CITIZENS & NORTHERN CORP
Form 10-K
February 24, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from _______________ to _________________________.

Commission file number: 0-16084

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)

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

Title of Each Class	Name of Exchange Where Registered
Common Stock Par Value $1.00	The NASDAQ Stock Market LLC

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions 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

The aggregate market value of the registrant's common stock held by non-affiliates at June 30, 2011, the registrant's most recently completed second fiscal quarter, was $179,234,623.

The number of shares of common stock outstanding at February 21, 2012 was 12,204,259.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the annual meeting of its shareholders to be held April 17, 2012 are incorporated by reference into Parts III and IV of this report.

PART I

ITEM 1. BUSINESS

Citizens & Northern Corporation (“Corporation”) is a holding company whose principal activity is community banking. The Corporation’s principal office is located in Wellsboro, Pennsylvania. The largest subsidiary is Citizens & Northern Bank (“C&N Bank” or the “Bank”). In 2005, the Corporation acquired Canisteo Valley Corporation and its subsidiary, First State Bank, a New York State chartered commercial bank with offices in Canisteo and South Hornell, NY. Management considers the New York State branches, which are located in the southern tier of New York State in close proximity to some of the Pennsylvania branches, to be part of the same community banking operating segment as the Pennsylvania locations. Effective September 1, 2010, the First State Bank operations were merged into C&N Bank, and later in September 2010, Canisteo Valley Corporation was merged into the Corporation. The Corporation’s other wholly-owned subsidiaries are Citizens & Northern Investment Corporation and Bucktail Life Insurance Company (“Bucktail”). Citizens & Northern Investment Corporation was formed in 1999 to engage in investment activities. Bucktail reinsures credit and mortgage life and accident and health insurance on behalf of C&N Bank.

C&N Bank is a Pennsylvania banking institution that was formed by the consolidation of Northern National Bank of Wellsboro and Citizens National Bank of Towanda on October 1, 1971. Subsequent mergers included: First National Bank of Ralston in May 1972; Sullivan County National Bank in October 1977; Farmers National Bank of Athens in January 1984; and First National Bank of East Smithfield in May 1990. On May 1, 2007, the Corporation acquired Citizens Bancorp, Inc. (“Citizens”), with banking offices in Coudersport, Emporium and Port Allegany, Pennsylvania. Citizens Trust Company, the banking subsidiary of Citizens, was merged with and into C&N Bank as part of the transaction. C&N Bank has held its current name since May 6, 1975, at which time C&N Bank changed its charter from a national bank to a Pennsylvania bank.

C&N Bank provides an extensive range of banking services, including deposit and loan products for personal and commercial customers. The Bank also maintains a trust division that provides a wide range of financial services, such as 401(k) plans, retirement planning, estate planning, estate settlements and asset management. In January 2000, C&N Bank formed a subsidiary, C&N Financial Services Corporation (“C&NFSC”). C&NFSC is a licensed insurance agency that provides insurance products to individuals and businesses. In 2001, C&NFSC added a broker-dealer division, which offers mutual funds, annuities, educational savings accounts and other investment products through registered agents. C&NFSC’s operations are not significant in relation to the total operations of the Corporation.

All phases of the Bank’s business are competitive. The Bank primarily competes in Tioga, Bradford, Sullivan, Lycoming, Potter, Cameron and McKean counties in Pennsylvania, and Steuben and Allegany counties in New York. The Bank competes with local commercial banks headquartered in our market area as well as other commercial banks with branches in our market area. Some of the banks that have branches in our market area are larger in overall size. With respect to lending activities and attracting deposits, the Bank also competes with savings banks, savings and loan associations, insurance companies, regulated small loan companies and credit unions. Also, the Bank competes with mutual funds for deposits. C&N Bank competes with insurance companies, investment counseling firms, mutual funds and other business firms and individuals for trust, investment management, brokerage and insurance services. The Bank is generally competitive with all financial institutions in our service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts and interest rates charged on loans. The Bank serves a diverse customer base, and is not economically dependent on any small group of customers or on any individual industry.

Major initiatives within the last 5 years included the following:

- as described above, in May 2007, acquired Citizens Bancorp, Inc.;
- implemented an overdraft privilege program in 2008;
- underwent an operational process review in 2008, resulting in identification of opportunities for increases in revenue and decreases in expenses, including a net reduction in work force of 15.9%, to 297 full-time equivalent employees at December 31, 2008 from 353 at December 31, 2007;
- in 2009, raised capital of $26.440 million by issuing preferred stock and a warrant to sell 194,794 shares of common stock to the U.S. Department of the Treasury under the Troubled Asset Relief Program ("TARP") Capital Purchase Program;
- in 2009, issued common stock, which raised a total of $24.585 million of capital, net of offering costs;

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- repurchased in 2010 all of the preferred stock and redeemed the warrant from the TARP Capital Purchase Program;

- merged the operations of First State Bank into C&N Bank and Canisteo Valley Corporation into Citizens & Northern Corporation in 2010;

- in 2011,sold the banking facility at 130 Court Street, Williamsport, PA, and entered into a leasing arrangement to continue to offer banking and trust services from the facility, resulting in an estimated annual $150,000 (pre-tax) reduction in future operating expenses; and

- in the fourth quarter 2011, began rebuilding the Athens, PA, facility, which was damaged by flooding in September 2011, has been closed since the flooding and is expected to re-open in late March 2012.

Virtually all of the Corporation's banking offices are located in the "Marcellus Shale," an area extending across portions of New York State, Pennsylvania, Ohio, Maryland, West Virginia and Virginia. In 2009 through 2011, most of the Pennsylvania counties in which the Corporation operates have been significantly affected by an upsurge in natural gas exploration, as technological developments have made exploration of the Marcellus Shale commercially feasible. A significant portion of the Corporation's new business opportunities in lending, Trust and other services during this time frame have arisen either directly or indirectly from Marcellus Shale-related activity. Due to its pervasive nature, it is virtually impossible to quantify the aggregate impact of Marcellus Shale-related activity on the Corporation's financial position and results of operations in 2009 through 2011.

At December 31, 2011, C&N Bank had total assets of $1,312,496,000, total deposits of $1,019,932,000, net loans outstanding of $700,610,000 and 290 full-time equivalent employees.

Most activities of the Corporation and its subsidiaries are regulated by federal or state agencies. The primary regulatory relationships are described as follows:

- The Corporation is a bank holding company formed under the provisions of Section 3 of the Federal Reserve Act. The Corporation is under the direct supervision of the Federal Reserve and must comply with the reporting requirements of the Federal Bank Holding Company Act.

- C&N Bank is a state-chartered, nonmember bank, supervised by the Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking.

- C&NFSC is a Pennsylvania corporation. The Pennsylvania Department of Insurance regulates C&NFSC's insurance activities. Brokerage products are offered through third party networking agreements.

- Bucktail is incorporated in the state of Arizona and supervised by the Arizona Department of Insurance.

A copy of the Corporation’s annual report on Form 10-K, quarterly reports on Form 10-Q, current events reports on Form 8-K, and amendments to these reports, will be furnished without charge upon written request to the Corporation’s Treasurer at P.O. Box 58, Wellsboro, PA 16901. Copies of these reports will be furnished as soon as reasonably possible, after they are filed electronically with the Securities and Exchange Commission. The information is also available through the Corporation’s web site at www.cnbankpa.com.

ITEM 1A. RISK FACTORS

The Corporation is subject to the many risks and uncertainties applicable to all banking companies, as well as risks specific to the Corporation’s geographic locations. Although the Corporation seeks to effectively manage risks, and maintains a level of equity that exceeds the banking regulatory agencies’ thresholds for being considered “well capitalized” (see Note 18 to the consolidated financial statements), management cannot predict the future and cannot eliminate the possibility of credit, operational or other losses. Accordingly, actual results may differ materially from management's expectations. Some of the Corporation’s significant risks and uncertainties are discussed below.

Credit Risk from Lending Activities - A significant source of risk is the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most of the Corporation's loans are secured, but some loans are unsecured. With respect to secured loans, the collateral securing the repayment of these loans may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, wide-spread disease, terrorist activity, environmental contamination and other external events. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards may create the impression that a loan is adequately collateralized when it is not. The Corporation has adopted underwriting and credit monitoring procedures and policies, including regular reviews of appraisals and borrower financial statements, that management believes are appropriate to mitigate the risk of loss. Also, as discussed further in the "Provision and Allowance for Loan Losses" section of Management's Discussion and Analysis, the Corporation attempts to estimate the amount of losses that may be inherent in the portfolio through a quarterly evaluation process that includes several members of management and that addresses specifically identified problem loans, as well as other quantitative data and qualitative factors. Such risk management and accounting policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Interest Rate Risk - Business risk arising from changes in interest rates is an inherent factor in operating a banking organization. The Corporation's assets are predominantly long-term, fixed-rate loans and debt securities. Funding for these assets comes principally from shorter-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation's financial instruments when interest rates change. Significant fluctuations in interest rates could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. For additional information regarding interest rate risk, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Mortgage Banking – In September 2009, the Corporation entered into an agreement to originate and sell residential mortgage loans to the secondary market through the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago. The Corporation's mortgage sales activity under this program was not significant in 2009, but increased in 2010 and 2011. At December 31, 2011, total residential mortgages serviced amounted to $56,638,000. The Corporation must strictly adhere to the MPF Xtra program guidelines for origination, underwriting and servicing loans, and failure to do so could result in the Corporation being forced to repurchase loans or being dropped from the program. If such a forced repurchase of loans were to occur, or if the Corporation were to be dropped from the program, it could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Equity Securities Risk - The Corporation's equity securities portfolio consists of investments in stocks of banks and bank holding companies. Investments in bank stocks are subject to the risk factors affecting the banking industry, and that could cause a general market decline in the value of bank stocks. Also, losses could occur in individual stocks held by the Corporation because of specific circumstances related to each bank. These factors could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. For additional information regarding equity securities risk, including management's assessment of equity securities for other-than-temporary impairment as of December 31, 2011, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Debt Securities Risk – As described in the Earnings Overview section of Management’s Discussion and Analysis, the Corporation’s earnings were materially impaired in 2009 by securities losses. Much of the Corporation’s 2009 losses from trust-preferred securities and other securities stem from the much-publicized economic problems affecting the national and international economy, which particularly hurt the banking industry. The Corporation has exposure to the possibility of future losses from investments in a senior tranche pooled trust-preferred security, trust-preferred securities issued by individual banks, obligations of states and political subdivisions (also known as municipal bonds) and other debt securities. For additional information regarding debt securities, see Note 7 to the consolidated financial statements.

Realization of Deferred Tax Asset – The Corporation recognizes deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At December 31, 2011, the net deferred tax asset was $6.2 million, down from a balance of approximately $16.1 million at December 31, 2010. The decrease in the net deferred tax asset resulted from appreciation in the fair value of available-for-sale securities in 2011, as well as other changes described in more detail in the “Income Taxes” section of Management’s Discussion and Analysis.

The Corporation regularly reviews deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. Based on current conditions, management believes the recorded net deferred tax asset at December 31, 2011 is fully realizable, including amounts classified as capital losses from securities. However, if management determines the Corporation will be unable to realize all or part of the net deferred tax asset, the Corporation would adjust the deferred tax asset, which would negatively impact earnings.

Federal Home Loan Bank of Pittsburgh Common Stock - We own common stock of the Federal Home Loan Bank of Pittsburgh, or the FHLB, in order to qualify for membership in the Federal Home Loan Bank system, which enables us to borrow funds under the Federal Home Loan Bank advance program. The carrying value and fair market value of our FHLB common stock, which is included in Other Assets in the consolidated balance sheet, was $6.6 million as of December 31, 2011. Published reports indicate that certain member banks of the Federal Home Loan Bank system may be subject to asset quality risks that could result in materially lower regulatory capital levels. In December 2008, the FHLB had notified its member banks that it had suspended dividend payments and the repurchase of capital stock until further notice is provided. Subsequently, though we have received no dividends from the FHLB since 2008, we have received capital stock redemptions in 2010 and 2011 totaling $1.9 million. Further, in February 2012, the FHLB declared a dividend of 0.10% annualized, payable to FHLB shareholders on February 23, 2012. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the FHLB, could be substantially diminished or reduced to zero. Consequently, given that there is no market for our FHLB common stock, we believe that there is a risk that our investment could be deemed other-than-temporarily impaired at some time in the future. If this occurs, it may adversely affect our results of operations and financial condition. If the FHLB were to cease operations, or if we were required to write-off our investment in the FHLB, our business, financial condition, liquidity, capital and results of operations may be materially adversely affected.

FDIC Insurance Assessments - In 2008 and 2009, higher levels of bank failures dramatically increased the resolution costs of the Federal Deposit Insurance Corporation, or the FDIC, and depleted the deposit insurance fund. In addition, the FDIC and the U.S. Congress have taken action to increase federal deposit insurance coverage, placing additional stress on the deposit insurance fund. In order to maintain a strong funding position and restore reserve ratios of the deposit insurance fund, in 2009 the FDIC increased assessment rates and imposed a special assessment on all insured institutions. The FDIC has indicated that future special assessments are possible, although it has not determined the magnitude or timing of any future assessments. In December 2009, we paid a pre-payment of the FDIC’s estimated assessment total for the next three years, totaling approximately $5.5 million. The pre-payment amount has been included in Other Assets in the consolidated balance sheet, with amounts amortized in 2010 and 2011 based on current assessments. At the end of 2011, approximately $3.4 million remains to be amortized, subject to adjustments imposed by the FDIC, over future years.

Although our total expenses from FDIC assessments have decreased to $832,000 in 2011 and $1,450,000 in 2010 from $2,092,000 in 2009, we are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If additional bank or financial institution failures occur, we may be required to pay higher FDIC premiums. Future increases in FDIC insurance premiums or additional special assessments may materially adversely affect our results of operations.

Breach of Information Security and Technology Dependence - The Corporation relies on software, communication, and information exchange on a variety of computing platforms and networks and over the Internet. Despite numerous safeguards, the Corporation cannot be certain that all of its systems are entirely free from vulnerability to attack or other technological difficulties or failures. The Corporation relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and the Corporation could be exposed to claims from customers. Any of these results could have a material adverse effect on the Corporation’s financial condition, results of operations or liquidity.

Limited Geographic Diversification - The Corporation grants commercial, residential and personal loans to customers primarily in the Pennsylvania Counties of Tioga, Bradford, Sullivan, Lycoming, Potter, Cameron and McKean, and in Steuben and Allegany Counties in New York State. Although the Corporation has a diversified loan portfolio, a significant portion of its debtors’ ability to honor their contracts is dependent on the local economic conditions within the region. As described in the “Business” section of Form 10-K, in recent years the Corporation’s market area has been significantly impacted by natural gas development activities associated with exploration of the Marcellus Shale. While Marcellus Shale-related development has created economic opportunities for business and individuals throughout much of our market area, the possibility exists that this activity could be reduced or cease as a result of changes in economic conditions, environmental concerns or other factors.

Deterioration in economic conditions, including possible effects if Marcellus Shale-related activity were to diminish or cease, could adversely affect the quality of the Corporation's loan portfolio and the demand for its products and services, and accordingly, could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Competition - All phases of the Corporation’s business are competitive. Some competitors are much larger in total assets and capitalization than the Corporation, have greater access to capital markets and can offer a broader array of financial services. There can be no assurance that the Corporation will be able to compete effectively in its markets. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Government Regulation and Monetary Policy - The Corporation and the banking industry are subject to extensive regulation and supervision under federal and state laws and regulations. The requirements and limitations imposed by such laws and regulations limit the manner in which the Corporation conducts its business, undertakes new investments and activities and obtains financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit the Corporation's shareholders. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Corporation. Significant new laws or changes in, or repeals of, existing laws could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects short-term interest rates and credit conditions, and any unfavorable change in these conditions could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Bank Secrecy Act and Related Laws and Regulations - These laws and regulations have significant implications for all financial institutions. They increase due diligence requirements and reporting obligations for financial institutions, create new crimes and penalties, and require the federal banking agencies, in reviewing merger and other acquisition transactions, to consider the effectiveness of the parties to such transactions in combating money laundering activities. Even innocent noncompliance and inconsequential failure to follow the regulations could result in significant fines or other penalties, which could have a material adverse impact on the Corporation's financial condition, results of operations or liquidity.

Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”) - On July 21, 2010, President Obama signed the Act into law. The Act contains numerous and wide-ranging changes to the structure of the U.S. financial system. Portions of the Act are effective at different times, and though some provisions were implemented in 2010 and 2011, many of the provisions require follow-on, more detailed rulemaking by regulators. Consequently, the Act’s impact on the financial system in general and the Corporation in particular cannot be predicted at this time. Some of the Act’s provisions that management believes may impact the Corporation’s financial condition and results of operations over the next few years are as follows:

- required the Federal Reserve to prescribe regulations to establish standards for determining that interchange transaction fees meet the new statutory standard of reasonable and proportional to the cost. These regulations were enacted, effective October 1, 2011, establishing maximum rates that may be paid to large (as defined) financial institutions. The maximum rates established under the rule are approximately 45% lower than the rates paid to the Corporation throughout the last several years. Although the rules do not apply directly to the Corporation (because the Corporation is not considered a large financial institution for this purpose), management believes interchange revenues could be reduced in the future, either because of lower volumes or because market conditions will dictate that smaller financial institutions receive rates similar to larger financial institutions.

- effective in July 2011, eliminated the prohibition against paying interest on commercial checking accounts, effective one year after enactment;

- effective for the second quarter 2011 assessment, altered the FDIC's base for determining deposit insurance assessments by requiring the assessments be determined based on "average consolidated total assets" less the institution's "average tangible equity," rather than on a bank's deposits;

- increases the FDIC's minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% of estimated deposits with no upward limit. The FDIC is required to "offset the effect" of the increased minimum reserve ratio on institutions with less than $10 billion in total consolidated assets. The intent appears to be to require the FDIC to impose higher premiums on larger banks in order to get from the old minimum of 1.15% to the new 1.35%, but given that the current reserve ratio is negative, all institutions can expect assessments to remain significant for the foreseeable future. The Act allows the FDIC until September 30, 2020 to reach 1.35%; and

- requires the establishment of minimum leverage and risk-based capital requirements applicable to bank holding companies that are not less than those currently applicable to insured depository institutions (currently 5%, 6% and 10% to be "well capitalized", and 4%, 4% and 8% to be "adequately capitalized").

The Act has other significant features, some of which are as follows: (i) makes permanent the 2008 increase in the maximum deposit insurance amount to $250,000, and extends until December 31, 2012 full deposit insurance coverage for qualifying noninterest-bearing transaction accounts, (ii) within the Act is the Mortgage Reform and Anti-Predatory Lending Act, a broad piece of legislation intended to curtail abusive residential mortgage lending practices that contributed to the mortgage/housing crisis, (iii) required the formation of the Bureau of Consumer Financial Protection as a new, independent bureau within the Federal Reserve, with very broad rulemaking and supervisory authority with respect to federal consumer financial laws, (iv) establishes the Financial Stability Oversight Council, to serve as an early warning system identifying risks in firms and market activities, to enhance oversight of the financial system as a whole and to harmonize prudential standards across financial regulatory agencies, and (v) establishes several requirements related to executive compensation and corporate governance.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

The Bank owns each of its properties, except for the two branch facilities located at 130 Court Street, Williamsport, PA, and at 2 East Mountain Avenue, South Williamsport, PA, which are leased. In September 2011, the Athens, PA office was damaged by flooding and has been closed since that time. The process of rebuilding the office is underway, and management expects to reopen the office in late March 2012. Management does not expect to incur a significant financial loss associated with the flooding, as almost all of the cost of replacement is covered by insurance. All of the other properties are in good condition. None of the owned properties are subject to encumbrance.

A listing of properties is as follows:

Main administrative offices:

90-92 Main Street Wellsboro, PA 16901	or	10 Nichols Street Wellsboro, PA 16901

Branch offices – Citizens & Northern Bank:

428 S. Main Street Athens, PA 18810	514 Main Street Laporte, PA 18626	2 East Mountain Avenue ** South Williamsport, PA 17702

10 North Main Street Coudersport, PA 16915	4534 Williamson Trail Liberty, PA 16930	41 Main Street Tioga, PA 16946
111 W. Main Street Dushore, PA 18614	1085 S. Main Street Mansfield, PA 16933	428 Main Street Towanda, PA 18848
563 Main Street East Smithfield, PA 18817	612 James Monroe Avenue Monroeton, PA 18832	64 Elmira Street Troy, PA 16947
104 Main Street Elkland, PA 16920	3461 Route 405 Highway Muncy, PA 17756	90-92 Main Street Wellsboro, PA 16901
135 East Fourth Street Emporium, PA 15834	100 Maple Street Port Allegany, PA 16743	1510 Dewey Avenue Williamsport, PA 17701
230 Railroad Street Jersey Shore, PA 17740	24 Thompson Street Ralston, PA 17763	130 Court Street ** Williamsport, PA 17701
102 E. Main Street Knoxville, PA 16928	1827 Elmira Street Sayre, PA 18840	1467 Golden Mile Road Wysox, PA 18854
3 Main Street Canisteo, NY 14823	6250 County Rte 64, East Avenue Ext. Hornell, NY 14843	

Facilities management office:

13 Water Street
Wellsboro, PA 16901

** designates leased branch facility

ITEM 3. LEGAL PROCEEDINGS

The Corporation and the Bank are involved in various legal proceedings incidental to their business. Management believes the aggregate liability, if any, resulting from such pending and threatened legal proceedings will not have a material adverse effect on the Corporation's financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

QUARTERLY SHARE DATA

Trades of the Corporation's stock are executed through various brokers who maintain a market in the Corporation's stock. The Corporation's stock is listed on the NASDAQ Capital Market with the trading symbol CZNC. As of December 31, 2011, there were 2,512 shareholders of record of the Corporation's common stock.

