

CITIZENS & NORTHERN CORP
Form 10-K
March 01, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010

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

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

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

Indicate by check mark whether the registrant 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 No

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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, 2010, the registrant's most recently completed second fiscal quarter, was \$127,336,891.

The number of shares of common stock outstanding at February 25, 2011 was 12,181,184.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the annual meeting of its shareholders to be held April 19, 2011 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:

- constructed and opened a branch facility in Old Lycoming Township, PA, which opened in March 2006;

- constructed an administration building in Wellsboro, PA, which opened in March 2006;
- 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;
- repurchased in 2010 all of the preferred stock and redeemed the warrant from the TARP Capital Purchase Program; and
- merged the operations of First State Bank into C&N Bank and Canisteo Valley Corporation into Citizens & Northern Corporation in 2010.

At December 31, 2010, C&N Bank had total assets of \$1,306,012,000, total deposits of \$1,005,244,000, net loans outstanding of \$721,304,000 and 281 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 a third party networking agreement between C&N Bank and UVEST Financial Services, Inc.
- 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. At December 31, 2010, total residential mortgages serviced amounted to \$25,716,000. 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, 2010, 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 and 2008 by securities losses. Much of the Corporation's 2009 and 2008 losses from trust-preferred securities and other securities stem from the much-publicized economic problems affecting the national and international economy, which have 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, 2010, the net deferred tax asset was \$16.1 million, down from a balance of approximately \$22.0 million at December 31, 2009. The decrease in the net deferred tax asset was primarily attributed to a reduction in the net deferred tax asset as of December 31, 2010 related to other-than-temporary impairment losses on securities to \$5.8 million at December 31, 2010 from \$16.1 million at December 31, 2009. In addition, the deferred tax asset as of December 31, 2010 includes \$2.8 million of net operating loss carryforwards available after the carryback of both ordinary and capital losses. The Corporation currently expects to fully realize all available tax benefits from the carryforward losses, and therefore has eliminated the valuation allowance of \$373,000 previously established at December 31, 2009.

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, 2010 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 \$8.2 million as of December 31, 2010. 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. 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, the FDIC increased assessment rates of insured institutions uniformly by seven cents for every \$100 of deposits beginning with the first quarter of 2009, with additional changes beginning April 1, 2009, which require riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels. To further support the rebuilding of the deposit insurance fund, the FDIC imposed a special assessment on each insured institution, equal to five basis points of the institution's total assets minus Tier 1 capital as of September 30, 2009. For our banks, an aggregate charge of \$589,000 was recorded as a charge to operating costs in 2009. 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 approximately one-third amortized in 2010 and the remaining two-thirds to be amortized, subject to adjustments imposed by the FDIC, over the next two years.

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 even higher FDIC premiums. Our expenses, especially for 2009, have been significantly and adversely affected by the increased premiums and the special assessment. These increases and assessment and any future increases in 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. Deterioration in economic conditions 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.

Growth Strategy – In recent years, the Corporation has expanded its operations by acquisitions and by building and opening new branches. The Corporation's future financial performance will depend on its ability to execute its strategic plan and manage its future growth. Failure to execute these plans 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 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 management believes may impact the Corporation's financial condition and results of operations over the next few years are as follows:

- 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");
- alters 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%;

- eliminates the prohibition against paying interest on commercial checking accounts, effective one year after enactment; and
- requires the Federal Reserve, within nine months of enactment, to prescribe regulations to establish standards for determining that interchange transaction fees meet the new statutory standard of reasonable and proportional to the cost, which may lead to reductions in the Corporation's non-interest revenue from interchange fees.

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) requires 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 facility located at 2 East Mountain Avenue, South Williamsport, which is leased. All of the 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	or	10 Nichols Street
Wellsboro, PA 16901		Wellsboro, PA 16901

Branch offices – Citizens & Northern Bank:

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

10 N. Main Street	4534 Williamson Trail	41 Main Street
Coudersport, PA 16915	Liberty, PA 16930	Tioga, PA 16946

111 W. Main Street	1085 S. Main Street	428 Main Street
Dushore, PA 18614	Mansfield, PA 16933	Towanda, PA 18848

563 Main Street	612 James Monroe Avenue	64 Elmira Street
East Smithfield, PA 18817	Monroeton, PA 18832	Troy, PA 16947

104 Main Street	3461 Route 405 Highway	90-92 Main Street
Elkland, PA 16920	Muncy, PA 17756	Wellsboro, PA 16901

135 East Fourth Street	100 Maple Street	1510 Dewey Avenue
Emporium, PA 15834	Port Allegany, PA 16743	Williamsport, PA 17701

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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

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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. (Removed and Reserved)

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, 2010, there were 2,564 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 2010 and 2009.

