CITIZENS & NORTHERN CORP
Form 10-Q
May 09, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **March 31, 2013**

or

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

For the transition period from _______________ to _________________________.

Commission file number: 000-16084

CITIZENS & NORTHERN CORPORATION

(Exact name of Registrant as specified in its charter)

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

90-92 MAIN STREET, WELLSBORO, PA 16901

(Address of principal executive offices) (Zip code)

570-724-3411

(Registrant's telephone number including area code)

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

Yes x No ¨

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

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

Common Stock ($1.00 par value) 12,332,905 Shares Outstanding on May 6, 2013

CITIZENS & NORTHERN CORPORATION

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ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Data) (Unaudited)	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks:		
Noninterest-bearing	$14,228	$21,356
Interest-bearing	30,841	38,480
Total cash and due from banks	45,069	59,836
Available-for-sale securities, at fair value	459,855	472,577
Loans held for sale	799	2,545
Loans receivable	666,746	683,910
Allowance for loan losses	(7,118)	(6,857)
Loans, net	659,628	677,053
Bank-owned life insurance	21,437	21,344
Accrued interest receivable	4,567	4,281
Bank premises and equipment, net	18,459	18,707
Foreclosed assets held for sale	915	879
Deferred tax asset, net	1,493	1,725
Intangible asset – Core deposit intangibles	125	138
Intangible asset – Goodwill	11,942	11,942
Other assets	16,032	15,880
TOTAL ASSETS	$1,240,321	$1,286,907
LIABILITIES		
Deposits:		
Noninterest-bearing	$191,330	$189,941
Interest-bearing	776,644	816,165
Total deposits	967,974	1,006,106
Short-term borrowings	4,637	5,567
Long-term borrowings	76,661	83,812
Accrued interest and other liabilities	7,841	8,636
TOTAL LIABILITIES	1,057,113	1,104,121
STOCKHOLDERS' EQUITY		
Preferred stock, $1,000 par value; authorized 30,000 shares; $1,000 liquidation preference per share; no shares issued at March 31, 2013 and December 31, 2012	0	0
Common stock, par value $1.00 per share; authorized 20,000,000 shares in 2013 and 2012; issued 12,543,580 at March 31, 2013 and 12,525,411 at December 31, 2012	12,543	12,525
Paid-in capital	68,640	68,622
Retained earnings	96,497	94,839
Treasury stock, at cost; 211,926 shares at March 31, 2013 and 251,376 shares at December 31, 2012	(3,543)	(4,203)
Sub-total	174,137	171,783
Accumulated other comprehensive income:		
Unrealized gains on available-for-sale securities	9,223	11,568

Defined benefit plans	(152)	(565)
Total accumulated other comprehensive income	9,071	11,003
TOTAL STOCKHOLDERS' EQUITY	183,208	182,786
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$1,240,321	$1,286,907

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

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Consolidated Statements of Income (In Thousands Except Per Share Data) (Unaudited)	**3 Months Ended March 31, 2013**	**March 31, 2012**
INTEREST INCOME		
Interest and fees on loans	$9,225	$10,366
Interest on balances with depository institutions	28	28
Interest on loans to political subdivisions	362	377
Interest on loans held for sale	21	9
Income from available-for-sale securities:		
Taxable	1,717	2,658
Tax-exempt	1,212	1,263
Dividends	82	75
Total interest and dividend income	12,647	14,776
INTEREST EXPENSE		
Interest on deposits	778	1,350
Interest on short-term borrowings	1	3
Interest on long-term borrowings	821	1,149
Total interest expense	1,600	2,502
Net interest income	11,047	12,274
Provision (credit) for loan losses	183	(182)
Net interest income after provision (credit) for loan losses	10,864	12,456
OTHER INCOME		
Service charges on deposit accounts	1,159	1,161
Service charges and fees	201	220
Trust and financial management revenue	944	929
Interchange revenue from debit card transactions	464	495
Net gains from sale of loans	545	265
Increase in cash surrender value of life insurance	93	119
Insurance commissions, fees and premiums	45	34
Other operating income	392	432
Sub-total	3,843	3,655
Total other-than-temporary impairment losses on available-for-sale securities	(25)	(67)
Portion of (gain) recognized in other comprehensive loss (before taxes)	0	0
Net impairment losses recognized in earnings	(25)	(67)
Realized gains on available-for-sale securities, net	1,184	65
Net realized gains (losses) recognized in earnings on available-for-sale securities	1,159	(2)
Total other income	5,002	3,653
OTHER EXPENSES		
Salaries and wages	3,600	3,575
Pensions and other employee benefits	1,255	1,366
Occupancy expense, net	634	636
Furniture and equipment expense	494	482
FDIC assessments	152	146
Pennsylvania shares tax	350	332
Loss on prepayment of debt	1,023	0
Other operating expense	2,068	1,876
Total other expenses	9,576	8,413

Income before income tax provision	6,290	7,696
Income tax provision	1,584	2,109
NET INCOME	$4,706	$5,587
NET INCOME PER SHARE - BASIC	$0.38	$0.46
NET INCOME PER SHARE - DILUTED	$0.38	$0.46

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

Consolidated Statements of Comprehensive Income

(In Thousands) (Unaudited)	**Three Months Ended March 31,**	
	2013	**2012**
Net income	$4,706	$5,587
Unrealized (losses) gains on available-for-sale securities:		
Unrealized holding (losses) gains on available-for-sale securities	(2,447)	344
Reclassification adjustment for (gains) losses realized in income	(1,159)	2
Other comprehensive (loss) gain on available-for-sale securities	(3,606)	346
Unfunded pension and postretirement obligations:		
Changes from plan amendments and actuarial gains and losses included in accumulated other comprehensive gain	636	200
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	0	20
Other comprehensive gain on unfunded retirement obligations	636	220
Other comprehensive (loss) income before income tax	(2,970)	566
Income tax related to other comprehensive loss (income)	1,038	(352)
Net other comprehensive (loss) income	(1,932)	214
Comprehensive income	$2,774	$5,801

