CITIZENS & NORTHERN CORP
Form 10-Q
November 07, 2012

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, 2012**

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 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) 12,255,383 Shares Outstanding on November 1, 2012

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (Unaudited)

(In Thousands, Except Share Data)	September 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks:		
Noninterest-bearing	$ 20,567	$ 17,618
Interest-bearing	21,929	42,957
Total cash and due from banks	42,496	60,575
Available-for-sale securities, at fair value	487,314	481,685
Loans held for sale	3,846	939
Loans receivable	698,149	708,315
Allowance for loan losses	(7,792)	(7,705)
Loans, net	690,357	700,610
Bank-owned life insurance	21,236	20,889
Accrued interest receivable	4,927	4,797
Bank premises and equipment, net	19,010	19,028
Foreclosed assets held for sale	839	1,235
Deferred tax asset, net	2,122	6,173
Intangible asset - Core deposit intangibles	156	212
Intangible asset - Goodwill	11,942	11,942
Other assets	25,764	15,650
TOTAL ASSETS	$ 1,310,009	$ 1,323,735
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 187,920	$ 193,595
Interest-bearing	825,090	824,611
Total deposits	1,013,010	1,018,206
Short-term borrowings	19,657	4,950
Long-term borrowings	89,954	125,363
Accrued interest and other liabilities	7,242	7,831
TOTAL LIABILITIES	1,129,863	1,156,350
STOCKHOLDERS' EQUITY		
Preferred stock, $1,000 par value; authorized 30,000 shares; $1,000 liquidation preference per share; no shares issued at September 30, 2012 and December 31, 2011	0	0
Common stock, par value $1.00 per share; authorized 20,000,000 shares in 2012 and 2011; issued 12,506,759 at September 30, 2012 and 12,460,920 at December 31, 2011	12,507	12,461
Paid-in capital	68,215	67,568
Retained earnings	91,811	82,302
Treasury stock, at cost; 252,000 shares at September 30, 2012 and 305,391 shares at December 31, 2011	(4,213)	(5,106)

Sub-total	168,320	157,225
Accumulated other comprehensive income:		
Unrealized gains on available-for-sale securities	12,278	10,791
Defined benefit plans	(452)	(631)
Total accumulated other comprehensive income	11,826	10,160
TOTAL STOCKHOLDERS' EQUITY	180,146	167,385
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 1,310,009	$ 1,323,735

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

CITIZENS & NORTHERN CORPORATION - FORM 10-Q

CONSOLIDATED STATEMENTS OF OPERATIONS	3 Months Ended		Fiscal Year To Date	
(In Thousands, Except Per Share Data) (Unaudited)	Sept. 30, 2012	Sept. 30, 2011	9 Months Ended Sept. 30, 2012	2011
INTEREST INCOME				
Interest and fees on loans	$9,996	$10,790	$ 30,604	$ 32,485
Interest on balances with depository institutions	31	13	90	45
Interest on loans to political subdivisions	395	372	1,147	1,119
Interest on loans held for sale	42	9	74	36
Income from available-for-sale and held-to-maturity securities:				
Taxable	2,019	2,784	7,197	8,326
Tax-exempt	1,275	1,285	3,803	3,860
Dividends	78	64	226	187
Total interest and dividend income	13,836	15,317	43,141	46,058
INTEREST EXPENSE				
Interest on deposits	1,158	1,775	3,779	6,610
Interest on short-term borrowings	2	6	6	20
Interest on long-term borrowings	1,068	1,327	3,346	4,122
Total interest expense	2,228	3,108	7,131	10,752
Net interest income	11,608	12,209	36,010	35,306
Provision (credit) for loan losses	236	(37)	421	(198)
Net interest income after provision (credit) for loan losses	11,372	12,246	35,589	35,504
OTHER INCOME				
Service charges on deposit accounts	1,290	1,230	3,707	3,586
Service charges and fees	239	218	694	643
Trust and financial management revenue	873	785	2,762	2,608
Interchange revenue from debit card transactions	477	490	1,460	1,427
Net gains from sale of loans	625	263	1,263	677
Increase in cash surrender value of life insurance	111	127	347	381
Insurance commissions, fees and premiums	62	66	169	192
Impairment loss on limited partnership investment	0	0	0	(948)
Other operating income	426	820	1,555	1,661
Sub-total	4,103	3,999	11,957	10,227
Total other-than-temporary impairment losses on available-for-sale securities	0	0	(67)	0
Portion of (gain) loss recognized in other comprehensive loss (before taxes)	0	0	0	0
Net impairment losses recognized in earnings	0	0	(67)	0
Realized gains on available-for-sale securities, net	2,430	26	2,698	2,028
Net realized gains on available-for-sale securities	2,430	26	2,631	2,028
Total other income	6,533	4,025	14,588	12,255
OTHER EXPENSES				
Salaries and wages	3,594	3,451	10,755	10,321
Pensions and other employee benefits	982	1,020	3,438	3,344
Occupancy expense, net	610	641	1,874	2,038
Furniture and equipment expense	475	498	1,418	1,435
FDIC assessments	165	174	468	688
Pennsylvania shares tax	339	345	1,011	984