	2010			2009		
	High	Low	Dividend Declared per Quarter	High	Low	Dividend Declared per Quarter
First quarter	\$ 12.95	\$ 8.76	\$ 0.08	\$ 20.94	\$ 14.06	\$ 0.24
Second quarter	13.86	10.70	0.09	22.46	16.46	0.24
Third quarter	13.30	10.15	0.10	22.06	14.50	0.24
Fourth quarter	15.84	12.45	0.12	15.14	8.15	0.00

In December 2009, the Corporation announced that the Board of Directors was delaying until January 2010 a decision regarding the size of the dividend on common stock to be declared for the fourth quarter of 2009. This was a departure from the Corporation's customary practice which had been to declare a dividend for the fourth quarter of the year in mid-December, with a dividend payment date in mid- to late January. In January 2010, the Board of Directors declared a dividend of \$0.08 per share on common stock, which was paid in February 2010. As a result of this change in timing of the quarterly dividend payment, the table above presents the quarterly dividend as paid one quarter later.

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.

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, 2005 and ended December 31, 2010. 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

Index	Period Ending					
	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10
Citizens & Northern Corporation	100.00	90.32	76.84	90.37	45.49	73.16
Russell 2000	100.00	118.37	116.51	77.15	98.11	124.46
CZNC Peer Group Index*	100.00	106.37	91.20	75.37	73.92	83.87

The C&N peer group consists of banks headquartered in Pennsylvania with total assets of \$500 million to \$1.3 billion. This peer group consists of 1st Summit Bancorp of Johnstown, Inc., Johnstown; ACNB Corporation, Gettysburg; American Bank Incorporated, Allentown; AmeriServ Financial, Inc., Johnstown; CCFNB Bancorp, Inc., Bloomsburg; Citizens Financial Services, Inc., Mansfield; Codorus Valley Bancorp, York; Customers Bank, Phoenixville; Dimeco, Inc., Honesdale; DNB Financial Corporation, Downingtown; Embassy Bancorp, Inc., Bethlehem; ENB Financial Corp., Ephrata; Fidelity D & D Bancorp, Inc., Dunmore; First Keystone Corporation, Berwick; FNB Bancorp, Inc., Newtown; Franklin Financial Services Corporation, Chambersburg; Honat Bancorp, Inc., Honesdale; Kish Bancorp, Inc., Reedsville; Mid Penn Bancorp, Inc., Millersburg; Norwood Financial Corp., Honesdale; Penns Woods Bancorp, Inc., Williamsport; Pensco Financial Services Corporation, Scranton; Peoples Financial Services Corp., Hallstead; QNB Corp., Quakertown; Republic First Bancorp, Inc., Philadelphia; Royal Bancshares of Pennsylvania, Inc., Narberth; Somerset Trust Holding Company, Somerset.

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, 2010.

	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted-average Price of Outstanding Options	Number of Securities Remaining for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by shareholders	226,894	\$ 20.54	595,609
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.

ITEM 6. SELECTED FINANCIAL DATA

	As of or for the Year Ended December 31,				
	2010	2009	2008	2007	2006
INCOME STATEMENT (In Thousands)					
Interest and fee income	\$62,114	\$67,976	\$74,237	\$70,221	\$64,462
Interest expense	19,245	24,456	31,049	33,909	30,774
Net interest income	42,869	43,520	43,188	36,312	33,688
Provision for loan losses	1,191	680	909	529	672
Net interest income after provision for loan losses	41,678	42,840	42,279	35,783	33,016
Noninterest income excluding securities gains (losses) and gains from sale of credit card loans	13,917	13,021	13,140	10,440	7,970
Net impairment losses recognized in earnings from available-for-sale securities	(433)	(85,363)	(10,088)	0	0
Net realized gains on available-for-sale securities	1,262	1,523	750	127	5,046
Gain from sale of credit card loans	0	0	0	0	340
Noninterest expense	31,569	34,011	33,703	33,283	31,614
Income (loss) before income tax provision (credit)	24,855	(61,990)	12,378	13,067	14,758
Income tax provision (credit)	5,800	(22,655)	2,319	2,643	2,772
Net income (loss)	19,055	(39,335)	10,059	10,424	11,986
U.S. Treasury preferred dividends	1,474	1,428	0	0	0
Net income (loss) available to common shareholders	\$17,581	\$(40,763)	\$10,059	\$10,424	\$11,986
PER COMMON SHARE: (1)					
Basic earnings per share	\$1.45	\$(4.40)	\$1.12	\$1.19	\$1.42
Diluted earnings per share	\$1.45	\$(4.40)	\$1.12	\$1.19	\$1.42
Cash dividends declared per share	\$0.39	\$0.72	\$0.96	\$0.96	\$0.96
Stock dividend	None	None	None	1 %	1 %
Book value per common share at period-end	\$11.43	\$10.46	\$13.66	\$15.34	\$15.51
Tangible book value per common share at period-end	\$10.42	\$9.43	\$12.22	\$13.85	\$15.13
Weighted average common shares outstanding - basic	12,131,039	9,271,869	8,961,805	8,784,134	8,422,495
Weighted average common shares outstanding - diluted	12,131,039	9,271,869	8,983,300	8,795,366	8,448,169
END OF PERIOD BALANCES (In Thousands)					
Available-for-sale securities	\$443,956	\$396,288	\$419,688	\$432,755	\$356,665
Gross loans	730,411	721,011	743,544	735,941	687,501
Allowance for loan losses	9,107	8,265	7,857	8,859	8,201
Total assets	1,316,588	1,321,795	1,281,637	1,283,746	1,127,368
Deposits	1,004,348	926,789	864,057	838,503	760,349
Borrowings	166,908	235,471	285,473	300,132	228,440