The following table sets forth the high and low sales prices of the common stock during 2011 and 2010.

	2011			**2010**		
	High	Low	Dividend Declared per Quarter	High	Low	Dividend Declared Per Quarter
First quarter	$16.96	$14.37	$ 0.13	$12.95	$8.76	$ 0.08
Second quarter	17.66	13.10	0.14	13.86	10.70	0.09
Third quarter	17.40	14.06	0.15	13.30	10.15	0.10
Fourth quarter	19.16	14.00	0.16	15.84	12.45	0.12

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. Also, the Corporation and C&N Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities. These restrictions are described in Note 18 to the consolidated financial statements.

On May 19, 2011, the Corporation authorized a plan for repurchases of outstanding common stock, up to a total of $1 million. On September 22, 2011, the Corporation's Board of Directors authorized additional repurchases of outstanding common stock in open market or privately negotiated transactions, up to a total of $1 million, as an addition to the May 2011 stock repurchase program. The Board of Directors' authorizations provide that: (1) the treasury stock repurchase programs became effective when publicly announced and shall continue thereafter until suspended or terminated by the Board of Directors, in its sole discretion; and (2) all shares of common stock repurchased pursuant to the programs shall be held as treasury shares and be available for use and reissuance for purposes as and when determined by the Board of Directors including, without limitation, pursuant to the Corporation's Dividend Reinvestment and Stock Purchase Plan and its equity compensation program. As of December 31, 2011, the maximum additional value available for purchases under this program was $980,694.

The following table sets forth a summary of the purchases by the Corporation, on the open market, of its equity securities in the fourth quarter 2011:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
October 1 - 31, 2011	2,439	$ 14.75	70,849	$ 980,694
November 1 - 30, 2011	0		70,849	$ 980,694
December 1 - 31, 2011	0		70,849	$ 980,694

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PERFORMANCE GRAPH

Set forth below is a chart comparing the Corporation's cumulative return to stockholders against the cumulative return of the Russell 2000 and a Peer Group Index of similar banking organizations selected by the Corporation for the five-year period commencing December 31, 2006 and ended December 31, 2011. The index values are market-weighted dividend-reinvestment numbers, which measure the total return for investing $100.00 five years ago. This meets Securities & Exchange Commission requirements for showing dividend reinvestment share performance over a five-year period and measures the return to an investor for placing $100.00 into a group of bank stocks and reinvesting any and all dividends into the purchase of more of the same stock for which dividends were paid.

COMPARISON OF 5-YEAR CUMULATIVE RETURN

Citizens & Northern Corporation

	Period Ending					
Index	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11
Citizens & Northern Corporation	100.00	85.08	100.06	50.37	81.01	104.25
Russell 2000	100.00	98.43	65.18	82.89	105.14	100.75
CZNC Peer Group Index*	100.00	85.56	76.60	72.25	82.42	79.00

The Corporation's peer group consists of banks headquartered in Pennsylvania with total assets of $700 million to $2 billion. This peer group consists of 1st Summit Bancorp of Johnstown, Inc., Johnstown; ACNB Corporation, Gettysburg; AmeriServ Financial, Inc., Johnstown; Bryn Mawr Bank Corporation, Bryn Mawr; Citizens Financial Services, Inc., Mansfield; CNB Financial Corporation, Clearfield; Codorus Valley Bancorp, Inc., York; ENB Financial Corp., Ephrata; ESSA Bancorp, Inc., Stroudsburg; First Keystone Corporation, Berwick; FNB Bancorp, Inc., Newtown; Fox Chase Bancorp, Inc., Hatboro; Franklin Financial Services Corporation, Chambersburg; Harleysville Savings Financial Corporation, Harleysville; Mid Penn Bancorp, Inc., Millersburg; Orrstown Financial Services, Inc., Shippensburg; Penns Woods Bancorp, Inc., Williamsport; Penseco Financial Services Corporation, Scranton; QNB Corp., Quakertown; Republic First Bancorp, Inc., Philadelphia; Royal Bancshares of Pennsylvania, Inc., Narberth; VIST Financial Corp., Wyomissing.

The data for this graph was obtained from SNL Financial LC, Charlottesville, VA.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information concerning the Stock Incentive Plan and Independent Directors Stock Incentive Plan, both of which have been approved by the Corporation's shareholders. The figures shown in the table below are as of December 31, 2011.

	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted-average Exercise Price of Outstanding Options	Number of Securities Remaining for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by shareholders	301,797	$ 19.05	492,448
Equity compensation plans not approved by shareholders	0	N/A	0

More details related to the Corporation's equity compensation plans are provided in Notes 1 and 13 to the consolidated financial statements.

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ITEM 6. SELECTED FINANCIAL DATA

	As of or for the Year Ended December 31,				
INCOME STATEMENT (In Thousands)	2011	2010	2009	2008	2007
Interest and fee income	$61,256	$62,114	$67,976	$74,237	$70,221
Interest expense	13,556	19,245	24,456	31,049	33,909
Net interest income	47,700	42,869	43,520	43,188	36,312
(Credit) provision for loan losses	(285)	1,191	680	909	529
Net interest income after (credit) provision for loan losses	47,985	41,678	42,840	42,279	35,783
Noninterest income excluding securities/gains (losses)	13,938	13,917	13,021	13,140	10,440
Net impairment losses recognized in earnings from available-for-sale securities	0	(433)	(85,363)	(10,088)	0
Net realized gains on available-for-sale securities	2,216	1,262	1,523	750	127
Noninterest expense	32,057	31,569	34,011	33,703	33,283
Income (loss) before income tax provision (credit)	32,082	24,855	(61,990)	12,378	13,067
Income tax provision (credit)	8,714	5,800	(22,655)	2,319	2,643
Net income (loss)	23,368	19,055	(39,335)	10,059	10,424
U.S. Treasury preferred dividends	0	1,474	1,428	0	0
Net income (loss) available to common shareholders	$23,368	$17,581	$(40,763)	$10,059	$10,424
PER COMMON SHARE: (1)					
Basic earnings per share	$1.92	$1.45	$(4.40)	$1.12	$1.19
Diluted earnings per share	$1.92	$1.45	$(4.40)	$1.12	$1.19
Cash dividends declared per share	$0.58	$0.39	$0.72	$0.96	$0.96
Stock dividend	None	None	None	None	1%
Book value per common share at period-end	$13.77	$11.43	$10.46	$13.66	$15.34
Tangible book value per common share at period-end	$12.77	$10.42	$9.43	$12.22	$13.85
Weighted average common shares outstanding - basic	12,162,045	12,131,039	9,271,869	8,961,805	8,784,134
Weighted average common shares outstanding - diluted	12,166,768	12,131,039	9,271,869	8,983,300	8,795,366
END OF PERIOD BALANCES (In Thousands)					
Available-for-sale securities	$481,685	$443,956	$396,288	$419,688	$432,755
Gross loans	708,315	730,411	721,011	743,544	735,941
Allowance for loan losses	7,705	9,107	8,265	7,857	8,859
Total assets	1,323,735	1,316,588	1,321,795	1,281,637	1,283,746
Deposits	1,018,206	1,004,348	926,789	864,057	838,503
Borrowings	130,313	166,908	235,471	285,473	300,132
Stockholders' equity	167,385	138,944	152,410	122,026	137,781
Common stockholders' equity (stockholders' equity, excluding preferred stock)	167,385	138,944	126,661	122,026	137,781

AVERAGE BALANCES (In Thousands)					
Total assets	1,313,445	1,326,145	1,296,086	1,280,924	1,178,904
Earning assets	1,208,584	1,205,608	1,208,280	1,202,872	1,090,035
Gross loans	715,321	723,318	728,748	743,741	729,269
Deposits	1,001,125	965,615	886,703	847,714	812,255
Stockholders' equity	152,718	150,133	141,787	130,790	138,669

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ITEM 6. SELECTED FINANCIAL DATA, Continued

	As of or for the Year Ended December 31,									
	2011		2010		2009		2008		2007	
KEY RATIOS										
Return on average equity	15.30	%	12.69	%	-27.74	%	7.69	%	7.52	%
Average equity to average assets	11.63	%	11.32	%	10.94	%	10.21	%	11.76	%
Net interest margin (2)	4.22	%	3.81	%	3.84	%	3.77	%	3.51	%
Efficiency (3)	49.40	%	52.73	%	57.22	%	57.59	%	68.39	%
Cash dividends as a % of diluted earnings per share	30.21	%	26.90	%	NM		85.71	%	80.67	%
Tier 1 leverage	10.93	%	9.20	%	9.86	%	10.12	%	10.91	%
Tier 1 risk-based capital	19.95	%	15.87	%	16.70	%	13.99	%	15.46	%
Total risk-based capital	21.17	%	17.17	%	17.89	%	14.84	%	16.52	%
Tangible common equity/tangible assets	11.84	%	9.71	%	8.72	%	8.61	%	9.79	%
Nonperforming assets/total assets	0.73	%	0.92	%	0.76	%	0.69	%	0.66	%
Nonperforming loans/total loans	1.19	%	1.58	%	1.27	%	1.14	%	1.11	%
Allowance for loan losses/total loans	1.09	%	1.25	%	1.15	%	1.06	%	1.20	%
Net charge-offs/average loans	0.16	%	0.05	%	0.04	%	0.26	%	0.06	%
NM = Not a meaningful ratio.										

(1) All share and per share data have been restated to give effect to stock dividends and splits.
(2) Rates of return on tax-exempt securities and loans are calculated on a fully-taxable equivalent basis.
(3) The efficiency ratio is calculated by dividing total noninterest expense by the sum of net interest income (including income from tax-exempt securities and loans on a fully-taxable equivalent basis) and noninterest income excluding securities gains and losses.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this section and elsewhere in this Annual Report on Form 10-K are forward-looking statements. Citizens & Northern Corporation and its wholly-owned subsidiaries (collectively, the Corporation) intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995. Forward-looking statements, which are not historical facts, are based on certain assumptions and describe future plans, business objectives and expectations, and are generally identifiable by the use of words such as, "should", “likely”, "expect", “plan”, "anticipate", “target”, “forecast”, and “goal”. These forward-looking statements are subject to risks and uncertainties that are difficult to predict, may be beyond management’s control and could cause results to differ materially from those expressed or implied by such forward-looking statements. Factors which could have a material, adverse impact on the operations and future prospects of the Corporation include, but are not limited to, the following:

- changes in monetary and fiscal policies of the Federal Reserve Board and the U.S. Government, particularly related to changes in interest rates
- changes in general economic conditions
- legislative or regulatory changes
- downturn in demand for loan, deposit and other financial services in the Corporation’s market area
- increased competition from other banks and non-bank providers of financial services
- technological changes and increased technology-related costs
- changes in accounting principles, or the application of generally accepted accounting principles.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

EARNINGS OVERVIEW

In 2011, net income available to common shareholders was $23,368,000, or $1.92 per basic and diluted share, up 32.4% over net income per share of $1.45 in 2010. The Corporation reported a net loss available to common shareholders of $40,763,000 ($4.40 per share-basic and diluted) in 2009, including the impact of after-tax other-than-temporary impairment (OTTI) charges on available-for-sale securities (adjusted for realized gains on some securities subsequently sold) of $55,849,000.

2011 vs. 2010

The most significant fluctuations in earnings in 2011 as compared to 2010 are as follows:

- Net interest income of $47,700,000 was $4,831,000 (11.3%) higher in 2011 than 2010. The improvement in 2011 has resulted from several factors, including reductions in cost of funds, reduction in outstanding borrowings and lower balances maintained in overnight investment with the Federal Reserve and other banks. In 2011, net interest income includes the benefit of accretion of $826,000 from the offset of a previous write-down on a security, with a corresponding benefit of $83,000 recorded in 2010.

- In 2011, the provision for loan losses was a credit (reduction in expense) of $285,000, as compared to a provision of $1,191,000 in 2010. The credit for loan losses in 2011 resulted, in part, from a reduction in loans outstanding, as the general component of the allowance for loan losses was reduced. Further, in recent years, the Corporation has experienced a limited amount of loan-related credit problems, as compared to averages for comparable-sized peer banks.

- Total noninterest revenue was $13,938,000 in 2011, up $100,000 over 2010, despite an impairment loss in 2011 of $948,000 related to an investment in a real estate limited partnership. In 2011, noninterest revenue included net gains from sales of premises and equipment totaling $324,000, including a gain in the third quarter of $329,000 from sale of the banking facility at 130 Court Street, Williamsport, PA. The Corporation has entered into a leasing arrangement to continue to utilize a portion of the facility and continues to provide retail, trust and commercial banking services at the location. In 2010, noninterest revenue included net gains from sales of premises and equipment totaling $445,000. Excluding gains from sales of premises and equipment and the impairment loss, noninterest revenue for 2011 totaled $14,562,000, or 8.7% higher than the corresponding 2010 amount. In 2011, revenues increased significantly over 2010 from origination and sale of mortgage loans, interchange on debt card transactions, service charges on deposit accounts, brokerage services and other operating income.

- Gains from available-for-sale securities totaled $2,216,000 in 2011, considerably higher than the total gains of $829,000 realized in 2010. In the first quarter 2011, the Corporation realized gains of $1,510,000 from two pooled trust-preferred securities that had been written off in prior periods.

- Total noninterest expense was $32,057,000 in 2011, up $567,000, or 1.8%, over 2010. Total salaries and wages for 2011 were $803,000 (6.1%) higher than in 2010, including an increase in total employee stock-based compensation of $319,000. Pensions and employee benefits expense was $567,000 (14.8%) higher in 2011 than in 2010, including higher estimated self-insured employee health insurance expense. Furniture and equipment expense was $171,000 (8.1%) lower in 2011 as compared to 2010, as depreciation expense was lower due to some computer-related hardware and software becoming fully depreciated. FDIC assessments were $618,000 (42.6%) lower in 2011 than in 2010, reflecting the benefit of changes in the FDIC's method for determining assessments and improvements in the Corporation's financial data that impact the amounts assessed.

- The provision for income taxes totaled $8,714,000 or 27.2% of pre-tax income in 2011, up from $5,800,000 or 23.3% of pre-tax income in 2010. The provision for income taxes was higher in 2011 than in 2010 primarily because of the increase in pre-tax income. Also, the provision for income tax in 2010 included a benefit (reduction in expense) of $373,000 resulting from reduction in a valuation reserve.

In the third quarter 2010, the Corporation redeemed preferred stock that had previously been issued, and has had no preferred stock outstanding and no corresponding dividend costs in 2011. In 2010, earnings available for common shareholders were impacted by dividends paid on preferred stock totaling $1,474,000.

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2010 vs. 2009

Net income available to common shareholders was $17,581,000 ($1.45 per share) in 2010 compared to a net loss of $40,763,000 ($4.40 per share) in 2009. The most significant fluctuations in the components of earnings for 2010 compared to 2009 are as follows:

- In 2010, gains from sales of available-for-sale securities totaled $829,000, including realized gains totaling $1,262,000 and impairment losses of $433,000. In contrast, in 2009, the Corporation experienced significant losses from available-for-sale securities. Losses from available-for-sale securities totaled $83,340,000 in 2009, including impairment losses of $85,363,000, net of realized gains of $1,523,000. The securities losses in 2009 included $73,674,000 from pooled trust-preferred securities.

- Net interest income was $42,869,000 in 2010, down 1.5% from 2009 net interest income of $43,520,000. On a fully taxable equivalent basis, net interest income was 1.0% lower in 2010 than in 2009. While the Corporation's interest margin benefited in 2010 from a lower cost of funds, the average yield on available-for-sale securities dropped significantly as compared to 2009. Also, the Corporation held approximately $25 million more in average overnight investments (mainly at the Federal Reserve) in 2010 than in 2009, which gave the Corporation a great deal of flexibility from a liquidity standpoint but which generated an average yield of only 0.23%.

- The provision for loan losses was $1,191,000, up from $680,000 in 2009. In 2010, management increased the estimated allowance for loan losses related to individually impaired loans.

- Non-interest revenue for 2010 was $896,000, or 6.9%, higher than in 2009, reflecting substantial increases for 2010 in revenue from sales of mortgages, as well as from debit card-related interchange fees.

- Non-interest expense was $2,442,000, or 7.2%, lower than in 2009. The decrease reflects the impact of lower FDIC assessments, lower furniture and equipment expense primarily associated with much of the core banking system software and equipment becoming fully depreciated, as well as reductions in several other categories of operating costs.

- The provision for income taxes for 2010 was $5,800,000, or 23.3% of pre-tax income. In 2009, the Corporation recorded a credit provision for income taxes based on an effective tax rate of 36.5%. Fluctuations in the tax provision/pre-tax income rate for these periods include the impact of changes in the average holdings of tax-exempt securities and loans. Also, the 2010 provision includes the reversal of a valuation allowance established in 2009 on certain deferred tax assets.

More detailed information concerning fluctuations in the Corporation's earnings results are provided in other sections of Management's Discussion and Analysis.

CRITICAL ACCOUNTING POLICIES

The presentation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate and reasonable. The Corporation's methodology for determining the allowance for loan losses is described in a separate section later in Management's Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions, and could, therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation's debt securities. For most of the Corporation's debt securities, the Corporation receives estimated fair values of debt securities from an independent valuation service, or from brokers. In developing fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services.

As described in Note 6 to the consolidated financial statements, management calculates the fair values of pooled trust-preferred securities by applying discount rates to estimated cash flows for each security. Management estimated the cash flows expected to be received from each security, taking into account estimated levels of deferrals and defaults by the underlying issuers, and used discount rates considered reflective of a market participant's expectations regarding the extent of credit and liquidity risk inherent in the securities. Management's estimates of cash flows and discount rates used to calculate fair values of pooled trust-preferred securities were based on sensitive assumptions, and use of different assumptions could result in calculations of fair values that would be substantially different than the amounts calculated by management.

As described in Note 7 to the consolidated financial statements, management evaluates securities for OTTI. In making that 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. Management's assessments of the likelihood and potential for recovery in value of securities are subjective and based on sensitive assumptions. Also, management's estimates of cash flows used to evaluate OTTI of pooled trust-preferred securities are based on sensitive assumptions, and use of different assumptions could produce different conclusions for each security.

NET INTEREST INCOME

The Corporation's primary source of operating income is net interest income, which is equal to the difference between the amounts of interest income and interest expense. Tables I, II and III include information regarding the Corporation's net interest income in 2011, 2010, and 2009. In each of these tables, the amounts of interest income earned on tax-exempt securities and loans have been adjusted to a fully taxable-equivalent basis. Accordingly, the net interest income amounts reflected in these tables exceed the amounts presented in the consolidated financial statements. The discussion that follows is based on amounts in the tables.

2011 vs. 2010

Fully taxable equivalent net interest income was $50,955,000 in 2011, $5,001,000 (10.9%) higher than in 2010. As shown in Table III, net changes in volume had the effect of increasing net interest income $3,238,000 in 2011 compared to 2010, and interest rate changes had the effect of increasing net interest income $1,763,000. The most significant components of the volume change in net interest income in 2011 were a decrease in interest expense of $1,623,000 attributable to a reduction in the balance of long-term borrowed funds and an increase in interest income of $1,600,000 attributable to growth in the balance of available-for-sale securities. The most significant components of the rate change in net interest income in 2011 were a decrease in interest expense of $3,260,000 due to lower rates paid on interest-bearing deposits and a decrease in interest income of $1,126,000 attributable to lower rates earned on available-for-sale securities. As presented in Table II, the "Interest Rate Spread" (excess of average rate of return on earning assets over average cost of funds on interest-bearing liabilities) was 3.96% in 2011, as compared to 3.53% in 2010.

INTEREST INCOME AND EARNING ASSETS

Interest income totaled $64,511,000 in 2011, a decrease of 1.1% from 2010. Income from available-for-sale securities increased $474,000 (2.6%), while interest and fees from loans decreased $1,107,000, or 2.4%. As indicated in Table II, total average available-for-sale securities (at amortized cost) in 2011 increased to $461,904,000, an increase of $34,384,000, or 8.0% from 2010. During 2010 and 2011, the Corporation increased the size of its tax-exempt municipal security portfolio. Net growth in the taxable available-for-sale securities portfolio was primarily made up of U.S. Government agency collateralized mortgage obligations and also included a significant increase in the balance of taxable municipal securities. This growth was partially offset by reductions in the balances of U.S. Government agency bonds and pooled trust preferred securities. The Corporation’s yield on taxable securities fell in 2010 and 2011 primarily because of low market interest rates, including the effects of management’s decision to limit purchases of taxable securities to investments that mature or are expected to repay a substantial portion of principal within approximately four years or less. The average rate of return on available-for-sale securities was 4.11% for 2011 and 4.33% in 2010.

The average balance of gross loans decreased 1.1% to $715,321,000 in 2011 from $723,318,000 in 2010. The Corporation experienced modest contraction in the residential mortgage and consumer loan portfolios, primarily resulting from management’s decision to sell a portion of newly originated residential mortgages on the secondary market. The total average balance of commercial loans increased slightly in 2011 compared to 2010. The Corporation’s yield on loans fell as rates on new loans as well as existing, variable-rate loans have decreased. The average rate of return on loans was 6.36% in 2011 and 6.44% in 2010.