Loss on prepayment of debt	2,190	0	2,333	0
Other operating expense	2,042	1,923	5,897	5,299
Total other expenses	10,397	8,052	27,194	24,109
Income before income tax provision	7,508	8,219	22,983	23,650
Income tax provision	2,014	2,230	6,217	6,423
NET INCOME	$5,494	$5,989	$ 16,766	$ 17,227
NET INCOME PER SHARE - BASIC	$0.45	$0.49	$ 1.37	$ 1.42
NET INCOME PER SHARE - DILUTED	$0.45	$0.49	$ 1.37	$ 1.42

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands) (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$ 5,494	$ 5,989	$ 16,766	$ 17,227
Unrealized gains on available-for-sale securities:				
Unrealized holding gains on available-for-sale securities	3,597	5,310	5,168	17,384
Reclassification adjustment for gains realized in income	(2,430)	(26)	(2,631)	(2,028)
Other comprehensive gain on available-for-sale securities	1,167	5,284	2,537	15,356
Unfunded pension and postretirement obligations:				
Change in items from defined benefit plans included in accumulated other comprehensive income	0	0	200	(122)
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	20	14	60	41
Other comprehensive gain (loss) on unfunded retirement obligations	20	14	260	(81)
Other comprehensive income before income tax	1,187	5,298	2,797	15,275
Income tax related to other comprehensive income	(415)	(1,800)	(1,131)	(5,190)
Net other comprehensive income	772	3,498	1,666	10,085
Total comprehensive income	$ 6,266	$ 9,487	$ 18,432	$ 27,312

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

CONSOLIDATED STATEMENTS OF CASH FLOWS	Nine Months Ended Sept. 30,	
(In Thousands) (Unaudited)	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 16,766	$ 17,227
Adjustments to reconcile net income to net cash provided by operating activities: Provision (credit) for loan losses	421	(198)
Realized gains on available-for-sale securities, net	(2,631)	(2,028)
Loss on prepayment of debt	2,333	0
Gain on disposition of premises and equipment	(271)	(324)
Loss (gain) on sale of foreclosed assets, net	99	(8)
Depreciation expense	1,444	1,584
Accretion and amortization on securities, net	1,022	1,045
Accretion and amortization on loans, deposits and borrowings, net	(40)	(27)
Amortization of mortgage servicing rights	69	48
Impairment loss on limited partnership interest	0	948
Increase in cash surrender value of life insurance	(347)	(381)
Stock-based compensation	487	386
Amortization of core deposit intangibles	56	86
Deferred income taxes	2,920	2,936
Gains on sales of mortgage loans, net	(1,263)	(677)
Origination of mortgage loans for sale	(42,571)	(15,166)
Proceeds from sales of mortgage loans	40,665	19,683
(Increase) decrease in accrued interest receivable and other assets	(1,266)	888
(Decrease) increase in accrued interest payable and other liabilities	(545)	1,280
Net Cash Provided by Operating Activities	17,348	27,302
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of certificates of deposit	(1,060)	0
Proceeds from sales of available-for-sale securities	14,804	16,696
Proceeds from calls and maturities of available-for-sale securities	81,595	79,813
Purchase of available-for-sale securities	(107,483)	(108,327)
Redemption of Federal Home Loan Bank of Pittsburgh stock	1,222	1,164
Net decrease in loans	9,141	22,150
Proceeds from bank-owned life insurance	0	1,442
Purchase of premises and equipment	(1,428)	(666)
Proceeds from disposition of premises and equipment	455	3,060
Purchase of investment in limited liability entity	(538)	(200)
Return of principal on limited liability entity investments	80	93
Proceeds from sale of foreclosed assets	1,120	640
Net Cash (Used in) Provided by Investing Activities	(2,092)	15,865
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(5,202)	(8,632)
Net increase in short-term borrowings	14,707	821
Repayments of long-term borrowings	(37,742)	(20,471)
Purchase of treasury stock	0	(983)
Sale of treasury stock	219	16
Tax benefit from compensation plans	83	48
Common dividends paid	(6,460)	(4,513)