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Stockholders' equity	138,944	152,410	122,026	137,781	129,888
Common stockholders' equity (stockholders' equity, excluding preferred stock)	138,944	126,661	122,026	137,781	129,888
AVERAGE BALANCES (In Thousands)					
Total assets	1,326,145	1,296,086	1,280,924	1,178,904	1,134,689
Earning assets	1,205,608	1,208,280	1,202,872	1,090,035	1,055,103
Gross loans	723,318	728,748	743,741	729,269	662,714
Deposits	965,615	886,703	847,714	812,255	750,982
Stockholders' equity	150,133	141,787	130,790	138,669	131,082

ITEM 6. SELECTED FINANCIAL DATA, Continued

	As of or for the Year Ended December 31,									
	2010		2009		2008		2007		2006	
KEY RATIOS										
Return on average assets	1.44	%	-3.03	%	0.79	%	0.88	%	1.06	%
Return on average equity	12.69	%	-27.74	%	7.69	%	7.52	%	9.14	%
Average equity to average assets	11.32	%	10.94	%	10.21	%	11.76	%	11.55	%
Net interest margin (2)	3.81	%	3.84	%	3.77	%	3.51	%	3.42	%
Efficiency (3)	52.73	%	57.22	%	57.59	%	68.39	%	71.73	%
Cash dividends as a % of diluted earnings per share	26.90	%	NM		85.71	%	80.67	%	67.61	%
Tier 1 leverage	9.20	%	9.86	%	10.12	%	10.91	%	11.22	%
Tier 1 risk-based capital	15.87	%	16.70	%	13.99	%	15.46	%	16.51	%
Total risk-based capital	17.17	%	17.89	%	14.84	%	16.52	%	17.97	%
Tangible common equity/tangible assets	9.71	%	8.72	%	8.61	%	9.79	%	11.27	%
Nonperforming assets/total assets	0.92	%	0.76	%	0.69	%	0.66	%	0.78	%
Nonperforming loans/total loans	1.58	%	1.27	%	1.14	%	1.11	%	1.46	%
Allowance for loan losses/total loans	1.25	%	1.15	%	1.06	%	1.20	%	1.19	%
Net charge-offs/average loans	0.05	%	0.04	%	0.26	%	0.06	%	0.13	%

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 gains from sale of credit card loans.

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". The 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

For the year ended December 31, 2010, net income available to common shareholders was reported of \$17,581,000, or \$1.45 per share (basic and diluted). The Corporation reported a net loss of \$40,763,000 (\$4.40 per share-basic and diluted) in 2009, while net income was \$10,059,000 (\$1.12 per share – basic and diluted) in 2008. The net loss for the year ended December 31, 2009 included 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. In 2008, the after-tax impact of OTTI charges was \$6,638,000.

