CITIZENS & NORTHERN CORP
Form 10-Q
November 07, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011
or

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

For the transition period from _______________ to _________________________.

Commission file number: 000-16084

CITIZENS & NORTHERN CORPORATION
(Exact name of Registrant as specified in its charter)

PENNSYLVANIA	23-2451943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

90-92 MAIN STREET, WELLSBORO, PA 16901
(Address of principal executive offices) (Zip code)
570-724-3411
(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” accelerated filer”and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ¨ Accelerated filer x Non-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 x

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock ($1.00 par value)	12,138,191 Shares Outstanding on November 3, 2011

CITIZENS & NORTHERN CORPORATION

Index

PART 1 - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED BALANCE SHEET (Unaudited)
(In Thousands Except Share Data)

	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks:		
Noninterest-bearing	$ 20,608	$ 16,840
Interest-bearing	35,146	29,461
Total cash and cash equivalents	55,754	46,301
Available-for-sale securities, at fair value	472,113	443,956
Loans held for sale	1,218	5,247
Loans receivable	705,879	730,411
Allowance for loan losses	(8,177)	(9,107)
Loans, net	697,702	721,304
Bank-owned life insurance	20,761	21,822
Accrued interest receivable	5,144	4,960
Bank premises and equipment, net	19,372	22,636
Foreclosed assets held for sale	1,596	537
Deferred tax asset, net	7,927	16,054
Intangible asset - Core deposit intangibles	240	326
Intangible asset - Goodwill	11,942	11,942
Other assets	18,285	21,503
TOTAL ASSETS	$ 1,312,054	$ 1,316,588
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 177,326	$ 158,767
Interest-bearing	818,404	845,581
Total deposits	995,730	1,004,348
Short-term borrowings	19,234	18,413
Long-term borrowings	128,024	148,495
Accrued interest and other liabilities	7,856	6,388
TOTAL LIABILITIES	1,150,844	1,177,644
STOCKHOLDERS' EQUITY		
Preferred stock, $1,000 par value; authorized 30,000 shares; $1,000 liquidation preference per share; no shares issued at September 30, 2011 and December 31, 2010	0	0
Common stock, par value $1.00 per share; authorized 20,000,000 shares in 2011 and 2010; issued 12,447,219 at September 30, 2011 and 12,408,212 at December 31, 2010	12,447	12,408
Paid-in capital	67,322	66,648
Retained earnings	78,085	65,920
Treasury stock, at cost; 306,589 shares at September 30, 2011 and 254,614 shares at December 31, 2010	(5,128)	(4,431)
Sub-total	152,726	140,545
Accumulated other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale securities	8,787	(1,351)

Defined benefit plans	(303)	(250)
Total accumulated other comprehensive income (loss)	8,484	(1,601)
TOTAL STOCKHOLDERS' EQUITY	161,210	138,944
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 1,312,054	$ 1,316,588

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

CONSOLIDATED STATEMENT OF OPERATIONS (In Thousands, Except Per Share Data) (Unaudited)	3 Months Ended Sept. 30, 2011 (Current)	3 Months Ended Sept. 30, 2010 (Prior Year)	Fiscal Year To Date 9 Months Ended Sept. 30, 2011 (Current)	Fiscal Year To Date 9 Months Ended Sept. 30, 2010 (Prior Year)
INTEREST INCOME				
Interest and fees on loans	$10,799	$11,153	$32,521	$33,112
Interest on balances with depository institutions	13	26	45	102
Interest on loans to political subdivisions	372	395	1,119	1,192
Interest on trading securities	0	0	0	1
Income from available-for-sale and held-to-maturity securities:				
Taxable	2,784	2,641	8,326	8,425
Tax-exempt	1,285	1,223	3,860	3,588
Dividends	64	57	187	194
Total interest and dividend income	15,317	15,495	46,058	46,614
INTEREST EXPENSE				
Interest on deposits	1,775	2,916	6,610	9,131
Interest on short-term borrowings	6	15	20	166
Interest on long-term borrowings	1,327	1,708	4,122	5,638
Total interest expense	3,108	4,639	10,752	14,935
Net interest income	12,209	10,856	35,306	31,679
(Credit) provision for loan losses	(37)	189	(198)	472
Net interest income after (credit) provision for loan losses	12,246	10,667	35,504	31,207
OTHER INCOME				
Service charges on deposit accounts	1,230	1,166	3,586	3,449
Service charges and fees	218	191	643	594
Trust and financial management revenue	785	876	2,608	2,605
Interchange revenue from debit card transactions	490	427	1,427	1,226
Net gains from sale of loans	263	275	677	478
Increase in cash surrender value of life insurance	127	121	381	352
Insurance commissions, fees and premiums	66	65	192	186
Impairment loss on limited partnership investment	0	0	(948)	0
Other operating income	820	441	1,661	1,480
Sub-total	3,999	3,562	10,227	10,370
Total other-than-temporary impairment losses on available-for-sale securities	0	0	0	(381)
Portion of (gain) loss recognized in other comprehensive loss (before taxes)	0	0	0	(52)
Net impairment losses recognized in earnings	0	0	0	(433)
Realized gains on available-for-sale securities, net	26	388	2,028	1,198
Net realized gains on available-for-sale securities	26	388	2,028	765
Total other income	4,025	3,950	12,255	11,135
OTHER EXPENSES				
Salaries and wages	3,451	3,354	10,321	9,631
Pensions and other employee benefits	1,020	980	3,344	2,902
Occupancy expense, net	641	654	2,038	2,004
Furniture and equipment expense	498	500	1,435	1,610
FDIC Assessments	174	382	688	1,201
Pennsylvania shares tax	345	305	984	916