Net Cash Used in Financing Activities	(34,395)	(33,714)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(19,139)	9,453
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	56,815	46,301
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 37,676	$ 55,754
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Assets acquired through foreclosure of real estate loans	$ 737	$ 1,691
Interest paid	$ 7,392	$ 10,817
Income taxes paid	$ 4,150	$ 2,300

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

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Consolidated Statements of Changes in Stockholders' Equity

Nine Months Ended September 30, 2012 and 2011

(In Thousands Except Share and Per Share Data)

(Unaudited)

	Common Shares	Treasury Shares	Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Comprehensive Income (Loss)	Treasury Stock	Total
Nine Months Ended September 30, 2012:								
Balance, December 31, 2011	12,460,920	305,391	$12,461	$67,568	$82,302	$10,160	$(5,106)	$167,
Net income					16,766			16,7
Other comprehensive income, net						1,666		1,66
Cash dividends declared on common stock, $.60 per share					(7,331)			(7,3
Shares issued for dividend reinvestment plan	45,839		46	825				871
Shares issued from treasury related to exercise of stock options		(14,399)		(22)			241	219
Restricted stock granted		(42,552)		(711)			711	0
Forfeiture of restricted stock		3,560		59			(59)	0
Stock-based compensation expense				487				487
Tax benefit of stock options				9				9
Tax benefit from employee benefit plan					74			74
Balance, September 30, 2012	12,506,759	252,000	$12,507	$68,215	$91,811	$11,826	$(4,213)	$180,
Nine Months Ended September 30, 2011:								
Balance, December 31, 2010	12,408,212	254,614	$12,408	$66,648	$65,920	$(1,601)	$(4,431)	$138,
Net income					17,227			17,2
Other comprehensive income, net						10,085		10,0
Cash dividends declared on common stock, $.42 per share					(5,110)			(5,1
Shares issued for dividend reinvestment plan	39,007		39	558				597
Treasury stock purchased		68,410					(983)	(983
Shares issued from treasury related to exercise of stock options		(1,108)		(3)			19	16
Restricted stock granted		(15,622)		(272)			272	0
Forfeiture of restricted stock		295		5			(5)	0
Stock-based compensation expense				386				386
Tax benefit from employee benefit plan					48			48
Balance, September 30, 2011	12,447,219	306,589	$12,447	$67,322	$78,085	$8,484	$(5,128)	$161,

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

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, 2011, 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, comprehensive income, 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 2011 information has been reclassified for consistency with the 2012 presentation.

Operating results reported for the three-month and nine-month periods ended September 30, 2012 might not be indicative of the results for the year ending December 31, 2012. 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	Weighted-Average Common Shares	Earnings Per Share
Nine Months Ended September 30, 2012			
Earnings per share – basic	$16,766,000	12,225,895	$ 1.37
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		202,199	
Hypothetical share repurchase at $19.35		(175,737)	
Earnings per share – diluted	$16,766,000	12,252,357	$ 1.37

Nine Months Ended September 30, 2011			
Earnings per 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 share – diluted	$17,227,000	12,170,611	$ 1.42
Quarter Ended September 30, 2012			
Earnings per share – basic	$5,494,000	12,244,797	$ 0.45
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		198,863	
Hypothetical share repurchase at $19.35		(172,975)	
Earnings per share – diluted	$5,494,000	12,270,685	$ 0.45

	Net Income	Weighted-Average Common Shares	Earnings Per Share
Quarter Ended September 30, 2011			
Earnings per 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 share – diluted	$5,989,000	12,153,861	$ 0.49

Stock options that were anti-dilutive were excluded from net income per share calculations. Weighted-average common shares available from anti-dilutive instruments totaled 146,295 shares in the nine-month period ended September 30, 2012, 224,651 shares in the nine-month period ended September 30, 2011, 143,866 shares in the third quarter 2012 and 223,463 shares in the third quarter 2011.