Core Earnings is an earnings performance measurement which the Corporation's management has defined to exclude the effects of OTTI losses on available-for-sale securities and realized gains on securities for which OTTI has previously been recognized. Core Earnings is a performance measurement that is not based on U.S. generally accepted accounting principles. Management believes Core Earnings information is meaningful for evaluating the Corporation's operating performance, because it excludes some of the impact of market volatility as it relates to investments in pooled trust-preferred securities and other securities. More information concerning Core Earnings, including a reconciliation to the Corporation's earnings results based on U.S. generally accepted accounting principles, is provided in the following section of Management's Discussion and Analysis. Core Earnings available to common shareholders were \$17,027,000 for 2010 or \$1.40 per diluted share. The Corporation's results for 2009 included positive Core Earnings available to common shareholders of \$15,086,000 (\$1.63 per diluted share), reduced by after-tax OTTI charges on available-for-sale securities (net of subsequent gains from selling some of the securities) of \$55,849,000. In 2008, the Corporation had Core Earnings of \$16,697,000 (\$1.86 per diluted share). Core earnings per share in 2010 have been impacted by a higher number of weighted average common shares outstanding than in the previous two years, resulting from the issuance of common shares in a public offering in December 2009.

Pre-tax OTTI charges totaled \$433,000 in 2010 compared with \$85,363,000 in 2009 and \$10,088,000 in 2008. Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. The Corporation's process for evaluating all available-for-sale securities for OTTI is described in more detail in Note 7 to the consolidated financial statements.

As described in more detail in Note 7 to the consolidated financial statements, the Corporation adopted new accounting principles in 2009, which resulted in the impairment of debt securities being separated into (a) the amount of the total impairment related to credit loss, which is recognized in the income statement, and (b) the amount of the total impairment related to all other factors, which is recognized in other comprehensive income. In 2009, the effect of the new principles was to increase impairment losses recognized in earnings by \$3,451,000, and decrease the income tax provision by \$1,173,000, resulting in a decrease in net income (larger net loss) of \$2,275,000, or \$0.25 per average common share.

STATEMENT REGARDING NON-GAAP FINANCIAL MEASUREMENT

This report contains supplemental financial information determined by a method other than in accordance with Accounting Principles Generally Accepted in the United States of America (“GAAP”). Management uses this non-GAAP measure in its analysis of the Corporation’s performance. This measure, Core Earnings, excludes the effects of OTTI losses on available-for-sale securities and realized gains on securities for which OTTI has previously been recognized. Management believes the presentation of this financial measure, which excludes the impact of the specified items, provides useful supplemental information that is essential to a proper understanding of the financial results of the Corporation. The Core Earnings measure provides a method to assess operating performance excluding the impact of market volatility related to investments in pooled trust-preferred securities and other securities. This disclosure should not be viewed as a substitute for results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies.

RECONCILIATION OF NON-GAAP MEASURE (UNAUDITED)

For years ended December 31,

(In thousands, except per-share data)

	2010	2009	2008
Net (loss) income available to common shareholders	\$ 17,581	\$ (40,763)	\$ 10,059
Other-than-temporary impairment losses on available-for-sale securities	(433)	(85,363)	(10,088)
Realized gains on assets previously written down	707	1,308	31
Other-than-temporary impairment losses on available-for-sale securities, net of related gains	274	(84,055)	(10,057)
Income taxes (1)	280	28,206	3,419
Other-than-temporary impairment losses, net	554	(55,849)	(6,638)
Core earnings available to common shareholders	\$ 17,027	\$ 15,086	\$ 16,697
Net income (loss) per share – diluted	\$ 1.45	\$ (4.40)	\$ 1.12
Core earnings per share – diluted	\$ 1.40	\$ 1.63	\$ 1.86
Weighted average shares outstanding – diluted	12,131,039	9,271,869	8,983,300
Weighted average shares outstanding - diluted - used in core earnings per share calculations	12,131,039	9,272,489	8,983,300

(1) Income tax has been allocated to the non-core losses at 34%, adjusted for a valuation allowance on deferred tax assets associated with losses from securities classified as capital assets for federal income tax reporting purposes. The valuation allowance was recorded at \$373,000 in 2009 and was eliminated in the fourth quarter of 2010. The valuation allowance is described in more detail in Note 14 to the consolidated financial statements.

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. Core Earnings available to common shareholders were \$17,027,000 for 2010, or \$1.40 per diluted share, compared to Core Earnings in 2009 of \$15,086,000 (\$1.63 per diluted share). The most significant fluctuations in the components of Core Earnings for 2010 compared to 2009 are as follows:

-

Net interest income was \$42,869,000 for the year ended December 31, 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.