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

CONSOLIDATED STATEMENTS OF CASH FLOWS	**Three Months Ended March 31,**	
(In Thousands) (Unaudited)	**2013**	**2012**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$4,706	$5,587
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses	183	(182)
Realized (gains) losses on available-for-sale securities, net	(1,159)	2
Loss on prepayment of debt	1,023	0
Loss (gain) on sale of foreclosed assets, net	3	(104)
Depreciation expense	511	493
Accretion and amortization on securities, net	513	182
Accretion and amortization on loans and deposits, net	(8)	(12)
Amortization of mortgage servicing rights	33	21
Increase in cash surrender value of life insurance	(93)	(119)
Stock-based compensation	287	241
Amortization of core deposit intangibles	13	19
Deferred income taxes	1,270	818
Gains on sales of loans, net	(545)	(265)
Origination of loans for sale	(16,346)	(9,174)
Proceeds from sales of loans	18,471	8,100
Increase in accrued interest receivable and other assets	(1,009)	(2,941)
(Decrease) increase in accrued interest payable and other liabilities	(970)	741
Net Cash Provided by Operating Activities	6,883	3,407
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of certificates of deposit	0	(480)
Proceeds from sales of available-for-sale securities	23,024	27
Proceeds from calls and maturities of available-for-sale securities	22,614	27,279
Purchase of available-for-sale securities	(35,065)	(31,358)
Redemption of Federal Home Loan Bank of Pittsburgh stock	693	332
Net decrease in loans	17,202	10,094
Purchase of premises and equipment	(263)	(226)
Purchase of investment in limited liability entity	(26)	(214)
Return of principal on limited liability entity investments	37	27
Proceeds from sale of foreclosed assets	9	858
Net Cash Provided by Investing Activities	28,225	6,339
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(38,132)	(1,409)
Net decrease in short-term borrowings	(930)	(920)
Repayments of long-term borrowings	(8,174)	(10,161)
Sale of treasury stock	53	101
Tax benefit from compensation plans	28	22
Common dividends paid	(2,720)	(1,936)
Net Cash Used in Financing Activities	(49,875)	(14,303)
DECREASE IN CASH AND CASH EQUIVALENTS	(14,767)	(4,557)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	55,016	56,815

CASH AND CASH EQUIVALENTS, END OF PERIOD	$40,249	$52,258
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Assets acquired through foreclosure of real estate loans	$48	$496
Accrued purchase of available-for-sale securities	$811	$765
Interest paid	$1,609	$2,573
Income taxes paid	$200	$300

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

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Consolidated Statements of Changes in Stockholders' Equity
Three Months Ended March 31, 2013 and 2012
(In Thousands Except Share and Per Share Data)
(Unaudited)

	Common Shares	Treasury Shares	Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Comprehensive Income	Treasury Stock	Total
Three Months Ended March 31, 2013:								
Balance, December 31, 2012	**12,525,411**	**251,376**	**$12,525**	**$68,622**	**$94,839**	**$11,003**	**($4,203)**	**$182,78**
Net income					4,706			4,706
Other comprehensive loss, net						(1,932)		(1,932)
Cash dividends declared on common stock, $.25 per share					(3,078)			(3,078)
Shares issued for dividend reinvestment plan	18,169		18	340				358
Shares issued from treasury related to exercise of stock options		(3,091)		1			52	53
Restricted stock granted		(37,886)		(633)			633	0
Forfeiture of restricted stock		1,527		25			(25)	0
Stock-based compensation expense				287				287
Tax effect of stock option exercises				(2)				(2)
Tax benefit from employee benefit plan					30			30
Balance, March 31, 2013	**12,543,580**	**211,926**	**$12,543**	**$68,640**	**$96,497**	**$9,071**	**($3,543)**	**$183,20**
Three Months Ended March 31, 2012:								
Balance, December 31, 2011	**12,460,920**	**305,391**	**$12,461**	**$67,568**	**$82,302**	**$10,160**	**($5,106)**	**$167,38**
Net income					5,587			5,587
Other comprehensive income, net						214		214
Cash dividends declared on common stock, $.18 per share					(2,196)			(2,196)
Shares issued for dividend reinvestment plan	12,575		**13**	247				260
Shares issued from treasury related to exercise of stock options		(6,835)		(15)			116	101
Restricted stock granted		(42,552)		(711)			711	0
Forfeiture of restricted stock		1,741		30			(30)	0
Stock-based compensation expense				241				241
Tax benefit from employee benefit plan					22			22
Balance, March 31, 2012	**12,473,495**	**257,745**	**$12,474**	**$67,360**	**$85,715**	**$10,374**	**($4,309)**	**$171,61**

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

Notes to Unaudited Consolidated Financial Statements

1. BASIS OF INTERIM PRESENTATION

The consolidated financial information included herein, with the exception of the consolidated balance sheet dated December 31, 2012, is unaudited. Such information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations, comprehensive income, cash flows and changes in stockholders’ equity for the interim periods; however, the information does not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”) for a complete set of financial statements. Certain 2012 information has been reclassified for consistency with the 2013 presentation.

Operating results reported for the three-month period ended March 31, 2013 might not be indicative of the results for the year ending December 31, 2013. The Corporation evaluates subsequent events through the date of filing with the Securities and Exchange Commission.

2. 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	**Weighted-Average Common Shares**	**Earnings Per Share**
Quarter Ended March 31, 2013			
Earnings per share – basic	$4,706,000	12,321,014	$0.38
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		257,449	
Hypothetical share repurchase at $ 19.58		(229,199)	

Earnings per share – diluted	$4,706,000	12,349,264	$0.38
Quarter Ended March 31, 2012			
Earnings per share – basic	$5,587,000	12,206,870	$0.46
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		271,980	
Hypothetical share repurchase at $20.45		(233,098)	
Earnings per share – diluted	$5,587,000	12,245,752	$0.46

Stock options that were anti-dilutive were excluded from net income per share calculations. Weighted-average common shares available from anti-dilutive instruments totaled 121,878 shares in the three-month period ended March 31, 2013 and 84,144 shares in the three-month period ended March 31, 2012.