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 other comprehensive income, and the related tax effects, are as follows:

(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Nine Months Ended September 30, 2012			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$ 5,168	$ (1,971)	$ 3,197
Reclassification adjustment for gains realized in income	(2,631)	921	(1,710)
Other comprehensive gain on available-for-sale securities	2,537	(1,050)	1,487
Unfunded pension and postretirement obligations:			
Change in items from defined benefit plans included in accumulated other comprehensive income	200	(61)	139
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	60	(20)	40
Other comprehensive gain on unfunded retirement obligations	260	(81)	179
Total other comprehensive income	$ 2,797	$ (1,131)	$ 1,666

	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Nine Months Ended September 30, 2011			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$ 17,384	$ (5,908)	$ 11,476
Reclassification adjustment for gains realized in income	(2,028)	690	(1,338)
Other comprehensive gain on available-for-sale securities	15,356	(5,218)	10,138
Unfunded pension and postretirement obligations:			
Change in items from defined benefit plans included in accumulated other comprehensive income	(122)	41	(81)
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	41	(13)	28
Other comprehensive loss on unfunded retirement obligations	(81)	28	(53)
Total other comprehensive income	$ 15,275	$ (5,190)	$ 10,085

	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Quarter Ended September 30, 2012			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$ 3,597	$ (1,259)	$ 2,338
Reclassification adjustment for gains realized in income	(2,430)	851	(1,579)
Other comprehensive gain on available-for-sale securities	1,167	(408)	759
Unfunded pension and postretirement obligations:			
Change in items from defined benefit plans included in accumulated other comprehensive income	0	0	0
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	20	(7)	13
Other comprehensive gain on unfunded retirement obligations	20	(7)	13
Total other comprehensive income	$ 1,187	$ (415)	$ 772

	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Quarter Ended September 30, 2011			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$ 5,310	$ (1,805)	$ 3,505
Reclassification adjustment for gains realized in income	(26)	9	(17)
Other comprehensive gain on available-for-sale securities	5,284	(1,796)	3,488
Unfunded pension and postretirement obligations:			

Change in items from defined benefit plans included in accumulated other comprehensive income	0	0	0
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	14	(4)	10
Other comprehensive gain on unfunded retirement obligations	14	(4)	10
Total other comprehensive income	$ 5,298	$ (1,800)	$ 3,498

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Changes in the components of accumulated other comprehensive income are as follows:

(In Thousands)

	Unrealized Holding Gains on Securities	Unfunded Retirement Obligations	Accumulated Other Comprehensive Income
Nine Months Ended September 30, 2012			
Balance, beginning of period	$ 10,791	$ (631)	$ 10,160
Change during nine months ended September 30, 2012	1,487	179	1,666
Balance, end of period	$ 12,278	$ (452)	$ 11,826
Nine Months Ended September 30, 2011			
Balance, beginning of period	$ (1,351)	$ (250)	$ (1,601)
Change during nine months ended September 30, 2011	10,138	(53)	10,085
Balance, end of period	$ 8,787	$ (303)	$ 8,484
Quarter Ended September 30, 2012			
Balance, beginning of period	$ 11,519	$ (465)	$ 11,054
Change during three months ended September 30, 2012	759	13	772
Balance, end of period	$ 12,278	$ (452)	$ 11,826
Quarter Ended September 30, 2011			
Balance, beginning of period	$ 5,299	$ (313)	$ 4,986
Change during three months ended September 30, 2011	3,488	10	3,498
Balance, end of period	$ 8,787	$ (303)	$ 8,484

4. CASH AND DUE FROM BANKS

Cash and due from banks at September 30, 2012 and December 31, 2011 include the following:

(In thousands)	Sept. 30, 2012	Dec. 31, 2011
Cash and cash equivalents	$37,676	$56,815
Certificates of deposit	4,820	3,760
Total cash and due from banks	$42,496	$60,575

Certificates of deposit are issues by U.S. banks with original maturities greater than three months. Each certificate of deposit is fully FDIC-insured. The Corporation maintains cash and cash equivalents with certain financial institutions in excess of the FDIC insurance limit.