2009 vs. 2008

The most significant changes in components of the Corporation's Core Earnings results for 2009, as compared to 2008, were as follows:

- Net interest income increased \$332,000, or 0.8%. On a fully taxable-equivalent basis, net interest income increased \$1,032,000, or 2.3%. The interest margin has been positively impacted by lower short-term market interest rates, which have reduced interest rates paid on deposits and borrowings. The interest margin has also been positively impacted by increased levels of investments and high yields on municipal bonds. The interest margin has been negatively impacted by weak consumer loan demand, as average loans outstanding shrunk approximately \$15.0 million in 2009 as compared to 2008.
- The provision for loan losses was \$229,000 lower in 2009 than in 2008. The ratio of nonperforming loans (including nonaccrual loans and loans 90 days or more past due and still accruing interest) and other real estate owned, as a percentage of assets, was 0.76% at December 31, 2009, higher than the 0.69% level at December 31, 2008, but still relatively low by historical standards.
- Non-interest income decreased \$214,000, or 1.7%. In 2008, non-interest income included a gain of \$533,000 from redemption of restricted shares of Visa, resulting from Visa's initial public offering. Also, in 2009, the Corporation received no dividend income on its investment in restricted stock issued by the Federal Home Loan Bank of Pittsburgh, while dividend income on this stock was \$334,000 in 2008.
- Non-interest expense increased \$213,000, or 0.6%. FDIC insurance assessments increased \$1,784,000 in 2009, to \$2,092,000 from \$308,000. The higher FDIC assessments included the effects of premium increases and a special assessment of \$589,000. Excluding FDIC costs, total non-interest expense was 4.7% lower in 2009 than in 2008.
- Core Earnings for 2009 were reduced by dividends on preferred stock issued to the U.S. Treasury under the TARP Capital Purchase Program of \$1,428,000.

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 2010, 2009, and 2008. 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.

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 have 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 have 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.

2009 vs. 2008

Interest income totaled \$70,874,000 in 2009, a decrease of 7.3% from 2008. Income from available-for-sale securities decreased \$1,912,000 (7.7%), while interest and fees from loans decreased \$3,505,000, or 6.9%. As indicated in Table II, total average available-for-sale securities (at amortized cost) in 2009 fell to \$439,823,000, a decrease of \$9,408,000, or 2.1% from 2008. During 2009, the Corporation increased the size of its tax-exempt municipal security portfolio, while shrinking the taxable available-for-sale securities portfolio. The Corporation's yield on taxable securities fell in 2009 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. Also, interest rates on variable-rate trust preferred securities decreased consistent with short-term global interest rates. The average rate of return on available-for-sale securities was 5.24% for 2009 and 5.55% in 2008.

INTEREST INCOME AND EARNING ASSETS

The average balance of gross loans decreased 2.0% to \$728,748,000 in 2009 from \$743,741,000 in 2008. Due to the challenging economic environment, the Corporation experienced contraction in the balance of its mortgage and consumer loan portfolios, with slight growth in average commercial and tax-exempt 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 6.54% in 2009 and 6.88% in 2008.

The average balance of interest-bearing due from banks, which in 2009 consisted primarily of balances held by the Federal Reserve, increased to \$29,348,000 in 2009 from \$2,385,000 in 2008. Also, the average balance of federal funds sold increased to \$8,983,000 in 2009 from \$5,038,000 in 2008. Although the rates of return are low, the Corporation maintained relatively high levels of these liquid assets in 2009 (as opposed to increasing long-term, available-for-sale securities at higher yields) due to management's concern about the possibility of substantial increases in interest rates in 2010 or 2011.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense fell \$6,593,000, or 21.2%, to \$24,456,000 in 2009 from \$31,049,000 in 2008. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 2.40% in 2009 from 3.05% in 2008.

Total average deposits (interest-bearing and noninterest-bearing) increased 4.6%, to \$886,703,000 in 2009 from \$847,714,000 in 2008. This increase came mainly in interest checking, money market, and individual retirement accounts and is partially offset by a reduction in the balance of certificates of deposit. Consistent with substantial reductions in short-term global interest rates, the average rates incurred on deposit accounts decreased significantly in 2009 as compared to 2008.

Total average borrowed funds decreased \$34,275,000 to \$260,413,000 in 2009 from \$294,688,000 in 2008. During 2008 and 2009, the Corporation generally 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 3.77% in 2009, down from 3.98% in 2008. This change primarily reflects lower rates being paid on customer repurchase agreements, which make up most of the Corporation's short-term borrowed funds.

As presented in Table II, the "interest rate spread" (excess of average rate of return on interest-bearing assets over average cost of funds on interest-bearing liabilities) was 3.47% in 2009, up significantly from 3.30% in 2008. As shown in Table III, changes in volume decreased net interest income by \$89,000, and changes in rates increased net interest income by \$1,121,000. The most significant components of changes in volume were decreases of \$1,041,000 in interest and fees on loans and \$1,379,000 in interest expense on borrowed funds. The most significant components of changes in rates were decreases of \$1,934,000 in income on taxable available-for-sale securities, \$2,464,000 in interest and fees on loans, and \$5,138,000 in interest expense on deposits.