The average balance of interest-bearing due from banks decreased to $31,359,000 in 2011 from $54,655,000 in 2010. This has consisted primarily of balances held by the Federal Reserve. Although the rates of return on balances with the Federal Reserve are low, the Corporation has maintained relatively high levels of liquid assets in 2010 and 2011 (as opposed to increasing long-term, available-for-sale securities at higher yields) in order to maximize flexibility for dealing with possible fluctuations in cash requirements, and due to management's concern about the possibility of substantial increases in interest rates within the next few years. Also, in 2010, management maintained a portion of the balance with the Federal Reserve in anticipation of repurchasing the TARP Preferred Stock and Warrant. These repurchases were completed during the third quarter 2010. During the fourth quarter 2011, the Corporation began investing in FDIC-insured certificates of deposit issued by other financial institutions and maturing within five years; these investments averaged $677,000 for 2011 and totaled $3,760,000 at December 31, 2011. The Corporation held no such investments in 2010 or prior periods.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense fell $5,689,000, or 29.6%, to $13,556,000 in 2011 from $19,245,000 in 2010. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 1.38% in 2011 from 1.88% in 2010.

Total average deposits (interest-bearing and noninterest-bearing) increased 3.7%, to $1,001,125,000 in 2011 from $965,615,000 in 2010. This increase came mainly in interest checking, savings accounts, and demand deposits; the increases were partially offset by decreases in the average balance of certificates of deposit and Individual Retirement Accounts. Consistent with continuing low short-term market interest rates, the average rates incurred on deposit accounts have decreased significantly in 2011 as compared to 2010.

Variable-rate accounts comprised $144,008,000 of the average balance in Individual Retirement Accounts in 2011 and $151,688,000 in 2010. Prior to May 2011, substantially all of these accounts were paid interest at a rate that could change quarterly at management's discretion with a contractual floor of 3.00%. Effective in May 2011, the rate floor was removed; following this change, the rate paid on these accounts was lowered several times and was 0.75% at December 31, 2011. As shown in Table II, the average rate on Individual Retirement Accounts decreased to 2.04% in 2011 from 3.06% in 2010.

Total average borrowed funds decreased $50,682,000 to $152,110,000 in 2011 from $202,792,000 in 2010. During 2010 and 2011, the Corporation has paid off long-term borrowings as they matured using the cash flow received from loans, mortgage-backed securities, and growth in deposit balances. The average rate on borrowed funds was 3.58% in 2011, down from 3.62% in 2010.

2010 vs. 2009

Fully taxable equivalent net interest income was $45,954,000 in 2010, $464,000 (1.0%) lower than in 2009. As shown in Table III, net changes in volume had the effect of increasing net interest income $816,000 in 2010 compared to 2009, and interest rate changes had the effect of decreasing net interest income $1,280,000. The most significant components of the volume change in net interest income in 2010 were: a decrease in interest income of $1,260,000 attributable to a reduction in the balance of taxable available-for-sale securities and a decrease in interest expense of $1,902,000 attributable to a reduction in the balance of long-term borrowed funds. The most significant components of the rate change in net interest income in 2010 were: a decrease in interest income of $3,895,000 attributable to lower rates earned on taxable available-for-sale securities and a decrease in interest expense of $3,315,000 due to lower rates paid on interest-bearing deposits. As presented in Table II, the "Interest Rate Spread" (excess of average rate of return on earning assets over average cost of funds on interest-bearing liabilities) was 3.53% in 2010, as compared to 3.47% in 2009.

INTEREST INCOME AND EARNING ASSETS

Interest income totaled $65,199,000 in 2010, a decrease of 8.0% from 2009. Income from available-for-sale securities decreased $4,540,000 (19.7%), while interest and fees from loans decreased $1,102,000, or 2.3%. As indicated in Table II, total average available-for-sale securities (at amortized cost) in 2010 decreased to $427,520,000, a decrease of $12,303,000, or 2.8% from 2009. During 2009 and 2010, the Corporation increased the size of its tax-exempt municipal security portfolio, while shrinking the average taxable available-for-sale securities portfolio. The Corporation's yield on taxable securities fell in 2009 and 2010 primarily because of low market interest rates, including the effects of management's decision to limit purchases of taxable securities to investments that mature or are expected to repay a substantial portion of principal within approximately four years or less. In addition to the impact of falling rates, the Corporation's yield on taxable securities was also negatively affected in 2010 by higher-than-expected prepayments on mortgage-backed securities; these prepayments were caused by procedural changes by the U.S. Government agencies that issued the securities. The average rate of return on available-for-sale securities was 4.33% for 2010 and 5.24% in 2009.

The average balance of gross loans decreased 0.7% to $723,318,000 in 2010 from $728,748,000 in 2009. Due to the challenging economic environment and the Corporation's decision to sell a portion of its newly originated residential mortgages on the secondary market, the Corporation experienced contraction in the balance of its mortgage and consumer loan portfolios, with modest growth in average commercial loan balances. The Corporation's yield on loans fell as rates on new loans as well as existing, variable-rate loans decreased. The average rate of return on loans was 6.44% in 2010 and 6.54% in 2009.

The average balance of interest-bearing due from banks increased to $54,655,000 in 2010 from $29,348,000 in 2009. In the last half of 2009 and all of 2010, this consisted primarily of balances held by the Federal Reserve. In early 2009, more overnight funds were invested in federal funds sold to other banks, which decreased to an average balance of $48,000 in 2010 from $8,983,000 in 2009. Although the rates of return on balances with the Federal Reserve are low, the Corporation maintained relatively high levels of liquid assets in 2009 and 2010 (as opposed to increasing long-term, available-for-sale securities at higher yields) in order to maximize flexibility for dealing with possible fluctuations in cash requirements, and due to management's concern about the possibility of substantial increases in interest rates within the next few years. Also, in 2010, management maintained a portion of the balance with the Federal Reserve in anticipation of repurchasing the TARP Preferred Stock and Warrant. These repurchases were completed during the third quarter 2010.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense fell $5,211,000, or 21.3%, to $19,245,000 in 2010 from $24,456,000 in 2009. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 1.88% in 2010 from 2.40% in 2009.

Total average deposits (interest-bearing and noninterest-bearing) increased 8.9%, to $965,615,000 in 2010 from $886,703,000 in 2009. This increase came mainly in interest checking, savings, Individual Retirement Accounts, and demand deposits. Consistent with substantial reductions in short-term global interest rates, the average rates incurred on deposit accounts decreased significantly in 2010 as compared to 2009. As shown in Table III, decreases in rates reduced interest expense on deposits by $3,315,000.

Total average borrowed funds decreased $57,621,000 to $202,792,000 in 2010 from $260,413,000 in 2009. During 2009 and 2010, the Corporation paid off long-term borrowings as they matured using the cash flow received from loans, mortgage-backed securities, and growth in deposit balances. The average rate on borrowed funds was 3.62% in 2010, down from 3.77% in 2009. This change primarily reflects lower rates being paid on customer repurchase agreements, which make up most of the Corporation's short-term borrowed funds.

TABLE I - ANALYSIS OF INTEREST INCOME AND EXPENSE

	Years Ended December 31,			Increase/(Decrease)	
(In Thousands)	2011	2010	2009	2011/2010	2010/2009
INTEREST INCOME					
Available-for-sale securities:					
Taxable	$11,297	$11,342	$16,497	$(45)	$(5,155)
Tax-exempt	7,676	7,157	6,542	519	615
Total available-for-sale securities	18,973	18,499	23,039	474	(4,540)
Held-to-maturity securities,					
Taxable	0	2	21	(2)	(19)
Trading securities	0	2	64	(2)	(62)
Interest-bearing due from banks	73	124	61	(51)	63
Federal funds sold	0	0	15	0	(15)
Loans:					
Taxable	43,231	44,229	45,236	(998)	(1,007)
Tax-exempt	2,234	2,343	2,438	(109)	(95)
Total loans	45,465	46,572	47,674	(1,107)	(1,102)
Total Interest Income	64,511	65,199	70,874	(688)	(5,675)
INTEREST EXPENSE					
Interest-bearing deposits:					
Interest checking	399	798	901	(399)	(103)
Money market	494	872	2,004	(378)	(1,132)
Savings	161	194	272	(33)	(78)
Certificates of deposit	3,905	5,060	6,672	(1,155)	(1,612)
Individual Retirement Accounts	3,150	4,977	4,796	(1,827)	181
Other time deposits	3	6	6	(3)	0
Total interest-bearing deposits	8,112	11,907	14,651	(3,795)	(2,744)
Borrowed funds:					
Short-term	23	177	544	(154)	(367)
Long-term	5,421	7,161	9,261	(1,740)	(2,100)
Total borrowed funds	5,444	7,338	9,805	(1,894)	(2,467)
Total Interest Expense	13,556	19,245	24,456	(5,689)	(5,211)
Net Interest Income	$50,955	$45,954	$46,418	$5,001	$(464)

(1) Interest income from tax-exempt securities and loans has been adjusted to a fully taxable-equivalent basis, using the Corporation’s marginal federal income tax rate of 34%.

(2) Fees on loans are included with interest on loans and amounted to $1,312,000 in 2011, $1,207,000 in 2010 and $1,176,000 in 2009.

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Table II - Analysis of Average Daily Balances and Rates

(Dollars in Thousands)

	Year Ended 12/31/2011 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2010 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2009 Average Balance	Rate of Return/ Cost of Funds %
EARNING ASSETS						
Available-for-sale securities, at amortized cost:						
Taxable	$333,441	3.39 %	$314,462	3.61 %	$342,332	4.82 %
Tax-exempt	128,463	5.98 %	113,058	6.33 %	97,491	6.71 %
Total available-for-sale securities	461,904	4.11 %	427,520	4.33 %	439,823	5.24 %
Held-to-maturity securities,						
Taxable	0	0.00 %	38	5.27 %	373	5.63 %
Trading securities	0	0.00 %	29	6.99 %	1,005	6.37 %
Interest-bearing due from banks	31,359	0.23 %	54,655	0.23 %	29,348	0.21 %
Federal funds sold	0	0.00 %	48	0.00 %	8,983	0.17 %
Loans:						
Taxable	680,257	6.36 %	687,520	6.43 %	689,275	6.56 %
Tax-exempt	35,064	6.37 %	35,798	6.55 %	39,473	6.18 %
Total loans	715,321	6.36 %	723,318	6.44 %	728,748	6.54 %
Total Earning Assets	1,208,584	5.34 %	1,205,608	5.41 %	1,208,280	5.87 %
Cash	17,762		17,505		17,042	
Unrealized gain/loss on securities	7,105		2,555		(24,334)	
Allowance for loan losses	(8,688)		(8,552)		(7,914)	
Bank premises and equipment	21,381		23,522		25,239	
Intangible Asset - Core Deposit Intangible	272		417		669	
Intangible Asset - Goodwill	11,942		11,942		11,953	
Other assets	55,087		73,148		65,151	
Total Assets	$1,313,445		$1,326,145		$1,296,086	
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	$162,583	0.25 %	$147,494	0.54 %	$104,444	0.86 %
Money market	206,612	0.24 %	203,191	0.43 %	200,982	1.00 %
Savings	97,099	0.17 %	78,012	0.25 %	69,002	0.39 %
Certificates of deposit	205,231	1.90 %	225,542	2.24 %	226,913	2.94 %
Individual Retirement Accounts	154,688	2.04 %	162,754	3.06 %	154,340	3.11 %
Other time deposits	1,231	0.24 %	1,242	0.48 %	1,276	0.47 %
Total interest-bearing deposits	827,444	0.98 %	818,235	1.46 %	756,957	1.94 %
Borrowed funds:						
Short-term	17,216	0.13 %	27,563	0.64 %	38,731	1.40 %
Long-term	134,894	4.02 %	175,229	4.09 %	221,682	4.18 %
Total borrowed funds	152,110	3.58 %	202,792	3.62 %	260,413	3.77 %

Total Interest-bearing Liabilities	979,554	1.38 %	1,021,027	1.88 %	1,017,370	2.40 %
Demand deposits	173,681		147,380		129,746	
Other liabilities	7,492		7,605		7,183	
Total Liabilities	1,160,727		1,176,012		1,154,299	
Stockholders' equity, excluding other comprehensive income/loss	148,324		148,735		158,120	
Other comprehensive income/loss	4,394		1,398		(16,333)	
Total Stockholders' Equity	152,718		150,133		141,787	
Total Liabilities and Stockholders' Equity	$1,313,445		$1,326,145		$1,296,086	
Interest Rate Spread		3.96 %		3.53 %		3.47 %
Net Interest Income/Earning Assets		4.22 %		3.81 %		3.84 %
Total Deposits (Interest-bearing and Demand)	$1,001,125		$965,615		$886,703	

(1) Rates of return on tax-exempt securities and loans are calculated on a fully-taxable equivalent basis, using the Corporation’s marginal federal income tax rate of 34%.
(2) Nonaccrual loans are included in the loan balances above.

TABLE III - ANALYSIS OF VOLUME AND RATE CHANGES

(In Thousands)	Year Ended 12/31/11 vs. 12/31/10 Change in Volume	Change in Rate	Total Change	Year Ended 12/31/10 vs. 12/31/09 Change in Volume	Change in Rate	Total Change
EARNING ASSETS						
Available-for-sale securities:						
Taxable	$ 664	$ (709)	$ (45)	$ (1,260)	$ (3,895)	$ (5,155)
Tax-exempt	936	(417)	519	1,001	(386)	615
Total available-for-sale securities	1,600	(1,126)	474	(259)	(4,281)	(4,540)
Held-to-maturity securities,						
Taxable	(1)	(1)	(2)	(18)	(1)	(19)
Trading securities	(1)	(1)	(2)	(64)	2	(62)
Interest-bearing due from banks	(54)	3	(51)	57	6	63
Federal funds sold	0	0	0	(7)	(8)	(15)
Loans:						
Taxable	(465)	(533)	(998)	(115)	(892)	(1,007)
Tax-exempt	(48)	(61)	(109)	(236)	141	(95)
Total loans	(513)	(594)	(1,107)	(351)	(751)	(1,102)
Total Interest Income	1,031	(1,719)	(688)	(642)	(5,033)	(5,675)
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	75	(474)	(399)	299	(402)	(103)
Money market	15	(393)	(378)	22	(1,154)	(1,132)
Savings	41	(74)	(33)	32	(110)	(78)
Certificates of deposit	(430)	(725)	(1,155)	(40)	(1,572)	(1,612)
Individual Retirement Accounts	(236)	(1,591)	(1,827)	258	(77)	181
Other time deposits	0	(3)	(3)	0	0	0
Total interest-bearing deposits	(535)	(3,260)	(3,795)	571	(3,315)	(2,744)
Borrowed funds:						
Short-term	(49)	(105)	(154)	(127)	(240)	(367)
Long-term	(1,623)	(117)	(1,740)	(1,902)	(198)	(2,100)
Total borrowed funds	(1,672)	(222)	(1,894)	(2,029)	(438)	(2,467)
Total Interest Expense	(2,207)	(3,482)	(5,689)	(1,458)	(3,753)	(5,211)
Net Interest Income	$ 3,238	$ 1,763	$ 5,001	$ 816	$ (1,280)	$ (464)

(1) Changes in interest income on tax-exempt securities and loans are presented on a fully taxable-equivalent basis, using the Corporation's marginal federal income tax rate of 34%.

(2) The change in interest due to both volume and rates has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

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NON-INTEREST INCOME

Years 2011, 2010 and 2009

The table below presents a comparison of non-interest income and excludes realized gains (losses) on available for sale securities, which are discussed in the "Earnings Overview" section of Management's Discussion and Analysis.

TABLE IV - COMPARISON OF NON-INTEREST INCOME

(In Thousands)	2011	% Change	2010	% Change	2009
Service charges on deposit accounts	$4,773	4.2	$4,579	(4.4)	$4,791
Service charges and fees	849	(1.0)	858	7.8	796
Trust and financial management revenue	3,472	(0.1)	3,475	6.5	3,262
Brokerage revenue	640	37.6	465	0.2	464
Insurance commissions, fees and premiums	257	3.6	248	(15.4)	293
Interchange revenue from debit card transactions	1,922	14.5	1,678	25.4	1,338
Net gains from sales of loans	1,107	45.5	761	617.9	106
Increase in cash surrender value of life insurance	509	9.2	466	(7.0)	501
Net gain (loss) from sale of premises and equipment	324	(27.2)	445		(30)
Net gain from other real estate	41	(62.0)	108	(65.2)	310
Impairment loss on limited partnership investment	(948)		0		0
Other operating income	992	31.4	755	(36.6)	1,190
Total other operating income before realized gains (losses) on available-for-sale securities, net	$13,938	0.7	$13,838	6.3	$13,021

Total non-interest income, as shown in Table IV, increased $100,000 or less than 1% in 2011 compared to 2010. In 2010, total non-interest income increased $817,000 (6.3%) from 2009. Items of significance are as follows:

2011 vs. 2010

Service charges on deposit accounts increased $194,000 or 4.2% in 2011 compared to 2010. Overdraft fee revenues associated with an overdraft privilege program represented approximately 80% of this category in 2011, and remained relatively stable (increase of $35,000) compared to 2010. Overdraft privilege programs were impacted by 2009 federal legislation that requires all consumers to "opt in" for participation in the program. Other deposit account fees increased $159,000 in 2011 compared to 2010, mainly due to fee pricing changes effective at the beginning of 2011.

Brokerage revenue of $640,000 in 2011 was $175,000 higher than in 2010. The increase in brokerage revenue includes the effects of sales of annuities to customers who had previously held variable-rate Individual Retirement Accounts (deposits) with the Corporation. Changes in variable-rate Individual Retirement Account deposits are discussed in more detail in the Net Interest Income section of Management's Discussion and Analysis.

Interchange revenue from debit card transactions of $1,922,000 in 2011 is $244,000, or 14.5%, higher than in 2010. The increased level of interchange fees reflects customers' higher volume of debit card transactions. The Federal Reserve issued a final rule, effective October 1, 2011, which establishes maximum interchange rates that may be paid to large (as defined) financial institutions. The maximum rates established under the rule are approximately 45% lower than the average market rates paid to the Corporation throughout the last several years. Although the rule's rate constraints do not directly apply to the Corporation (because the Corporation is not considered a large financial institution for this purpose), management believes interchange revenues could be reduced either because of lower volumes or because market conditions may dictate that smaller financial institutions receive rates similar to large financial institutions. Management is monitoring regulatory and market conditions associated with interchange processing, but cannot reasonably estimate the timing or amount of future changes in interchange revenues that may occur.

Net gains from the sale of loans totaled $1,107,000 in 2011, an increase of $346,000 (45.5%) over 2010. In 2010, management began to sell a significant amount of residential mortgage originations into the secondary market. The Corporation sells mortgage loans through the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago. The increased volume of mortgage loans sold reflects the impact of significant refinancing activity, with a new upsurge starting in the third quarter 2011, triggered by falling long-term market interest rates on mortgages. The recent increase in volume is similar to the surge in refinancing activity the Corporation experienced in the last several months of 2010.

As described in the Earnings Overview section of Management's Discussion and Analysis, in the third quarter 2011, the Corporation realized net gains from sales of premises and equipment totaling $324,000, including a gain of $329,000 from sale of the Court Street, Williamsport, PA location. The Corporation has entered into a leasing arrangement to continue to utilize a portion of the facility. The leaseback is for use of approximately 18% of the total building space, for a period of two years with monthly rent of approximately $8,000 per month, plus allocable utilities, property taxes and other building-related expenses identified in the lease. The lease provides the Corporation with an option to renew for an additional two years, for monthly rent of approximately $9,000 per month, plus allocable building-related expenses. The Corporation's continuing interest in the property is limited to its role as lessee, and the Corporation did not provide financing to the buyer. The Corporation has accounted for the leaseback as an operating lease. In 2010, net gains from sales of premises and equipment totaled $445,000, including a gain of $448,000 from the sale of a parcel adjacent to the Court Street, Williamsport location.

In the first quarter 2011, the Corporation reported an impairment loss of $948,000 related to an investment in a real estate limited partnership, which was included in Other Assets in the consolidated balance sheet at December 31, 2010. In addition to the limited partnership investment, the Corporation has a loan receivable from the limited partnership of $1,036,000 at December 31, 2011. Based on updated financial information, management prepared an estimated valuation based on cash flow analysis. Such analysis showed the estimated return to the Corporation would be sufficient to repay the loan in full, but would not provide sufficient additional cash flow for return on the limited partnership investment. Accordingly, management made the decision to completely write-off the limited partnership investment.

Other operating income of $992,000 in 2011 was $237,000 higher than in 2010. In 2011, this category included income of $150,000 from a limited liability equity investment in an entity performing title insurance services throughout Pennsylvania. Comparatively, the Corporation recognized $20,000 of income from investment in this entity in 2010. The Corporation has also experienced increases in revenues from check sales (up $41,000) and merchant services (up $30,000) in 2011 as compared to 2010.

2010 vs. 2009

Service charges on deposit accounts decreased $212,000 or 4.4% in 2010 compared to 2009. Overdraft fee revenues associated with an overdraft privilege program decreased $215,000 reflecting the initial impact of limitations imposed on such fees by 2009 federal legislation that requires all consumers to affirmatively "opt in" to the program. The program change became effective in the third quarter of 2010.

Trust and financial management revenue increased $213,000 (6.5%) in 2010 compared to 2009, as Trust revenues in 2010 included fees from the settlement of several large estates.

