FIRST NATIONAL COMMUNITY BANCORP INC
Form 10-K
March 13, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from __________ to __________

Commission File No. 333-24121

FIRST NATIONAL COMMUNITY BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	23-2900790
(State or Other Jurisdiction	(I.R.S. Employer
of Incorporation or Organization)	Identification No.)

102 E. Drinker St., Dunmore, PA	18512
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code(570) 346-7667

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $1.25 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes |__| No |X |

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or section 15(d) of the Act. Yes |__| No |X |

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes |X | No |__ |

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. |X |

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 |_ |

(Do not check if a 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 |

The aggregate market value of the voting and non-voting common stock of the registrant, held by non-affiliates was approximately $246,044,877 at June 30, 2008.

APPLICABLE ONLY TO CORPORATE REGISTRANTS
State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:16,047,928 shares of common stock as of March 11, 2009.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 20, 2009 are incorporated by reference into Part III of this report.

FIRST NATIONAL COMMUNITY BANCORP, INC.

PART I

Item 1. Business.

CORPORATE PROFILE

The Business of First National Community Bancorp, Inc.

THE COMPANY

First National Community Bancorp, Inc. (the "company") is a Pennsylvania business, incorporated in 1997 and is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended. The company became an active bank holding company on July 1, 1998 when it acquired ownership of First National Community Bank (the "bank"). On November 2, 2000, the Federal Reserve Bank of Philadelphia approved the company's application to change its status to a financial holding company as a complement to the company's strategic objective. The bank is a wholly-owned subsidiary of the company.

The company's primary activity consists of owning and operating the bank, which provides customary retail and commercial banking services to individuals and businesses. The bank provides practically all of the company's earnings as a result of its banking services.

THE BANK

The bank was established as a national banking association in 1910 as "The First National Bank of Dunmore." Based upon shareholder approval received at a Special Shareholders' Meeting held October 27, 1987, the bank changed its name to "First National Community Bank" effective March 1, 1988. The bank's operations are conducted from offices located in Lackawanna, Luzerne, Wayne and Monroe Counties, Pennsylvania:

Office	Date Opened
Main	October 1910
Scranton	September 1980
Dickson City	December 1984
Keyser Village (formerly Fashion Mall)	April 2008
Wilkes-Barre	July 1993
Pittston Plaza	April 1995
Kingston	August 1996
Exeter	November 1998
Daleville	April 2000
Plains	June 2000
Back Mountain	October 2000
Clarks Green	October 2001
Hanover Township	January 2002
Nanticoke	April 2002
Hazleton	October 2003
Route 315	February 2004

Honesdale	November 2006
Stroudsburg	May 2007
Honesdale Route 6	October 2007
Marshalls Creek	May 2008

The bank provides many commercial banking services to individuals and businesses including Image Checking and E-Statement. Deposit products include standard checking, savings and certificate of deposit products, as well as a variety of preferred products for higher balance customers. The bank also participates in the Certificate of Deposit Account Registry program which allows customers to secure FDIC insurance on balances in excess of the standard limitations. Consumer loans include both secured and unsecured installment loans, fixed and variable rate mortgages, jumbo mortgages, home equity term loans and lines of credit and "Instant Money" overdraft protection loans. Additionally, the bank is also in the business of underwriting indirect auto loans which are originated through various auto dealers in northeastern Pennsylvania and dealer floor plan loans. VISA personal credit cards are available through the bank, as well as the FNCB Check Card which allows customers to access their checking account at any retail location that accepts VISA and serves the dual purpose of an ATM card. In the commercial lending field, the bank offers demand

and term loans, either secured or unsecured, letters of credit, working capital loans, accounts receivable, inventory or equipment financing loans, and commercial mortgages. In addition, the bank offers MasterCard, VISA processing services and Remote Deposit Capture to its commercial customers, as well as our Cash Management service which can be accessed through FNCBusiness Online, which is Internet based. FNCBusiness Online is a menu driven product that allows our business customers to have direct access to their account information and the ability to perform internal and external transfers and process Direct Deposit payroll transactions for employees, 24 hours a day, 7 days a week, from their place of business. Asset management services are conveniently available at FNCB through FNCB Investment Services. As a result of the bank's partnership with FNCB Investment Services, our customers are able to access alternative products such as mutual funds, annuities, stock and bond purchases, etc. directly from our FNCB Investment Services representatives. The bank also offers customers the convenience of 24-hour banking, seven days a week, through FNCB Online and its Bill Payment service via the Internet and its ATM network. Automated teller machines are available at the following locations:

Community Offices	Remote Locations
Dunmore	Petro Truck Stop, 98 Grove St., Dupont
Scranton	Bill's Shoprite Supermarket, Rt. 502, Daleville
Dickson City	Joe's Kwik Mart, 620 N. Blakely St., Dunmore
Keyser Village	Joe's Kwik Mart, Rts 940 and I-380, Pocono Summit
Wilkes-Barre	Joe's Kwik Mart, 303 Route 315, Dupont
Pittston	107 Woodland Road, Mt. Pocono
Kingston	Pocono Village Mall, Mt. Pocono
Exeter	Cooper's Seafood, 701 N. Washington Ave., Scranton
Daleville	
Plains	
Back Mountain	
Clarks Green	
Hanover Township	
Nanticoke	
Hazleton	
Route 315	
Honesdale	
Stroudsburg	
Honesdale Route 6	
Marshalls Creek	

Additionally, to further enhance 24-hour banking services, Telephone Banking (Account Link), Loan by Phone, and Mortgage Link are available to customers. These services provide consumers the ability to access account information, perform related account transfers, and apply for a loan through the use of a touch tone telephone. Also, in our efforts to continually provide consumers the best possible service, the bank implemented in 2004 a Bounce Protection service which provides consumers with an added level of protection against unanticipated cash flow emergencies and account reconciliation errors.

As of December 31, 2008 industry concentrations exist within the following four industries. Loans and lines of credit to each of these industries were as follows:

	Amount	% of Regulatory Capital
Land Subdivision	$89,040,000	70%
Shopping Centers/Complexes	$41,404,000	33%
Hotels	$36,260,000	29%
Solid Waste Landfills Industry	$35,132,000	28%

First lien mortgages on the real estate and a diverse group of borrowers provide security against undue risks in the portfolio.

COMPETITION

The bank is one of two financial institutions with principal offices in Dunmore. Primary competition in the Lackawanna County market comes from numerous commercial banks and savings and loan associations operating in the area. Our Luzerne County offices share many of the same competitors we face in Lackawanna County as well as several banks and savings and loans that are not in our Lackawanna County market. In 2006, the bank entered the Wayne County market. Competition for loan and deposit relationships is primarily with three banks headquartered in Wayne County as well as other institutions located within the market. In 2007, the bank ventured into Monroe County with its first office in Stroudsburg and added a second office in Marshalls Creek in 2008. Competition in Monroe County comes from many of the same competitors we face in the other markets as well as other institutions headquartered in that area. Deposit deregulation has intensified the competition for deposits among banks in recent years. Additional competition is derived from credit unions, finance companies, brokerage firms, insurance companies and retailers.

SUPERVISION AND REGULATION

The company is subject to the Securities Exchange Act of 1934 (“1934 Act”) and must file quarterly and annual reports with the U.S. Securities and Exchange Commission regarding its business operations. As a registered financial holding company under the Bank Holding Company Act of 1956, as amended, the company is subject to the supervision and examination by the Federal Reserve Board.

The bank is subject to regulation and supervision by the Office of the Comptroller of the Currency, which includes regular examinations of the bank's records and operations. With the passage of legislation to foster economic recovery and ease consumer concerns, as a member of the Federal Deposit Insurance Corporation (FDIC), the bank's depositors' accounts are insured up to $250,000 per ownership category until December 31, 2009. Individual Retirement Accounts (IRA's) are insured up to $250,000 permanently. This substantive change is designed to bolster consumer confidence in the safety of their money in banks and in the strength of the banking system. To obtain this protection for its depositors, the bank pays an assessment and is subject to the regulations of the FDIC. The bank is also a member of the Federal Reserve System and as such is subject to the rules promulgated by the Federal Reserve Board.

During 2008, the United States government responded to the financial crisis with programs designed to strengthen the financial system and provide the liquidity necessary to allow banks to continue to serve their customers. The Troubled Asset Relief Program (TARP) was designed to inject capital into banks who would then have liquidity to better manage their business. Inclusion in the program carried restrictions on the participating financial institution. The bank reviewed the merits of the program, but ultimately decided not to participate in TARP. The Temporary Liquidity Guarantee Program (TLGP) was designed to provide unlimited FDIC insurance coverage on certain categories of deposits until December 31, 2009. In order to provide the coverage for its customers, the bank agreed to pay increased insurance premiums. For the benefit of our customers, First National Community Bank elected to participate in the TLGP.

Financial Services Modernization Legislation. - In November 1999, the Gramm-Leach-Bliley Act of 1999, or the GLB, was enacted. The GLB repeals provisions of the Glass-Steagall Act which restricted the affiliation of Federal Reserve member banks with firms “engaged principally” in specified securities activities, and which restricted officer, director or employee interlocks between a member bank and any company or person “primarily engaged” in specified securities activities.

In addition, the GLB also contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company to engage in a full range of financial activities through a new entity known as a “financial holding company.” “Financial activities” is broadly defined to include not only banking, insurance and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may have a subsidiary engaged in any activity authorized for national banks directly or any financial activity, except for insurance underwriting, insurance investments, real estate investment or development, or merchant banking, which may only be conducted through a subsidiary of a financial holding company. Financial activities include all activities permitted under new sections of the Bank Holding Company Act or permitted by regulation.