TABLE I - ANALYSIS OF INTEREST INCOME AND EXPENSE

(In Thousands)	Years Ended December 31,			Increase/(Decrease)	
	2010	2009	2008	2010/2009	2009/2008
INTEREST INCOME					
Available-for-sale securities:					
Taxable	\$ 11,342	\$ 16,497	\$ 20,347	\$(5,155)	\$(3,850)
Tax-exempt	7,157	6,542	4,604	615	1,938
Total available-for-sale securities	18,499	23,039	24,951	(4,540)	(1,912)
Held-to-maturity securities,					
Taxable	2	21	23	(19)	(2)
Trading securities	2	64	129	(62)	(65)
Interest-bearing due from banks	124	61	33	63	28
Federal funds sold	0	15	120	(15)	(105)
Loans:					
Taxable	44,229	45,236	48,933	(1,007)	(3,697)
Tax-exempt	2,343	2,438	2,246	(95)	192
Total loans	46,572	47,674	51,179	(1,102)	(3,505)
Total Interest Income	65,199	70,874	76,435	(5,675)	(5,561)
INTEREST EXPENSE					
Interest-bearing deposits:					
Interest checking	798	901	1,047	(103)	(146)
Money market	872	2,004	4,162	(1,132)	(2,158)
Savings	194	272	335	(78)	(63)
Certificates of deposit	5,060	6,672	8,993	(1,612)	(2,321)
Individual Retirement Accounts	4,977	4,796	4,777	181	19
Other time deposits	6	6	6	0	0
Total interest-bearing deposits	11,907	14,651	19,320	(2,744)	(4,669)
Borrowed funds:					
Short-term	177	544	986	(367)	(442)
Long-term	7,161	9,261	10,743	(2,100)	(1,482)
Total borrowed funds	7,338	9,805	11,729	(2,467)	(1,924)
Total Interest Expense	19,245	24,456	31,049	(5,211)	(6,593)
Net Interest Income	\$45,954	\$46,418	\$45,386	\$(464)	\$1,032

(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 \$1,207,000 in 2010, \$1,176,000 in 2009 and \$1,061,000 in 2008.

Table II - Analysis of Average Daily Balances and Rates
(Dollars in Thousands)

	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 %		Year Ended 12/31/2008 Average Balance	Rate of Return/ Cost of Funds %	
EARNING ASSETS									
Available-for-sale securities, at amortized cost:									
Taxable	\$314,462	3.61	%	\$342,332	4.82	%	\$379,999	5.35	%
Tax-exempt	113,058	6.33	%	97,491	6.71	%	69,232	6.65	%
Total available-for-sale securities	427,520	4.33	%	439,823	5.24	%	449,231	5.55	%
Held-to-maturity securities,									
Taxable	38	5.27	%	373	5.63	%	408	5.64	%
Trading securities	29	6.99	%	1,005	6.37	%	2,069	6.23	%
Interest-bearing due from banks	54,655	0.23	%	29,348	0.21	%	2,385	1.38	%
Federal funds sold	48	0.00	%	8,983	0.17	%	5,038	2.38	%
Loans:									
Taxable	687,520	6.43	%	689,275	6.56	%	709,377	6.90	%
Tax-exempt	35,798	6.55	%	39,473	6.18	%	34,364	6.54	%
Total loans	723,318	6.44	%	728,748	6.54	%	743,741	6.88	%
Total Earning Assets	1,205,608	5.41	%	1,208,280	5.87	%	1,202,872	6.35	%
Cash	17,505			17,042			19,299		
Unrealized gain/loss on securities	2,555			(24,334)			(24,877)		
Allowance for loan losses	(8,552)			(7,914)			(8,765)		
Bank premises and equipment	23,522			25,239			27,044		
Intangible Asset - Core Deposit Intangible									
	417			669			1,113		
Intangible Asset - Goodwill									
	11,942			11,953			12,023		
Other assets									
	73,148			65,151			52,215		
Total Assets	\$1,326,145			\$1,296,086			\$1,280,924		
INTEREST-BEARING LIABILITIES									
Interest-bearing deposits:									
Interest checking	\$147,494	0.54	%	\$104,444	0.86	%	\$82,795	1.26	%
Money market	203,191	0.43	%	200,982	1.00	%	193,800	2.15	%
Savings	78,012	0.25	%	69,002	0.39	%	67,276	0.50	%
Certificates of deposit	225,542	2.24	%	226,913	2.94	%	238,316	3.77	%
Individual Retirement Accounts									
	162,754	3.06	%	154,340	3.11	%	139,321	3.43	%
Other time deposits	1,242	0.48	%	1,276	0.47	%	1,306	0.46	%
Total interest-bearing deposits	818,235	1.46	%	756,957	1.94	%	722,814	2.67	%
Borrowed funds:									
Short-term	27,563	0.64	%	38,731	1.40	%	41,524	2.37	%