Interchange revenue from debit card transactions totaled $1,678,000 in 2010, an increase of 25.4% over 2009. The increase in interchange revenue in 2010 reflects the ongoing national trend for consumers' increasing usage of debit cards. The significance of this source of revenue, and the 2010 increase, also reflects the impact of the Corporation's "E-Z Money" checking product, which pays an attractive rate of interest, provided customers use their debit cards at least 10 times per month and meet other requirements.

In 2010, net gains from sales of loans increased to $761,000 as compared to $106,000 in 2009. In September 2009, the Corporation began selling loans into the secondary market via the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago.

In 2010, net gains from sale of premises and equipment amounted to $445,000 as compared to net losses of $30,000 in 2009. In 2010, the Corporation generated a gain of $448,000 from sale of a parcel of land adjacent to a banking facility.

Net gains from sale of foreclosed real estate properties in 2010 totaled $108,000, down from $310,000 in 2009. In 2009, the Corporation realized a gain of $325,000 from sale of a commercial property.

Other operating income decreased $435,000 in 2010 compared to 2009. In 2009, other operating income included $306,000 of rental revenues from the temporary operation of a foreclosed commercial real estate property.

NON-INTEREST EXPENSE

Years 2011, 2010 and 2009

As shown in Table V below, total non-interest expense increased $567,000 (1.8%) in 2011 compared to 2010. In 2010 total non-interest expense decreased $2,521,000 or 7.4% in 2010 compared to 2009. Changes of significance are discussed in the narrative that follows:

TABLE V - COMPARISON OF NON-INTEREST EXPENSE

(In Thousands)	2011	% Change	2010	% Change	2009
Salaries and wages	$13,866	6.1	$13,063	2.6	$12,737
Pensions and other employee benefits	4,407	14.8	3,840	(2.9)	3,956
Occupancy expense, net	2,638	(0.3)	2,645	(3.5)	2,741
Furniture and equipment expense	1,932	(8.1)	2,103	(21.5)	2,679
FDIC Assessments	832	(42.6)	1,450	(30.7)	2,092
Pennsylvania shares tax	1,306	6.9	1,222	(3.9)	1,272
Other operating expense	7,076	(1.3)	7,167	(16.0)	8,534
Total Other Expense	$32,057	1.8	$31,490	(7.4)	$34,011

2011 vs. 2010

Salaries and wages increased $803,000, or 6.1%. In 2011, salaries and wages expense includes officers' incentive stock option compensation of $244,000; however, since no stock options were awarded in 2010, there was no officers' incentive stock option expense incurred in 2010. In addition, salaries and wages expense in 2011 include increases of $55,000 in estimated incentive bonuses and $75,000 in officers' restricted stock compensation over the comparable 2010 amounts. Excluding performance based stock and bonus compensation incentives, total salaries and wages were 3.3% higher in 2011 as compared to 2010.

Pensions and other employee benefits increased $567,000, or 14.8%. Within this category, group health insurance expense was $368,000 higher in 2011. In the first quarter 2010, the Corporation recorded a reduction in group health insurance expense of $215,000 for the difference between actual and estimated claims from the previous year (2009). Payroll taxes and employer contributions expense associated with the Savings & Retirement Plan (a 401(k) plan) and Employee Stock Ownership Plan are $90,000 higher in 2011 than in the same period of 2010, including higher costs in the first quarter 2011 related to incentive compensation paid in January 2011 based on 2010 performance.

Furniture and equipment expense decreased $171,000, or 8.1% in 2011 with the decrease primarily associated with reductions in depreciation for the Corporation's core banking systems.

FDIC Assessments decreased $618,000, or 42.6% in 2011. Effective April 1, 2011, the FDIC's method of determining assessments to banks has changed, with the new methodology resulting in higher assessments to larger, more complex or higher-risk institutions, with smaller assessments to many community and small regional banks. Since the second quarter 2011, the Corporation's 2011 FDIC assessments, determined using the new methodology, are substantially lower than the amounts assessed for the prior several quarters. The favorable decline also reflects rate changes attributed to improvements in the Corporation's risk profile based on financial ratios.

Other operating expense decreased $91,000, or 1.3%, in 2011 as compared to 2010. This category includes many different types of expenses, with the most significant differences in amounts between 2011 and 2010 as follows:

- Professional fees and other costs associated with public company requirements, down $137,000, or 48.9%
- Consulting fees associated with an overdraft privilege program, down $71,000, or 93.3%
- Amortization of core deposit intangibles from 2005 and 2007 acquisitions, down $62,000, or 35.2%
- Out-of-pocket collection-related expenses, net of reimbursements, down $58,000, or 33.0%
- Office supplies, down $53,000, or 16.3%
- Attorney fees, primarily associated with lending and collection matters, down $51,000, or 19.4%
- Telephone data lines and service, down $39,000, or 7.6%
- Professional and administrative expenses associated with Citizens & Northern Investment Corporation activities, down $36,000, or 58.1%
- Expenses associated with other real estate properties, down $31,000, or 26.8%
- Software-related subscriptions and updates, up $164,000, or 25.3%
- Expenses associated with Bucktail Life Insurance Company, up $156,000. In the second quarter 2010, the Corporation recorded a $245,000 reduction in estimated insurance reserves
- Fees paid related to interchange and ATM processing increased $98,000, or 10.6%
- Charitable donations, up $26,000, mainly due to a $50,000 donation to the Red Cross for victims of flooding that occurred in the Corporation's market area in September 2011.

2010 vs. 2009

Salaries and wages increased $326,000 or 2.6%. Incentive bonus compensation totaled $1,260,000 in 2010, an increase of $926,000 over 2009. In 2009, incentive bonus compensation excluded all senior executives, including the 5 highest compensated as required by the TARP program, and there was no award to any participants for the corporate performance-based portion of the plan for 2009. Base salary costs were reduced in 2010 due to net reductions in full-time equivalent employees (281 "FTEs" at December 31, 2010 as compared to 293 FTEs at December 31, 2009), including elimination of one senior executive position. No stock options were awarded in 2010 and, as a result, there was no officers' incentive stock option expense compared to $205,000 in 2009.

Pensions and other employee benefits decreased $116,000 or 2.9%. Within this category, group health insurance costs were $74,000 lower primarily due to favorable rate adjustments determined based on 2009 claims experience.

Occupancy expense decreased $96,000 (3.5%) in 2010 and is associated with reductions in certain building maintenance costs ($49,000), and reductions of seasonal fuel and snow removal costs ($48,000).

Furniture and equipment expense decreased $576,000 (21.5%), with decreases in depreciation ($449,000) related to the core operating system. Also, equipment maintenance costs decreased $82,000 compared to 2009.

FDIC insurance costs decreased $642,000 to $1,450,000 in 2010. The 2009 FDIC insurance costs reflect the impact of a $589,000 special assessment imposed by the FDIC.

Other operating expense decreased $1,367,000 or 16.0%. The category includes a variety of expenses, and the most significant increases and decreases of individual expenses are as follows:

- Bucktail Life Insurance Company's operating expenses, primarily for estimated GAAP policy reserves, were reduced by $324,000 compared to 2009.
- Expenses related to foreclosed properties decreased in 2010 by $316,000 compared to 2009, primarily from lower operating expenses associated with one large commercial property that was sold in the fourth quarter of 2009.
- Amortization of core deposit intangibles decreased $148,000.
- Professional fees associated with the overdraft privilege program decreased $147,000 in 2010.
- No stock option expense was incurred in 2010 under the Independent Directors Stock Incentive Plan compared with costs of $68,000 in 2009.
- Certain operating costs, which were substantially discretionary, were lower in 2010. Advertising, certain public relations costs, and certain professional membership dues decreased $176,000 in 2010.

INCOME TAXES

The effective income tax rate was 27.2% of pre-tax income in 2011 compared to 23.3% of pre-tax income in 2010. In 2009, the credit for income tax was 36.6% of the pre-tax loss. Fluctuations in the tax provision/pre-tax income rate for these periods include the impact of changes in the average holdings of tax-exempt securities and loans. In 2009, the Corporation recorded a valuation reserve of $373,000 related to deferred tax assets, and in 2010, the valuation reserve was eliminated, resulting in a benefit (reduction in expense) of $373,000.

The Corporation recognizes deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax basis of assets and liabilities. At December 31, 2011, the net deferred tax asset was $6,173,000, down from the balance at December 31, 2010 of $16,054,000 and from the balance at December 31, 2009 of $22,037,000. Some of the significant components of the net reduction in deferred tax asset at December 31, 2011 as compared to December 31, 2010 are as follows:

- At December 31, 2011, the Corporation had a deferred tax liability of $5,558,000 associated with net unrealized gains on available-for-sale securities. In comparison, at December 31, 2010, there was a deferred tax asset of $695,000 associated with net unrealized losses on available-for-sale securities. Changes in unrealized gains and losses on available-for-sale securities, net of deferred income tax, are excluded from the determination of earnings but are included in Comprehensive Income.

- The net deferred tax asset balance at December 31, 2011 attributable to realized securities losses was $3,175,000, down from the balance at December 31, 2010 of $5,755,000. In 2011, the Corporation sold a pooled trust-preferred security that had been written off in 2009 and 2010 for financial statement purposes, resulting in a book gain of $1,485,000. The loss for income tax purposes from this transaction is $5,295,000, with the large book/tax difference representing the main reason for the reduction in the deferred tax asset.

- The Corporation has available an estimated $130,000 capital loss carryforward at December 31, 2011, expiring in 2015. At December 31, 2010, the Corporation had an ordinary loss carryforward of $7,886,000, expiring in 2030, and a capital loss carryforward of $502,000, expiring in 2015. The amount of deferred tax asset from unused loss carryforwards at December 31, 2011 of $44,000 is down from $2,794,000 at December 31, 2010, primarily as a result of taxable income generated in 2011.

- At December 31, 2011, the deferred tax asset based on the credit for alternative minimum tax (AMT) paid was $4,569,000, up from $3,287,000 at December 31, 2010. The increase in 2011 reflects estimated AMT payable for 2011. Realization of the deferred tax asset for AMT depends on generation of sufficient ordinary taxable income in excess of AMT income in future years, though there is no expiration of the credit for AMT paid under current tax law.

The Corporation regularly reviews deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. Management believes the recorded net deferred tax asset at December 31, 2011 is fully realizable; however, if management determines the Corporation will be unable to realize all or part of the net deferred tax asset, the Corporation would adjust the deferred tax asset, which would negatively impact earnings.

In the fourth quarter 2009, the Corporation sold some securities for which other-than-temporary impairment losses (OTTI) had been recognized for financial reporting purposes in 2008 and the first nine months of 2009. As a result of these sales, the Corporation realized both ordinary and capital tax losses for 2009, and filed net operating loss carryback returns resulting in tax refunds totaling $4,352,000 received in 2010 from recovery of some of the taxes previously paid for 2006, 2007 and 2008. In late 2010, the Internal Revenue Service (IRS) sent the Corporation an information document request related to the Corporation’s 2009 federal return, as part of an evaluation to determine whether the return will be examined or accepted without examination. In 2011, the Corporation received a final determination from the IRS that the Corporation’s loss carryback returns of 2009 losses will not result in an IRS examination.

In 2010, the Corporation sold additional securities for which OTTI had been previously recognized. These sales resulted in tax losses for 2010, and in 2011 the Corporation filed net operating loss carryback returns to recover additional taxes previously paid. The Corporation received refunds totaling $1,084,000 in 2011 attributable to the net operating loss carryback returns.

Additional information related to income taxes is presented in Note 14 to the consolidated financial statements.

SECURITIES

Table VI shows the composition of the investment portfolio at December 31, 2011, 2010 and 2009. Comparison of the amortized cost totals of available-for-sale securities at each year-end presented reflects an increase of $48,946,000 to $446,001,000 at December 31, 2010 from December 31, 2009. This change was followed by an increase of $19,334,000 to $465,335,000 at December 31, 2011. In both 2010 and 2011, the Corporation grew its available-for-sale investment portfolio primarily through purchases of municipal bonds and agency collateralized mortgage obligations and focused on purchasing investments with relatively short expected lives. The increases were partially offset by decreases in the balances of U.S. Government agency securities and trust preferred securities. The Corporation's balance of agency mortgage-backed securities declined in 2010 as management reinvested cash flows from these securities in other types of investments. Changes in the investment portfolio are discussed in more detail in the Net Interest Income section of Management's Discussion and Analysis. As discussed in more detail in Note 7 to the financial statements, in 2011 the Corporation reported net realized gains from available-for-sale securities of $2,216,000, including a realized pretax gain of $1,485,000 on the sale of a pooled trust preferred security in the first quarter 2011. Management has reviewed the Corporation's holdings as of December 31, 2011 and concluded that unrealized losses on all of the securities in an unrealized loss position are considered temporary. Notes 6 and 7 to the consolidated financial statements provide more detail concerning the Corporation's processes for evaluating securities for other-than-temporary impairment, and for valuation of trust-preferred securities. Management will continue to closely monitor the status of impaired securities in 2012.

TABLE VI - INVESTMENT SECURITIES

	As of December 31,					
	2011		2010		2009	
	Amortized	Fair	Amortized	Fair	Amortized	Fair
(In Thousands)	Cost	Value	Cost	Value	Cost	Value
AVAILABLE-FOR-SALE SECURITIES:						
Obligations of U.S. Government agencies	$24,877	$25,587	$44,005	$44,247	$48,949	$48,993
Obligations of states and political subdivisions:						
Tax-exempt	129,401	132,962	127,210	119,874	108,365	104,235
Taxable	14,004	14,334	7,808	7,668	744	755
Mortgage-backed securities	116,602	121,769	113,176	118,386	150,700	156,378

Collateralized mortgage obligations:						
Issued by U.S. Government agencies	161,818	165,131	131,040	130,826	47,083	47,708
Private label	0	0	0	0	15,465	15,494
Corporate bonds	0	0	1,000	1,027	1,000	1,041
Trust preferred securities issued by individual institutions	7,334	8,146	6,535	7,838	7,043	6,018
Collateralized debt obligations:						
Pooled trust preferred securities - senior tranches	4,996	4,638	9,957	7,400	11,383	8,199
Pooled trust preferred securities - mezzanine tranches	0	730	0	0	266	115
Other collateralized debt obligations	660	660	681	681	690	690
Total debt securities	459,692	473,957	441,412	437,947	391,688	389,626
Marketable equity securities	5,643	7,728	4,589	6,009	5,367	6,662
Total	$465,335	$481,685	$446,001	$443,956	$397,055	$396,288
HELD-TO-MATURITY SECURITIES,						
Obligations of the U.S. Treasury	$0	$0	$0	$0	$300	$302

The following table presents the contractual maturities and the weighted-average yields (calculated based on amortized cost) of investment securities as of December 31, 2011. 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, Except for Percentages)	Within One Year	Yield	One-Five Years	Yield	Five-Ten Years	Yield	After Ten Years	Yield	Total
AVAILABLE-FOR-SALE SECURITIES:									
Obligations of U.S. Government agencies	$3,082	0.75 %	$21,795	1.90%	$0	0.00%	$0	0.00%	$24,877
Obligations of states and political subdivisions:									
Tax-exempt	4,940	2.72 %	10,334	1.74%	22,552	2.72%	91,575	4.58%	129,40
Taxable	115	1.40 %	12,898	2.09%	991	3.00%	0	0.00%	14,004
Trust preferred securities issued by individual institutions	1,143	146.61%	0	0.00%	0	0.00%	6,191	9.13%	7,334
Collateralized debt obligations:									
Pooled trust preferred securities - senior tranches	0	0.00 %	0	0.00%	0	0.00%	4,996	7.72%	4,996
Pooled trust preferred securities - mezzanine tranches	0	0.00 %	0	0.00%	0	0.00%	0	0.00%	0
Other collateralized debt obligations	0	0.00 %	0	0.00%	0	0.00%	660	0.00%	660
Subtotal	$9,280	19.77 %	$45,027	1.92%	$23,543	2.73%	$103,422	4.98%	$181,27
Mortgage-backed securities									116,60
Collateralized mortgage obligations, Issued by U.S. Government agencies									161,81
Total									$459,69

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. As rates increase, cash flows generally decrease as prepayments on the underlying mortgage loans decrease. As rates decrease, cash flows generally increase as prepayments increase. In the table above, the entire balances and weighted-average rates for mortgage-backed securities and collateralized mortgage obligations are shown in one period.

In 2009, the Corporation recorded OTTI of $3,209,000 on its holding of a trust preferred security issued by Carolina First Mortgage Loan Trust, a subsidiary of The South Financial Group, Inc., and the Corporation also ceased accruing interest income on the security. In January 2010, The South Financial Group, Inc. began deferring its interest payments on the security. In April 2010, the Corporation sold half of its investment in the security, and in the first quarter 2010 recorded OTTI of $320,000 to further write down amortized cost based on the selling price of the April transaction.

In the fourth quarter 2010, The Toronto-Dominion Bank acquired The South Financial Group, Inc., made a payment for the full amount of previously deferred interest, and resumed quarterly payments on the security. The Corporation recognized a material change in the expected cash flows and began recording accretion income (included in interest income) to offset the previous OTTI charges as an adjustment to the security's yield over its remaining life. The estimated yield to maturity is 146.61%. The security has a face amount of $2 million, matures in May 2012, and has an interest rate which adjusts quarterly based on 3-month LIBOR. The security had an amortized cost of $1,143,000 and a fair value of $2,004,000 at December 31, 2011.

The actual and estimated future amounts of accretion income from this security are as follows:

	Accretion of Prior OTTI
4th Quarter 2010 (Actual)	$ 83
1st Quarter 2011 (Actual)	111
2nd Quarter 2011 (Actual)	160
3rd Quarter 2011 (Actual)	229
4th Quarter 2011 (Actual)	325
1st Quarter 2012 (Estimated)	457
2nd Quarter 2012 (Estimated)	398
Total	$ 1,763

FINANCIAL CONDITION

Significant changes in the average balances of the Corporation’s earning assets and interest-bearing liabilities are described in the Net Interest Income section of Management’s Discussion and Analysis. The discussion provides useful information regarding changes in the Corporation’s balance sheet over the 3-year period ended December 31, 2011, including discussions related to available-for-sale securities, loans, deposits and borrowings. Other significant balance sheet items - the allowance for loan losses and stockholders’ equity - are discussed in separate sections of Management’s Discussion and Analysis.

The total of loans outstanding (without consideration of the allowance for loan losses) reflects a total decrease of $27,626,000 (3.8%) from the balance at December 31, 2007 to the total outstanding of $708,315,000 at December 31, 2011. Loan volumes are heavily dependent on economic conditions in the Corporation’s market area, and are significantly influenced by interest rates. Since the end of 2007, the Corporation experienced a net decrease in total loans outstanding under the residential mortgage segment ($29,281,000) with more residential mortgage originations than in previous years sold into the secondary market. In September 2009, the Corporation initiated participation in the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago for the sale of mortgage loans to the secondary market. At December 31, 2011, the outstanding balance of residential mortgage loans originated by the Corporation, and sold with servicing retained was $56,638,000. Also, in the last four years, consumer loans have steadily decreased ($24,528,000) to the December 31, 2011 balance of $12,665,000. Total commercial segment loans increased $26,183,000 at December 31, 2011 as compared to December 31, 2007, though total commercial loans decreased $13,793,000 in 2011 from year-end 2010.

Table VIII presents loan maturity data as of October 31, 2011 (the last date in 2011 for which the Corporation ran the interest rate simulation model used to generate the loan maturity information included in Table VIII). The interest rate simulation model classifies certain loans under different categories than they appear in Table VII. Fixed-rate loans are included in Table VIII based on their contractually scheduled principal repayments, while variable-rate loans are included based on contractual principal repayments, with the remaining balance reflected in the Table as of the date of the next change in rate. Table VIII shows that fixed-rate loans are approximately 42% of the loan portfolio. Of the 58% of the portfolio made up of variable-rate loans, a significant portion (34%) will re-price after more than one year. Variable-rate loans re-pricing after more than one year include significant amounts of residential and commercial real estate loans. The Corporation's substantial investment in long-term, fixed-rate loans and variable-rate loans with extended periods until re-pricing is one of the concerns management attempts to address through interest rate risk management practices. See Part II, Item 7A for a more detailed discussion of the Corporation's interest rate risk.

Total future capital purchases in 2012 are estimated at approximately $2.2 million. Management does not expect capital expenditures to have a material, detrimental effect on the Corporation's financial condition during 2012.