To the extent that the GLB permits banks, securities firms and insurance companies to affiliate, the financial services industry may experience further consolidation. The GLB is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis and which unitary savings and loan holding companies already possess. Nevertheless, the GLB may have the result of increasing the amount of competition that First National Community Bancorp, Inc. faces from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than First National Community Bancorp, Inc. has.

USA Patriot Act of 2001**-** In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington D.C. which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

IMLAFATA - As part of the USA Patriot Act, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (IMLAFATA). IMLAFATA amended the Bank Secrecy Act and adopted certain additional measures that increase the obligation of financial institutions, including First National Community Bancorp, Inc., to identify their customers, watch for and report upon suspicious transactions, respond to requests for information by federal banking regulatory authorities and law enforcement agencies, and share information with other financial institutions. The Secretary of the Treasury has adopted several regulations to implement these provisions. First National Community Bancorp, Inc. is also barred from dealing with foreign "shell" banks. In addition, IMLAFATA expands the circumstances under which funds in a bank account may be forfeited. IMLAFATA also amended the BHC Act and the Bank Merger Act to require the federal banking regulatory authorities to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application to expand operations. First National Community Bancorp, Inc. has in place a Bank Secrecy Act compliance program.

Sarbanes-Oxley Act of 2002 - In 2002, the Sarbanes-Oxley Act (the "Act") became law. The stated goals of the Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Act is the most far-reaching U.S. securities legislation enacted in decades. The Act generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934. Due to the SEC's extensive role in implementing rules relating to many of the Act's new requirements, the final scope of these requirements remains to be determined.

The Act includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC. The Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The Act addresses, among other matters:

- audit committees for all reporting companies;
- certification of financial statements by the chief executive officer and the chief financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;
- a prohibition on insider trading during pension plan black out periods;
- disclosure of off-balance sheet transactions;

- a prohibition on personal loans to directors and officers; expedited filing requirements for Form 4's;

- disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;
- "real time" filing of periodic reports;
- the formation of a public accounting oversight board;
- auditor independence; and
- various increased criminal penalties for violations of securities laws.

The SEC was delegated the task of enacting rules to implement various provisions with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

Regulation W - Transactions between a bank and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve Board has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate. Affiliates of a bank include, among other entities, the bank's holding company and companies that are under common control with the bank. First National Community Bancorp, Inc. is considered to be an affiliate of First National Community Bank. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in "covered transactions" with affiliates:

- to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and
- to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A "covered transaction" includes:

- a loan or extension of credit to an affiliate;
- a purchase of, or an investment in, securities issued by an affiliate;
- a purchase of assets from an affiliate, with some exceptions;
- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and
- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under Regulation W:

- a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;
- covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and
- with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

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Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve Board decides to treat these subsidiaries as affiliates.

Concurrently with the adoption of Regulation W, the Federal Reserve Board has proposed a regulation which would further limit the amount of loans that could be purchased by a bank from an affiliate to not more than 100% of the bank's capital and surplus.

The global and U.S. economies are experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system during the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions. The availability of credit, confidence in the financial sector, and level of volatility in the financial markets have been significantly adversely affected as a result. In recent weeks, volatility and disruption in the capital and credit markets has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength.

In response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the "EESA") was signed into law. Pursuant to the EESA, the U.S. Treasury will have the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. The EESA included a provision for a temporary increase in FDIC insurance from $100,000 to $250,000 per depositor through December 31, 2009.

On October 14, 2008, Secretary Paulson, after consulting with the Federal Reserve and the FDIC, announced that the Department of the Treasury will purchase equity stakes in a wide variety of banks and thrifts. Under this program, known as the Troubled Asset Relief Program ("TARP") Capital Purchase Program, from the $700 billion authorized by the EESA, the Treasury will make $250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions will be required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under TARP Capital Purchase Program.

Also on October 14, 2008, after receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, Secretary Paulson signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction deposit accounts under a Temporary Liquidity Guarantee Program. Coverage under the Temporary Liquidity Guarantee Program is available until November 12, 2008 without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits. Under the Capital Purchase Program, the Corporation sold $10,000,000 in Series A Fixed Rate Cumulative Perpetual Preferred Stock to the United States Department of the Treasury.

It is not clear at this time what impact the EESA, TARP Capital Purchase Program, the Temporary Liquidity Guarantee Program, other liquidity and funding initiatives of the Federal Reserve and other agencies that have been previously announced, and any additional programs that may be initiated in the future will have on the financial markets and the other difficulties described above, including the extreme levels of volatility and limited credit availability currently being experienced, or on the U.S. banking and financial industries and the broader U.S. and global economies. Further adverse effects could have an adverse effect on the Corporation and its business.

EMPLOYEES

As of December 31, 2008 the bank employed 310 persons, including 60 part-time employees.