Other operating expense	1,923	1,907	5,299	5,518
Total other expenses	8,052	8,082	24,109	23,782
Income before income tax provision	8,219	6,535	23,650	18,560
Income tax provision	2,230	1,671	6,423	4,389
Net income	5,989	4,864	17,227	14,171
U.S Treasury preferred dividends	0	729	0	1,474
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$5,989	$4,135	$17,227	$12,697
Net income per share – basic	$0.49	$0.34	$1.42	$1.05
Net income per share – diluted	$0.49	$0.34	$1.42	$1.05

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

CONSOLIDATED STATEMENT OF CASH FLOWS	Nine Months Ended September 30,	
(In Thousands) (Unaudited)	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 17,227	$ 14,171
Adjustments to reconcile net income to net cash provided by operating activities:		
(Credit) provision for loan losses	(198)	472
Realized gains on available-for-sale securities, net	(2,028)	(765)
Gain on sale of foreclosed assets, net	(8)	(113)
Depreciation expense	1,584	1,787
Gain on disposition of premises and equipment	(324)	(442)
Accretion and amortization on securities, net	1,045	1,740
Accretion and amortization on loans, deposits and borrowings, net	(27)	(179)
Amortization of mortgage servicing rights	48	0
Impairment loss on limited partnership interest	948	0
Increase in cash surrender value of life insurance	(381)	(352)
Stock-based compensation	386	50
Amortization of core deposit intangibles	86	132
Deferred income taxes	2,936	6,360
Gains on sales of mortgage loans, net	(677)	(478)
Origination of mortgage loans for sale	(15,166)	(19,228)
Proceeds from sales of mortgage loans	19,683	19,516
Net decrease in trading securities	0	1,045
Decrease in accrued interest receivable and other assets	888	3,543
Increase (decrease) in accrued interest payable and other liabilities	1,280	(238)
Net Cash Provided by Operating Activities	27,302	27,021
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturity of held-to-maturity securities	0	300
Proceeds from sales of available-for-sale securities	16,696	51,528
Proceeds from calls and maturities of available-for-sale securities	79,813	137,313
Purchase of available-for-sale securities	(108,327)	(219,143)
Redemption of Federal Home Loan Bank of Pittsburgh stock	1,164	0
Net decrease (increase) in loans	22,150	(5,615)
Proceeds from bank-owned life insurance	1,442	1,442
Purchase of premises and equipment	(666)	(595)
Proceeds from disposition of premises and equipment	3,060	100
Purchase of investment in limited liability entity	(200)	0
Return of principal on limited liability entity investments	93	49
Proceeds from sale of foreclosed assets	640	1,100
Net Cash Provided by (Used in) Investing Activities	15,865	(33,521)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	(8,632)	56,711
Net increase (decrease) in short-term borrowings	821	(20,827)
Repayments of long-term borrowings	(20,471)	(37,453)
Redemption of US Treasury preferred stock and warrant	0	(26,840)
Purchase of treasury stock	(983)	0
Sale of treasury stock	16	0
Tax benefit from compensation plans	48	29
US Treasury preferred dividends paid	0	(952)
Common dividends paid	(4,513)	(3,008)

Net Cash Used in Financing Activities	(33,714)	(32,340)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,453	(38,840)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	46,301	92,065
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 55,754	$ 53,225
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Assets acquired through foreclosure of real estate loans	$ 1,691	$ 644
Interest paid	$ 10,817	$ 15,280
Income taxes paid (refunded)	$ 2,300	$ (3,781)

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

5

Consolidated Statement of Changes in Stockholders' Equity
Nine Months Ended September 30, 2011 and 2010
(In Thousands Except Per Share Data)
(Unaudited)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Comprehensive Income (Loss)	Treasury Stock	Total
Nine Months Ended September 30, 2011:							
Balance, December 31, 2010	$ 0	$ 12,408	$ 66,648	$ 65,920	$ (1,601)	$ (4,431)	$ 138,944
Comprehensive income:							
Net income				17,227			17,227
Unrealized gain on securities, net of reclassification and tax					10,138		10,138
Other comprehensive loss related to defined benefit plans					(53)		(53)
Total comprehensive income							27,312
Cash dividends declared on common stock, $.42 per share				(5,110)			(5,110)
Shares issued for dividend reinvestment plan		39	558				597
Treasury stock purchased						(983)	(983)
Shares issued from treasury related to exercise of stock options			(3)			19	16
Restricted stock granted			(272)			272	0
Forfeiture of restricted stock			5			(5)	0
Stock-based compensation expense			386				386
Tax benefit from employee benefit plan				48			48
Balance, September 30, 2011	$ 0	$ 12,447	$ 67,322	$ 78,085	$ 8,484	$ (5,128)	$ 161,210
Nine Months Ended September 30, 2010:							
	$ 25,749	$ 12,374	$ 66,726	$ 53,027	$ (891)	$ (4,575)	$ 152,410

Balance, December 31, 2009							
Comprehensive income:							
Net income				14,171			14,171
Unrealized gain on securities, net of reclassification and tax					4,915		4,915
Other comprehensive income related to defined benefit plans					138		138
Total comprehensive income							19,224
Accretion of discount associated with U.S. Treasury preferred stock	691			(691)			0
Cash dividends on U.S. Treasury preferred stock				(783)			(783)
Redemption of U.S. Treasury preferred stock	(26,440)						(26,440)
Redemption of U.S. Treasury warrant			(400)				(400)
Cash dividends declared on common stock, $.27 per share				(3,273)			(3,273)
Shares issued for dividend reinvestment plan		23	242				265
Restricted stock granted			(159)			159	0
Forfeiture of restricted stock			15			(15)	0
Stock-based compensation expense			50				50
Tax benefit from employee benefit plan				29			29
Balance, September 30, 2010	$ 0	$ 12,397	$ 66,474	$ 62,480	$ 4,162	$ (4,431)	$ 141,082

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

6

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF INTERIM PRESENTATION

The consolidated financial information included herein, with the exception of the consolidated balance sheet dated December 31, 2010, is unaudited. Such information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations, cash flows and changes in stockholders' equity for the interim periods; however, the information does not include all disclosures required by accounting principles generally accepted in the United States of America ("U.S. GAAP") for a complete set of financial statements. Certain 2010 information has been reclassified for consistency with the 2011 presentation.