TABLE VII - FIVE-YEAR SUMMARY OF LOANS BY TYPE

(In Thousands)	2011	%	2010	%	2009	%	2008	%	2007	%
Residential mortgage:										
Residential mortgage loans - first liens	$331,015	46.7	$333,012	45.6	$340,268	47.2	$353,909	47.6	$363,467	49.4
Residential mortgage loans - junior liens	28,851	4.1	31,590	4.3	35,734	5.0	40,657	5.5	40,392	5.5
Home equity lines of credit	30,037	4.2	26,853	3.7	23,577	3.3	21,304	2.9	20,542	2.8
1-4 Family residential construction	9,959	1.4	14,379	2.0	11,452	1.6	11,262	1.5	4,742	0.6
Total residential mortgage	399,862	56.5	405,834	55.6	411,031	57.0	427,132	57.4	429,143	58.3
Commercial:										
Commercial loans secured by real estate	156,388	22.1	167,094	22.9	163,483	22.7	165,979	22.3	144,742	19.7
Commercial and industrial	57,191	8.1	59,005	8.1	49,753	6.9	48,295	6.5	52,241	7.1
Political subdivisions	37,620	5.3	36,480	5.0	37,598	5.2	38,790	5.2	33,013	4.5
Commercial construction	23,518	3.3	24,004	3.3	15,264	2.1	13,730	1.8	17,755	2.4
Loans secured by farmland	10,949	1.5	11,353	1.6	11,856	1.6	9,140	1.2	8,287	1.1
Multi-family (5 or more) residential	6,583	0.9	7,781	1.1	8,338	1.2	8,367	1.1	9,004	1.2
Agricultural loans	2,987	0.4	3,472	0.5	3,848	0.5	4,495	0.6	3,553	0.5
Other commercial loans	552	0.1	392	0.1	638	0.1	884	0.1	1,010	0.1
Total commercial	295,788	41.8	309,581	42.4	290,778	40.3	289,680	39.0	269,605	36.6
Consumer	12,665	1.8	14,996	2.1	19,202	2.7	26,732	3.6	37,193	5.1
Total	708,315	100.0	730,411	100.0	721,011	100.0	743,544	100.0	735,941	100.0
Less: allowance for loan losses	(7,705)		(9,107)		(8,265)		(7,857)		(8,859)	
Loans, net	$700,610		$721,304		$712,746		$735,687		$727,082	

TABLE VIII – LOAN MATURITY DISTRIBUTION

(In Thousands)	As of October 31, 2011							
	Fixed-Rate Loans				Variable- or Adjustable-Rate Loans			
	1 Year or Less	1-5 Years	>5 Years	Total	1 Year or Less	1-5 Years	>5 Years	Total
Real Estate	$826	$29,752	$210,874	$241,452	$105,625	$215,104	$2,583	$323,312
Commercial	21,885	16,307	7,106	45,298	62,965	18,316	1,025	82,306
Consumer	3,132	6,716	3,308	13,156	281	24	0	305
Total	$25,843	$52,775	$221,288	$299,906	$168,871	$233,444	$3,608	$405,923

PROVISION AND ALLOWANCE FOR LOAN LOSSES

The Corporation maintains an allowance for loan losses that represents management's estimate of the losses inherent in the loan portfolio as of the balance sheet date and recorded as a reduction of the investment in loans. Notes 1 and 8 to the consolidated financial statements provide an overview of the process management uses for evaluating and determining the allowance for loan losses.

While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for loan losses of $7,705,000 at December 31, 2011 was down from $9,107,000 at December 31, 2010. As presented in Table X, the specific component of the allowance on impaired loans decreased to $1,126,000 at December 31, 2011 from $2,288,000 at December 31, 2010. Table X also shows that the collectively determined components of the allowance fell by a total of $240,000 as of December 31, 2011 compared to December 31, 2010, mainly because total outstanding loans decreased for each segment of the portfolio. The average net charge-off percentages and average qualitative factors used in determining the collectively evaluated components of the allowance did not change significantly at December 31, 2011 as compared to the December 31, 2010 analysis.

The decrease in the allowance on impaired loans at December 31, 2011 as compared to December 31, 2010 included the following significant transactions:

- In 2011, charge-offs totaling $1,101,000 ($663,000 in the second quarter and an additional $438,000 in the fourth quarter) were recorded related to a commercial relationship for which specific allowances totaling $765,000 had been established at December 31, 2010. After the impact of these charge-offs and re-evaluation of the allowances required, the Corporation had loans outstanding totaling $467,000 with no specific allowance at December 31, 2011 related to this commercial borrower.

- In 2011, a charge-off of $46,000 was recorded for a commercial relationship for which specific allowances totaling $200,000 had been established at December 31, 2010. After the impact of the charge-off, there were no loans outstanding from this borrower. At December 31, 2011, there was a balance in foreclosed assets held for sale of $121,000, based on the estimated fair value of real estate that had collateralized the loans.

- In 2011, the Corporation was paid off in full on a commercial loan relationship for which an allowance of $150,000 had been established at December 31, 2010.

Table IX shows a credit for loan losses of $285,000 in 2011, in comparison to a provision for loan losses of $1,191,000 in 2010. As shown in Table XII, the average provision for loan losses for the five-year period ended December 31, 2011 was $605,000. The total amount of the provision for loan losses for each period is determined based on the amount required to maintain an appropriate allowance in light of all of the factors described above. In 2011, the Corporation's credit for loan losses included the effects of the following: (1) although there were significant changes in the specific allowance amounts required on some large commercial relationships (described in the bullet points above), the net impact on the provision for loan losses of those changes was not significant, (2) the total amount of loans newly identified as impaired and requiring specific allowances in 2011 was not significant, (3) as reflected in Table IX, recoveries of previously charged off loans were higher in 2011 than in the recent past, and (4) the allowance amounts required on collectively evaluated loans fell due to a decrease in outstanding loans. Note 8 to the consolidated financial statements includes a summary of the (credit) provision for loan losses and activity in the allowance for loan losses, by segment and class, for 2011.

Table XI presents information related to past due and impaired loans, and loans that have been modified under terms that are considered troubled debt restructurings (TDRs). At December 31, 2011, total impaired loans were $7,864,000, down from $8,648,000 at December 31, 2010. The balance of impaired loans at December 31, 2011 included loans newly identified as impaired in 2011 totaling $1,525,000, resulting from implementation of new FASB guidance (ASU 2011-02) related to accounting for TDRs. Nonaccrual loans totaled $7,197,000 at December 31, 2011, down from $10,809,000 at December 31, 2010, and total loans past due 90 days or more and still in accrual status increased to $1,267,000 at December 31, 2011 from $727,000 at December 31, 2010. Interest continues to be accrued on loans 90 days or more past due that management deems to be well secured and in the process of collection, and for which no loss is anticipated. Over the period 2007-2011, each period includes a few large commercial relationships that have required significant monitoring and workout efforts. As a result, a limited number of relationships may significantly impact the total amount of allowance required on impaired loans, and may significantly impact the amount of total charge-offs reported in any one period.

As shown in Table XI, loans classified as TDRs increased to $3,477,000 at December 31, 2011 from $645,000 at December 31, 2010. The increase in TDRs reflects the impact of new (ASU 2011-02) accounting guidance, as modifications such as extensions of terms and maturities that would have not been considered TDRs in the past (because the contractual interest rate had not been changed) are now considered TDRs because the current (un-modified) contractual rate would be considered less than a market rate for the applicable borrower.

Management believes it has been conservative in its decisions concerning identification of impaired loans, estimates of loss, and nonaccrual status; however, the actual losses realized from these relationships could vary materially from the allowances calculated as of December 31, 2011. Management continues to closely monitor its commercial loan relationships for possible credit losses, and will adjust its estimates of loss and decisions concerning nonaccrual status, if appropriate.

Tables IX through XII present historical data related to the allowance for loan losses.

TABLE IX - ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

(In Thousands)	Years Ended December 31,				
	2011	2010	2009	2008	2007
Balance, beginning of year	$9,107	$8,265	$7,857	$8,859	$8,201
Charge-offs:					
Residential mortgage	(100)	(340)	(146)	(173)	(149)
Commercial	(1,189)	(91)	(39)	(1,607)	(174)
Consumer	(157)	(188)	(293)	(259)	(221)
Total charge-offs	(1,446)	(619)	(478)	(2,039)	(544)
Recoveries:					
Residential mortgage	3	55	8	19	5
Commercial	255	113	77	22	31
Consumer	71	102	121	87	50
Total recoveries	329	270	206	128	86
Net charge-offs	(1,117)	(349)	(272)	(1,911)	(458)
Allowance for loan losses recorded in acquisition	0	0	0	0	587
(Credit) provision for loan losses	(285)	1,191	680	909	529
Balance, end of period	$7,705	$9,107	$8,265	$7,857	$8,859

TABLE X - COMPONENTS OF THE ALLOWANCE FOR LOAN LOSSES

(In Thousands)	As of December 31,				
	2011	2010	2009	2008	2007
ASC 310 - Impaired loans	$1,126	$2,288	$1,126	$456	$2,255
ASC 450 - Collective segments:					
Commercial	2,811	3,047	2,677	2,654	1,870
Residential mortgage	3,130	3,227	3,859	3,920	4,201
Consumer	204	232	281	399	533
Unallocated	434	313	322	428	0
Total Allowance	$7,705	$9,107	$8,265	$7,857	$8,859

The above allocation is based on estimates and subjective judgments and is not necessarily indicative of the specific amounts or loan categories in which losses may occur.

TABLE XI - PAST DUE AND IMPAIRED LOANS, NONPERFORMING ASSETS

AND TROUBLED DEBT RESTRUCTURINGS (TDRs)

(In Thousands)

	As of December 31,				
	2011	2010	2009	2008	2007
Impaired loans with a valuation allowance	$3,433	$5,457	$2,690	$2,230	$5,361
Impaired loans without a valuation allowance	4,431	3,191	3,257	3,435	857
Total impaired loans	$7,864	$8,648	$5,947	$5,665	$6,218
Total loans past due 30-89 days and still accruing	$7,898	$7,125	$9,445	$9,875	$10,822
Nonperforming assets:					
Total nonaccrual loans	$7,197	$10,809	$9,092	$7,200	$6,955
Total loans past due 90 days or more and still accruing	1,267	727	31	1,305	1,200
Foreclosed assets held for sale (real estate)	1,235	537	873	298	258
Total nonperforming assets	$9,699	$12,073	$9,996	$8,803	$8,413
Total nonperforming assets as a % of assets	0.73 %	0.92 %	0.76 %	0.69 %	0.66 %
Loans subject to troubled debt restructurings (TDRs):					
Performing	$1,064	$645	$326	$0	$0
Nonperforming	2,413	0	0	0	0
Total TDRs	$3,477	$645	$326	$0	$0

TABLE XII - FIVE-YEAR HISTORY OF LOAN LOSSES (In Thousands)

	2011	2010	2009	2008	2007	Average
Average gross loans	$715,321	$723,318	$728,748	$743,741	$729,269	$728,079
Year-end gross loans	708,315	730,411	721,011	743,544	735,941	727,844
Year-end allowance for loan losses	7,705	9,107	8,265	7,857	8,859	8,359
Year-end nonaccrual loans	7,197	10,809	9,092	7,200	6,955	8,251
Year-end loans 90 days or more past due and still accruing	1,267	727	31	1,305	1,200	906
Net charge-offs	1,117	349	272	1,911	458	821
(Credit) provision for loan losses	(285)	1,191	680	909	529	605
Earnings coverage of charge-offs	21	55	(145)	5	23	6
Allowance coverage of charge-offs	7	26	30	4	19	10
Net charge-offs as a % of (credit) provision for loan losses	-391.93 %	29.30 %	40.00 %	210.23 %	86.58 %	135.70 %
Net charge-offs as a % of average gross loans	0.16 %	0.05 %	0.04 %	0.26 %	0.06 %	0.11 %
Net income (loss)	23,368	19,055	(39,335)	10,059	10,424	4,714

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CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

Table XIII presents the Corporation's significant fixed and determinable contractual obligations as of December 31, 2011 by payment date. The payment amounts represent the principal amounts of time deposits and borrowings, and do not include interest.

TABLE XIII – CONTRACTUAL OBLIGATIONS

(In Thousands)

Contractual Obligations	1 Year or Less	1-3 Years	3-5 Years	Over 5 Years	Total
Time deposits	$186,300	$134,490	$19,948	$7	$340,745
Long-term borrowings:					
Federal Home Loan Bank of Pittsburgh	23,507	3,553	236	13,067	40,363
Repurchase agreements	0	5,000	0	80,000	85,000
Total	$209,807	$143,043	$20,184	$93,074	$466,108

In addition to the amounts described in Table XIII, the Corporation has obligations related to deposits without a stated maturity with outstanding principal balances totaling $677,461,000 at December 31, 2011. The Corporation also has obligations related to overnight customer repurchase agreements with principal balances of $4,950,000 at December 31, 2011.

The Corporation's operating lease commitments at December 31, 2011 are immaterial. The Corporation's significant off-balance sheet arrangements consist of commitments to extend credit and standby letters of credit. Off-balance sheet arrangements are described in Note 16 to the consolidated financial statements.

LIQUIDITY

Liquidity is the ability to quickly raise cash at a reasonable cost. An adequate liquidity position permits the Corporation to pay creditors, compensate for unforeseen deposit fluctuations and fund unexpected loan demand. At December 31, 2011, the Corporation maintained overnight interest-bearing deposits with the Federal Reserve Bank of Philadelphia and other correspondent banks totaling $39,197,000.

The Corporation maintains overnight borrowing facilities with several correspondent banks that provide a source of day-to-day liquidity. Also, the Corporation maintains borrowing facilities with the Federal Home Loan Bank of Pittsburgh, secured by various mortgage loans.

The Corporation has a line of credit with the Federal Reserve Bank of Philadelphia's Discount Window. Management intends to use this line of credit as a contingency funding source. As collateral for the line, the Corporation has pledged available-for-sale securities with a carrying value of $28,681,000 at December 31, 2011.

The Corporation's outstanding, available, and total credit facilities are presented in the following table.

	Outstanding		Available		Total Credit	
(In Thousands)	Dec. 31, 2011	Dec. 31, 2010	Dec. 31, 2011	Dec. 31, 2010	Dec. 31, 2011	Dec. 31, 2010
Federal Home Loan Bank of Pittsburgh	$40,363	$55,995	$292,304	$304,584	$332,667	$360,579
Federal Reserve Bank Discount Window	0	0	27,438	26,274	27,438	26,274
Other correspondent banks	0	0	25,000	25,000	25,000	25,000
Total credit facilities	$40,363	$55,995	$344,742	$355,858	$385,105	$411,853

At December 31, 2011 and 2010, the Corporation's outstanding credit facilities with the Federal Home Loan Bank of Pittsburgh consisted of long-term borrowings. No letters of credit were outstanding at either date.

Additionally, the Corporation uses repurchase agreements placed with brokers to borrow funds secured by investment assets, and uses "RepoSweep" arrangements to borrow funds from commercial banking customers on an overnight basis. If required to raise cash in an emergency situation, the Corporation could sell available-for-sale securities to meet its obligations. At December 31, 2011, the carrying value of available-for-sale securities in excess of amounts required to meet pledging or repurchase agreement obligations was $216,266,000.

Management believes the Corporation is well-positioned to meet its short-term and long-term obligations.

STOCKHOLDERS' EQUITY AND CAPITAL ADEQUACY

The Corporation and C&N Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Details concerning regulatory capital amounts and ratios are presented in Note 18 to the consolidated financial statements. As reflected in Note 18, at December 31, 2011 and 2010, the ratios of total capital to risk-weighted assets, tier 1 capital to risk-weighted assets and tier 1 capital to average total assets are well in excess of regulatory capital requirements.

In January 2009, the Corporation issued Preferred Stock and a Warrant to purchase up to 194,794 shares of common stock at an exercise price of $20.36 per share to the United States Department of the Treasury under the TARP Program for an aggregate price of $26,440,000. The Preferred Stock paid a cumulative dividend rate of 5% per annum. On August 4, 2010, the Corporation redeemed all of the Preferred Stock. Subsequently, the Corporation negotiated with the Treasury for repurchase of the Warrant on September 1, 2010 for a total cash cost of $400,000, which was recorded as a reduction in paid-in capital. As a result, the Corporation is no longer subject to the requirements and limitations of the TARP program.

In 2009, the Corporation issued approximately 3,090,000 shares of common stock, raising a total of $24,585,000, net of related offering costs. Of this total, 2,875,000 shares were issued at a price of $8.00 per share in a public offering that was completed in December 2009, and which resulted in net proceeds of $21,410,000 (included in the $24,585,000 for the year). The additional $3,175,000 was raised through the issuance of shares under our dividend reinvestment plan. Although the Corporation maintained capital ratios that exceeded regulatory requirements to be considered well capitalized throughout 2009, the additional capital provides flexibility to absorb any additional, unexpected securities losses or other economic issues that might arise. Further, the additional capital provided funding for repayment of the TARP Preferred Stock in 2010, and improves the Corporation's ability to respond to any opportunities that could arise for branch or full-bank acquisitions.

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. In addition, the Corporation, and C&N Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities. These restrictions are described in Note 18 to the consolidated financial statements.

The Corporation's total stockholders' equity is affected by fluctuations in the fair values of available-for-sale securities. The difference between amortized cost and fair value of available-for-sale securities, net of deferred income tax, is included in "Accumulated Other Comprehensive Income (Loss)" within stockholders' equity. The balance in Accumulated Other Comprehensive Income (Loss) related to unrealized gains or losses on available-for-sale securities, net of deferred income tax, amounted to $10,791,000 at December 31, 2011 and ($1,351,000) at December 31, 2010. Changes in accumulated other comprehensive income are excluded from earnings and directly increase or decrease stockholders' equity. If available-for-sale securities are deemed to be other-than-temporarily impaired, unrealized losses are recorded as a charge against earnings, and amortized cost for the affected securities is reduced. Note 7 to the consolidated financial statements provides additional information concerning management's evaluation of available-for-sale securities for other-than-temporary impairment at December 31, 2011.

Stockholders' equity is also affected by the underfunded or overfunded status of defined benefit pension and postretirement plans. The balance in Accumulated Other Comprehensive Income (Loss) related to underfunded defined benefit plans, net of deferred income tax, was ($631,000) at December 31, 2011 and ($250,000) at December 31, 2010.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income or loss is a measure of the change in equity of a corporation, excluding transactions with owners in their capacity as owners (such as proceeds from issuances of stock and dividends). The difference between net income and comprehensive income is termed "Other Comprehensive Income (Loss)". For the Corporation, other comprehensive income includes unrealized gains and losses on available-for-sale securities, net of deferred income tax. The amount of unrealized gains or losses reflected in comprehensive income may vary widely from period-to-period, depending on the financial markets as a whole and how the portfolio of available-for-sale securities is affected by interest rate movements. The change in accumulated other comprehensive income attributable to the underfunded or overfunded status of defined benefit plans is also included in other comprehensive income. Total comprehensive income was $35,129,000 in 2011 and $18,345,000 in 2010, while in 2009 the total comprehensive loss was $14,634,000. Other comprehensive income (loss) amounted to $11,761,000 in 2011, ($710,000) in 2010 and $24,701,000 in 2009.

As described in more detail in Note 2 to the consolidated financial statements, a new accounting standard (ASU No. 2011-05) will change the financial statement presentation of comprehensive income, starting in the first quarter 2012. The intent of the new standard is to increase the prominence of comprehensive income in the financial statements. The new standard requires the components of comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The single format would include the traditional income statement and the components of other comprehensive income, total other comprehensive income and total comprehensive income. In the two statement approach, the first statement would be the traditional income statement, which would be immediately followed by a separate statement which would include the components of other comprehensive income, total other comprehensive income and total comprehensive income.

INFLATION

The Corporation is significantly affected by the Federal Reserve Board’s efforts to control inflation through changes in short-term interest rates. Beginning in September 2007, in response to concerns about weakness in the U.S. economy, the Federal Reserve lowered the fed funds target rate numerous times; in December 2008, it established a target range of 0% to 0.25%, which it has maintained throughout 2009, 2010 and 2011. Also, the Federal Reserve has injected massive amounts of liquidity into the nation’s monetary system through a variety of programs. The Federal Reserve has purchased large amounts of securities in an effort to keep interest rates low and stimulate economic growth.

Despite the current low short-term rate environment, liquidity injections, and commodity price increases, inflation statistics indicate that the overall rate of inflation is unlikely to significantly affect the Corporation’s operations within the near future. Although management cannot predict future changes in the rates of inflation, management monitors the impact of economic trends, including any indicators of inflationary pressures, in managing interest rate and other financial risks.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 2 to the consolidated financial statements for a description of recent accounting pronouncements and their recent or potential future effects on the Corporation's financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

Market risk is the risk of loss arising from adverse changes in market rates and prices of the Corporation's financial instruments. In addition to the effects of interest rates, the market prices of the Corporation's debt securities within the available-for-sale securities portfolio are affected by fluctuations in the risk premiums (amounts of spread over risk-free rates) demanded by investors.

Management cannot control changes in market prices of securities based on fluctuations in the risk premiums demanded by investors, nor can management control the volume of deferrals or defaults by other entities on trust-preferred securities. However, management attempts to limit the risk that economic conditions would force the Corporation to sell securities for realized losses by maintaining a strong capital position (discussed in the "Stockholders' Equity and Capital Adequacy" section of Management's Discussion and Analysis) and ample sources of liquidity (discussed in the "Liquidity" section of Management's Discussion and Analysis).

The Corporation's two major categories of market risk are interest rate risk and equity securities risk, which are discussed in the following sections.

INTEREST RATE RISK

Business risk arising from changes in interest rates is an inherent factor in operating a bank. The Corporation's assets are predominantly long-term, fixed-rate loans and debt securities. Funding for these assets comes principally from shorter-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation's financial instruments when interest rates change.

The Corporation uses a simulation model to calculate the potential effects of interest rate fluctuations on net interest income and the market value of portfolio equity. For purposes of these calculations, the market value of portfolio equity includes the fair values of financial instruments, such as securities, loans, deposits and borrowed funds, and the book values of nonfinancial assets and liabilities, such as premises and equipment and accrued expenses. The model measures and projects potential changes in net interest income, and calculates the discounted present value of anticipated cash flows of financial instruments, assuming an immediate increase or decrease in interest rates. Management ordinarily runs a variety of scenarios within a range of plus or minus 50-400 basis points of current rates.

The Corporation's Board of Directors has established policy guidelines for acceptable levels of interest rate risk, based on an immediate increase or decrease in interest rates. The policy limits acceptable fluctuations in net interest income from the baseline (flat rates) one-year scenario and variances in the market value of portfolio equity from the baseline values based on current rates. During the third quarter 2011, the policy was reviewed and extended to provide limits at +/- 100, 200, 300, and 400 basis points from current rates. Previously, the policy provided limits at +/- 100, 200, and 300 basis points.