The Corporation is required to maintain reserves against deposit liabilities in the form of cash and balances with the Federal Reserve Bank. The reserves are based on deposit levels, account activity, and other services provided by the Federal Reserve Bank. Required reserves were $12,118,000 at September 30, 2012 and $14,035,000 at December 31, 2011.

5. FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS

The Corporation measures certain assets at fair value. 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” 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.

The Corporation monitors and evaluates available data relating to fair value measurements on an ongoing basis and recognizes transfers among the levels of the fair value hierarchy as of the date of an event or change in circumstances that affects the valuation method chosen. Examples of such changes may include the market for a particular asset becoming active or inactive, changes in the availability of quoted prices, or changes in the availability of other market data.

At September 30, 2012 and December 31, 2011, assets measured at fair value and the valuation methods used are as follows:

		September 30, 2012		
(In Thousands)	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Recurring fair value measurements				
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$ 0	$23,844	$ 0	$23,844
Obligations of states and political subdivisions:				
Tax-exempt	0	141,519	0	141,519
Taxable	0	22,244	0	22,244
Mortgage-backed securities	0	90,357	0	90,357
Collateralized mortgage obligations, Issued by U.S. Government agencies	0	191,945	0	191,945
Trust preferred securities issued by individual institutions	0	6,221	0	6,221
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	0	0	2,496	2,496
Other collateralized debt obligations	0	660	0	660
Total debt securities	0	476,790	2,496	479,286
Marketable equity securities	8,028	0	0	8,028
Total available-for-sale securities	8,028	476,790	2,496	487,314

Servicing rights	0	0	568	568
Total recurring fair value measurements	$ 8,028	$476,790	$ 3,064	$487,882
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	$ 0	$0	$ 4,119	$4,119
Valuation allowance	0	0	(1,468)	(1,468)
Impaired loans, net	0	0	2,651	2,651
Foreclosed assets held for sale	0	0	839	839
Total nonrecurring fair value measurements	$ 0	$0	$ 3,490	$3,490

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	December 31, 2011			
(In Thousands)	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Recurring fair value measurements				
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$ 0	$25,587	$ 0	$25,587
Obligations of states and political subdivisions:				
Tax-exempt	0	132,962	0	132,962
Taxable	0	14,334	0	14,334
Mortgage-backed securities	0	121,769	0	121,769
Collateralized mortgage obligations, Issued by U.S. Government agencies	0	165,131	0	165,131
Trust preferred securities issued by individual institutions	0	8,146	0	8,146
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	0	0	4,638	4,638
Pooled trust preferred securities - mezzanine tranches	0	0	730	730
Other collateralized debt obligations	0	660	0	660
Total debt securities	0	468,589	5,368	473,957
Marketable equity securities	7,728	0	0	7,728
Total available-for-sale securities	7,728	468,589	5,368	481,685
Servicing rights	0	0	375	375
Total recurring fair value measurements	$ 7,728	$468,589	$ 5,743	$482,060
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	$ 0	$0	$ 3,433	$3,433
Valuation allowance	0	0	(1,126)	(1,126)
Impaired loans, net	0	0	2,307	2,307
Foreclosed assets held for sale	0	0	1,235	1,235
Total nonrecurring fair value measurements	$ 0	$0	$ 3,542	$3,542

Management determined there have been few trades of pooled trust-preferred securities since 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, the Corporation follows a method of valuing pooled trust-preferred securities using a Level 3 methodology, based on discounted cash flows.