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3. COMPREHENSIVE INCOME

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

(In Thousands)	**Before-Tax Amount**	**Income Tax Effect**	**Net-of-Tax Amount**
Three Months Ended March 31, 2013:			
Unrealized gains on available-for-sale securities:			
Unrealized holding losses on available-for-sale securities	($2,447)	$855	($1,592)
Reclassification adjustment for (gains) realized in income	(1,159)	406	(753)
Other comprehensive loss on available-for-sale securities	(3,606)	1,261	(2,345)
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	636	(223)	413
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	0	0	0
Other comprehensive gain on unfunded retirement obligations	636	(223)	413
Total other comprehensive loss	($2,970)	$1,038	($1,932)

(In Thousands)	**Before-Tax Amount**	**Income Tax Effect**	**Net-of-Tax Amount**
Three Months Ended March 31, 2012:			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$344	($284)	$60
Reclassification adjustment for losses realized in income	2	(1)	1
Other comprehensive gain on available-for-sale securities	346	(285)	61
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	200	(61)	139
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	20	(6)	14
Other comprehensive gain on unfunded retirement obligations	220	(67)	153
Total other comprehensive income	$566	($352)	$214

Changes in the components of accumulated other comprehensive income are as follows and are presented net of tax:

(In Thousands)	**Unrealized Holding Gains (Losses) on Securities**	**Unfunded Pension and Postretirement Obligations**	**Accumulated Other Comprehensive Income**
Three Months Ended March 31, 2013			
Balance, beginning of period	$11,568	($565)	$11,003
Other comprehensive income before reclassifications	(1,592)	413	(1,179)
Amounts reclassified from accumulated other comprehensive income	(753)	0	(753)
Other comprehensive income	(2,345)	413	(1,932)
Balance, end of period	$9,223	($152)	$9,071
Three Months Ended March 31, 2012			
Balance, beginning of period	$10,791	($631)	$10,160
Other comprehensive income before reclassifications	60	139	199
Amounts reclassified from accumulated other comprehensive income	1	14	15
Other comprehensive income	61	153	214
Balance, end of period	$10,852	($478)	$10,374

Items reclassified out of each component of other comprehensive income are as follows:

For the Three Months Ended March 31, 2013
(In Thousands)

Details about Accumulated Other Comprehensive Income Components	**Reclassified from Accumulated Other Comprehensive Income**	**Affected Line Item in the Conso Statements of Income**
Unrealized gains and losses on available-for-sale Securities	$25	Total other-than-temporary impai available-for-sale securities
	(1,184)	Realized gains on available-for-sa
	(1,159)	Total before tax
	406	Income tax effect
	(753)	Net of tax
Amortization of defined benefit pension and postretirement items		
Prior service cost	(8)	Pensions and other employee ben
Actuarial loss	8	Pensions and other employee ben
	0	Total before tax
	0	Income tax effect
	0	Net of tax

Total reclassifications for the period	($753)

4. CASH AND DUE FROM BANKS

Cash and due from banks at March 31, 2013 and December 31, 2012 include the following:

(In thousands)	**March 31, 2013**	**Dec. 31, 2012**
Cash and cash equivalents	$40,249	$55,016
Certificates of deposit	4,820	4,820
Total cash and due from banks	$45,069	$59,836

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

The Corporation is required to maintain reserves against deposit liabilities in the form of cash and balances with the Federal Reserve Bank of Philadelphia. The reserves are based on deposit levels, account activity, and other services provided by the Federal Reserve Bank. Required reserves were $13,921,000 at March 31, 2013 and $14,128,000 at December 31, 2012.

5. FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS

The Corporation measures certain assets at fair value. Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. FASB ASC topic 820, "Fair Value Measurements and Disclosures" establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

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

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

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

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

At March 31, 2013 and December 31, 2012, assets measured at fair value and the valuation methods used are as follows:

	March 31, 2013			
(In Thousands)	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Recurring fair value measurements				
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$0	$36,246	$0	$36,246
Obligations of states and political subdivisions:				
Tax-exempt	0	138,910	0	138,910
Taxable	0	27,595	0	27,595
Mortgage-backed securities	0	67,666	0	67,666
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	0	173,918	0	173,918
Trust preferred securities issued by individual institutions	0	5,163	0	5,163
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	0	0	1,659	1,659
Other collateralized debt obligations	0	660	0	660
Total debt securities	0	450,158	1,659	451,817
Marketable equity securities	8,038	0	0	8,038
Total available-for-sale securities	8,038	450,158	1,659	459,855
Servicing rights	0	0	738	738
Total recurring fair value measurements	$8,038	$450,158	$2,397	$460,593
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	$0	$0	$2,722	$2,722
Valuation allowance	0	0	(591)	(591)
Impaired loans, net	0	0	2,131	2,131
Foreclosed assets held for sale	0	0	915	915
Total nonrecurring fair value measurements	$0	$0	$3,046	$3,046

	December 31, 2012			
(In Thousands)	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Recurring fair value measurements				
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	$0	$31,217	$0	$31,217
Obligations of states and political subdivisions:				

Tax-exempt	0	137,020	0	137,020
Taxable	0	24,817	0	24,817
Mortgage-backed securities	0	80,196	0	80,196
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	0	183,510	0	183,510
Trust preferred securities issued by individual institutions	0	5,171	0	5,171
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	0	0	1,613	1,613
Other collateralized debt obligations	0	660	0	660
Total debt securities	0	462,591	1,613	464,204
Marketable equity securities	8,373	0	0	8,373
Total available-for-sale securities	8,373	462,591	1,613	472,577
Servicing rights	0	0	605	605
Total recurring fair value measurements	$8,373	$462,591	$2,218	$473,182
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	$0	$0	$2,710	$2,710
Valuation allowance	0	0	(623)	(623)
Impaired loans, net	0	0	2,087	2,087
Foreclosed assets held for sale	0	0	879	879
Total nonrecurring fair value measurements	$0	$0	$2,966	$2,966

As of March 31, 2013, the Corporation's investment in the senior tranche of MMCAPS Funding I, Ltd. is the only pooled trust preferred security held by the Corporation. 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 security to be reliable as observable inputs. Accordingly, the Corporation follows a method of valuing this security using a Level 3 methodology, based on discounted cash flows.

