as appropriate. All maturities, calls and prepayments in the securities portfolio are assumed to be reinvested in like instruments. Mortgage loans and mortgage backed securities prepayment assumptions are based on industry estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Different interest rate scenarios and yield curves are used to measure the sensitivity of earnings to changing interest rates. Interest rates on different asset and liability accounts move differently when the prime rate changes and are reflected in the different rate scenarios.

The Company uses its simulation model to estimate earnings in rate environments where rates ramp up or down around a "most likely" rate scenario, based on implied forward rates. The analysis assesses the impact on net interest income over a 12-month time horizon by applying 12-month rate ramps (with interest rates rising gradually versus an immediate increase or "shock" in rates) of 100 basis points up to 200 basis points. The following table represents the interest rate sensitivity on net interest income for the Company across the rate paths modeled for the balances ending September 30, 2008:

	Change In Net Interest Income	
	%	\$
Change in Yield Curve:		
+200 basis points	5.92%	5,070
+100 basis points	2.92%	2,500
Most likely rate scenario	—	—
-100 basis points	-3.24%	(2,774)
-200 basis points	-6.07%	(5,193)

ECONOMIC VALUE SIMULATION

Economic value simulation is used to calculate the estimated fair value of assets and liabilities over different interest rate environments. Economic values are calculated based on discounted cash flow analysis. The net economic value of equity is the economic value of all assets minus the economic value of all liabilities. The change in net economic value over different rate environments is an indication of the longer term earnings capability of the balance sheet. The same assumptions are used in the economic value simulation as in the earnings simulation. The economic value simulation uses instantaneous rate shocks to the balance sheet where the earnings simulation uses rate ramps over 12-months. The following chart reflects the estimated change in net economic value over different rate environments using economic value simulation for the balances ending September 30, 2008:

	Change In Economic Value Of Equity	
	%	\$
Change in Yield Curve:		
+200 basis points	1.37%	5,459
+100 basis points	1.04%	4,128
Most likely rate scenario	—	—
-100 basis points	-2.06%	(8,194)
-200 basis points	-11.94%	(47,589)

[Table of Contents](#)

ITEM 4 – CONTROLS AND PROCEDURES

The Company maintains “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating its disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this quarterly report on Form 10-Q, the Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective at the reasonable assurance level. There was no change in the internal control over financial reporting that occurred during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, the internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

In the ordinary course of its operations, the Company is a party to various legal proceedings. Based on the information presently available, and after consultation with legal counsel, management believes that the ultimate outcome in such proceedings, in the aggregate, will not have a material adverse effect on the business or the financial condition or results of operations of the Company.

ITEM 1A – RISK FACTORS

As of September 30, 2008, there were no material changes to the risk factors previously disclosed on the Company’s Annual Report on Form 10-K for the year ended December 31, 2007.

[Table of Contents](#)

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Sales of Unregistered Securities – None
- (b) Use of Proceeds – Not Applicable
- (c) Issuer Purchases of Securities – None

ITEM 6 – EXHIBITS

The following exhibits are filed as part of this Form 10-Q and this list includes the Exhibit Index:

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements 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.

Union Bankshares Corporation
(Registrant)

Date: November 10, 2008

By: /s/ G. William Beale
G. William Beale,
President and Chief Executive Officer

Date: November 10, 2008

By: /s/ D. Anthony Peay
D. Anthony Peay,
Executive Vice President and Chief Financial Officer

CERTIFICATIONS

I, G. William Beale, certify that:

1. I have reviewed this report on Form 10-Q of Union Bankshares Corporation;
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 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 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.

Date: November 10, 2008

/s/ G. William Beale

G. William Beale,
President and Chief Executive Officer

CERTIFICATIONS

I, D. Anthony Peay, certify that:

1. I have reviewed this report on Form 10-Q of Union Bankshares Corporation;
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 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 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.

Date: November 10, 2008

/s/ D. Anthony Peay

D. Anthony Peay,
Executive Vice President and Chief 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 Quarterly Report of Union Bankshares Corporation (the "Company") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002 that based on their knowledge and belief: 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.

/s/ G. William Beale

G. William Beale, President and Chief Executive Officer

/s/ D. Anthony Peay

D. Anthony Peay, Executive Vice President and Chief Financial Officer

Date: November 10, 2008

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to Union Bankshares Corporation and will be retained by Union Bankshares Corporation and furnished to the Securities and Exchange Commission or its staff upon request.