AVAILABLE INFORMATION

The company files reports, proxy and information statements and other information electronically with the Securities and Exchange Commission. You may read and copy any materials that the company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's website site address ishttp://www.sec.gov. The company's web site address is http://www.fncb.com. The company makes available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Further, we will provide electronic or paper copies of the company's filings free of charge upon request. A copy of the company's Annual Report on Form 10-K for the year ended December 31, 2008 may be obtained without charge from our website at www.fncb.com or via email at fncb@fncb.com. Information may also be obtained via written request to First National Community Bancorp, Inc. Attention: Treasurer, 102 East Drinker Street, Dunmore, PA 18512.

Item 1A. Risk Factors.

The soundness of other financial institutions may adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. The Corporation has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose the Corporation to credit risk in the event of a default by a counterparty or client. In addition, the Corporation's credit risk may be exacerbated when the collateral held by the Corporation cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Corporation. Any such losses could have a material adverse affect on the Corporation's financial condition and results of operations.

Current levels of market volatility are unprecedented and may have materially adverse effects on our liquidity and financial condition.

The capital and credit markets have been experiencing extreme volatility and disruption for more than 12 months. In recent weeks, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on stock prices, security prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength. If the current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience adverse effects, which may be material, on our liquidity, financial condition and profitability.

The Company Is Subject To Interest Rate Risk

The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies, to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

The Company Is Subject To Lending Risk

As of December 31, 2008, approximately 44% of the Company's loan portfolio consisted of commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because the Company's loan portfolio contains a significant number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations.

If the Company's allowance for loan losses is not sufficient to cover actual loan losses, its earnings could decrease.

The Company's loan customers may not repay their loans according to the terms of their loans, and the collateral securing the payment of their loans may be insufficient to assure repayment. The Company may experience significant credit losses, which could have a material adverse effect on its operating results. The Company makes various assumptions and judgments about the collectability of its loan portfolio, including the creditworthiness of its borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of its loans. In determining the amount of the allowance for loan losses, the Company reviews its loans and its loss and delinquency experience, and the Company evaluates economic conditions. If its assumptions prove to be incorrect, its allowance for loan losses may not cover inherent losses in its loan portfolio at the date of its financial statements. Material additions to the Company's allowance would materially decrease its net income. At December 31, 2008, its allowance for loan losses totaled $8.3 million, representing .86% of its total loans.

Although the Company believes it has underwriting standards to manage normal lending risks, it is difficult to assess the future performance of its loan portfolio due to the relatively recent origination of many of these loans. The Company can give you no assurance that its non-performing loans will not increase or that its non-performing or delinquent loans will not adversely affect its future performance.

In addition, federal and state regulators periodically review the Company's allowance for loan losses and may require it to increase its allowance for loan losses or recognize further loan charge-offs. Any increase in its allowance for loan losses or loan charge-offs as required by these regulatory agencies could have a material adverse effect on its results of operations and financial condition.

The Company's Profitability Depends Significantly On Economic Conditions In The Commonwealth of Pennsylvania specifically in Lackawanna and Luzerne County

The Company's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the Lackawanna and Luzerne County markets. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Company's financial condition and results of operations.

There is no assurance that the Company will be able to successfully compete with others for business.

The Company competes for loans, deposits and investment dollars with numerous regional and national banks and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, and private lenders. Many competitors have substantially greater resources than the Company does, and operate under less stringent regulatory environments. The differences in resources and regulations may make it harder for the Company to compete profitably, reduce the rates that it can earn on loans and investments, increase the rates it must offer on deposits and other funds, and adversely affect its overall financial condition and earnings.

The Company's Controls and Procedures May Fail or Be Circumvented

Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

The Company Relies On Dividends From Its Subsidiaries For Most Of Its Revenue

The Company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company's common stock, interest and principal on debt when applicable, and normal operating expenditures. Various federal and/or state laws and regulations limit the amount of dividends that the Bank and certain non-bank subsidiaries may pay to the Company. Also, its right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to the Company, it may not be able to service debt, pay obligations or pay dividends on the Company's common stock. The inability to receive dividends from the Bank could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company May Not Be Able To Attract and Retain Skilled People

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel. The Company does not currently have employment agreements or non-competition agreements with any of its senior officers.

The Company Is Subject To Claims and Litigation Pertaining To Fiduciary Responsibility

From time to time, customers make claims and take legal action pertaining to the Company's performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Company's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to the Company they may result in significant financial liability and/or adversely affect the market perception of the Company and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

The Trading Volume In The Company's Common Stock Is Less Than That Of Other Larger Financial Services Companies

The Company's common stock is traded on the Over-the-Counter (OTC) Bulletin Board; the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company's common stock, significant sales of the Company's common stock, or the expectation of these sales, could cause the Company's stock price to fall.

Item 1B. Unresolved Staff Comments.

Not Applicable

Item 2. Properties.