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

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

Management's evaluation and selection of valuation techniques and the unobservable inputs used in determining the fair values of assets valued using Level 3 methodologies include sensitive assumptions. Other market participants might use substantially different assumptions, which could result in calculations of fair values that would be substantially different than the amount calculated by management. At March 31, 2013 and December 31, 2012, quantitative information regarding significant techniques and inputs used for assets measured on a recurring basis using unobservable inputs (Level 3 methodologies) are as follows:

Asset	**Fair Value at 3/31/13 (In Thousands)**	**Valuation Technique**	**Unobservable Input(s)**		**Method or Value As of 3/31/13**
Pooled trust preferred securities - senior tranches	$1,659	Discounted cash flow	Issuer defaults	50.26%	Actual deferrals and defaults as % of outstanding collateral

				18.13%	Expected additional net deferrals and defaults as % of performing collateral
			Issuer prepayments	41.24%	Expected issuer prepayments as % of performing collateral
			Discount rate	11.70%	Implied 7.57% discount rate at 12/31/07 plus 4.13% spread for credit and liquidity risk
Servicing rights	738	Discounted cash flow	Discount rate	12.00%	Rate used through modeling period
			Loan prepayment speeds	258.00%	Weighted-average PSA
			Servicing fees	0.25%	of loan balances
				5.00%	of payments are late
				5.00%	late fees assessed
				$1.94	Miscellaneous fees per account per month
			Servicing costs	$6.00	Monthly servicing cost per account
				$24.00	Additional monthly servicing cost per loan on loans more than 30 days delinquent
				1.50%	of loans more than 30 days delinquent
				3.00%	annual increase in servicing costs

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Asset	**Fair Value at 12/31/12 (In Thousands)**	**Valuation Technique**	**Unobservable Input(s)**		**Method or Value As of 12/31/12**
Pooled trust preferred securities - senior tranches	$1,613	Discounted cash flow	Issuer defaults	50.26%	Actual deferrals and defaults as % of outstanding collateral
				19.73%	Expected additional net deferrals and defaults as % of performing collateral
			Issuer prepayments	41.24%	Expected issuer prepayments as % of performing collateral
			Discount rate	11.70%	Implied 7.57% discount rate at 12/31/07 plus 4.13% spread for credit and liquidity risk
Servicing rights	605	Discounted cash flow	Discount rate	12.00%	Rate used through modeling period
			Loan prepayment speeds	288.00%	Weighted-average PSA
			Servicing fees	0.25%	of loan balances
				5.00%	of payments are late
				5.00%	late fees assessed
				$1.94	Miscellaneous fees per account per month
			Servicing costs	$6.00	Monthly servicing cost per account
				$24.00	Additional monthly servicing cost per loan on loans more than 30 days delinquent
				1.50%	of loans more than 30 days delinquent
				3.00%	annual increase in servicing costs

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

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

	Three Months Ended March 31, 2013			
(In Thousands)	**Pooled Trust Preferred Securities - Senior Tranches**	**Pooled Trust Preferred Securities - Mezzanine Tranches**	**Servicing Rights**	**Total**
Balance, beginning of period	$1,613	$0	$605	$2,218

Issuances of servicing rights	0	0	166	166
Accretion and amortization, net	(1)	0	0	(1)
Proceeds from sales and calls	0	(571)	0	(571)
Realized gains, net	0	571	0	571
Unrealized losses included in earnings	0	0	(33)	(33)
Unrealized gains included in other comprehensive income	47	0	0	47
Balance, end of period	$1,659	$0	$738	$2,397

	Three Months Ended March 31, 2012			
(In Thousands)	**Pooled Trust Preferred Securities - Senior Tranches**	**Pooled Trust Preferred Securities - Mezzanine Tranches**	**Servicing Rights**	**Total**
Balance, beginning of period	$4,638	$730	$375	$5,743
Issuances of servicing rights	0	0	55	55
Accretion and amortization, net	(3)	0	0	(3)
Proceeds from sales and calls	0	(27)	0	(27)
Realized gains, net	0	27	0	27
Unrealized losses included in earnings	0	0	(21)	(21)
Unrealized gains included in other comprehensive income	3	52	0	55
Balance, end of period	$4,638	$782	$409	$5,829

No other-than-temporary impairment losses on securities valued using Level 3 methodologies were recorded in 2013 or 2012.

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

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

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

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

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

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

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

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

DEPOSITS - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, money market and interest checking accounts, is (by definition) equal to the amount payable on demand at March 31, 2013 and December 31, 2012. The fair value of time deposits, such as certificates of deposit and Individual Retirement Accounts, is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates of deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

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

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

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

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

(In Thousands)	**Valuation Method(s) Used**	**March 31, 2013**		**December 31, 2012**	
		Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:					
Cash and cash equivalents	Level 1	$40,249	$40,249	$55,016	$55,016
Certificates of deposit	Level 2	4,820	4,857	4,820	4,860
Available-for-sale securities	See Above	459,855	459,855	472,577	472,577
Restricted equity securities (included in Other Assets)	Level 2	4,149	4,149	4,842	4,842
Loans held for sale	Level 1	799	799	2,545	2,545
Loans, net	Level 3	659,628	673,256	677,053	693,047
Accrued interest receivable	Level 1	4,567	4,567	4,281	4,281
Servicing rights	Level 3	738	738	605	605
Financial liabilities:					
Deposits with no stated maturity	Level 1	680,822	680,822	693,687	693,687
Time deposits	Level 3	287,152	289,339	312,419	315,005
Short-term borrowings	Level 3	4,637	4,601	5,567	5,527
Long-term borrowings	Level 3	76,661	87,242	83,812	96,032
Accrued interest payable	Level 1	128	128	137	137

6. SECURITIES

Amortized cost and fair value of available-for-sale securities at March 31, 2013 and December 31, 2012 are summarized as follows:

		March 31, 2013		
(In Thousands)	**Amortized Cost**	**Gross Unrealized Holding Gains**	**Gross Unrealized Holding Losses**	**Fair Value**
Obligations of U.S. Government agencies	$35,802	$504	($60)	$36,246
Obligations of states and political subdivisions:				
Tax-exempt	132,917	6,259	(266)	138,910
Taxable	27,215	455	(75)	27,595
Mortgage-backed securities	64,505	3,164	(3)	67,666
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	172,222	3,198	(1,502)	173,918
Trust preferred securities issued by individual institutions	5,160	3	0	5,163
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	1,614	45	0	1,659
Other collateralized debt obligations	660	0	0	660
Total debt securities	440,095	13,628	(1,906)	451,817
Marketable equity securities	5,570	2,472	(4)	8,038
Total	$445,665	$16,100	($1,910)	$459,855