Management has calculated the fair value of the Corporation's pooled trust-preferred securities by applying a discount rate to the estimated cash flows. Management used the cash flow estimates determined using the process described in Note 6 for evaluating pooled trust-preferred securities for other-than-temporary impairment (OTTI). Management used discount rates considered reflective of a market participant's expectations regarding the extent of credit and liquidity risk inherent in the securities. In establishing the discount rate, management considered: (1) the implied discount rates as of the end of 2007, prior to the market for trust-preferred securities becoming inactive; (2) an adjustment to the year-end 2007 discount rates for the change in the spread between indicative market rates and corresponding risk-free rates; and (3) an additional adjustment for liquidity risk. Management considered the adjustment for liquidity risk necessary in order to give some consideration to price estimates based on trades made under distressed conditions, as reported by brokers and pricing services.

Loans are classified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Foreclosed assets held for sale consist of real estate acquired by foreclosure. For impaired commercial loans secured by real estate and foreclosed assets held for sale, estimated fair values are determined primarily using values from third-party appraisals less estimated selling costs.

Management's evaluation and selection of valuation techniques and the unobservable inputs used in determining the fair values of assets valued using Level 3 methodologies include sensitive assumptions. Other market participants might use substantially different assumptions, which could result in calculations of fair values that would be substantially different than the amount calculated by management. The following table shows quantitative information regarding significant techniques and inputs used at September 30, 2012 for assets measured using unobservable inputs (Level 3 methodologies) on a recurring basis:

Asset	Fair Value at 9/30/12 (In Thousands)	Valuation Technique	Unobservable Input(s)	Method or Value As of 9/30/12		
Pooled trust preferred securities - senior tranches	$ 2,496	Discounted cash flow	Issuer defaults	46.15	%	Actual deferrals and defaults as % of outstanding collateral
				18.33	%	Expected additional net deferrals and defaults as % of performing collateral
			Issuer prepayments	50.15	%	Expected issuer prepayments as % of performing collateral
			Discount rate	11.70	%	Implied 7.57% discount rate at 12/31/07 plus 4.13% spread for credit and liquidity risk
Servicing rights	568	Discounted cash flow	Discount rate	12.00	%	Rate used through modeling period
			Loan prepayment speeds	260.00	%	Weighted-average PSA
			Servicing fees	0.25	%	of loan balances
				5.00	%	of payments are late
				5.00	%	late fees assessed
				$1.94		Miscellaneous fees per account per month
			Servicing costs	$5.50		Monthly servicing cost per account
				$22.00		Additional monthly servicing cost per loan on loans more than 30 days delinquent
				1.50	%	of loans more than 30 days delinquent
				3.00	%	annual increase in servicing costs

Increases (decreases) in actual or expected issuer defaults tend to decrease (increase) the fair value of the Corporation's pooled trust preferred securities. The fair value of servicing rights is affected by expected future interest rates. Increases (decreases) in future expected interest rates tend to increase (decrease) the fair value of the Corporation's servicing rights because of changes in expected prepayment behavior by the borrowers on the underlying loans.

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Following is a reconciliation of activity for Level 3 assets measured at fair value on a recurring basis:

	Three Months Ended September 30, 2012				Nine Months Ended September 30, 2012			
	Pooled Trust Preferred Securities - Senior Tranches	Pooled Trust Preferred Securities - Mezzanine Tranches	Servicing Rights	Total	Pooled Trust Preferred Securities - Senior Tranches	Pooled Trust Preferred Securities - Mezzanine Tranches	Servicing Rights	Total
Balance, beginning of period	$ 2,386	$ 1,146	$ 460	$ 3,992	$ 4,638	$ 730	$ 375	$ 5,743
Issuances of servicing rights	0	0	133	133	0	0	262	262
Accretion and amortization, net	(1)	0	0	(1)	(6)	0	0	(6)
Proceeds from sales and calls	0	(1,781)	0	(1,781)	(2,515)	(1,835)	0	(4,350)
Realized gains, net	0	1,781	0	1,781	40	1,835	0	1,875
Unrealized losses included in earnings	0	0	(25)	(25)	0	0	(69)	(69)
Unrealized gains (losses) included in other comprehensive income	111	(1,146)	0	(1,035)	339	(730)	0	(391)
Balance, end of period	$ 2,496	$ 0	$ 568	$ 3,064	$ 2,496	$ 0	$ 568	$ 3,064