Property	Location	Ownership	Type of Use
1	102 East Drinker Street Dunmore, PA	Own	Main Office
2	419-421 Spruce Street Scranton, PA	Own	Scranton Branch
3	934 Main Street Dickson City, PA	Own	Dickson City Branch
4	1743 North Keyser Avenue Scranton, PA	Lease	Keyser Village Branch
5	23 West Market Street Wilkes-Barre, PA	Lease	Wilkes-Barre Branch
6	1700 North Township Blvd. Pittston, PA	Lease	Pittston Plaza Branch
7	754 Wyoming Avenue Kingston, PA	Lease	Kingston Branch
8	1625 Wyoming Avenue Exeter, PA	Lease	Exeter Branch
9	Route 502 & 435 Daleville, PA	Lease	Daleville Branch
10	27 North River Road Plains, PA	Lease	Plains Branch
11	169 North Memorial Highway Shavertown, PA	Lease	Back Mountain Branch
12	269 East Grove Street Clarks Green, PA	Own	Clarks Green Branch
13	734 Sans Souci Parkway Hanover Township, PA	Lease	Hanover Township Branch
14	194 South Market Street Nanticoke, PA	Own	Nanticoke Branch
15	330-352 West Broad Street Hazleton, PA	Own	Hazleton Branch
16	3 Old Boston Road Pittston, PA	Lease	Route 315 Branch

17	1001 Main Street Honesdale, PA	Own	Honesdale Branch
18	301 McConnell Street Stroudsburg, PA	Own	Stroudsburg Branch
19	1127 Texas Palmyra Highway Honesdale, PA	Lease	Honesdale Route 6 Branch
20	5120 Milford Road East Stroudsburg, PA	Own	Marshalls Creek Branch
21	200 South Blakely Street Dunmore, PA	Lease	Administrative Center
22	107-109 South Blakely Street Dunmore, PA	Own	Parking Lot
23	114-116 South Blakely Street Dunmore, PA	Own	Parking Lot

24	1708 Tripp Avenue Dunmore, PA	Own	Parking Lot
25	119-123 South Blakely Street Dunmore, PA	Own	Parking Lot
26	Rt. 940 Blakeslee, PA	Own	Land
27	Route 611 Paradise Township, PA	Own	Land
28	Main Street Taylor, PA	Own	Land

Item 3. Legal Proceedings.

Neither the company nor its subsidiaries are involved in any material pending legal proceedings, other than routine litigation incidental to the business nor does the company know of any proceedings contemplated by governmental authorities.

Item 4. Submission of Matters to a Vote of Security Holders.

Not Applicable

PART II

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

INVESTOR INFORMATION

MARKET PRICES OF STOCK AND DIVIDENDS PAID

The company's common stock is not actively traded. The principal market area for the company's stock is northeastern Pennsylvania, although shares are held by residents of other states across the country. First National Community Bancorp, Inc. is listed in the Over-The-Counter Bulletin Board (OTCBB) Stocks under the symbol "FNCB". Quarterly market highs and lows and dividends paid for each of the past two years are presented below. These prices represent actual transactions. The company expects that comparable cash dividends will be paid in the future.

	MARKET PRICE		DIVIDENDS PAID PER SHARE
	HIGH	LOW	
QUARTER	2008		
First	$18.96	$12.98	$ .11
Second	16.47	13.48	.11
Third	15.27	11.87	.11
Fourth	13.48	9.56	.13
			$ 0.46
QUARTER	2007		
First	$23.76	$20.00	$ .10
Second	22.48	19.20	.10
Third	20.00	16.25	.10
Fourth	18.99	16.00	.12
			$ 0.42

* Share and per share information includes the retroactive effect of the 25% stock dividend paid December 27, 2007.

MARKET MAKERS

The following firms are known to make a market in the company's stock:

Boenning & Scattergood, Inc. 4 Tower Bridge 200 Barr Harbor Drive, Suite 300 W. Conshohocken, PA 19428-2979 (610) 832-1212	Ferris, Baker Watts, Incorporated 100 Light Street Baltimore, MD 21202 (800) 638-7411	Monroe Securities 47 State Street Rochester, NY 14614 (800) 766-5560	Stifel Nicolaus & Co. One Financial Plaza 501 North Broadway St. Louis, MO 63102-2102 (800) 776-6821

TRANSFER AGENT

Registrar and Transfer Company

10 Commerce Drive

Cranford, NJ 07016-9982

Shareholder questions regarding stock ownership should be directed to the Investor Relations Department at Registrar and Transfer Company at 1-800-368-5948.

HOLDERS

As of March 11, 2009, there were approximately 1,650 holders of the company's common stock.

DIVIDEND CALENDAR

Dividends on the company's common stock, if approved by the Board of Directors, are customarily paid on or about March 15, June 15, September 15 and December 15. Record dates for dividends are customarily on or about March 1, June 1, September 1, and December 1.

EQUITY COMPENSATION PLAN

Information regarding the company's compensation plans under which equity securities of the registrant are authorized for issuance as of December 31, 2008 is set forth under the caption "Equity Compensation Plan Information" in the Proxy Statement filed for the annual meeting of shareholders to be held on May 20, 2009 and is incorporated by reference.