		December 31, 2012		
(In Thousands)	**Amortized Cost**	**Gross Unrealized Holding Gains**	**Gross Unrealized Holding Losses**	**Fair Value**
Obligations of U.S. Government agencies	$30,695	$572	($50)	$31,217
Obligations of states and political subdivisions:				
Tax-exempt	130,168	7,030	(178)	137,020
Taxable	24,426	462	(71)	24,817
Mortgage-backed securities	76,368	3,828	0	80,196
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	179,770	3,887	(147)	183,510
Trust preferred securities issued by individual institutions	5,167	4	0	5,171
Collateralized debt obligations:				
Pooled trust preferred securities - senior tranches	1,615	0	(2)	1,613
Other collateralized debt obligations	660	0	0	660
Total debt securities	448,869	15,783	(448)	464,204
Marketable equity securities	5,912	2,500	(39)	8,373

Total	$454,781	$18,283	($487)	$472,577

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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 March 31, 2013 and December 31, 2012:

March 31, 2013	**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	$9,994	($60)	$0	$0	$9,994	($60)
Obligations of states and political subdivisions:						
Tax-exempt	12,248	(189)	2,308	(77)	14,556	(266)
Taxable	6,381	(75)	0	0	6,381	(75)
Mortgage-backed securities	5,021	(3)	0	0	5,021	(3)
Collateralized mortgage obligations,						
Issued by U.S. Government agencies	58,304	(1,501)	400	(1)	58,704	(1,502)
Total debt securities	91,948	(1,828)	2,708	(78)	94,656	(1,906)
Marketable equity securities	98	(4)	0	0	98	(4)
Total temporarily impaired available-for-sale securities	$92,046	($1,832)	$2,708	($78)	$94,754	($1,910)

December 31, 2012	**Less Than 12 Months**		**12 Months or More**		**Total**	
(In Thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Obligations of U.S. Government agencies	$10,006	($50)	$0	$0	$10,006	($50)
Obligations of states and political subdivisions:						
Tax-exempt	7,082	(92)	3,285	(86)	10,367	(178)
Taxable	4,149	(71)	0	0	4,149	(71)
Collateralized mortgage obligations,						
Issued by U.S. Government agencies	16,755	(146)	454	(1)	17,209	(147)
Collateralized debt obligations,						
Pooled trust preferred securities - senior tranches	0	0	1,613	(2)	1,613	(2)
Total debt securities	37,992	(359)	5,352	(89)	43,344	(448)
Marketable equity securities	95	(6)	67	(33)	162	(39)
Total temporarily impaired available-for-sale securities	$38,087	($365)	$5,419	($122)	$43,506	($487)

Gross realized gains and losses from available-for-sale securities were as follows:

(In Thousands)	3 Months Ended March 31, 2013	March 31, 2012
Gross realized gains from sales	$1,302	$65
Gross realized losses from sales	(118)	0
Losses from OTTI impairment	(25)	(67)
Net realized gains (losses)	$1,159	($2)

The amortized cost and fair value of available-for-sale debt securities by contractual maturity are shown in the following table as of March 31, 2013. Actual maturities may differ from contractual maturities because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties.

(In Thousands)	**Amortized Cost**	**Fair Value**
Due in one year or less	$15,462	$15,661
Due from one year through five years	51,601	52,936
Due from five years through ten years	60,436	61,460
Due after ten years	75,869	80,176
Subtotal	203,368	210,233
Mortgage-backed securities	64,505	67,666
Collateralized mortgage obligations,		
Issued by U.S. Government agencies	172,222	173,918
Total	$440,095	$451,817

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 $295,039,000 at March 31, 2013 and $293,310,000 at December 31, 2012 were pledged as collateral for public deposits, trusts and certain other deposits as provided by law. See Note 8 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.

A summary of information management considered in evaluating debt and equity securities for OTTI at March 31, 2013 is provided below.

Debt Securities

At March 31, 2013, 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 debt securities, including municipal bonds with no external ratings, at March 31, 2013 to be temporary.

The credit rating agencies have withdrawn their ratings on numerous municipal bonds held by the Corporation. At March 31, 2013, the total amortized cost basis of municipal bonds with no external credit ratings was $21,394,000, with an aggregate unrealized gain of $133,000. 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 payment.

The following table provides detailed information related to a security issued by Astoria Capital Trust I, a subsidiary of Astoria Financial Corporation, which is the only trust preferred security issued by an individual institution held by the Corporation as of March 31, 2013:

Par Amount Outstanding	$5,000
Amortized Cost	5,160
Fair Value	5,163
Unrealized Gain	3
Cumulative Realized Credit Losses	$0
Moody's Credit Rating	Ba1
S&P Credit Rating	BB
Fitch Credit Rating	B+

Management assesses the security shown above for the possibility of OTTI by reviewing financial information that is publicly available. Astoria Financial Corporation has not deferred or defaulted on payments associated with the Corporation's security. In April 2013, Astoria Financial Corporation announced its intent to redeem (call) the security held by the Corporation in full in May 2013. Pursuant to the terms of the security, it will be redeemed at a premium to the par amount outstanding, and management expects to record a gain related to the redemption of approximately $13,000 in the second quarter 2013.

The Corporation recognized OTTI charges in 2009 and 2010 related to its holding of a trust preferred security issued by Carolina First Mortgage Loan Trust, a subsidiary of The South Financial Group, Inc. In the fourth quarter 2010, The Toronto-Dominion Bank acquired The South Financial Group, Inc. 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 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 security had a face amount of $2,000,000 and matured in May 2012. Because the security matured, the Corporation recorded no accretion income in the three-month period ended March 31, 2013 but recorded accretion income totaling $457,000 in the three-month period ended March 31, 2012. For the year ended December 31, 2012, the Corporation recorded accretion income totaling $855,000.

During the first quarter 2013, management sold the Corporation's holding of the mezzanine tranche of ALESCO Preferred Funding IX, Ltd. for aggregate pretax proceeds of $571,000, which was recorded as a gain on the sale of securities. This security had an original face amount of $3,000,000. In 2009, the Corporation recognized other-than-temporary impairment on this security and wrote the carrying value down to zero.

As of March 31, 2013, the Corporation's investment in the senior tranche of MMCAPS Funding I, Ltd. is the only pooled trust preferred security held by the Corporation. The underlying debt securities in this pool are issued by banking companies with geographic and size diversification. Trust-preferred securities typically permit deferral of quarterly interest payments for up to five years. Some of the issuers of trust-preferred securities that are included in the Corporation's investment have elected to defer payment of interest on their obligations, and some issuers have defaulted.