	Three Months Ended September 30, 2011				Nine Months Ended September 30, 2011			
	Pooled Trust Preferred Securities - Senior Tranches	Pooled Trust Preferred Securities - Mezzanine Tranches	Servicing Rights	Total	Pooled Trust Preferred Securities - Senior Tranches	Pooled Trust Preferred Securities - Mezzanine Tranches	Servicing Rights	Total
Balance, beginning of period	$ 7,207	$ 0	$ 315	$ 7,522	$ 7,400	$ 0	$ 204	$ 7,604
Issuances of servicing rights	0	0	50	50	0	0	190	190
Accretion and amortization, net	0	0	0	0	(34)	0	0	(34)
Proceeds from sales and calls	0	(24)	0	(24)	(2,035)	(74)	0	(2,109)
Realized gains, net	0	24	0	24	25	74	0	99
Unrealized losses included in earnings	0	0	(19)	(19)	0	0	(48)	(48)
Unrealized (losses) gains included in other comprehensive income	(104)	0	0	(104)	1,747	0	0	1,747
Balance, end of period	$ 7,103	$ 0	$ 346	$ 7,449	$ 7,103	$ 0	$ 346	$ 7,449

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.

CERTIFICATES OF DEPOSIT - Fair values for certificates of deposit, included in cash and due from banks in the consolidated balance sheet, are based on quoted market prices for certificates of similar remaining maturities.

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 sale prices 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 prepayment speeds 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, 2012 and December 31, 2011. The fair value of time deposits, such as certificates of deposit and Individual Retirement Accounts, 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)	Valuation	September 30, 2012		December 31, 2011	
	Method(s)	Carrying	Fair	Carrying	Fair

	Used	Amount	Value	Amount	Value
Financial assets:					
Cash and cash equivalents	Level 1	$37,676	$37,676	$56,815	$56,815
Certificates of deposit	Level 2	4,820	4,858	3,760	3,683
Available-for-sale securities	See Above	487,314	487,314	481,685	481,685
Restricted equity securities (included in Other Assets)	Level 2	5,551	5,551	6,773	6,773
Loans held for sale	Level 1	3,846	3,846	939	939
Loans, net	Level 3	690,357	711,553	700,610	718,670
Accrued interest receivable	Level 1	4,927	4,927	4,797	4,797
Servicing rights	Level 3	568	568	375	375
Financial liabilities:					
Deposits with no stated maturity	Level 1	677,100	677,100	677,461	677,461
Time deposits	Level 3	335,910	339,060	340,745	344,936
Short-term borrowings	Level 3	19,657	19,684	4,950	4,897
Long-term borrowings	Level 3	89,954	103,009	125,363	145,641
Accrued interest payable	Level 1	163	163	358	358

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6. SECURITIES

Amortized cost and fair value of available-for-sale securities at September 30, 2012 and December 31, 2011 are summarized as follows:

(In Thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	September 30, 2012			
Obligations of U.S. Government agencies	$ 23,181	$ 663	$ 0	$ 23,844
Obligations of states and political subdivisions:				
Tax-exempt	134,651	7,084	(216)	141,519
Taxable	21,766	522	(44)	22,244
Mortgage-backed securities	85,750	4,607	0	90,357
Collateralized mortgage obligations, Issued by U.S. Government agencies	188,169	3,777	(1)	191,945
Trust preferred securities issued by individual institutions	6,173	48	0	6,221
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	2,515	0	(19)	2,496
Other collateralized debt obligations	660	0	0	660
Total debt securities	462,865	16,701	(280)	479,286
Marketable equity securities	5,562	2,506	(40)	8,028
Total	$ 468,427	$ 19,207	$ (320)	$ 487,314

(In Thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
	December 31, 2011			
Obligations of U.S. Government agencies	$ 24,877	$ 710	$ 0	$ 25,587
Obligations of states and political subdivisions:				
Tax-exempt	129,401	4,891	(1,330)	132,962
Taxable	14,004	334	(4)	14,334
Mortgage-backed securities	116,602	5,167	0	121,769
Collateralized mortgage obligations, Issued by U.S. Government agencies	161,818	3,350	(37)	165,131
Trust preferred securities issued by individual institutions	7,334	865	(53)	8,146
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	4,996	0	(358)	4,638
Pooled trust preferred securities - mezzanine tranches	0	730	0	730