Operating results reported for the three-month and nine-month periods ended September 30, 2011 might not be indicative of the results for the year ending December 31, 2011. The Corporation evaluates subsequent events through the date of filing with the Securities and Exchange Commission.

2. PER COMMON SHARE DATA

Net income per share is based on the weighted-average number of shares of common stock outstanding. The following data show the amounts used in computing basic and diluted net income per share. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted-average common shares available from the exercise of all dilutive stock options, less the number of shares that could be repurchased with the proceeds of stock option exercises based on the average share price of the Corporation's common stock during the period.

	Net Income Available to Common Shareholders	Weighted-Average Common Shares	Earnings Per Share
Nine Months Ended September 30, 2011			
Earnings per common share – basic	$ 17,227,000	12,167,563	$ 1.42
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		92,786	
Hypothetical share repurchase at $15.57		(89,738)	
Earnings per common share – diluted	$ 17,227,000	12,170,611	$ 1.42
Nine Months Ended September 30, 2010			
Earnings per common share – basic and diluted	$ 12,697,000	12,125,142	$ 1.05
Quarter Ended September 30, 2011			
Earnings per common share – basic	$ 5,989,000	12,150,910	$ 0.49
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		91,843	
Hypothetical share repurchase at $15.56		(88,892)	
Earnings per common share – diluted	$ 5,989,000	12,153,861	$ 0.49
Quarter Ended September 30, 2010			
Earnings per common share – basic and diluted	$ 4,135,000	12,136,516	$ 0.34

7

Stock options and a warrant that were anti-dilutive were excluded from net income per share calculations. Weighted-average common shares available from anti-dilutive instruments totaled 224,651 shares in the nine-month period ended September 30, 2011, 424,179 shares in the nine months ended September 30, 2010, 223,463 shares in the third quarter 2011 and 362,738 shares in the third quarter 2010. All instruments for 2010 were anti-dilutive.

3. COMPREHENSIVE INCOME

Comprehensive income is the total of (1) net income, and (2) all other changes in equity from non-stockholder sources, which are referred to as other comprehensive income. The components of comprehensive income, and the related tax effects, are as follows:

(In Thousands)	3 Months Ended September 30,		9 Months Ended September 30,	
	2011	2010	2011	2010
Net income	$5,989	$4,864	$17,227	$14,171
Unrealized gains on available-for-sale securities:				
Unrealized holding gains on available-for-sale securities	5,310	4,467	17,384	8,191
Reclassification adjustment for gains realized in income	(26)	(388)	(2,028)	(765)
Other comprehensive gain before income tax	5,284	4,079	15,356	7,426
Income tax related to other comprehensive gain	1,796	1,370	5,218	2,511
Other comprehensive gain on available-for-sale securities	3,488	2,709	10,138	4,915
Unfunded pension and postretirement obligations:				
Change in items from defined benefit plans included in accumulated other comprehensive income	0	16	(122)	168
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	14	13	41	40
Other comprehensive gain (loss) before income tax	14	29	(81)	208
Income tax related to other comprehensive gain (loss)	4	9	(28)	70
Other comprehensive gain (loss) on unfunded retirement obligations	10	20	(53)	138
Net other comprehensive gain	3,498	2,729	10,085	5,053
Total comprehensive income	$9,487	$7,593	$27,312	$19,224

The Corporation recognized other comprehensive income of $52,000 before income tax ($34,000 after income tax) related to available-for-sale debt securities for which a portion of an other-than-temporary impairment (OTTI) loss has been recognized in earnings in the nine months ended September 30, 2010, with no other comprehensive income in the third quarter 2010.

4. FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS

The Corporation measures certain assets at fair value on a recurring basis. Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. FASB ASC topic 820, "Fair Value Measurements and Disclosures" (formerly Statement of Financial Accounting Standards No. 157) establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 – Fair value is based on unadjusted quoted prices in active markets that are accessible to the Corporation for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 – Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets and other observable inputs.

Level 3 – Fair value is based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows and other similar techniques.

At September 30, 2011 and December 31, 2010, assets measured at fair value on a recurring basis and the valuation methods used are as follows:

	September 30, 2011 Market Values Based on:			
(In Thousands)	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$ 0	$34,250	$ 0	$34,250
Obligations of states and political subdivisions:				
Tax-exempt	0	132,545	0	132,545
Taxable	0	13,354	0	13,354
Mortgage-backed securities	0	121,967	0	121,967
Collateralized mortgage obligations, Issued by U.S. Government agencies	0	146,002	0	146,002
Corporate bonds	0	1,001	0	1,001
Trust preferred securities issued by individual institutions	0	8,181	0	8,181
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	0	0	7,103	7,103
Other collateralized debt obligations	0	660	0	660
Total debt securities	0	457,960	7,103	465,063
Marketable equity securities	7,050	0	0	7,050
Total available-for-sale securities	7,050	457,960	7,103	472,113
Servicing rights	0	0	346	346

Total assets measured at fair value on a recurring basis	$ 7,050	$457,960	$ 7,449	$472,459

(In Thousands)	December 31, 2010 Market Values Based on: Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$ 0	$44,247	$ 0	$44,247
Obligations of states and political subdivisions:				
Tax-exempt	4,574	115,301	0	119,875
Taxable	1,125	6,542	0	7,667
Mortgage-backed securities	0	118,386	0	118,386
Collateralized mortgage obligations, Issued by U.S. Government agencies	9,117	121,709	0	130,826
Corporate bonds	0	1,027	0	1,027
Trust preferred securities issued by individual institutions	0	7,838	0	7,838
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	0	0	7,400	7,400
Other collateralized debt obligations	0	681	0	681
Total debt securities	14,816	415,731	7,400	437,947
Marketable equity securities	6,009	0	0	6,009
Total available-for-sale securities	20,825	415,731	7,400	443,956
Servicing rights	0	0	204	204
Total assets measured at fair value on a recurring basis	$ 20,825	$415,731	$ 7,604	$444,160

Debt securities with a fair value of $14,816,000 at December 31, 2010 were transferred from Level 1 to Level 2 in the first quarter 2011 in the table above. These securities were purchased in the month of December 2010, and their fair values at December 31, 2010 were determined based on the Corporation's purchase prices. The fair values of these securities were determined at September 30, 2011 based on price estimates provided by an independent valuation service based on Level 2 inputs.