Table XV, which follows this discussion, is based on the results of calculations performed using the simulation model as of October 31, 2011 and 2010. The table shows that as of October 31, 2011, the changes in net interest income and changes in market value were within the policy limits in all scenarios. Table XV shows the simulation model results for +/- 400 basis points at October 31, 2010, but policy limits at +/- 400 basis points were not yet in effect at the simulation date. As of October 31, 2010, the changes in net interest income and changes in market value were within applicable policy limits in all scenarios except an immediate rate decrease of 300 basis points, which management considers to be highly unrealistic.

After preparation of the October 31, 2010 modeling results presented in Table XV, management engaged an outside consultant to study the Corporation's non-maturity deposits: checking, savings, and money market accounts. The consultant examined historical data provided by management to estimate the average life of each type of deposit account and the sensitivity of each type of account to changes in interest rates. The results of the study indicated that the Corporation's non-maturity deposits had significantly longer average lives than previously estimated. These updated estimates are included in the October 31, 2011 data presented and result in higher market values in all of the rate scenarios and in smaller percentage declines in value in rising rate scenarios. The study also indicated that the Corporation's interest rates on non-maturity deposits were slightly more sensitive to market changes than had previously been assumed, which contributed to the larger declines in net interest income in rising rate scenarios based on October 31, 2011 data.

In December 2007, the Corporation entered into repurchase agreements (borrowings) totaling $80 million to fund the purchase of investment securities. The borrowings include embedded caps providing that, if 3-month LIBOR were to exceed 5.15%, the interest rate payable on the repurchase agreements would fall, down to a minimum of 0%, based on parameters included in the repurchase agreements. Three-month LIBOR was 0.43% at October 31, 2011 and 0.29% at October 31, 2010, and has not exceeded 5.15% since the embedded caps were acquired. The embedded cap on one of the $40 million borrowings expired in December 2010, and the embedded cap on the other $40 million borrowing expires in December 2012.

The model makes estimates, at each level of interest rate change, regarding cash flows from principal repayments on loans and mortgage-backed securities and call activity on other investment securities. Actual results could vary significantly from these estimates, which could result in significant differences in the calculations of projected changes in net interest income and market value of portfolio equity. Also, the model does not make estimates related to changes in the composition of the deposit portfolio that could occur due to rate competition, and the table does not necessarily reflect changes that management would make to realign the portfolio as a result of changes in interest rates.

TABLE XV - THE EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES

October 31, 2011 Data					
(In Thousands)	Period Ending October 31, 2012				
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+400	$66,369	$29,617	$ 36,752	-18.0 %	25.0 %
+300	63,690	24,535	39,155	-12.6 %	20.0 %
+200	60,927	19,806	41,121	-8.2 %	15.0 %
+100	58,095	15,076	43,019	-4.0 %	10.0 %
0	55,164	10,346	44,818	0.0 %	0.0 %
-100	51,929	8,720	43,209	-3.6 %	10.0 %
-200	50,441	8,680	41,761	-6.8 %	15.0 %
-300	49,961	8,680	41,281	-7.9 %	20.0 %
-400	49,828	8,680	41,148	-8.2 %	25.0 %

	Market Value of Portfolio Equity at October 31, 2011		
Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+400	$153,307	-23.2 %	50.0 %
+300	165,701	-17.0 %	45.0 %

+200	178,261	-10.7	%	35.0	%
+100	189,315	-5.2	%	25.0	%
0	199,726	0.0	%	0.0	%
-100	197,329	-1.2	%	25.0	%
-200	211,794	6.0	%	35.0	%
-300	238,309	19.3	%	45.0	%
-400	278,876	39.6	%	50.0	%

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October 31, 2010 Data
(In Thousands) Period Ending October 31, 2011

Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+400	$68,628	$32,409	$ 36,219	-15.1 %	N/A
+300	66,098	27,402	38,696	-9.3 %	20.0 %
+200	63,465	23,146	40,319	-5.5 %	15.0 %
+100	60,661	18,891	41,770	-2.1 %	10.0 %
0	57,307	14,638	42,669	0.0 %	0.0 %
-100	54,005	13,794	40,211	-5.8 %	10.0 %
-200	51,995	13,732	38,263	-10.3 %	15.0 %
-300	51,507	13,732	37,775	-11.5 %	20.0 %
-400	51,418	13,732	37,686	-11.7 %	N/A

Market Value of Portfolio Equity at October 31, 2010

Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+400	$76,087	-40.0 %	N/A
+300	90,782	-28.4 %	45.0 %
+200	104,337	-17.7 %	35.0 %
+100	116,495	-8.1 %	25.0 %
0	126,789	0.0 %	0.0 %
-100	135,342	6.7 %	25.0 %
-200	162,919	28.5 %	35.0 %
-300	194,064	53.1 %	45.0 %
-400	233,720	84.3 %	N/A

EQUITY SECURITIES RISK

The Corporation’s equity securities portfolio consists of investments in stocks of banks and bank holding companies. Investments in bank stocks are subject to risk factors that affect the banking industry in general, including credit risk, competition from non-bank entities, interest rate risk and other factors, which could result in a decline in market prices. Also, losses could occur in individual stocks held by the Corporation because of specific circumstances related to each bank. As discussed further in Note 7 of the consolidated financial statements, the Corporation recognized no OTTI charges on bank stocks in 2011 but did recognize OTTI charges on bank stocks totaling $10,000 in 2010 and $6,324,000 in 2009.

Equity securities held as of December 31, 2011 and 2010 are presented in Table XVI. Table XVI presents quantitative data concerning the effects of a decline in fair value of the Corporation's equity securities of 10% or 20%. The data in Table XVI does not reflect the effects of any appreciation in value that may occur, nor does it present the Corporation's maximum exposure to loss on equity securities, which would be 100% of their fair value as of December 31, 2011.

TABLE XVI - EQUITY SECURITIES RISK
(In Thousands)

	As of December 31,	
	2011	2010
Cost	$5,643	$4,589
Fair Value	7,728	6,009
Hypothetical 10% Decline In Fair Value	(773)	(601)
Hypothetical 20% Decline In Fair Value	(1,546)	(1,202)

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Balance Sheets

(In Thousands Except Share Data)	December 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks:		
Noninterest-bearing	$ 17,618	$ 16,840
Interest-bearing	42,957	29,461
Total cash and due from banks	60,575	46,301
Available-for-sale securities, at fair value	481,685	443,956
Loans held for sale	939	5,247
Loans receivable	708,315	730,411
Allowance for loan losses	(7,705)	(9,107)
Loans, net	700,610	721,304
Bank-owned life insurance	20,889	21,822
Accrued interest receivable	4,797	4,960
Bank premises and equipment, net	19,028	22,636
Foreclosed assets held for sale	1,235	537
Deferred tax asset, net	6,173	16,054
Intangible asset - Core deposit intangibles	212	326
Intangible asset – Goodwill	11,942	11,942
Other assets	15,650	21,503
TOTAL ASSETS	$ 1,323,735	$ 1,316,588
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 193,595	$ 158,767
Interest-bearing	824,611	845,581
Total deposits	1,018,206	1,004,348
Short-term borrowings	4,950	18,413
Long-term borrowings	125,363	148,495
Accrued interest and other liabilities	7,831	6,388
TOTAL LIABILITIES	1,156,350	1,177,644
STOCKHOLDERS' EQUITY		
Preferred stock, $1,000 par value; authorized 30,000 shares; $1,000 liquidation preference per share; no shares issued at December 31, 2011 and December 31, 2010	0	0
Common stock, par value $1.00 per share; authorized 20,000,000 shares in 2011 and 2010; issued 12,460,920 at December 31, 2011 and 12,408,212 at December 31, 2010	12,461	12,408
Paid-in capital	67,568	66,648
Retained earnings	82,302	65,920
Treasury stock, at cost; 305,391 shares at December 31, 2011 and 254,614 shares at December 31, 2010	(5,106)	(4,431)
Sub-total	157,225	140,545
Accumulated other comprehensive income (loss):		

Unrealized gains (losses) on available-for-sale securities	10,791	(1,351)
Defined benefit plans	(631)	(250)
Total accumulated other comprehensive income (loss)	10,160	(1,601)
TOTAL STOCKHOLDERS' EQUITY	167,385	138,944
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 1,323,735	$ 1,316,588

The accompanying notes are an integral part of the consolidated financial statements

Consolidated Statements of Operations	Years Ended December 31,		
(In Thousands Except Per Share Data)	2011	2010	2009
INTEREST INCOME			
Interest and fees on loans	$43,231	$44,229	$45,236
Interest on balances with depository institutions	73	124	61
Interest on loans to political subdivisions	1,499	1,582	1,660
Interest on federal funds sold	0	0	15
Interest on trading securities	0	1	43
Income from available-for-sale and held-to-maturity securities:			
Taxable	11,036	11,092	15,926
Tax-exempt	5,156	4,834	4,443
Dividends	261	252	592
Total interest and dividend income	61,256	62,114	67,976
INTEREST EXPENSE			
Interest on deposits	8,112	11,907	14,651
Interest on short-term borrowings	23	177	544
Interest on long-term borrowings	5,421	7,161	9,261
Total interest expense	13,556	19,245	24,456
Net interest income	47,700	42,869	43,520
(Credit) provision for loan losses	(285)	1,191	680
Net interest income after (credit) provision for loan losses	47,985	41,678	42,840
OTHER INCOME			
Service charges on deposit accounts	4,773	4,579	4,791
Service charges and fees	849	858	796
Trust and financial management revenue	3,472	3,475	3,262
Interchange revenue from debit card transactions	1,922	1,678	1,338
Net gains from sale of loans	1,107	761	106
Increase in cash surrender value of life insurance	509	466	501
Insurance commissions, fees and premiums	257	248	293
Impairment loss on limited partnership investment	(948)	0	0
Other operating income	1,997	1,773	1,934
Sub-total	13,938	13,838	13,021
Total other-than-temporary impairment losses on available-for-sale securities	0	(381)	(81,912)
Portion of (gain) recognized in other comprehensive loss (before taxes)	0	(52)	(3,451)
Net impairment losses recognized in earnings	0	(433)	(85,363)
Realized gains on available-for-sale securities, net	2,216	1,262	1,523
Net realized gains (impairment losses) recognized in earnings on available-for-sale securities	2,216	829	(83,840)
Total other income (loss)	16,154	14,667	(70,819)
OTHER EXPENSES			
Salaries and wages	13,866	13,063	12,737
Pensions and other employee benefits	4,407	3,840	3,956
Occupancy expense, net	2,638	2,645	2,741
Furniture and equipment expense	1,932	2,103	2,679
FDIC Assessments	832	1,450	2,092
Pennsylvania shares tax	1,306	1,222	1,272
Other operating expense	7,076	7,167	8,534
Total other expenses	32,057	31,490	34,011

Income (loss) before income tax provision (credit)	32,082	24,855	(61,990)
Income tax provision (credit)	8,714	5,800	(22,655)
Net income (loss)	23,368	19,055	(39,335)
U.S. Treasury preferred dividends	0	1,474	1,428
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$23,368	$17,581	$(40,763)
NET INCOME (LOSS) PER SHARE - BASIC AND DILUTED	$1.92	$1.45	$(4.40)

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

Consolidated Statement of Changes in Stockholders' Equity
(In Thousands Except Share and Per Share Data)

	Common Shares	Treasury Shares	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2009	9,284,148	348,041	$0	$9,284	$44,260	$97,757	$(23,214)	$(6,061)	$122,026
Comprehensive (loss) income:									
Net loss						(39,335)			(39,335)
Unrealized gain on securities, net of reclassification and tax							24,976		24,976
Other comprehensive loss related to unfunded retirement obligations							(275)		(275)
Total comprehensive loss									(14,634)
Reclassify non-credit portion of other-than-temporary impairment losses recognized in prior period						2,378	(2,378)		0
Issuance of U.S. Treasury preferred stock, 26,440 shares			25,588		821				26,409
Accretion of discount associated with U.S. Treasury preferred stock			161			(161)			0
Cash dividends on U.S. Treasury preferred stock						(1,267)			(1,267)

Cash dividends declared on common stock, $.72 per share						(6,487)			(6,487)
Common shares issued	3,090,333			3,090	21,495				24,585
Shares issued for dividend reinvestment plan		(79,665)			(71)			1,388	1,317
Shares issued from treasury related to exercise of stock options		(1,979)			(4)			34	30
Restricted stock granted		(3,950)			(69)			69	0
Forfeiture of restricted stock		333			5			(5)	0
Stock-based compensation expense					286				286
Tax benefit from stock-based compensation					3				3
Tax benefit from employee benefit plan						142			142
Balance, December 31, 2009	12,374,481	262,780	$25,749	$12,374	$66,726	$53,027	$(891)	$(4,575)	$152,410

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Consolidated Statement of Changes in Stockholders' Equity
(In Thousands Except Share and Per Share Data) (Continued)

	Common Shares	Treasury Shares	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2009	12,374,481	262,780	$25,749	$12,374	$66,726	$53,027	$(891)	$(4,575)	$152,410
Comprehensive income:									
Net income						19,055			19,055
Unrealized loss on securities, net of reclassification and tax							(829)		(829)
Other comprehensive income related to unfunded retirement obligations							119		119
Total comprehensive income									18,345
Accretion of discount associated with U.S. Treasury preferred stock			691			(691)			0
Cash dividends on U.S. Treasury preferred stock						(783)			(783)
Redemption of U.S. Treasury preferred stock, 26,440 shares			(26,440)						(26,440)
Redemption of U.S. Treasury warrant					(400)				(400)
Cash dividends declared on common stock, $.39 per share						(4,730)			(4,730)

Shares issued for dividend reinvestment plan	33,731			34	399				433
Restricted stock granted		(9,125)			(159)			159	0
Forfeiture of restricted stock		959			15			(15)	0
Stock-based compensation expense					67				67
Tax benefit from employee benefit plan						42			42
Balance, December 31, 2010	12,408,212	254,614	0	12,408	66,648	65,920	(1,601)	(4,431)	138,944
Comprehensive income:									
Net income						23,368			23,368
Unrealized gain on securities, net of reclassification and tax							12,142		12,142
Other comprehensive loss related to unfunded retirement obligations							(381)		(381)
Total comprehensive income									35,129
Cash dividends declared on common stock, $.58 per share						(7,052)			(7,052)
Treasury stock purchased		70,849						(1,022)	(1,022)
Shares issued for dividend reinvestment plan	52,708			53	772				825
Shares issued from treasury related to exercise of stock options		(4,856)			(11)			82	71
Restricted stock granted		(15,622)			(272)			272	0

Forfeiture of restricted stock		406			7			(7)	0
Stock-based compensation expense					423				423
Tax benefit from stock-based Compensation					1				1
Tax benefit from employee benefit plan						66			66
Balance, December 31, 2011	12,460,920	305,391	$0	$12,461	$67,568	$82,302	$10,160	$(5,106)	$167,385

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

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Consolidated Statements of Cash Flows	Years Ended December 31,		
(In Thousands)	2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$23,368	$19,055	$(39,335)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
(Credit) provision for loan losses	(285)	1,191	680
Realized (gains) losses on available-for-sale securities, net	(2,216)	(829)	83,840
Gain on sale of foreclosed assets, net	(41)	(108)	(310)
Depreciation expense	2,077	2,339	2,816
(Gain) loss on disposition of premises and equipment	(324)	(445)	30
Accretion and amortization on securities, net	1,317	2,233	455
Accretion and amortization on loans, deposits and borrowings, net	(35)	(262)	(357)
Decrease in fair value of mortgage servicing rights	68	12	0
Impairment loss on limited partnership interest	948	0	0
Increase in cash surrender value of life insurance	(509)	(466)	(501)
Stock-based compensation	423	67	286
Amortization of core deposit intangibles	114	176	324
Deferred income taxes	3,818	6,371	(18,383)
Gains on sales of mortgage loans, net	(1,107)	(761)	(106)
Origination of mortgage loans for sale	(26,610)	(30,720)	(11,776)
Proceeds from sales of mortgage loans	31,786	26,826	11,396
Net decrease (increase) in trading securities	0	1,045	(382)
Decrease (increase) in accrued interest receivable and other assets	3,580	9,624	(14,632)
Increase (decrease) in accrued interest payable and other liabilities	1,092	(302)	(1,077)
Net Cash Provided by Operating Activities	37,464	35,046	12,968
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of certificates of deposit	(3,760)	0	0
Proceeds from maturity of held-to-maturity securities	0	300	106
Proceeds from sales of available-for-sale securities	25,471	53,115	41,242
Proceeds from calls and maturities of available-for-sale securities	108,138	163,618	68,432
Purchase of available-for-sale securities	(152,044)	(267,082)	(131,203)
Purchase of Federal Home Loan Bank of Pittsburgh stock	0	0	(4)
Redemption of Federal Home Loan Bank of Pittsburgh stock	1,513	429	0
Net decrease (increase) in loans	19,264	(10,330)	20,470
Proceeds from bank-owned life insurance	1,442	1,442	0
Purchase of premises and equipment	(998)	(707)	(1,253)
Proceeds from disposition of premises and equipment	3,060	103	0
Purchase of investment in limited liability entity	(397)	0	0
Return of principal on limited liability entity investments	116	66	18
Proceeds from sale of foreclosed assets	1,112	1,169	1,564
Net Cash Provided by (Used in) Investing Activities	2,917	(57,877)	(628)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in deposits	13,839	77,537	62,706

Net decrease in short-term borrowings	(13,463)	(20,816)	(9,318)
Repayments of long-term borrowings	(23,132)	(47,607)	(40,445)
Issuance of US Treasury preferred stock and warrant	0	0	26,409
Redemption of US Treasury preferred stock and warrant	0	(26,840)	0
Issuance of common stock	0	0	24,585
Purchase of treasury stock	(1,022)	0	0
Sale of treasury stock	71	0	30
Tax benefit from compensation plans	67	42	145
US Treasury preferred dividends paid	0	(952)	(1,098)
Common dividends paid	(6,227)	(4,297)	(7,317)
Net Cash (Used in) Provided by Financing Activities	(29,867)	(22,933)	55,697
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	10,514	(45,764)	68,037
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	46,301	92,065	24,028
CASH AND CASH EQUIVALENTS, END OF YEAR	$56,815	$46,301	$92,065

Consolidated Statements of Cash Flows (Continued)

(In Thousands)	Years Ending December 31,		
	2011	2010	2009
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Assets acquired through foreclosure of real estate loans	$1,769	$725	$1,829
Interest paid	$13,609	$19,614	$24,944
Income taxes paid (refunded)	$3,616	$(8,134)	$3,475
Securities transferred from trading to available-for-sale	$0	$0	$1,643

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF CONSOLIDATION - The consolidated financial statements include the accounts of Citizens & Northern Corporation and its subsidiaries, Citizens & Northern Bank ("C&N Bank"), Bucktail Life Insurance Company and Citizens & Northern Investment Corporation (collectively, "Corporation"), as well as C&N Bank's wholly-owned subsidiary, C&N Financial Services Corporation. The consolidated financial statements also include the accounts of the former Canisteo Valley Corporation (merged into Citizens & Northern Corporation in September 2010) and its former wholly-owned subsidiary, First State Bank (merged into C&N Bank, effective September 1, 2010). All material intercompany balances and transactions have been eliminated in consolidation.

NATURE OF OPERATIONS - The Corporation is primarily engaged in providing a full range of banking and mortgage services to individual and corporate customers in North Central Pennsylvania and Southern New York State. Lending products include mortgage loans, commercial loans and consumer loans, as well as specialized instruments such as commercial letters-of-credit. Deposit products include various types of checking accounts, passbook and statement savings, money market accounts, interest checking accounts, Individual Retirement Accounts and certificates of deposit. The Corporation also offers non-insured "Repo Sweep" accounts.

The Corporation provides Trust and Financial Management services, including administration of trusts and estates, retirement plans, and other employee benefit plans, and investment management services. The Corporation offers a variety of personal and commercial insurance products through C&N Financial Services Corporation. C&N Financial Services Corporation also has a broker-dealer division, which offers mutual funds, annuities, educational savings accounts and other investment products through registered agents. Management has determined that the Corporation has one reportable segment, "Community Banking." All of the Corporation's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Corporation supports the others.

The Corporation is subject to competition from other financial institutions. It is also subject to regulation by certain federal and state agencies and undergoes periodic examination by those regulatory authorities. As a consequence, the Corporation's business is particularly susceptible to being affected by future federal and state legislation and regulations.

USE OF ESTIMATES - The financial information is presented in accordance with generally accepted accounting principles and general practice for financial institutions in the United States of America. In preparing financial statements, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements. In addition, these estimates and assumptions affect revenues and expenses in the financial statements and as such, actual results could differ from those estimates.

Material estimates that are particularly susceptible to change include: (1) the allowance for loan losses, (2) fair values of debt securities based on estimates from independent valuation services or from brokers, (3) fair values of debt securities based on unobservable inputs, as determined using management's estimates of cash flows and applicable discount rates,(4) assessment of impaired securities to determine whether or not the securities are other-than-temporarily impaired, (5) valuation of deferred tax assets and (6) valuation of obligations from defined benefit plans.