Management evaluated the Corporation's investment in the senior tranche of MMCAPS Funding I, Ltd., with an amortized cost of $1,614,000, for OTTI by estimating the cash flows expected to be received from the 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. Management assigned estimated future default levels for the remaining issuers based on financial strength ratings assigned by a national ratings service. The resulting estimates of cash flows used to evaluate other-than-temporary impairment were based on sensitive assumptions regarding the timing and amounts of defaults that may occur, and changes in the assumptions used could produce a different conclusion for the security. Additional details regarding this security and the assumptions used for determining cash flows are included in Note 5 as well as in the following table:

Number of Issuers Currently Performing	8
Moody's Credit Rating	Aa2
Fitch Credit Rating	A
Actual Deferrals and Defaults as % of Outstanding Collateral	50.26%
Expected Additional Net Deferrals and Defaults as % of Performing Collateral	18.13%
Excess Subordination as % of Performing Collateral	67.90%
Expected Issuer Prepayments as % of Performing Collateral	41.24%

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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 2013 or 2012.

Equity Securities

The Corporation’s marketable equity securities at March 31, 2013 and December 31, 2012 consisted exclusively of stocks of banking companies. In the first quarter 2013, the Corporation recognized an other-than-temporary impairment loss related to a bank stock of $25,000. In the first quarter 2012, the Corporation recognized an other-than-temporary impairment loss related to a bank stock of $67,000. Management’s decisions followed evaluations of the issuers’ published financial results in which management determined that the recovery of the Corporation’s cost basis within the foreseeable future was uncertain. As a result of this determination, the Corporation recognized impairment losses to write each stock down to the most recent trade price at the end of the quarter in which each loss was recognized. At March 31, 2013, 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 other bank stock holdings at March 31, 2013 were other than temporarily impaired. Realized gains from sales of bank stocks totaled $521,000 in the first quarter 2013. The Corporation did not sell any bank stocks or realize any gains or losses from sales of bank stocks during the first quarter 2012.

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 $4,019,000 at March 31, 2013 and $4,712,000 at December 31, 2012. The Corporation evaluated its holding of FHLB-Pittsburgh stock for impairment and deemed the stock to not be impaired at March 31, 2013 and December 31, 2012. 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.

7. LOANS

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

Loans outstanding at March 31, 2013 and December 31, 2012 are summarized as follows:

Summary of Loans by Type (In Thousands)	**Mar. 31, 2013**	**Dec. 31, 2012**
Residential mortgage:		
Residential mortgage loans - first liens	$306,754	$311,627
Residential mortgage loans - junior liens	25,567	26,748
Home equity lines of credit	32,237	33,017
1-4 Family residential construction	12,032	12,842
Total residential mortgage	376,590	384,234
Commercial:		
Commercial loans secured by real estate	155,474	158,413
Commercial and industrial	47,031	48,442
Political subdivisions	27,366	31,789
Commercial construction and land	28,461	28,200
Loans secured by farmland	11,214	11,403
Multi-family (5 or more) residential	6,478	6,745
Agricultural loans	2,864	3,053
Other commercial loans	238	362
Total commercial	279,126	288,407
Consumer	11,030	11,269
Total	666,746	683,910
Less: allowance for loan losses	(7,118)	(6,857)
Loans, net	$659,628	$677,053

The Corporation grants loans to individuals as well as commercial and tax-exempt entities. Commercial, residential and personal loans are made to customers geographically concentrated in the Pennsylvania and New York counties that comprise the market serviced by Citizens & Northern Bank. Although the Corporation has a diversified loan portfolio, a significant portion of its debtors' ability to honor their contracts is dependent on the local economic conditions within the region. There is no concentration of loans to borrowers engaged in similar businesses or activities that exceed 10% of total loans at either March 31, 2013 or December 31, 2012.

The Corporation maintains an allowance for loan losses that represents management's estimate of the losses inherent in the loan portfolio as of the balance sheet date and recorded as a reduction of the investment in loans. The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available. In the process of evaluating the loan portfolio, management also considers the Corporation's exposure to losses from unfunded loan commitments. As of March 31, 2013 and December 31, 2012, management determined that no allowance for credit losses related to unfunded loan commitments was required.

Transactions within the allowance for loan losses, summarized by segment and class, for the three-month periods ended March 31, 2013 and 2012 were as follows:

Three Months Ended March 31, 2013 (In Thousands)	**December 31, 2012 Balance**	**Charge-offs**	**Recoveries**	**Provision (Credit)**	**March 31, 2013 Balance**
Allowance for Loan Losses:					
Residential mortgage:					
Residential mortgage loans - first liens	$2,619	($52)	$0	$219	$2,786
Residential mortgage loans - junior liens	247	0	0	(11)	236
Home equity lines of credit	255	0	0	(4)	251
1-4 Family residential construction	96	0	0	49	145
Total residential mortgage	3,217	(52)	0	253	3,418
Commercial:					
Commercial loans secured by real estate	1,930	0	250	(274)	1,906
Commercial and industrial	581	(108)	1	123	597
Political subdivisions	0	0	0	0	0
Commercial construction and land	234	0	0	134	368
Loans secured by farmland	129	0	0	(2)	127
Multi-family (5 or more) residential	67	0	0	(2)	65
Agricultural loans	27	0	0	(1)	26
Other commercial loans	3	0	0	(1)	2
Total commercial	2,971	(108)	251	(23)	3,091
Consumer	228	(33)	20	(4)	211
Unallocated	441	0	0	(43)	398
Total Allowance for Loan Losses	$6,857	($193)	$271	$183	$7,118

Three Months Ended March 31, 2012 (In Thousands)	**December 31, 2011 Balance**	**Charge-offs**	**Recoveries**	**Provision (Credit)**	**March 31, 2012 Balance**
Allowance for Loan Losses:					
Residential mortgage:					
Residential mortgage loans - first liens	$3,026	($138)	$0	$65	$2,953
Residential mortgage loans - junior liens	266	0	0	(6)	260
Home equity lines of credit	231	0	0	1	232
1-4 Family residential construction	79	0	0	(17)	62
Total residential mortgage	3,602	(138)	0	43	3,507
Commercial:					
Commercial loans secured by real estate	2,004	0	0	(84)	1,920
Commercial and industrial	946	0	1	(185)	762
Political subdivisions	0	0	0	0	0
Commercial construction and land	267	0	0	58	325
Loans secured by farmland	126	0	0	(5)	121
Multi-family (5 or more) residential	66	0	0	(3)	63

Agricultural loans	27	0	0	0	27
Other commercial loans	5	0	0	(2)	3
Total commercial	3,441	0	1	(221)	3,221
Consumer	228	(38)	22	(6)	206
Unallocated	434	0	0	2	436
Total Allowance for Loan Losses	$7,705	($176)	$23	($182)	$7,370

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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. 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.