Management determined there have been few trades of pooled trust-preferred securities since the first half of 2008, except for a limited number of transactions that have taken place as a result of bankruptcies, forced liquidations or similar circumstances. Also, in management's judgment, there were no available quoted market prices in active markets for assets sufficiently similar to the Corporation's pooled trust-preferred securities to be reliable as observable inputs. Accordingly, in the third quarter of 2008, the Corporation changed its method of valuing pooled trust-preferred securities from a Level 2 methodology that had been used in prior periods, based on price quotes received from pricing services, to a Level 3 methodology, using discounted cash flows.

Management has calculated the fair value of the Corporation's senior tranche pooled trust-preferred security by applying a discount rate to the estimated cash flows. In 2011, management's estimate of cash flows from the senior tranche security changed significantly from the estimates in previous years based on the level and timing of assumed prepayments that changed for some of the underlying issuers. Management used the cash flow estimates determined using the process described in Note 5 for evaluating pooled trust-preferred securities for other-than-temporary impairment (OTTI). Management used a discount rate considered reflective of a market participant's expectations regarding the extent of credit and liquidity risk inherent in the security. In establishing the discount rate, management considered: (1) the implied discount rate as of the end of 2007, prior to the market for trust-preferred securities becoming inactive; (2) adjustment to the year-end 2007 discount rate for the change in the spread between indicative market rates over corresponding risk-free rates; and (3) an additional adjustment – an increase of 2% in the discount rate – for liquidity risk. Management considered the additional 2% increase in the discount rate necessary in order to give some consideration to price estimates based on trades made under distressed conditions, as reported by brokers and pricing services. Management's estimate of cash flows and the discount rate used to calculate the fair value of the pooled trust-preferred security were based on sensitive assumptions, and market participants might use substantially different assumptions, which could result in calculations of a fair value that would be substantially different than the amount calculated by management.

Following is a reconciliation of activity for available-for-sale securities measured at fair value based on significant unobservable information:

	3 Months Ended		Fiscal Year To Date 9 Months Ended Sept. 30,	
	Sept. 30, 2011 (Current)	Sept. 30, 2010 (Prior Year)	2011 (Current)	2010 (Prior Year)
Balance, beginning of period	$ 7,207	$ 8,240	$ 7,400	$ 9,114
Accretion and amortization, net	0	(20)	(34)	(235)
Proceeds from sales and calls	(24)	(284)	(2,109)	(808)
Realized gains, net	24	284	99	284
Unrealized losses included in earnings	0	0	0	(423)
Unrealized (losses) gains included in other comprehensive income	(104)	20	1,747	308
Balance, end of period	$ 7,103	$ 8,240	$ 7,103	$ 8,240

Unrealized losses included in earnings are from the Corporation's other-than-temporary impairment analysis of securities, as described in Note 5, and are included in net impairment losses recognized in earnings in the consolidated statement of operations.
Assets measured at fair value on a nonrecurring basis include impaired commercial loans and foreclosed real estate assets held for sale. All of the Corporation's impaired commercial loans for which a valuation allowance was necessary at September 30, 2011 and December 31, 2010 were valued based on the estimated amount of net proceeds from liquidation of real estate and other collateral, or based on the estimated present value of cash flows to be received. The Corporation considers the fair value of such impaired commercial loans to be based on unobservable inputs (Level 3), and the balance of impaired loans for which a valuation allowance was recorded, net of allowance for loan losses, was $2,415,000 at September 30, 2011 and $3,169,000 at December 31, 2010. Similarly, the carrying values of foreclosed real estate assets held for sale were based on unobservable inputs (Level 3), with a balance of $1,596,000 at September 30, 2011 and $537,000 at December 31, 2010.

Certain of the Corporation's financial instruments are not measured at fair value in the consolidated financial statements. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from disclosure requirements. Therefore, the aggregate fair value amounts presented may not represent the underlying fair value of the Corporation.

The Corporation used the following methods and assumptions in estimating fair value disclosures for financial instruments:

CASH AND CASH EQUIVALENTS - The carrying amounts of cash and short-term instruments approximate fair values.

SECURITIES - Fair values for securities, excluding restricted equity securities, are based on quoted market prices or other methods as described above. The carrying value of restricted equity securities approximates fair value based on applicable redemption provisions.

LOANS HELD FOR SALE - Fair values of loans held for sale are determined based on applicable sales price available under the Federal Home Loan Banks' MPF Xtra program.

LOANS - Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential mortgage and other consumer. Each loan category is further segmented into fixed and adjustable rate interest terms and by performing and nonperforming categories. The fair value of performing loans is calculated by discounting contractual cash flows, adjusted for estimated prepayments based on historical experience, using estimated market discount rates that reflect the credit and interest rate risk inherent in the loans. Fair value of nonperforming loans is based on recent appraisals or estimates prepared by the Corporation's lending officers.

SERVICING RIGHTS – The fair value of servicing rights, included in other assets in the consolidated balance sheet, is determined through a discounted cash flow valuation. Significant inputs include expected net servicing income, the discount rate and the expected life of the underlying loans.