INVESTMENT SECURITIES - Investment securities are accounted for as follows:

Available-for-sale securities - includes debt securities not classified as held-to-maturity or trading, and unrestricted equity securities. Such securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported separately through accumulated other comprehensive income, net of tax. Amortization of premiums and accretion of discounts on available-for-sale securities are recorded using the level yield method over the remaining contractual life of the securities, adjusted for actual prepayments. Realized gains and losses on sales of available-for-sale securities are computed on the basis of specific identification of the adjusted cost of each security. Securities within the available-for-sale portfolio may be used as part of the Corporation's asset and liability management strategy and may be sold in response to changes in interest rate risk, prepayment risk or other factors.

Other-than-temporary impairment - Declines in the fair value of available-for-sale securities that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (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, (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value, and (4) whether the Corporation intends to sell the security or if it is more likely than not that the Corporation will be required to sell the security before the recovery of its amortized cost basis. The credit-related impairment is recognized in earnings, and is the difference between a security's amortized cost basis and the present value of expected future cash flows discounted at the security's effective interest rate. For debt securities classified as held-to-maturity, the amount of noncredit-related impairment is recognized in other comprehensive income and accreted over the remaining life of the debt security as an increase in the carrying value of the security. In addition, the risk of future other-than-temporary impairment may be influenced by additional bank failures, prolonged recession in the U.S. economy, changes to real estate values, interest deferrals and whether the federal government provides assistance to financial institutions.

Restricted equity securities - Restricted equity securities consist primarily of Federal Home Loan Bank of Pittsburgh stock, and are carried at cost and evaluated for impairment. Holdings of restricted equity securities are included in Other Assets in the Consolidated Balance Sheet, and dividends received on restricted securities are included in Other Income in the Consolidated Statement of Income.

LOANS HELD FOR SALE - Mortgage loans held for sale are reported at the lower of cost or market, determined in the aggregate.

LOANS RECEIVABLE - Loans receivable which management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan fees. Interest income is accrued on the unpaid principal balance. Loan origination and commitment fees, as well as certain direct origination costs, are deferred and amortized as a yield adjustment over the lives of the related loans using the interest method.

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

Loans are placed on nonaccrual status for all classes of loans when, in the opinion of management, collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on loans for which the risk of further loss is greater than remote are applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments. Also, the amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

ALLOWANCE FOR LOAN LOSSES - The allowance for loan losses represents management’s estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than when they are 120 days past due on a contractual basis, or earlier in the event of bankruptcy or if there is an amount deemed uncollectible.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Corporation’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation’s allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination. In the process of evaluating the loan portfolio, management also considers the Corporation’s exposure to losses from unfunded loan commitments. As of December 31, 2011 and 2010, management determined that no allowance for credit losses related to unfunded loan commitments was required.

The allowance consists primarily of two major components – (1) a specific component based on a detailed assessment of certain larger loan relationships, mainly commercial purpose, determined on a loan-by-loan basis; and (2) a general component for the remainder of the portfolio based on a collective evaluation of pools of loans with similar risk characteristics. The general component is assigned to each pool of loans based on both historical net charge-off experience, and an evaluation of certain qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the above methodologies for estimating specific and general losses in the portfolio.

The specific component relates to loans that are classified as impaired based on a detailed assessment of certain larger loan relationships evaluated by a management committee referred to as the Watch List Committee. Specific loan relationships are identified for evaluation based on the related credit risk rating. For individual loans classified as impaired, an allowance is established when the collateral value less estimated selling costs, present value of discounted cash flows or observable market price of the impaired loan is lower than the carrying value of that loan.

The general component covers pools of loans by loan class including commercial loans not considered individually impaired, as well as smaller balance homogeneous classes of loans, such as residential real estate, home equity lines of credit and other consumer loans. Accordingly, the Corporation generally does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are subject to a restructuring agreement. The pools of loans for each loan segment are evaluated for loss exposure based upon average historical net charge-off rates (currently three years), adjusted for qualitative factors. Qualitative risk factors (described in the following paragraph) are evaluated for the impact on each of the three distinct segments (residential mortgage, commercial and consumer) within the loan portfolio. Each qualitative factor is assigned a value to reflect improving, stable or declining conditions based on management's judgment using relevant information available at the time of the evaluation. Any adjustments to the factors are supported by a narrative documentation of changes in conditions accompanying the allowance for loan loss calculation.

The qualitative factors used in the general component calculations are designed to address credit risk characteristics associated with each segment. The Corporation's credit risk associated with all of the segments is significantly impacted by these factors, which include economic conditions within its market area, the Corporation's lending policies, changes or trends in the portfolio, risk profile, competition, regulatory requirements and other factors. Further, the residential mortgage segment is significantly affected by the values of residential real estate that provide collateral for the loans. The majority of the Corporation's commercial segment loans (approximately 67% at December 31, 2011) is secured by real estate, and accordingly, the Corporation's risk for the commercial segment is significantly affected by commercial real estate values. The consumer segment includes a wide mix of loans for different purposes, primarily secured loans, including loans secured by motor vehicles, manufactured housing and other types of collateral.

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. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial loans by the fair value of the collateral (if the loan is collateral dependent), by future cash flows discounted at the loan's effective rate or by the loan's observable market price.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Loans whose terms are modified are classified as troubled debt restructurings if the Corporation grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve an extension of a loan's stated maturity date or a temporary reduction in interest rate. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

BANK PREMISES AND EQUIPMENT - Bank premises and equipment are stated at cost less accumulated depreciation. Repair and maintenance expenditures which extend the useful lives of assets are capitalized, and other repair and maintenance expenditures are expensed as incurred. Depreciation expense is computed using the straight-line method.

IMPAIRMENT OF LONG-LIVED ASSETS - The Corporation reviews long-lived assets, such as premises and equipment and intangibles, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. These changes in circumstances may include a significant decrease in the market value of an asset or the manner in which an asset is used. If there is an indication the carrying value of an asset may not be recoverable, future undiscounted cash flows expected to result from use of the asset are estimated. If the sum of the expected cash flows is less than the carrying value of the asset, a loss is recognized for the difference between the carrying value and fair market value of the asset.

INTEREST COSTS - The Corporation capitalizes interest as a component of the cost of premises and equipment constructed or acquired for its own use. The amount of capitalized interest in 2011, 2010, and 2009 was not significant.

FORECLOSED ASSETS HELD FOR SALE - Foreclosed assets held for sale consist of real estate acquired by foreclosure and are initially recorded at fair value, less estimated selling costs. Subsequent to foreclosure, revenues are included in Other Operating income and expenses from operations and lower of cost or market changes in the valuation are included in Other Operating Expenses.

GOODWILL AND CORE DEPOSIT INTANGIBLE ASSETS - Goodwill represents the excess of the cost of acquisitions over the fair value of the net assets acquired. Goodwill is tested at least annually for impairment, or more often if events or circumstances indicate there may be impairment. Core deposit intangibles are being amortized over periods of time that represent the expected lives using a method of amortization that reflects the pattern of economic benefit. Core deposit intangibles are subject to impairment testing whenever events or changes in circumstances indicate their carrying amounts may not be recoverable.

SERVICING RIGHTS - The estimated fair value of servicing rights related to mortgage loans sold and serviced by the Corporation is recorded as an asset upon the sale of such loans. The valuation of servicing rights is adjusted quarterly, with changes in fair value included in Other Operating Income in the consolidated statements of operations. Significant inputs to the valuation include expected net servicing income to be received, the expected life of the underlying loans and the discount rate. The servicing rights asset is included in Other Assets in the consolidated balance sheet, with a balance equal to fair value of $375,000 at December 31, 2011 and $204,000 at December 31, 2010.

INCOME TAXES - Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases given the provisions of the enacted tax laws. Deferred tax assets are reduced, if necessary, by the amount of such benefits that are not expected to be realized based upon available evidence. The Corporation includes income tax penalties in the provision for income tax. The Corporation has no accrued interest related to unrecognized tax benefits.

STOCK COMPENSATION PLANS - The Corporation's stock-based compensation policy applies to all forms of stock-based compensation including stock options and restricted stock units. All stock-based compensation is accounted for under the fair value method as required by generally accepted accounting principles in the United States. The expense associated with stock-based compensation is recognized over the vesting period of each individual arrangement.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option valuation model. The fair value of restricted stock is based on the current market price on the date of grant.

OFF-BALANCE SHEET FINANCIAL INSTRUMENTS - In the ordinary course of business, the Corporation has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

CASH FLOWS - The Corporation utilizes the net reporting of cash receipts and cash payments for certain deposit and lending activities. Cash equivalents include federal funds sold and all cash and amounts due from depository institutions and interest-bearing deposits in other banks with original maturities of three months or less.

TRUST ASSETS AND INCOME - Assets held by the Corporation in a fiduciary or agency capacity for its customers are not included in the financial statements since such items are not assets of the Corporation. Trust income is recorded on a cash basis, which is not materially different from the accrual basis.

2. RECENT ACCOUNTING PRONOUNCEMENTS:

Since January 1, 2011, the FASB has issued additional FASB Accounting Standards Updates (ASUs) to the FASB Accounting Standards Codification (ASC). This section provides a summary description of recent ASUs that have significant implications (elected or required) within the consolidated financial statements, or that management expects may have a significant impact on financial statements issued in the near future.

In April 2011, the FASB issued ASU 2011-02, Receivables (Topic 310) - A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The Update amends ASC Topic 310 to provide guidance in evaluating whether a restructuring constitutes a Troubled Debt Restructuring. The main provisions conclude that a creditor must separately conclude that both of the following exist – (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The amendments then provide guidance on a creditor's evaluation of each of the requirements for a Troubled Debt Restructuring. For public entities, the Update was effective for the first interim or annual period beginning on or after June 15, 2011, including retrospective application to the beginning of the annual period of adoption. Note 6 provides information concerning the impact of this standard on the Corporation.

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update will result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. The Update includes various amendments, including amendments that: (1) clarify FASB's intent about the application of existing fair value measurement and disclosure requirements, and (2) change some particular principles or requirements for measuring fair value or disclosing information about fair value measurements. Management believes there will be no changes in the Corporation's procedures for determining fair value measurements as a result of this Update, but expects to provide additional quantitative disclosures about unobservable inputs used in fair value measurements categorized within Level 3 of the fair value hierarchy. The amendments in this ASU will be applied prospectively, and will be required for the Corporation beginning in the first quarter 2012.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220) – Presentation of Comprehensive Income. The intent of this standard is to increase the prominence of comprehensive income in the financial statements. This standard requires the components of comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The single format would include the traditional income statement and the components of other comprehensive income, total other comprehensive income and total comprehensive income. In the two statement approach, the first statement would be the traditional income statement, which would be immediately followed by a separate statement which would include the components of other comprehensive income, total other comprehensive income and total comprehensive income. The amendments in this ASU will be applied retrospectively, and will be required for the Corporation beginning in the first quarter 2012.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment. The amendments in this ASU permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, and as described in Note 10, management adopted this ASU in assessing goodwill for impairment as of December 31, 2011.

3. COMPREHENSIVE INCOME

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

(In Thousands)	2011	2010	2009
Net income (loss)	$23,368	$19,055	$(39,335)
Unrealized holding gains (losses) on available-for-sale securities	20,611	(448)	(45,998)
Reclassification adjustment for (gains) losses realized in income	(2,216)	(829)	83,840
Other comprehensive gain (loss) before income tax	18,395	(1,277)	37,842
Income tax related to other comprehensive gain (loss)	6,253	(448)	12,866
Other comprehensive gain (loss) on available-for-sale securities	12,142	(829)	24,976
Unfunded pension and postretirement obligations:			
Change in items from defined benefit plans included in accumulated other comprehensive loss	(626)	126	(511)
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	55	53	94
Other comprehensive (loss) gain before income tax	(571)	179	(417)
Income tax related to other comprehensive (loss) gain	(190)	60	(142)
Other comprehensive (loss) gain on unfunded retirement obligations	(381)	119	(275)
Net other comprehensive income (loss)	11,761	(710)	24,701
Comprehensive income (loss)	$35,129	$18,345	$(14,634)

The Corporation recognized other comprehensive income of $52,000 before income tax ($34,000 after income tax) related to available-for-sale debt securities for which a portion of an other-than-temporary impairment (OTTI) loss has been recognized in earnings in 2010. In 2009, the Corporation recognized other comprehensive income of $3,451,000 before income tax ($2,278,000 after income tax) related to available-for-sale debt securities for which a portion of an OTTI loss has been recognized in earnings.

The components of accumulated other comprehensive income (loss), included in stockholders' equity, are as follows:

(In Thousands)	Dec. 31 2011	Dec. 31 2010
Unrealized gain (loss) on available-for-sale securities	$16,349	$(2,046)
Tax effect	(5,558)	695
Net-of-tax amount	10,791	(1,351)

Unrealized loss on defined benefit plans	(955)	(384)
Tax effect	324	134
Net-of-tax amount	(631)	(250)
Total accumulated other comprehensive income (loss)	$10,160	$(1,601)

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4. PER 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 (Loss)	Weighted-Average Common Shares	Earnings Per Share
2011			
Earnings per share – basic	$23,368,000	12,162,045	$ 1.92
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		92,398	
Hypothetical share repurchase at $ 15.87		(87,675)	
Earnings per share – diluted	$23,368,000	12,166,768	$ 1.92
2010			
Earnings per common share – basic and diluted	$17,581,000	12,131,039	$ 1.45
2009			
Earnings per common share – basic and diluted	$(40,763,000)	9,271,869	$ (4.40)

Stock options and a warrant that were anti-dilutive were excluded from net income per share calculations. Weighted-average common shares available from anti-dilutive instruments totaled 223,333 shares in 2011, 359,092 shares in 2010 and 518,480 shares in 2009.

5. CASH AND DUE FROM BANKS

Cash and due from banks at December 31, 2011 and 2010 include the following:

(In thousands)	Dec. 31, 2011	Dec. 31, 2010
Cash and cash equivalents	$56,815	$46,301

Certificates of deposit	3,760	0
Total cash and due from banks	$60,575	$46,301

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 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 during the year, account activity, and other services provided by the Federal Reserve Bank. Required reserves were $14,035,000 at December 31, 2011 and $13,279,000 at December 31, 2010.

In 2010, the FDIC permanently increased the amount of insured deposits from $100,000 to $250,000. The Corporation maintains cash and cash equivalents with certain financial institutions in excess of the insured amount.

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6. FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

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

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

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

		December 31, 2011 Market Values Based on:		
(In Thousands)	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$ 0	$ 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
Certificates of deposit	0	3,683	0	3,683
Servicing rights	0	0	375	375
Total assets measured at fair value on a recurring basis	$ 7,728	$ 472,272	$ 5,743	$485,743

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

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

Management determined there have been few trades of pooled trust-preferred securities since 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. In 2011, management's estimates of cash flows from the securities changed significantly from the estimates in previous years based on the level and timing of assumed prepayments as well as financial strength ratings that changed for some of the underlying issuers. Management used the cash flow estimates determined using the process described in Note 7 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) adjustment to the year-end 2007 discount rates for the change in the spread between indicative market rates over corresponding risk-free rates; and (3) an additional adjustment – an increase of 2% in the discount rate – for liquidity risk. Management considered the additional 2% increase in the discount rate necessary in order to give some consideration to price estimates based on trades made under distressed conditions, as reported by brokers and pricing services. Management's estimates of cash flows and the discount rates used to calculate the fair values of the pooled trust-preferred securities were based on sensitive assumptions, and 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.

Following is a reconciliation of activity for Level 3 assets measured at fair value based on significant unobservable information (Level 3 valuation methods):

(In Thousands)	2011	2010	2009
Balance, beginning of period	$7,604	$9,114	$58,914
Issuances of servicing rights	239	216	0
Transfers	0	(240)	800
Capitalized interest payments/payments in kind	0	0	895
Accretion and amortization, net	(41)	(279)	(655)
Proceeds from sales and calls	(5,099)	(1,859)	(1,102)
Realized gains (losses), net	179	310	(182)
Unrealized losses included in earnings	(68)	(435)	(73,674)
Unrealized gains included in other comprehensive income	2,929	777	24,118
Balance, end of period	$5,743	$7,604	$9,114

Unrealized losses included in earnings include other-than-temporary impairment losses on securities, as described in Note 7, of $423,000 in 2010 and $73,674,000 in 2009, which are presented in net impairment losses recognized in earnings in the consolidated statements of operations. Unrealized losses included in earnings also include decreases in fair value of servicing rights of $68,000 in 2011 and $12,000 in 2010, which are presented as a component of other operating income in the consolidated statements of operations.

Assets measured at fair value on a nonrecurring basis include impaired commercial loans and foreclosed real estate assets held for sale. All of the Corporation's impaired commercial loans for which a valuation allowance was necessary at December 31, 2011 and 2010 were valued based on the estimated amount of net proceeds from liquidation of real estate and other collateral, or based on the estimated present value of cash flows to be received. The Corporation considers the fair value of such impaired commercial loans to be based on unobservable inputs (Level 3), and the net carrying value of impaired loans for which a valuation allowance was recorded was $2,307,000 (loan balances totaling $3,433,000, less allowances totaling $1,126,000) at December 31, 2011 and $3,169,000 (loan balances totaling $5,457,000, less allowances totaling $2,288,000) at December 31, 2010. Similarly, the carrying values of foreclosed real estate assets held for sale were based on unobservable inputs (Level 3), with a balance of $1,235,000 at December 31, 2011 and $537,000 at December 31, 2010.

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

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

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

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 life of the underlying loans.

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

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

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

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

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

(In Thousands)	December 31, 2011		December 31, 2010	
	Carrying	Fair	Carrying	Fair

	Amount	Value	Amount	Value
Financial assets:				
Cash and cash equivalents	$56,815	$56,815	$46,301	$46,301
Certificates of deposit	3,760	3,683	0	0
Available-for-sale securities	481,685	481,685	443,956	443,956
Restricted equity securities	6,773	6,773	8,286	8,286
Loans held for sale	939	939	5,247	5,249
Loans, net	700,610	718,274	721,304	728,744
Accrued interest receivable	4,797	4,797	4,960	4,960
Servicing rights	375	375	204	204
Financial liabilities:				
Deposits	1,018,206	1,022,397	1,004,348	1,012,247
Short-term borrowings	4,950	4,897	18,413	18,240
Long-term borrowings	125,363	145,641	148,495	171,877
Accrued interest payable	358	358	430	430

7. SECURITIES

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

(In Thousands)	December 31, 2011 Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
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

(In Thousands)	December 31, 2010 Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of U.S. Government agencies	$ 44,005	$ 270	$ (28)	$ 44,247
Obligations of states and political subdivisions:				
Tax-exempt	127,210	546	(7,882)	119,874
Taxable	7,808	1	(141)	7,668
Mortgage-backed securities	113,176	5,381	(171)	118,386
Collateralized mortgage obligations, Issued by U.S. Government agencies	131,040	869	(1,083)	130,826
Corporate bonds	1,000	27	0	1,027
Trust preferred securities issued by individual institutions	6,535	1,694	(391)	7,838
Collateralized debt obligations:				

Pooled trust preferred securities - senior tranches	9,957	0	(2,557)	7,400
Other collateralized debt obligations	681	0	0	681
Total debt securities	441,412	8,788	(12,253)	437,947
Marketable equity securities	4,589	1,496	(76)	6,009
Total	$ 446,001	$ 10,284	$ (12,329)	$ 443,956

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

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)

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

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

(In Thousands)	2011	2010	2009
Gross realized gains	$2,226	$1,270	$2,205
Gross realized losses	(10)	(441)	(86,045)
Net realized gains (losses)	$2,216	$829	$(83,840)
Income tax provision (credit) related to net realized gains (losses)	$753	$282	$(28,506)

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The amortized cost and fair value of available-for-sale debt securities by contractual maturity are shown in the following table as of December 31, 2011. 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.

	December 31, 2011	
	Amortized	Fair
(In Thousands)	Cost	Value
Due in one year or less	$9,280	$10,199
Due from one year through five years	45,027	46,108
Due from five years through ten years	23,543	24,397
Due after ten years	103,422	106,353
Subtotal	181,272	187,057
Mortgage-backed securities	116,602	121,769
Collateralized mortgage obligations, Issued by U.S. Government agencies	161,818	165,131
Total	459,692	473,957

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.

Investment securities carried at $266,149,000 at December 31, 2011 and $216,828,000 at December 31, 2010 were pledged as collateral for public deposits, trusts and certain other deposits as provided by law. See Note 12 for information concerning securities pledged to secure borrowing arrangements.

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

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

(In Thousands)			
	2011	2010	2009
Trust preferred securities issued by individual institutions	$ 0	$(320)	$(3,209)

Pooled trust preferred securities - mezzanine tranches	0	(103)	(73,674)
Marketable equity securities (bank stocks)	0	(10)	(6,324)
Private label collateralized mortgage obligations	0	0	(2,156)
Net impairment losses recognized in earnings	$ 0	$(433)	$(85,363)

A summary of information management considered in evaluating debt and equity securities for OTTI at December 31, 2011 is provided below.

Debt Securities

At December 31, 2011, management performed an assessment for possible OTTI of the Corporation's debt securities on an issue-by-issue basis, relying on information obtained from various sources, including publicly available financial data, ratings by external agencies, brokers and other sources. The extent of individual analysis applied to each security depended on the size of the Corporation's investment, as well as management's perception of the credit risk associated with each security. Based on the results of the assessment, management believes impairment of these debt securities, including municipal bonds with no external ratings, at December 31, 2011 to be temporary.

The credit rating agencies have withdrawn their ratings on numerous municipal bonds held by the Corporation. At December 31, 2011, the total amortized cost basis of municipal bonds with no external credit ratings was $24,290,000, with an aggregate unrealized loss of $605,000. 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.