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Long-term	175,229	4.09	%	221,682	4.18	%	253,164	4.24	%
Total borrowed funds	202,792	3.62	%	260,413	3.77	%	294,688	3.98	%
Total Interest-bearing									
Liabilities	1,021,027	1.88	%	1,017,370	2.40	%	1,017,502	3.05	%
Demand deposits	147,380			129,746			124,900		
Other liabilities	7,605			7,183			7,732		
Total Liabilities	1,176,012			1,154,299			1,150,134		
Stockholders' equity, excluding									
other comprehensive									
income/loss	148,735			158,120			147,535		
Other comprehensive									
income/loss	1,398			(16,333)			(16,745)		
Total Stockholders' Equity	150,133			141,787			130,790		
Total Liabilities and									
Stockholders' Equity	\$ 1,326,145			\$ 1,296,086			\$ 1,280,924		
Interest Rate Spread		3.53	%		3.47	%		3.30	%
Net Interest Income/Earning									
Assets		3.81	%		3.84	%		3.77	%
Total Deposits									
(Interest-bearing and Demand)	\$965,615			\$886,703			\$847,714		

(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 12/31/10 vs. 12/31/09			Year Ended 12/31/09 vs. 12/31/08		
	Change in Volume	Change in Rate	Total Change	Change in Volume	Change in Rate	Total Change
EARNING ASSETS						
Available-for-sale securities:						
Taxable	\$(1,260)	\$(3,895)	\$(5,155)	\$(1,916)	\$(1,934)	\$(3,850)
Tax-exempt	1,001	(386)	615	1,896	42	1,938
Total available-for-sale securities	(259)	(4,281)	(4,540)	(20)	(1,892)	(1,912)
Held-to-maturity securities,						
Taxable	(18)	(1)	(19)	(2)	0	(2)
Trading securities	(64)	2	(62)	(68)	3	(65)
Interest-bearing due from banks	57	6	63	78	(50)	28
Federal funds sold	(7)	(8)	(15)	54	(159)	(105)
Loans:						
Taxable	(115)	(892)	(1,007)	(1,362)	(2,335)	(3,697)
Tax-exempt	(236)	141	(95)	321	(129)	192
Total loans	(351)	(751)	(1,102)	(1,041)	(2,464)	(3,505)
Total Interest Income	(642)	(5,033)	(5,675)	(999)	(4,562)	(5,561)
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	299	(402)	(103)	235	(381)	(146)
Money market	22	(1,154)	(1,132)	149	(2,307)	(2,158)
Savings	32	(110)	(78)	9	(72)	(63)
Certificates of deposit	(40)	(1,572)	(1,612)	(413)	(1,908)	(2,321)
Individual Retirement Accounts	258	(77)	181	489	(470)	19
Other time deposits	0	0	0	0	0	0
Total interest-bearing deposits	571	(3,315)	(2,744)	469	(5,138)	(4,669)
Borrowed funds:						
Short-term	(127)	(240)	(367)	(62)	(380)	(442)
Long-term	(1,902)	(198)	(2,100)	(1,317)	(165)	(1,482)
Total borrowed funds	(2,029)	(438)	(2,467)	(1,379)	(545)	(1,924)
Total Interest Expense	(1,458)	(3,753)	(5,211)	(910)	(5,683)	(6,593)
Net Interest Income	\$816	\$(1,280)	\$(464)	\$(89)	\$1,121	\$1,032

(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.