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.

The following tables summarize the aggregate credit quality classification of outstanding loans by risk rating as of March 31, 2013 and December 31, 2012:

March 31, 2013:		**Special**			
(In Thousands)	**Pass**	**Mention**	**Substandard**	**Doubtful**	**Total**
Residential Mortgage:					
Residential mortgage loans - first liens	$290,838	$2,494	$13,231	$191	$306,754
Residential mortgage loans - junior liens	24,346	404	817	0	25,567
Home equity lines of credit	31,730	126	381	0	32,237
1-4 Family residential construction	11,949	0	83	0	12,032
Total residential mortgage	358,863	3,024	14,512	191	376,590
Commercial:					
Commercial loans secured by real estate	144,816	5,257	5,084	317	155,474
Commercial and Industrial	40,890	2,748	3,025	368	47,031
Political subdivisions	27,259	107	0	0	27,366
Commercial construction and land	27,007	228	478	748	28,461
Loans secured by farmland	8,704	978	1,500	32	11,214
Multi-family (5 or more) residential	6,091	337	50	0	6,478
Agricultural loans	2,767	36	61	0	2,864
Other commercial loans	238	0	0	0	238
Total commercial	257,772	9,691	10,198	1,465	279,126

Consumer	10,800	11	219	0	11,030
Totals	$627,435	$12,726	$24,929	$1,656	$666,746

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December 31, 2012: **(In Thousands)**	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Residential Mortgage:					
Residential mortgage loans - first liens	$295,929	$3,633	$11,872	$193	$311,627
Residential mortgage loans - junior liens	25,394	420	934	0	26,748
Home equity lines of credit	32,374	130	513	0	33,017
1-4 Family residential construction	12,759	0	83	0	12,842
Total residential mortgage	366,456	4,183	13,402	193	384,234
Commercial:					
Commercial loans secured by real estate	146,381	6,994	5,038	0	158,413
Commercial and Industrial	41,237	3,030	3,810	365	48,442
Political subdivisions	31,679	110	0	0	31,789
Commercial construction and land	26,744	231	477	748	28,200
Loans secured by farmland	9,102	751	1,517	33	11,403
Multi-family (5 or more) residential	6,394	342	9	0	6,745
Agricultural loans	2,963	28	62	0	3,053
Other commercial loans	362	0	0	0	362
Total commercial	264,862	11,486	10,913	1,146	288,407
Consumer	11,053	12	203	1	11,269
Totals	$642,371	$15,681	$24,518	$1,340	$683,910

The general component of the allowance for loan losses covers pools of loans 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 are evaluated for loss exposure based upon three-year average historical net charge-off rates for each loan class, adjusted for qualitative factors. Qualitative risk factors (described in the following paragraph) are evaluated for the impact on each of the three 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. The adjustment for qualitative factors is applied as an increase or decrease to the three-year average net charge-off rate to each loan class within each segment.

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 72% at March 31, 2013) 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.

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, all loans classified as troubled debt restructurings (discussed in more detail below) and all 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 tables summarizing the allowance and associated loan balances as of March 31, 2013 and December 31, 2012.

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 March 31, 2013 and December 31, 2012:

March 31, 2013 (In Thousands)	**Loans:**			**Allowance for Loan Losses:**		
	Individually Evaluated	**Collectively Evaluated**	**Totals**	**Individually Evaluated**	**Collectively Evaluated**	**Totals**
Residential mortgage:						
Residential mortgage loans - first liens	$2,678	$304,076	$306,754	$171	$2,615	$2,786
Residential mortgage loans - junior liens	219	25,348	25,567	0	236	236
Home equity lines of credit	0	32,237	32,237	0	251	251
1-4 Family residential construction	0	12,032	12,032	0	145	145
Total residential mortgage	2,897	373,693	376,590	171	3,247	3,418
Commercial:						
Commercial loans secured by real estate	1,774	153,700	155,474	169	1,737	1,906
Commercial and industrial	743	46,288	47,031	190	407	597
Political subdivisions	0	27,366	27,366	0	0	0
Commercial construction and land	1,004	27,457	28,461	0	368	368
Loans secured by farmland	922	10,292	11,214	32	95	127
Multi-family (5 or more) residential	50	6,428	6,478	0	65	65
Agricultural loans	40	2,824	2,864	0	26	26
Other commercial loans	0	238	238	0	2	2
Total commercial	4,533	274,593	279,126	391	2,700	3,091
Consumer	43	10,987	11,030	29	182	211
Unallocated						398
Total	$7,473	$659,273	$666,746	$591	$6,129	$7,118

December 31, 2012 (In Thousands)	**Loans:**			**Allowance for Loan Losses:**		
	Individually Evaluated	**Collectively Evaluated**	**Totals**	**Individually Evaluated**	**Collectively Evaluated**	**Totals**
Residential mortgage:						
Residential mortgage loans - first liens	$2,341	$309,286	$311,627	$206	$2,413	$2,619
Residential mortgage loans - junior liens	158	26,590	26,748	0	247	247
Home equity lines of credit	0	33,017	33,017	0	255	255
1-4 Family residential construction	0	12,842	12,842	0	96	96
Total residential mortgage	2,499	381,735	384,234	206	3,011	3,217
Commercial:						
Commercial loans secured by real estate	1,938	156,475	158,413	146	1,784	1,930
Commercial and industrial	939	47,503	48,442	197	384	581
Political subdivisions	0	31,789	31,789	0	0	0
Commercial construction and land	1,034	27,166	28,200	0	234	234
Loans secured by farmland	923	10,480	11,403	34	95	129
Multi-family (5 or more) residential	9	6,736	6,745	0	67	67
Agricultural loans	40	3,013	3,053	0	27	27
Other commercial loans	0	362	362	0	3	3
Total commercial	4,883	283,524	288,407	377	2,594	2,971
Consumer	47	11,222	11,269	40	188	228
Unallocated						441
Total	$7,429	$676,481	$683,910	$623	$5,793	$6,857

The average balance of impaired loans and interest income recognized on impaired loans is as follows:

(In Thousands)	**3 Months Ended March 31,**	
	2013	**2012**
Average investment in impaired loans	$7,451	$7,120
Interest income recognized on impaired loans	70	83
Interest income recognized on a cash basis on impaired loans	70	83

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.