DEPOSITS - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, money market and interest checking accounts, is (by definition) equal to the amount payable on demand at September 30, 2011 and December 31, 2010. The fair value of all other deposit categories is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates of deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

BORROWED FUNDS - The fair value of borrowings is estimated using discounted cash flow analyses based on rates currently available to the Corporation for similar types of borrowing arrangements.

ACCRUED INTEREST - The carrying amounts of accrued interest receivable and payable approximate fair values.

OFF-BALANCE SHEET COMMITMENTS - The Corporation has commitments to extend credit and has issued standby letters of credit. Standby letters of credit are conditional guarantees of performance by a customer to a third party. Estimates of the fair value of these off-balance sheet items were not made because of the short-term nature of these arrangements and the credit standing of the counterparties.

The estimated fair values, and related carrying amounts, of the Corporation’s financial instruments are as follows:

(In Thousands)	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 55,754	$ 55,754	$ 46,301	$ 46,301
Available-for-sale securities	472,113	472,113	443,956	443,956
Restricted equity securities	7,123	7,123	8,286	8,286
Loans held for sale	1,218	1,218	5,247	5,249
Loans, net	697,702	703,299	721,304	728,744
Accrued interest receivable	5,144	5,144	4,960	4,960
Servicing rights	346	346	204	204
Financial liabilities:				
Deposits	995,730	1,000,179	1,004,348	1,012,247
Short-term borrowings	19,234	18,965	18,413	18,240
Long-term borrowings	128,024	147,369	148,495	171,877
Accrued interest payable	351	351	430	430

5. SECURITIES

Amortized cost and fair value of available-for-sale securities at September 30, 2011 and December 31, 2010 are summarized as follows:

	September 30, 2011			
(In Thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of U.S. Government agencies	$33,459	$791	$0	$34,250
Obligations of states and political subdivisions:				
Tax-exempt	130,537	3,782	(1,774)	132,545
Taxable	13,080	282	(8)	13,354
Mortgage-backed securities	116,314	5,653	0	121,967
Collateralized mortgage obligations, Issued by U.S. Government agencies	143,275	2,774	(47)	146,002
Corporate bonds	1,000	1	0	1,001
Trust preferred securities issued by individual institutions	7,015	1,211	(45)	8,181
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	7,914	0	(811)	7,103
Other collateralized debt obligations	660	0	0	660
Total debt securities	453,254	14,494	(2,685)	465,063
Marketable equity securities	5,548	1,698	(196)	7,050
Total	$458,802	$16,192	$(2,881)	$472,113

	December 31, 2010			
(In Thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of U.S. Government agencies	$44,005	$270	$(28)	$44,247
Obligations of states and political subdivisions:				
Tax-exempt	127,210	546	(7,882)	119,874
Taxable	7,808	1	(141)	7,668
Mortgage-backed securities	113,176	5,381	(171)	118,386
Collateralized mortgage obligations, Issued by U.S. Government agencies	131,040	869	(1,083)	130,826
Corporate bonds	1,000	27	0	1,027
Trust preferred securities issued by individual institutions	6,535	1,694	(391)	7,838
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	9,957	0	(2,557)	7,400
Other collateralized debt obligations	681	0	0	681
Total debt securities	441,412	8,788	(12,253)	437,947
Marketable equity securities	4,589	1,496	(76)	6,009
Total	$446,001	$10,284	$(12,329)	$443,956

The following table presents gross unrealized losses and fair value of available-for-sale securities with unrealized loss positions that are not deemed to be other-than-temporarily impaired, aggregated by length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010:

September 30, 2011 (In Thousands)	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
Obligations of states and political subdivisions:						
Tax-exempt	$ 9,055	$ (702)	$ 24,904	$ (1,072)	$ 33,959	$ (1,774)
Taxable	699	(8)	0	0	699	(8)
Collateralized mortgage obligations, Issued by U.S. Government agencies	8,399	(45)	5,316	(2)	13,715	(47)
Trust preferred securities issued by individual institutions	0	0	955	(45)	955	(45)
Collateralized debt obligations:						
Pooled trust preferred securities - senior tranches	0	0	7,103	(811)	7,103	(811)
Total debt securities	18,153	(755)	38,278	(1,930)	56,431	(2,685)
Marketable equity securities	1,413	(137)	96	(59)	1,509	(196)
Total temporarily impaired available-for-sale securities	$ 19,566	$ (892)	$ 38,374	$ (1,989)	$ 57,940	$ (2,881)

December 31, 2010 (In Thousands)	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
Obligations of U.S. Government agencies	$ 10,230	$ (28)	$ 0	$ 0	$ 10,230	$ (28)
Obligations of states and political subdivisions:						
Tax-exempt	53,119	(2,533)	28,622	(5,349)	81,741	(7,882)
Taxable	6,542	(141)	0	0	6,542	(141)
Mortgage-backed securities	13,141	(171)	0	0	13,141	(171)
Collateralized mortgage obligations, Issued by U.S. Government agencies	56,257	(1,083)	0	0	56,257	(1,083)
Trust preferred securities issued by individual institutions	0	0	5,825	(391)	5,825	(391)
Collateralized debt obligations:						
Pooled trust preferred securities - senior tranches	0	0	7,400	(2,557)	7,400	(2,557)
Total debt securities	139,289	(3,956)	41,847	(8,297)	181,136	(12,253)
Marketable equity securities	710	(76)	0	0	710	(76)
Total temporarily impaired available-for-sale securities	$ 139,999	$ (4,032)	$ 41,847	$ (8,297)	$ 181,846	$ (12,329)

Gross realized gains and losses from available-for-sale securities (including OTTI losses in gross realized losses) and the related income tax provision were as follows:

(In Thousands)	3 Months Ended		9 months ended	
	Sept. 30, 2011	Sept. 30, 2010	Sept. 30, 2011	Sept. 30, 2010
Gross realized gains	$ 26	$ 388	$ 2,035	$ 1,206
Gross realized losses	0	0	(7)	(441)
Net realized gains	$ 26	$ 388	$ 2,028	$ 765
Income tax provision related to net realized gains	$ 9	$ 132	$ 690	$ 260

14

The maturities of available-for-sale debt securities at September 30, 2011 are summarized as follows:

(In Thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 5,211	$ 6,413
Due after one year through five years	51,569	52,662
Due after five years through ten years	91,689	93,683
Due after ten years	304,785	312,305
Total	$ 453,254	$ 465,063

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) whether the Corporation intends to sell the security or more likely than not will be required to sell the security before its anticipated recovery.