PERFORMANCE GRAPH

Information regarding the company's stock performance graph is set forth under the caption "Stock Performance Graph and Table" in the Proxy Statement filed for the annual meeting of shareholders to be held on May 20, 2009 and is incorporated by reference.

PURCHASE OF EQUITY SECURITIES BY THE ISSUER OR AFFILIATED PURCHASERS

None.

Item 6. Selected Financial Data.

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
SELECTED FINANCIAL DATA
(In thousands, except per share data)

	For the Years Ended December 31,				
	2008	2007	2006	2005	2004
Total assets	$1,313,759	$1,297,553	$1,186,327	$1,009,254	$908,498
Interest-bearing balances with financial institutions	0	0	0	2,178	1,980
Securities	258,795	306,530	270,433	238,223	231,831
Net loans	956,674	899,015	830,665	708,413	626,799
Total deposits	952,892	945,517	920,973	750,666	671,713
Long-Term Debt	202,243	135,942	147,489	126,942	138,449
Stockholders' equity	100,342	107,142	96,862	84,419	75,723
Net interest income before provision for credit losses	40,209	39,314	35,482	30,950	25,269
Provision for credit losses	2,700	2,200	2,080	1,860	1,400
Other income	7,812	6,345	4,897	3,904	4,789
Other expenses	25,634	23,797	20,773	18,943	17,399
Income before income taxes	19,687	19,662	17,526	14,051	11,259
Provision for income taxes	4,604	4,966	4,017	2,826	1,996
Net income	15,083	14,696	13,509	11,225	9,263
Cash dividends paid	7,294	6,614	5,776	4,513	3,885
Per share data:					
Net income - basic (1)	$0.95	$0.94	$0.88	$0.74	$0.62
Net income - diluted (1)	$0.93	$0.92	$0.86	$0.72	$0.60
Cash dividends (2)	$0.46	$0.42	$0.38	$0.30	$0.26
Book value (1)(3)	$6.33	$6.87	$6.31	$5.58	$5.11
Weighted average number of shares outstanding–basic (1)	15,862,335	15,601,377	15,352,406	15,125,382	14,823,060
Weighted average number of shares outstanding-diluted (1)	16,200,098	15,931,260	15,721,491	15,537,485	15,362,307

(1) Earnings per share and book value per share are calculated based on the weighted average number of shares outstanding during each year, after giving retroactive effect to the 25% stock dividend paid December 27, 2007, the 10% stock dividend paid March 31, 2006 and the 100% stock dividend paid September 30, 2004. Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is computed by dividing net income available to common shareholders, adjusted for any changes in income that would result from the assumed conversion of all potential dilutive common shares, by the sum of the weighted average number of common shares outstanding and the effect of all dilutive potential common shares outstanding for the period.

(2) Cash dividends per share have been restated to reflect to retroactive effect of the 25% stock dividend paid December 27, 2007, the 10% stock dividend paid March 31, 2006 and the 100% stock dividend paid September 30, 2004.

(3) Reflects the effect of SFAS No. 115 in the amount of $(20,201,000) IN 2008, $(2,190,000) in 2007, $(70,000) in 2006, $(524,000) in 2005, and $1,030,000 in 2004.

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

Certain of the matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operation," may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from future results, performance, or achievements expressed or implied by such forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate," and similar expressions are intended to identify such forward-looking statements.

The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation (a) the effects of future economic conditions on the Company and its customers; (b) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; (c) governmental monetary and fiscal policies, as well as legislative and regulatory changes; (d) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters; (e) the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks; (f) the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in the Company's market area and elsewhere, including institutions operating locally, regionally, nationally, and internationally, together with such competitors offering banking products and services by mail, telephone, computer, and the Internet; (g) technological changes; (h) acquisitions and integration of acquired businesses; (i) the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities; (j) acts of war or terrorism and (k) volatilities in the securities markets and in deteriorating economic conditions. All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements. The company undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review the risk factors described in other documents that are filed periodically with the SEC.

The following financial review of First National Community Bancorp, Inc. is presented on a consolidated basis and is intended to provide a comparison of the financial performance of the company, including its wholly-owned subsidiary, First National Community Bank for the years ended December 31, 2008, 2007 and 2006. The information presented below should be read in conjunction with the company's consolidated financial statements and accompanying notes appearing elsewhere in this report. All share and per share information reflects the retroactive effect of the 25% stock dividend paid December 27, 2007 and the 10% stock dividend paid March 31, 2006.

SUMMARY

Net Income totaled $15,083,000 in 2008 which was $387,000, or 3%, higher than the $14,696,000 earned last year. The 2007 earnings were $1.2 million, or 9%, higher than the $13,509,000 reported for 2006. Basic earnings per share increased from the $0.94 per share reported in 2007 to $0.95 in 2008. In 2007, basic earnings per share improved 7% from $0.88 in 2006 to $0.94. The weighted average number of shares outstanding used to calculate basic earnings per share was 15,862,335 in 2008, 15,601,377 in 2007, and 15,352,406 in 2006.