Other collateralized debt obligations	660	0	0	660
Total debt securities	459,692	16,047	(1,782)	473,957
Marketable equity securities	5,643	2,186	(101)	7,728
Total	$465,335	$18,233	$(1,883)	$481,685

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, 2012 and December 31, 2011:

September 30, 2012	Less Than 12 Months		12 Months or More		Total	
(In Thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions:						
Tax-exempt	$ 5,161	$ (85)	$ 4,800	$ (131)	$ 9,961	$ (216)
Taxable	2,722	(44)	0	0	2,722	(44)
Collateralized mortgage obligations, Issued by U.S. Government agencies	0	0	514	(1)	514	(1)
Collateralized debt obligations, Pooled trust preferred securities - senior tranches	0	0	2,496	(19)	2,496	(19)
Total debt securities	7,883	(129)	7,810	(151)	15,693	(280)
Marketable equity securities	93	(8)	68	(32)	161	(40)
Total temporarily impaired available-for-sale securities	$ 7,976	$ (137)	$ 7,878	$ (183)	$ 15,854	$ (320)

December 31, 2011	Less Than 12 Months		12 Months or More		Total	
(In Thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions:						
Tax-exempt	$ 4,301	$ (34)	$ 20,692	$ (1,296)	$ 24,993	$ (1,330)
Taxable	927	(2)	244	(2)	1,171	(4)
Collateralized mortgage obligations, Issued by U.S. Government agencies	6,886	(36)	5,075	(1)	11,961	(37)
Trust preferred securities issued by individual institutions	0	0	947	(53)	947	(53)
Collateralized debt obligations,Pooled trust preferred securities - senior tranches	0	0	4,638	(358)	4,638	(358)
Total debt securities	12,114	(72)	31,596	(1,710)	43,710	(1,782)
Marketable equity securities	776	(44)	98	(57)	874	(101)
Total temporarily impaired available-for-sale securities	$ 12,890	$ (116)	$ 31,694	$ (1,767)	$ 44,584	$ (1,883)

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, 2012	Sept. 30, 2011	Sept. 30, 2012	Sept. 30, 2011
Gross realized gains	$ 2,430	$ 26	$ 2,747	$ 2,035
Gross realized losses	0	0	(116)	(7)
Net realized gains	$ 2,430	$ 26	$ 2,631	$ 2,028
Income tax provision related to net realized gains	$ 851	$ 9	$ 921	$ 690

The amortized cost and fair value of available-for-sale debt securities by contractual maturity are shown in the following table as of September 30, 2012. Actual maturities may differ from contractual maturities because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties.

(In Thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 11,135	$ 11,200
Due from one year through five years	50,186	51,753
Due from five years through ten years	39,869	40,891
Due after ten years	87,756	93,140
Subtotal	188,946	196,984
Mortgage-backed securities	85,750	90,357
Collateralized mortgage obligations, Issued by U.S. Government agencies	188,169	191,945
Total	$ 462,865	$ 479,286

The Corporation’s mortgage-backed securities and collateralized mortgage obligations have stated maturities that may differ from actual maturities due to borrowers’ ability to prepay obligations. Cash flows from such investments are dependent upon the performance of the underlying mortgage loans and are generally influenced by the level of interest rates. In the table above, mortgage-backed securities and collateralized mortgage obligations are shown in one period.

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 no impairment losses in earnings in the three-month period ended September 30, 2012. The Corporation recognized an impairment loss in earnings totaling $67,000 in the nine-month period ended September 30, 2012, which was related to a bank stock. No impairment losses were recognized in the three-month or nine-month periods ended September 30, 2011.

A summary of information management considered in evaluating debt and equity securities for OTTI at September 30, 2012 is provided below.

Debt Securities

At September 30, 2012, 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, 2012 to be temporary.

The credit rating agencies have withdrawn their ratings on numerous municipal bonds held by the Corporation. At September 30, 2012, the total amortized cost basis of municipal bonds with no external credit ratings was $21,999,000, with an aggregate unrealized gain of $273,000. 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.

The following table provides information related to trust preferred securities issued by individual institutions as of September 30, 2012:

(In Thousands) &