The Corporation recognized net impairment losses in earnings, as follows:

(In Thousands)	3 Months Ended		9 Months Ended	
	Sept. 30, 2011	Sept. 30, 2010	Sept. 30, 2011	Sept. 30, 2010
Trust preferred securities issued by individual institutions	$0	$0	$0	$(320)
Pooled trust preferred securities - mezzanine tranches	0	0	0	(103)
Marketable equity securities (bank stocks)	0	0	0	(10)
Net impairment losses recognized in earnings	$0	$0	$0	$(433)

A summary of information management considered in evaluating debt and equity securities for OTTI at September 30, 2011 is provided below.

Debt Securities

At September 30, 2011, management performed an assessment for possible OTTI of the Corporation's debt securities on an issue-by-issue basis, relying on information obtained from various sources, including publicly available financial data, ratings by external agencies, brokers and other sources. The extent of individual analysis applied to each security depended on the size of the Corporation's investment, as well as management's perception of the credit risk associated with each security. Based on the results of the assessment, management believes impairment of these debt securities, including municipal bonds with no external ratings, at September 30, 2011 to be temporary.

The credit rating agencies have withdrawn their ratings on numerous municipal bonds held by the Corporation. At September 30, 2011, the total amortized cost basis of municipal bonds with no external credit ratings was $25,422,000, with an aggregate unrealized loss of $991,000. At the time of purchase, each of these bonds was considered investment grade and had been rated by at least one credit rating agency. The bonds for which the ratings were removed were almost all insured by an entity that has reported significant financial problems and declines in its regulatory capital ratios, and most of the ratings were removed in the fourth quarter 2009. However, the insurance remains in effect on the bonds, and none of the affected municipal bonds has failed to make a scheduled interest payment.

Included in the total amounts of bonds with no external credit ratings, in the paragraph above, is one municipal bond that had been downgraded from “A” to “BB” (less than investment grade) in the second quarter 2011. The external credit rating agency cited extended delays in the issuer’s publication of financial statements as one of the major reasons for the downgrade. In the third quarter 2011, the external credit rating agency removed its rating, again citing the lack of available financial information. At September 30, 2011, the bond had an amortized cost basis of $1,128,000, with an unrealized gain of $91,000.

The following table provides information related to trust preferred securities issued by individual institutions as of September 30, 2011:

(In Thousands) Name of Issuer	Issuer's Parent Company	Amortized Cost	Fair Value	Unrealized Gain (Loss)	Cumulative Realized Credit Losses	Moody's/ S&P/ Fitch Credit Ratings
Astoria Capital Trust I	Astoria Financial Corporation	$ 5,197	$ 5,219	$ 22	$ 0	Baa3/BB-/BB-
Carolina First Mortgage Loan Trust	The Toronto-Dominion Bank	$ 818	$ 2,007	1,189	(1,769)	NR
Patriot Capital Trust I	Susquehanna Bancshares, Inc.	$ 1,000	$ 955	(45)	0	NR
Total		$ 7,015	$ 8,181	$ 1,166	$ (1,769)	

NR = not rated.

Management assesses each of the trust preferred securities issued by individual institutions for the possibility of OTTI by reviewing financial information that is publicly available. Neither Astoria Financial Corporation nor Susquehanna Bancshares, Inc. has deferred or defaulted on payments associated with the Corporation's securities.

The Corporation recognized OTTI charges in 2009 and 2010 related to the Carolina First Mortgage Loan Trust security. In the fourth quarter 2010, The Toronto-Dominion Bank acquired The South Financial Group, Inc., the parent company of Carolina First. After the acquisition, The Toronto-Dominion Bank made a payment for the full amount of previously deferred interest and resumed quarterly payments on the security. The Corporation recognized a material change in the expected cash flows in the fourth quarter 2010. The Corporation recorded $229,000 in accretion income during the third quarter 2011 and accretion income totaling $500,000 in the first nine months of 2011. Management expects to record accretion income to offset the previous OTTI charges over the security's remaining life, through May 2012.

Pooled trust-preferred securities are very long-term (usually 30-year maturity) instruments, mainly issued by banks. The Corporation's investments in pooled trust-preferred securities are each made up of companies with geographic and size diversification. Almost all of the Corporation's pooled trust-preferred securities are composed of debt issued by banking companies, with lesser amounts issued by insurance companies. Some of the issuers of trust-preferred securities that are included in the Corporation's pooled investments have elected to defer payment of interest on these obligations (trust-preferred securities typically permit deferral of quarterly interest payments for up to five years), and some issuers have defaulted.

Management evaluated pooled trust-preferred securities for OTTI by estimating the cash flows expected to be received from each security, taking into account estimated levels of deferrals and defaults by the underlying issuers. In determining cash flows, management assumed all issuers currently deferring or in default would make no future payments, and assigned estimated future default levels for the remaining issuers in each security based on financial strength ratings assigned by a national ratings service. Management calculated the present value of each security based on the current book yield, adjusted for future changes in 3-month LIBOR (which is the index rate on the Corporation's adjustable-rate pooled trust-preferred securities) based on the applicable forward curve. Management's estimates of cash flows used to evaluate other-than-temporary impairment of pooled trust-preferred securities were based on sensitive assumptions regarding the timing and amounts of defaults that may occur, and changes in those assumptions could produce different conclusions for each security.