The earnings improvement recorded in 2008 included an $895,000, or 2%, increase in net interest income before providing for credit losses due to the growth of the balance sheet. Other income increased $1.5 million over 2007 which includes a $430,000 increase from service charges and fees and a $1,037,000 increase in net gains from the sale of assets. Operating expenses increased $1.8 million in comparison to 2007 which includes the costs associated with the addition of a new community office and additional growth. The annual provision for credit losses was $500,000 higher than in the prior period, and federal income tax expense decreased $362,000 due to a higher level of tax free income on loans and securities.

The earnings improvement recorded in 2007 included a $3.8 million, or 11%, increase in net interest income before providing for credit losses due to the growth of the balance sheet. Other income increased $1.5 million over 2006 which includes a $724,000 increase from service charges and fees and a $724,000 increase in net gains from the sale of assets. Operating expenses increased $3.0 million in comparison to 2006 which includes the expansion of the branch network by two offices and costs associated with additional growth. The annual provision for credit losses was $120,000 higher than the prior period, and federal income taxes increased $949,000 due to the overall improvement in earnings.

The company's return on assets for the years ended December 31, 2008, 2007, and 2006 was 1.17%, 1.18%, and 1.26%, respectively while the return on average equity was 14.35%, 14.32%, and 15.30%.

NET INTEREST INCOME

Net interest income, the difference between interest income and fees on earning assets and interest expense on deposits and borrowed funds, is the largest component of the company's operating income and as such is the primary determinant of profitability. Changes in net interest income occur due to fluctuations in the balances and/or mixes of interest-earning assets and interest-bearing liabilities, and changes in their corresponding interest yields and costs. Before providing for future credit losses, net interest income increased $895,000 in 2008 due to growth in loans and the positive impact of downward pricing on interest bearing assets and liabilities. Changes in non-performing assets, together with interest lost and recovered on those assets, also impacted comparisons of net interest income. In the following schedules, net interest income is analyzed on a tax-equivalent basis, thereby increasing interest income on certain tax-exempt loans and investments by the amount of federal income tax savings realized. In this manner, the true economic impact on earnings from various assets and liabilities can be more accurately compared.

In 2008, tax-equivalent net interest income improved $1.3 million, or 3%, when compared to the prior year. Growth of the balance sheet, effective asset-liability management strategies and the positive impact due to repricing all contributed to earnings improvement.

Average loans outstanding increased $39 million, or 4% in 2008. The average yield earned on the loan portfolio decreased one hundred twenty one basis points as a result of the Federal Reserve monetary policy which reduced the prime interest rate by 4.00% to help a struggling economy. This strategy had a significant impact on our variable rate loans, resulting in an $8.2 million decrease in income earned on total loans. Commercial loans were most severely impacted by the lower interest rate environment due to the high volume of variable rate credits. Interest income decreased $9.1 million on this group of loans in spite of a $24 million increase in average loans outstanding. Included in this total is over $16 million of commercial loan balances which were transferred to nonaccrual status during 2008, and this transfer combined with balances previously placed in this non-earning category, resulted in a $1.2 million loss of earnings on those assets. Retail loans outstanding grew $15.7 million on average due primarily to a $9.8 million increase in average indirect auto loans. Earnings on those loans improved $946,000 when compared to last year.

Average securities decreased $3 million in 2008 as liquidity was utilized to fund loan growth. Investment in higher yielding mortgage-back securities and tax- free municipal bonds led to a fourteen basis point improvement in the yield earned which resulted in an additional $206,000 of interest income over the prior year. Money market balances were limited to $717,000 on average as funds were utilized in higher earning assets. Earnings on this category of assets decreased $16,000 in 2008 due to the lower interest rate environment.

Average interest-bearing deposit balances decreased $18 million in 2008 as many time deposits matured and migrated to competitors paying above market rates due to their inability to access other sources of funds. Interest-bearing demand deposits decreased $4 million during the year due to activity in large commercial accounts and municipal relationships while average savings deposits increased $3 million. Average time deposits decreased $17 million as many customers withdrew funds as interest rates paid on certificates of deposit decreased. The average cost of interest-bearing deposits decreased 1.10% from the 2007 rate which helped to offset the earnings lost on assets. Average borrowed funds outstanding increased $60 million in 2008 to offset the deposits lost, and the average rate paid on these borrowings was ninety eight basis points lower than the rate paid in 2007.

Overall, growth of the balance sheet combined with a fourteen basis point increase in the spread earned resulted in the $1.3 million increase in tax-equivalent net interest income. The net interest margin remained stable at 3.59%. Investment leveraging transactions continued to add to the profitability of the company in 2008, contributing almost $1.4 million to pre-tax earnings, but the average spread earned on the transactions was 1.69% which negatively impacted the net interest margin. Exclusive of these transactions, the company's 2008 net interest margin would have been 3.73% which equals the comparable 3.73% recorded last year.