NON-INTEREST INCOME

Years 2010, 2009 and 2008

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)	2010	% Change	2009	% Change	2008
Service charges on deposit accounts	\$ 4,579	(4.4)	\$ 4,791	7.7	\$ 4,447
Service charges and fees	858	7.8	796	2.4	777
Trust and financial management revenue	3,475	6.5	3,262	(5.3)	3,443
Insurance commissions, fees and premiums	248	(15.4)	293	(11.7)	332
Increase in cash surrender value of life insurance	466	(7.0)	501	(33.9)	758
Interchange revenue from debit card transactions	1,678	25.4	1,338	19.3	1,122
Net gains from sales of loans	761	617.9	106	51.4	70
Brokerage revenue	465	0.2	464	5.7	439
Other operating income	1,387	(5.6)	1,470	(16.1)	1,752
Total other operating income before realized gains(losses) on available-for-sale securities, net	\$ 13,917	6.9	\$ 13,021	(0.9)	\$ 13,140

Total non-interest income, as shown in Table IV, increased \$896,000 (6.9%) in 2010 compared to 2009. In 2009, total non-interest income decreased \$119,000 or less than 1% from 2008. Items of significance are as follows:

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 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. The value of assets under management is currently \$608,843,000 at December 31, 2010, an increase of less than 1% compared to similar values 12 months ago. Fluctuations in the value of assets under management during the year have been mainly associated with fluctuations in the market values of equity securities. Also in 2010, Trust revenues included fees from the settlement of several large estates.

Interchange revenue from debit card transactions has been segregated within the Table IV presentation of “Other operating income” for all periods presented. Interchange revenues are generally associated with the secure processing of electronic banking transactions for both business and individual retail customers. 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. Management believes this source of revenue may be significantly reduced in the future, perhaps beginning as early as the third quarter 2011, depending on the final resolution of the Federal Reserve's proposal to greatly reduce the rate the Corporation and other financial institutions will receive from interchange transactions.

Annual totals for net gains from sales of loans are similarly shown in Table IV to illustrate the impact of management's decision to sell a significant amount of residential mortgage originations into the secondary market. For 2010, the increase in the net gains from sales of loans is almost entirely associated with the Corporation's participation in the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago.

Other operating income decreased \$83,000 in 2010 compared to 2009. In 2010, the category includes a first quarter gain of \$448,000 from the sale of a parcel adjacent to one of the bank operating locations. In 2009, other operating income included \$306,000 of rental revenues from the temporary operation of a foreclosed commercial real estate property, as well as a gain of \$325,000 on disposition of the property. Net gains from the sale of foreclosed real estate properties in 2010 totaled \$108,000, or \$202,000 less than the aggregate of these sales in 2009.

2009 vs. 2008

Service charges on deposit accounts increased \$344,000, or 7.7%, in 2009 as compared to 2008. In 2009, overdraft fee revenues associated with a new overdraft privilege program implemented in the first quarter of 2008 increased \$335,000.

Trust and financial management revenue decreased \$181,000, or 5.3%, in 2009 as compared to 2008. Trust and financial management revenues are significantly affected by the value of assets under management which were generally lower throughout most of 2009 as compared to 2008.

The increase in the cash surrender value of life insurance decreased \$257,000, or 33.9%, in 2009 over 2008. The decrease primarily relates to the changes in the earnings credit rate for the underlying contracts.

Interchange revenue from debit card transactions increased \$216,000, or 19.3%, in 2009 as compared to 2008. The increase in 2009 resulted from the same described in the “2010 vs. 2009” section of the Non-interest income discussion.

Other operating income decreased \$282,000, or 16.1%, in 2009 as compared to 2008. In 2009, the Corporation received no dividend income on its investment in restricted stock issued by the Federal Home Loan Bank of Pittsburgh, while dividend income on this stock was \$334,000 in 2008. In 2008, this category included a gain of \$533,000 from the redemption of restricted shares of Visa, resulting from Visa’s initial public offering. In 2009, other operating income included \$306,000 of rental revenues from the temporary operation of a foreclosed commercial real estate property, as well as a gain of \$325,000 on disposition of the property. Net gains from the sale of foreclosed real estate properties in 2009 totaled \$310,000, or \$272,000 more, than the aggregate of these sales in 2008.

NON-INTEREST EXPENSE

Years 2010, 2009 and 2008

As shown in Table V below, total non-interest expense decreased \$2,442,000 or 7.2% in 2010 compared to 2009. In 2009, total non-interest expense increased \$213,000 or 0.9% in 2009 compared to 2008. Changes of significance are discussed in the narrative that follows:

TABLE V - COMPARISON OF NON-INTEREST EXPENSE

(In Thousands)	2010	% Change	2009	% Change	2008
Salaries and wages	\$13,063	2.6	\$12,737	(12.5)	\$14,561
Pensions and other employee benefits	3,840	(2.9)	3,956	(5.9)	4,202
Occupancy expense, net	2,645	(3.5)	2,741	(4.2)	2,861
Furniture and equipment expense	2,103	(21.5)	2,679		