During the first quarter 2011, management sold the Corporation's holding of the mezzanine tranche of MMCAPS Funding I, Ltd. The security was sold for aggregate pretax proceeds of $1,485,000, which was recorded as a gain on the sale of securities in the first quarter.

The following table provides detailed information related to pooled trust preferred securities – mezzanine tranches held as of September 30, 2011:

Description	Amortized Cost	Fair Value	Unrealized Gain	Cumulative OTTI
U.S. Capital Funding II, Ltd. (B-1)	$ 0	$ 0	$ 0	$ (1,992)
U.S. Capital Funding II, Ltd. (B-2)	0	0	0	(2,973)
ALESCO Preferred Funding IX, Ltd.	0	0	0	(2,988)
Total	$ 0	$ 0	$ 0	$ (7,953)

As of September 30, 2011, the Corporation's investment in a senior tranche security (the senior tranche of MMCAPS Funding I, Ltd.) had an investment grade rating. The senior tranche security, with an amortized cost of $7,914,000, has been subjected to impairment analysis based on estimated cash flows (using the process described above), and management has determined that impairment was temporary as of September 30, 2011. The table that follows provides additional information related to the senior tranche of MMCAPS Funding I, Ltd.:

MMCAPS Funding I, Ltd. - Senior Tranche

Number of Banks Currently Performing	17	
Moody's/Fitch Credit Ratings	A3/BBB(1)	
Actual Deferrals and Defaults as % of Outstanding Collateral	31.0	%
Expected Additional Net Deferrals and Defaults as % of Performing Collateral	14.7	%
Excess Subordination as % of Performing Collateral	30.2	%

(1) Ratings information is as of September 30, 2011. Fitch has the senior tranche of MMCAPS Funding I, Ltd. on negative outlook.

In the table above, "Excess Subordination as % of Performing Collateral" (Excess Subordination Ratio) was calculated as follows: (Total face value of performing collateral – Face value of all outstanding note balances not subordinate to our investment)/Total face value of performing collateral.

The Excess Subordination Ratio measures the extent to which there may be tranches within the pooled trust preferred structure available to absorb credit losses before the Corporation's security would be impacted. The positive Excess Subordination Ratio signifies there is some support from subordinate tranches available to absorb losses before the Corporation's investment would be impacted.

The Corporation separates OTTI related to the trust-preferred securities into (a) the amount of the total impairment related to credit loss, which is recognized in the statement of earnings, and (b) the amount of the total impairment related to all other factors, which is recognized in other comprehensive income. The Corporation measures the credit loss component of OTTI based on the difference between: (1) the present value of estimated cash flows, at the book yield in effect prior to recognition of any OTTI, as of the most recent balance sheet date, and (2) the present value of estimated cash flows as of the previous quarter-end balance sheet date based on management's cash flow assumptions at that time.

The Corporation recorded no OTTI losses related to pooled trust-preferred securities in the three-month or nine-month periods ended September 30, 2011. The Corporation recorded no OTTI losses related to pooled trust-preferred securities in the three months ended September 30, 2010. Total OTTI from pooled trust-preferred securities in the nine months ended September 30, 2010 amounted to $51,000, including a pre-tax loss reflected in earnings of $103,000, with a pre-tax other comprehensive gain of $52,000 included in other comprehensive income.

A roll-forward of the credit losses from securities for which a portion of OTTI has been recognized in other comprehensive income is as follows:

(In Thousands)	3 Months Ended		9 Months Ended	
	Sept. 30, 2011	Sept. 30, 2010	Sept. 30, 2011	Sept. 30, 2010
Balance of credit losses on debt securities for which a portion of OTTI was recognized in other comprehensive income, beginning of period	$ 0	$ 0	$ 0	$ (10,695)
Reduction for securities losses realized during the period	0	0	0	10,798
Additional credit loss for which an OTTI was previously recognized when the Corporation does not intend to sell the security and it is not more likely than not the Corporation will be required to sell the security before recovery of its amortized cost basis	0	0	0	(103)
Balance of credit losses on debt securities for which a portion of OTTI was recognized in other comprehensive income, end of period	$ 0	$ 0	$ 0	$ 0

The line item labeled "Reduction for securities losses realized during the period" in the table immediately above includes OTTI write-downs associated with securities the Corporation continues to hold, but which have been deemed worthless.

Equity Securities

The Corporation's marketable equity securities at September 30, 2011 and December 31, 2010 consisted exclusively of stocks of banking companies. The Corporation recorded no OTTI losses related to bank stocks in the three-month or nine-month periods ended September 30, 2011. The Corporation recorded no OTTI losses related to bank stocks in the third quarter 2010 but recorded OTTI totaling $10,000 in the first nine months of 2010. Management's decision to record OTTI losses on bank stocks in 2010 was based on a combination of: (1) significant market depreciation in market prices in the first quarter 2009 (with some improvement subsequent to June 30, 2009), and (2) management's intent to sell some of the stocks to generate capital losses, which could be carried back and offset against capital gains generated in previous years to realize tax refunds. At September 30, 2011, management did not intend to sell impaired bank stocks, and based on the intent to hold the securities for the foreseeable future and other factors specific to the securities, has determined that none of the Corporation's bank stock holdings at September 30, 2011 were other than temporarily impaired.

During the three months ended September 30, 2011, the Corporation did not sell any bank stocks and did not realize any gains or losses. Realized gains from sales of bank stocks totaled $91,000 in the nine months ended September 30, 2011 including $89,000 of realized gains from sales of stocks for which OTTI had been previously recognized. Realized gains from sales of bank stocks totaled $93,000 in the three months ended September 30, 2010 including $59,000 of realized gains from sales of stocks for which OTTI had been previously recognized. Realized gains from sales of bank stocks totaled $576,000 in the nine months ended September 30, 2010 including $385,000 of realized gains from sales of stocks for which OTTI had been previously recognized.