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Included in the total amounts of bonds with no external credit ratings, in the paragraph above, is one municipal bond that had been downgraded from “A” to “BB” (less than investment grade) in the second quarter 2011. The external credit rating agency cited extended delays in the issuer’s publication of financial statements as one of the major reasons for the downgrade. In the third quarter 2011, the external credit rating agency removed its rating, again citing the lack of available financial information. At December 31, 2011, the bond had an amortized cost basis of $1,127,000, with an unrealized gain of $108,000.

The following table provides information related to trust preferred securities issued by individual institutions as of December 31, 2011:

(In Thousands)							Moody's/ S&P/ Fitch
					Unrealized	Cumulative Realized	
Name of Issuer	Issuer's Parent Company	Par Amount Outstanding	Amortized Cost	Fair Value	Gain (Loss)	Credit Losses	Credit Ratings
Astoria Capital Trust I	Astoria Financial Corporation	$ 5,000	$ 5,191	$ 5,195	$ 4	$ 0	Baa3/BB/BB- (1)
Carolina First Mortgage Loan Trust	The Toronto-Dominion Bank	$ 2,000	$ 1,143	$ 2,004	861	(1,769)	NR
Patriot Capital Trust I	Susquehanna Bancshares, Inc.	$ 1,000	$ 1,000	$ 947	(53)	0	NR
Total		$ 8,000	$ 7,334	$ 8,146	$ 812	$ (1,769)	

(1) Astoria Capital Trust I is on negative outlook with Moody's and negative watch with Fitch.

NR = not rated.

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

The Corporation recognized OTTI charges in 2009 and 2010 related to the Carolina First Mortgage Loan Trust security. In the fourth quarter 2010, The Toronto-Dominion Bank acquired The South Financial Group, Inc., the parent company of Carolina First. After the acquisition, The Toronto-Dominion Bank made a payment for the full amount of previously deferred interest and resumed quarterly payments on the security. The Corporation recognized a material change in the expected cash flows in the fourth quarter 2010. The Corporation recorded accretion income totaling $825,000 in 2011 and $83,000 in 2010. Management expects to record accretion income to offset the previous OTTI charges over the security's remaining life, through May 2012.

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

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

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

The following table provides detailed information related to pooled trust preferred securities – mezzanine tranches held as of December 31, 2011:

(In Thousands)

Security	Tranche	Par Amount Outstanding	Amortized Cost	Fair Value	Unrealized Gain	Cumulative OTTI
U.S. Capital Funding II, Ltd.	B-1	$ 2,000	$ 0	$ 292	$ 292	$ (1,992)
U.S. Capital Funding II, Ltd.	B-2	3,000	0	438	438	(2,973)
ALESCO Preferred Funding IX, Ltd.	C-1	3,000	0	0	0	(2,988)
Total		$ 8,000	$ 0	$ 730	$ 730	$ (7,953)

As of December 31, 2011, the Corporation's investment in the senior tranche of MMCAPS Funding I, Ltd. had an investment grade rating. The security, with an amortized cost of $4,996,000, has been subjected to impairment analysis based on estimated cash flows (using the process described above), and management has determined that impairment was temporary as of December 31, 2011.

The table that follows provides additional information related to pooled trust preferred securities as of December 31, 2011:

Security	MMCAPS Funding I, Ltd.	U.S. Capital Funding II, Ltd.	U.S. Capital Funding II, Ltd.
Tranche	Senior	B-1	B-2
Number of Banks Currently Performing	12	36	36
Moody's/Fitch Credit Ratings	A3/BBB (1)	Ca/C	Ca/C
Actual Deferrals and Defaults as % of Outstanding Collateral	37.7 %	22.7 %	22.7 %
Expected Additional Net Deferrals and Defaults as % of Performing Collateral	15.6 %	40.7 %	40.7 %
Excess Subordination as % of Performing Collateral	40.7 %	-16.6 %	-16.6 %

(1) Fitch has the senior tranche of MMCAPS Funding I, Ltd. on negative outlook.

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

The Excess Subordination Ratio measures the extent to which there may be tranches within the pooled trust preferred structure available to absorb credit losses before the Corporation's security would be impacted. A positive Excess Subordination Ratio signifies there is available support from subordinate tranches to absorb losses before the Corporation's investment would be impacted. A negative Excess Subordination Ratio signifies there is no available support from subordinate tranches to absorb losses before the Corporation's securities would be impacted. The Excess Subordination Ratio is not definitive, in isolation, for determining OTTI or whether the Corporation will receive future payments on a pooled trust preferred security. Other factors affect the timing and amount of cash flows available for payments to the note holders (investors), including the excess interest paid by the issuers, who typically pay higher rates of interest than are paid out to the note holders.

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

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

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

(In Thousands)	2011	2010	2009
Balance of credit losses on debt securities for which a portion of OTTI was recognized in other comprehensive income, beginning of period (as measured effective January 1, 2009 upon adoption of ASC Topic 320)	$ 0	$(10,695)	$(2,362)
Additional credit loss for which an OTTI was not previously recognized	0	0	(62,085)
Reduction for securities losses realized during the period	0	10,798	65,341
Additional credit loss for which an OTTI was previously recognized when the Corporation does not intend to sell the security and it is not more likely than not the Corporation will be required to sell the security before recovery of its amortized cost basis	0	(103)	(11,589)
Balance of credit losses on debt securities for which a portion of OTTI was recognized in other comprehensive income, end of period	$ 0	$0	$(10,695)

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

Equity Securities

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

Realized gains from sales of bank stocks totaled $91,000 in 2011 including $89,000 of realized gains from sales of stocks for which OTTI had been previously recognized. Realized gains from sales of bank stocks totaled $588,000 in

2010 including $397,000 of realized gains from sales of stocks for which OTTI had been previously recognized. Realized gains from sales of bank stocks totaled $1,689,000 in 2009 including $956,000 of realized gains from sales of stocks for which OTTI had been previously recognized.

C&N Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh), which is one of 12 regional Federal Home Loan Banks. As a member, C&N Bank is required to purchase and maintain stock in FHLB-Pittsburgh. There is no active market for FHLB-Pittsburgh stock, and it must ordinarily be redeemed by FHLB-Pittsburgh in order to be liquidated. C&N Bank's investment in FHLB-Pittsburgh stock, included in Other Assets in the consolidated balance sheet, was $6,643,000 at December 31, 2011 and $8,156,000 at December 31, 2010. The Corporation evaluated its holding of FHLB-Pittsburgh stock for impairment and deemed the stock to not be impaired at December 31, 2011 and 2010. In making this determination, management concluded that recovery of total outstanding par value, which equals the carrying value, is expected. The decision was based on review of financial information that FHLB-Pittsburgh has made publicly available.

8. LOANS

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

(In Thousands)	Dec. 31, 2011	% of Total	Dec. 31, 2010	% of Total
Residential mortgage:				
Residential mortgage loans - first liens	$331,015	46.73 %	$333,012	45.59 %
Residential mortgage loans - junior liens	28,851	4.07 %	31,590	4.32 %
Home equity lines of credit	30,037	4.24 %	26,853	3.68 %
1-4 Family residential construction	9,959	1.41 %	14,379	1.97 %
Total residential mortgage	399,862	56.45 %	405,834	55.56 %
Commercial:				
Commercial loans secured by real estate	156,388	22.08 %	167,094	22.88 %
Commercial and industrial	57,191	8.07 %	59,005	8.08 %
Political subdivisions	37,620	5.31 %	36,480	4.99 %
Commercial construction and land	23,518	3.32 %	24,004	3.29 %
Loans secured by farmland	10,949	1.55 %	11,353	1.55 %
Multi-family (5 or more) residential	6,583	0.93 %	7,781	1.07 %
Agricultural loans	2,987	0.42 %	3,472	0.48 %
Other commercial loans	552	0.08 %	392	0.05 %
Total commercial	295,788	41.76 %	309,581	42.38 %
Consumer	12,665	1.79 %	14,996	2.05 %
Total	708,315	100.00%	730,411	100.00%
Less: allowance for loan losses	(7,705)		(9,107)	
Loans, net	$700,610		$721,304	

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

A summary of transactions in the allowance for loan losses is as follows:

(In Thousands)	2011	2010	2009
Balance at beginning of year	$9,107	$8,265	$7,857
(Credit) provision charged to operations	(285)	1,191	680
Loans charged off	(1,446)	(619)	(478)
Recoveries	329	270	206

Balance at end of year	$7,705	$9,107	$8,265

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Transactions within the allowance for loan losses, summarized by segment and class, for 2011 were as follows:

(In Thousands)	December 31, 2010 Balance	Charge-offs	Recoveries	Provision (Credit)	December 31, 2011 Balance
Allowance for Loan Losses:					
Residential mortgage:					
Residential mortgage loans - first liens	$ 2,745	$(49)	$ 0	$ 330	$ 3,026
Residential mortgage loans - junior liens	334	(51)	3	(20)	266
Home equity lines of credit	218	0	0	13	231
1-4 Family residential construction	208	0	0	(129)	79
Total residential mortgage	3,505	(100)	3	194	3,602
Commercial:					
Commercial loans secured by real estate	3,314	(973)	1	(338)	2,004
Commercial and industrial	862	(216)	254	46	946
Political subdivisions	0	0	0	0	0
Commercial construction and land	590	0	0	(323)	267
Loans secured by farmland	139	0	0	(13)	126
Multi-family (5 or more) residential	63	0	0	3	66
Agricultural loans	32	0	0	(5)	27
Other commercial loans	0	0	0	5	5
Total commercial	5,000	(1,189)	255	(625)	3,441
Consumer	289	(157)	71	25	228
Unallocated	313			121	434
Total Allowance for Loan Losses	$ 9,107	$(1,446)	$ 329	$ (285)	$ 7,705

In the evaluation of the loan portfolio, management determines two major components for the allowance for loan losses – (1) a specific component based on an assessment of certain larger relationships, mainly commercial purpose loans, on a loan-by-loan basis; and (2) a general component for the remainder of the portfolio based on a collective evaluation of pools of loans with similar risk characteristics.

In determining the larger loan relationships for detailed assessment under the specific allowance component, the Corporation uses an internal risk rating system. Under the risk rating system, the Corporation classifies problem or potential problem loans as “Special Mention,” “Substandard,” or “Doubtful” on the basis of currently existing facts, conditions and values. Substandard loans include those characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Loans that do not currently expose the Corporation to sufficient risk to warrant classification as Substandard or Doubtful, but possess weaknesses that deserve management’s close attention, are deemed to be Special Mention. Risk ratings are updated any time that conditions or the situation warrants. Loans not classified are included in the “Pass” column in the table below.

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The following tables summarize the aggregate credit quality classification of outstanding loans by risk rating as of December 31, 2011 and 2010:

December 31, 2011:

(In Thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage:					
Residential mortgage loans - first liens	$314,900	$2,955	$ 12,956	$ 204	$331,015
Residential mortgage loans - junior liens	27,260	660	924	7	28,851
Home equity lines of credit	29,408	264	365	0	30,037
1-4 Family residential construction	9,959	0	0	0	9,959
Total residential mortgage	381,527	3,879	14,245	211	399,862
Commercial:					
Commercial loans secured by real estate	143,247	7,385	5,046	710	156,388
Commercial and industrial	46,110	6,254	4,413	414	57,191
Political subdivisions	37,499	121	0	0	37,620
Commercial construction and land	21,668	211	1,639	0	23,518
Loans secured by farmland	8,040	1,341	1,531	37	10,949
Multi-family (5 or more) residential	6,200	369	14	0	6,583
Agricultural loans	2,765	164	58	0	2,987
Other commercial loans	552	0	0	0	552
Total commercial	266,081	15,845	12,701	1,161	295,788
Consumer	12,437	20	207	1	12,665
Totals	$660,045	$19,744	$ 27,153	$ 1,373	$708,315

December 31, 2010:

(In Thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage:					
Residential mortgage loans - first liens	$318,813	$2,197	$ 11,778	$ 224	$333,012
Residential mortgage loans - junior liens	30,072	551	959	8	31,590
Home equity lines of credit	26,569	32	252	0	26,853
1-4 Family residential construction	13,582	0	797	0	14,379
Total residential mortgage	389,036	2,780	13,786	232	405,834
Commercial:					
Commercial loans secured by real estate	152,157	6,671	6,472	1,794	167,094
Commercial and industrial	45,779	8,235	4,533	458	59,005
Political subdivisions	36,480	0	0	0	36,480
Commercial construction	22,430	314	1,260	0	24,004
Loans secured by farmland	8,877	1,248	1,188	40	11,353
Multi-family (5 or more) residential	7,781	0	0	0	7,781

Agricultural loans	3,219	209	44	0	3,472
Other commercial loans	260	132	0	0	392
Total commercial	276,983	16,809	13,497	2,292	309,581
Consumer	14,696	33	265	2	14,996
Totals	$680,715	$19,622	$27,548	$2,526	$730,411

The scope of loans evaluated individually for impairment include all loan relationships greater than $200,000 for which there is at least one extension of credit graded Special Mention, Substandard or Doubtful. Also, loan relationships less than $200,000 in the aggregate, but with an estimated loss of $100,000 or more, are individually evaluated for impairment. Loans that are individually evaluated for impairment, but which are not determined to be impaired, are combined with all remaining loans that are not reviewed on a specific basis, and such loans are included within larger pools of loans based on similar risk and loss characteristics for purposes of determining the general component of the allowance. The loans that have been individually evaluated, but which have not been determined to be impaired, are included in the "Collectively Evaluated" column in the table summarizing the allowance and associated loan balances as of both December 31, 2011 and 2010.

The following tables present a summary of loan balances and the related allowance for loan losses summarized by portfolio segment and class for each impairment method used as of December 31, 2011 and 2010:

December 31, 2011 (In Thousands)	Individually Evaluated	Collectively Evaluated	Totals
Loans:			
Residential mortgage:			
Residential mortgage loans - first liens	$ 2,227	$ 328,788	$331,015
Residential mortgage loans - junior liens	137	28,714	28,851
Home equity lines of credit	93	29,944	30,037
1-4 Family residential construction	0	9,959	9,959
Total residential mortgage	2,457	397,405	399,862
Commercial:			
Commercial loans secured by real estate	2,169	154,219	156,388
Commercial and industrial	942	56,249	57,191
Political subdivisions	0	37,620	37,620
Commercial construction and land	1,266	22,252	23,518
Loans secured by farmland	927	10,022	10,949
Multi-family (5 or more) residential	14	6,569	6,583
Agricultural loans	39	2,948	2,987
Other commercial loans	0	552	552
Total commercial	5,357	290,431	295,788
Consumer	50	12,615	12,665
Total Loans	$ 7,864	$ 700,451	$708,315

December 31, 2011 (In Thousands)	Individually Evaluated	Collectively Evaluated	Totals
Allowance for Loan Losses:			
Residential mortgage:			
Residential mortgage loans - first liens	$ 461	$ 2,565	$3,026
Residential mortgage loans - junior liens	11	255	266
Home equity lines of credit	0	231	231
1-4 Family residential construction	0	79	79
Total residential mortgage	472	3,130	3,602
Commercial:			
Commercial loans secured by real estate	169	1,835	2,004
Commercial and industrial	361	585	946
Political subdivisions	0	0	0
Commercial construction and land	65	202	267
Loans secured by farmland	35	91	126
Multi-family (5 or more) residential	0	66	66
Agricultural loans	0	27	27
Other commercial loans	0	5	5
Total commercial	630	2,811	3,441

Consumer	24	204	228
Unallocated		434	434
Total Allowance for Loan Losses	$ 1,126	$ 6,579	$7,705

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December 31, 2010 (In Thousands)	Individually Evaluated	Collectively Evaluated	Totals
Loans:			
Residential mortgage:			
Residential mortgage loans - first liens	$ 442	$ 332,570	$333,012
Residential mortgage loans - junior liens	239	31,351	31,590
Home equity lines of credit	0	26,853	26,853
1-4 Family residential construction	994	13,385	14,379
Total residential mortgage	1,675	404,159	405,834
Commercial:			
Commercial loans secured by real estate	3,818	163,276	167,094
Commercial and industrial	931	58,074	59,005
Political subdivisions	0	36,480	36,480
Commercial construction and land	1,197	22,807	24,004
Loans secured by farmland	931	10,422	11,353
Multi-family (5 or more) residential	0	7,781	7,781
Agricultural loans	39	3,433	3,472
Other commercial loans	0	392	392
Total commercial	6,916	302,665	309,581
Consumer	57	14,939	14,996
Total Loans	$ 8,648	$ 721,763	$730,411

December 31, 2010 (In Thousands)	Individually Evaluated	Collectively Evaluated	Totals
Allowance for Loan Losses:			
Residential mortgage:			
Residential mortgage loans - first liens	$ 98	$ 2,647	$2,745
Residential mortgage loans - junior liens	80	254	334
Home equity lines of credit	0	218	218
1-4 Family residential construction	100	108	208
Total residential mortgage	278	3,227	3,505
Commercial:			
Commercial loans secured by real estate	1,335	1,979	3,314
Commercial and industrial	202	660	862
Political subdivisions	0	0	0
Commercial construction and land	380	210	590
Loans secured by farmland	36	103	139
Multi-family (5 or more) residential	0	63	63
Agricultural loans	0	32	32
Other commercial loans	0	0	0
Total commercial	1,953	3,047	5,000
Consumer	57	232	289
Unallocated			313
Total Allowance for Loan Losses	$ 2,288	$ 6,506	$9,107

Summary information related to impaired loans as of December 31, 2011 and 2010 is as follows:

(In Thousands)	2011	2010
Impaired loans with a valuation allowance	$3,433	$5,457
Impaired loans without a valuation allowance	4,431	3,191
Total impaired loans	$7,864	$8,648
Valuation allowance related to impaired loans	$1,126	$2,288

No additional funds are committed to be advanced in connection with impaired loans.

Additional summary information related to impaired loans for 2011, 2010 and 2009 is as follows:

(In Thousands)	2011	2010	2009
Average investment in impaired loans	$7,455	$6,142	$5,996
Interest income recognized on impaired loans	$245	$204	$322
Interest income recognized on a cash basis on impaired loans	$245	$204	$322

The breakdown by portfolio segment and class of nonaccrual loans and loans past due ninety days or more and still accruing is as follows:

	December 31, 2011		December 31, 2010	
(In Thousands)	Past Due 90+ Days and Accruing	Nonaccrual	Past Due 90+ Days and Accruing	Nonaccrual
Residential mortgage:				
Residential mortgage loans - first liens	$ 949	$ 3,058	$ 571	$ 3,301
Residential mortgage loans - junior liens	11	67	0	218
1-4 Family residential construction	0	0	0	797
Total residential mortgage	960	3,125	571	4,316
Commercial:				
Commercial loans secured by real estate	75	1,595	60	3,666
Commercial and industrial	21	541	0	611
Commercial construction and land	139	978	0	1,197
Loans secured by farmland	53	927	90	932
Agricultural loans	0	0	0	40
Total commercial	288	4,041	150	6,446
Consumer	19	31	6	47

Totals	$ 1,267	$ 7,197	$ 727	$ 10,809

The amounts shown in the table immediately above include loans classified as troubled debt restructuring (described in more detail below), if such loans are considered past due ninety days or more, or nonaccrual.

The tables below present a summary of the contractual aging of loans as of December 31, 2011 and 2010:

(In Thousands)	As of December 31, 2011 Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total
Residential mortgage:				
Residential mortgage loans - first liens	$321,907	$ 6,723	$ 2,385	$331,015
Residential mortgage loans - junior liens	28,437	393	21	28,851
Home equity lines of credit	29,986	51	0	30,037
1-4 Family residential construction	9,959	0	0	9,959
Total residential mortgage	390,289	7,167	2,406	399,862
Commercial:				
Commercial loans secured by real estate	155,025	343	1,020	156,388
Commercial and industrial	56,835	169	187	57,191
Political subdivisions	37,620	0	0	37,620
Commercial construction and land	22,323	1,056	139	23,518
Loans secured by farmland	9,973	33	943	10,949
Multi-family (5 or more) residential	6,583	0	0	6,583
Agricultural loans	2,945	3	39	2,987
Other commercial loans	552	0	0	552
Total commercial	291,856	1,604	2,328	295,788
Consumer	12,340	306	19	12,665
Totals	$694,485	$ 9,077	$ 4,753	$708,315

(In Thousands)	As of December 31, 2010 Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total
Residential mortgage:				
Residential mortgage loans - first liens	$325,567	$ 5,132	$ 2,313	$333,012
Residential mortgage loans - junior liens	30,997	436	157	31,590
Home equity lines of credit	26,744	109	0	26,853
1-4 Family residential construction	14,379	0	0	14,379
Total residential mortgage	397,687	5,677	2,470	405,834
Commercial:				
Commercial loans secured by real estate	163,343	940	2,811	167,094
Commercial and industrial	58,474	319	212	59,005
Political subdivisions	36,480	0	0	36,480

Commercial construction and land	23,674	330	0	24,004
Loans secured by farmland	10,294	77	982	11,353
Multi-family (5 or more) residential	7,769	12	0	7,781
Agricultural loans	3,422	10	40	3,472
Other commercial loans	77	315	0	392
Total commercial	303,533	2,003	4,045	309,581
Consumer	14,686	289	21	14,996
Totals	$715,906	$ 7,969	$ 6,536	$730,411

Nonaccrual loans are included in the contractual aging immediately above. A summary of the contractual aging of nonaccrual loans at December 31, 2011 and 2010 is as follows:

(In Thousands)	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total
December 31, 2011 Nonaccrual Totals	$ 2,532	$ 1,179		