During 2007, tax-equivalent net interest income improved $4,172,000, or 11%, compared to the 2006 total. Significant loan growth once again had a major impact on the company's improved earnings. Higher yields earned on loans and securities also contributed to the increased income. Effective asset-liability management strategies allowed the company to avoid significant margin compression while positioning for the next cycle of interest rates. The net interest margin decreased fourteen basis points from the 3.73% reported in 2006 to 3.59% in 2007.

Average loans outstanding increased $119 million, or 15%, over the 2006 level and the average yield earned on total loans improved .17% in 2007, resulting in a $10.4 million increase in earnings from the portfolio. Commercial lending provided the majority of the growth, adding almost $82 million of balances on average and $7.4 million of the earnings improvement. Average consumer loans outstanding increased $37 million in 2007 primarily due to growth in indirect auto loans and home equity lending, providing an additional $3.0 million improvement.

Average investment securities were $39 million higher than the prior year, and the higher yields recorded on new purchases contributed to a .39% increase in the average yield earned, resulting in $3.3 million of additional interest income. Money market balances decreased $2.1 million on average, resulting in a $100,000 reduction in earnings from these low yielding assets.

Average deposit growth was also significant in 2007, due primarily to increased municipal relationships and the full year's impact from the deposits acquired in 2006. Average interest-bearing deposit balances grew $135 million in 2007. Municipal growth contributed to a $38 million increase in interest-bearing demand balances and also factored into the .22% increase in the cost of these funds. Time deposits greater than $100,000 increased $31 million on average as commercial customers took advantage of rising interest rates and moved monies into these higher earning deposits. Overall, the company's cost of deposits increased .40% in 2007. Borrowed funds and other interest-bearing liabilities increased $18 million on average, and this growth combined with a .24% increase in the cost of these borrowings added $1.3 million of interest expense in 2007.

As a result, the positive growth of the balance sheet offset the impact of rising liability costs, but the net interest margin decreased from the 3.73% reported in 2006 to 3.59% in 2007. Another factor affecting the company's net interest margin was investment leveraging transactions which match assets with liabilities at various points in the interest rate cycles. These transactions provided over $800,000 of net interest income in 2007, but the interest spread of 1.24% had a negative impact on the company's overall net interest margin. Exclusive of these transactions, the 2007 margin would have been 3.73% which is .15% lower than the comparable 3.88% recorded in 2006.

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Yield Analysis
(dollars in thousands-taxable equivalent basis)(1)

	2008			2007			2006		
	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate	Average Balance	Interest Income/ Expense	Average Interest Rate
ASSETS:									
Earning Assets:(2)									
Commercial loans-taxable	$664,333	$42,523	6.40%	$650,679	$52,276	8.03%	$576,002	$45,461	7.89%
Commercial loans-tax free	48,325	3,494	7.23%	38,229	2,874	7.52%	31,085	2,256	7.26%
Mortgage loans	36,890	2,619	7.10%	34,695	2,352	6.78%	29,642	1,961	6.62%
Installment loans	177,228	11,253	6.35%	163,729	10,574	6.46%	131,767	7,994	6.07%
Total Loans	926,776	59,889	6.46%	887,332	68,076	7.67%	768,496	57,672	7.50%
Securities-taxable	194,162	11,020	5.68%	211,139	11,446	5.42%	177,315	8,338	4.70%
Securities-tax free	88,376	5,774	6.53%	74,817	5,142	6.87%	69,313	4,996	7.21%
Total Securities	282,538	16,794	5.94%	285,956	16,588	5.80%	246,628	13,334	5.41%
Interest-bearing deposits with banks	0	0	0.00%	0	0	0.00%	1,279	55	4.30%
Federal funds sold	717	12	1.67%	544	28	5.15%	1,406	73	5.19%
Total Money Market Assets	717	12	1.67%	544	28	5.15%	2,685	128	4.77%
Total Earning Assets	1,210,031	76,695	6.34%	1,173,832	84,692	7.22%	1,017,809	71,134	6.99%
Non-earning assets	90,921			81,529			59,947		
Allowance for credit losses	(6,861)			(8,357)			(7,873)		
Total Assets	$1,294,091			$1,247,004			$1,069,883		
LIABILITIES AND STOCKHOLDERS' EQUITY:									
Interest-Bearing Liabilities:									
Interest-bearing demand deposits	$288,226	$4,025	1.40%	$292,134	$8,064	2.76%	$254,065	$6,453	2.54%
Savings deposits	74,349	692	0.93%	71,444	868	1.21%	72,889	960	1.32%
Time deposits over $100,000	182,205	6,633	3.64%	193,834	9,271	4.78%	162,559	7,143	4.39%
Other time deposits	309,585	12,239	3.95%	314,469	15,413	4.90%	246,993	10,959	4.44%
Total Interest-Bearing Deposits	854,365	23,589	2.76%	871,881	33,616	3.86%	736,506	25,515	3.46%
Borrowed funds and other									
Interest-bearing liabilities									