C&N Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh), which is one of 12 regional Federal Home Loan Banks. As a member, C&N Bank is required to purchase and maintain stock in FHLB-Pittsburgh. There is no active market for FHLB-Pittsburgh stock, and it must ordinarily be redeemed by FHLB-Pittsburgh in order to be liquidated. C&N Bank's investment in FHLB-Pittsburgh stock, included in Other Assets in the consolidated balance sheet, was $6,992,000 at September 30, 2011 and $8,156,000 at December 31, 2010. The Corporation evaluated its holding of FHLB-Pittsburgh stock for impairment and deemed the stock to not be impaired at September 30, 2011 and December 31, 2010. In making this determination, management concluded that recovery of total outstanding par value, which equals the carrying value, is expected. The decision was based on review of financial information that FHLB-Pittsburgh has made publicly available.

6. LOANS

The loans receivable portfolio is segmented into residential mortgage, commercial and consumer loans. The residential mortgage segment includes the following classes: first and junior lien residential mortgages, home equity lines of credit and residential construction loans. The most significant classes of commercial loans are commercial loans secured by real estate, non-real estate secured commercial and industrial loans, loans to political subdivisions, commercial construction and land loans, and loans secured by farmland.

Loans outstanding at September 30, 2011 and December 31, 2010 are summarized as follows:

Summary of Loans by Type
(In Thousands)

	Sept. 30, 2011	% of Total	Dec. 31, 2010	% of Total
Residential mortgage:				
Residential mortgage loans - first liens	$ 334,551	47.39 %	$ 333,012	45.59 %
Residential mortgage loans - junior liens	29,748	4.21 %	31,590	4.32 %
Home equity lines of credit	29,667	4.20 %	26,853	3.68 %
1-4 Family residential construction	9,762	1.38 %	14,379	1.97 %
Total residential mortgage	403,728	57.20 %	405,834	55.56 %
Commercial:				
Commercial loans secured by real estate	149,853	21.23 %	167,094	22.88 %
Commercial and industrial	55,792	7.90 %	59,005	8.08 %
Political subdivisions	36,403	5.16 %	36,480	4.99 %
Commercial construction and land	26,552	3.76 %	24,004	3.29 %
Loans secured by farmland	10,470	1.48 %	11,353	1.55 %
Multi-family (5 or more) residential	6,782	0.96 %	7,781	1.07 %
Agricultural loans	2,819	0.40 %	3,472	0.48 %
Other commercial loans	561	0.08 %	392	0.05 %
Total commercial	289,232	40.97 %	309,581	42.38 %
Consumer	12,919	1.83 %	14,996	2.05 %
Total	705,879	100.00 %	730,411	100.00 %
Less: allowance for loan losses	(8,177)		(9,107)	
Loans, net	$ 697,702		$ 721,304	

The Corporation grants loans to individuals as well as commercial and tax-exempt entities. Commercial, residential and personal loans are made to customers geographically concentrated in the Pennsylvania and New York counties that comprise the market serviced by Citizens & Northern Bank. Although the Corporation has a diversified loan portfolio, a significant portion of its debtors' ability to honor their contracts is dependent on the local economic conditions within the region. There is no concentration of loans to borrowers engaged in similar businesses or activities that exceed 10% of total loans at either September 30, 2011 or December 31, 2010.

The Corporation maintains an allowance for loan losses that represents management's estimate of the losses inherent in the loan portfolio as of the balance sheet date and recorded as a reduction of the investment in loans. The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated.

Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available. In the process of evaluating the loan portfolio, management also considers the Corporation's exposure to losses from unfunded loan commitments. As of September 30, 2011 and December 31, 2010, management determined that no allowance for credit losses related to unfunded loan commitments was required.

Transactions within the allowance for loan losses, summarized by segment and class, for the year to date and the most recent quarter were as follows:

(In Thousands)	December 31, 2010 Balance	Charge-offs	Recoveries	Provision (Credit)	Sept. 30, 2011 Balance
Allowance for Loan Losses:					
Residential mortgage:					
Residential mortgage loans - first liens	$ 2,745	$(49)	$0	$367	$3,063
Residential mortgage loans - junior liens	334	(51)	0	(6)	277
Home equity lines of credit	218	0	0	13	231
1-4 Family residential construction	208	0	0	(130)	78
Total residential mortgage	3,505	(100)	0	244	3,649
Commercial:					
Commercial loans secured by real estate	3,314	(535)	1	(336)	2,444
Commercial and industrial	862	(216)	177	51	874
Political subdivisions	0	0	0	0	0
Commercial construction and land	590	0	0	(295)	295
Loans secured by farmland	139	0	0	(17)	122
Multi-family (5 or more) residential	63	0	0	5	68
Agricultural loans	32	0	0	(7)	25
Other commercial loans	0	0	0	5	5
Total commercial	5,000	(751)	178	(594)	3,833
Consumer	289	(116)	57	(3)	227
Unallocated	313			155	468
Total Allowance for Loan Losses	$ 9,107	$(967)	$235	$(198)	$8,177

(In Thousands)	June 30, 2011 Balance	Charge-offs	Recoveries	Provision (Credit)	Sept. 30, 2011 Balance
Allowance for Loan Losses:					
Residential mortgage:					
Residential mortgage loans - first liens	$3,050	$(21)	$0	$34	$3,063
Residential mortgage loans - junior liens	293	0	0	(16)	277
Home equity lines of credit	220	0	0	11	231
1-4 Family residential construction	67	0	0	11	78
Total residential mortgage	3,630	(21)	0	40	3,649
Commercial:					
Commercial loans secured by real estate	2,502	0	1	(59)	2,444
Commercial and industrial	908	(17)	0	(17)	874
Political subdivisions	0	0	0	0	0
Commercial construction and land	281	0	0	14	295
Loans secured by farmland	134	0	0	(12)	122
Multi-family (5 or more) residential	75	0	0	(7)	68
Agricultural loans	29	0	0	(4)	25
Other commercial loans	5	0	0	0	5
Total commercial	3,934				