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

(In Thousands)	**March 31, 2013**		**December 31, 2012**	
	Past Due 90+ Days and Accruing	**Nonaccrual**	**Past Due 90+ Days and Accruing**	**Nonaccrual**
Residential mortgage:				
Residential mortgage loans - first liens	$1,578	$3,042	$1,900	$3,064
Residential mortgage loans - junior liens	83	111	29	111
Home equity lines of credit	40	63	40	200
1-4 Family residential construction	0	83	0	0
Total residential mortgage	1,701	3,299	1,969	3,375
Commercial:				
Commercial loans secured by real estate	234	1,331	120	1,338
Commercial and industrial	3	583	68	761
Commercial construction and land	149	887	149	887
Loans secured by farmland	236	923	0	923
Agricultural loans	0	39	0	40
Total commercial	622	3,763	337	3,949
Consumer	28	28	5	29
Totals	$2,351	$7,090	$2,311	$7,353

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

The table below presents a summary of the contractual aging of loans as of March 31, 2013 and December 31, 2012:

(In Thousands)	**As of March 31, 2013**				**As of December 31, 2012**			
	Current & Past Due Less than 30 Days	**Past Due 30-89 Days**	**Past Due 90+ Days**	**Total**	**Current & Past Due Less than 30 Days**	**Past Due 30-89 Days**	**Past Due 90+ Days**	**Total**
Residential mortgage:								
Residential mortgage loans - first liens	$298,832	$5,491	$2,431	$306,754	$302,373	$6,228	$3,026	$311,627
Residential mortgage loans - junior liens	25,177	206	184	25,567	26,247	371	130	26,748
Home equity lines of credit	31,970	164	103	32,237	32,593	184	240	33,017
1-4 Family residential construction	11,949	0	83	12,032	12,627	215	0	12,842
Total residential mortgage	367,928	5,861	2,801	376,590	373,840	6,998	3,396	384,234
Commercial:								

Commercial loans secured by real estate	153,578	516	1,380	155,474	156,834	704	875	158,413
Commercial and industrial	46,162	355	514	47,031	47,569	317	556	48,442
Political subdivisions	27,366	0	0	27,366	31,789	0	0	31,789
Commercial construction and land	27,289	164	1,008	28,461	26,944	248	1,008	28,200
Loans secured by farmland	10,055	33	1,126	11,214	10,438	75	890	11,403
Multi-family (5 or more) residential	6,477	1	0	6,478	6,743	2	0	6,745
Agricultural loans	2,825	0	39	2,864	3,003	10	40	3,053
Other commercial loans	238	0	0	238	362	0	0	362
Total commercial	273,990	1,069	4,067	279,126	283,682	1,356	3,369	288,407
Consumer	10,921	81	28	11,030	11,135	129	5	11,269
Totals	$652,839	$7,011	$6,896	$666,746	$668,657	$8,483	$6,770	$683,910

Nonaccrual loans are included in the contractual aging in the immediately preceding table. A summary of the contractual aging of nonaccrual loans at March 31, 2013 and December 31, 2012 is as follows:

(In Thousands)	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total
March 31, 2013 Nonaccrual Totals	$1,900	$645	$4,545	$7,090
December 31, 2012 Nonaccrual Totals	$2,167	$727	$4,459	$7,353

Loans whose terms are modified are classified as Troubled Debt Restructurings (TDRs) if the Corporation grants such borrowers concessions, and it is deemed that those borrowers are experiencing financial difficulty. Loans classified as TDRs are designated as impaired. The outstanding balance of loans subject to TDRs, as well as contractual aging information at March 31, 2013 and December 31, 2012 is as follows:

Troubled Debt Restructurings (TDRs):

(In Thousands)	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Nonaccrual	Total
March 31, 2013 Totals	$829	$0	$184	$1,154	$2,167
December 31, 2012 Totals	$785	$121	$0	$1,155	$2,061

TDRs that occurred during the three-month periods ended March 31, 2013 and 2012 are as follows:

Three Months Ended March 31, 2013 (Balances in Thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Residential mortgage:			
Residential mortgage loans - first liens	5	$534	$534
Residential mortgage loans - junior liens	2	37	37

Three Months Ended March 31, 2012 (Balances in Thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**

Commercial,			
Commercial and industrial	1	$65	$65

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The TDRs in the three-month period ended March 31, 2013 included extensions of the final maturity date (3 contracts), reduction in interest rate (2 contracts), reduction in payment amount (1 contract) and interest only (1 contract). There was no allowance for loan losses on these loans at March 31, 2013 and no change in the allowance for loan losses resulting from these TDRs.

The TDR in the three-month period ended March 31, 2012 was an extension of the final maturity and lowering of monthly payments required on a commercial loan. There was no allowance for loan losses on this loan at March 31, 2012, and no change in the allowance for loan losses resulting from this TDR.

In the three-month periods ended March 31, 2013 and 2012, there were no changes in the allowance for loan losses resulting from the TDRs that occurred during those periods.

In the first quarter 2013, there were no defaults on loans for which modifications considered to be TDRs were entered into within the previous 12 months. In the first quarter 2012, defaults on loans for which modifications considered to be TDRs were entered into within the previous 12 months were as follows:

(Balances in Thousands)	**Number of Contracts**	**Recorded Investment**
Commercial, Commercial construction and land	1	$950

The event of default in the table above resulted from the borrowers' failure to make payments due at maturity, based on a loan maturity date that had been extended from the original due date. The allowance for loan losses on this loan was $122,000 at March 31, 2012, an increase of $57,000 over the allowance on the loan at December 31, 2011. In the fourth quarter 2012, the Corporation recorded a partial charge-off of $288,000 related to this loan, leaving an outstanding recorded investment of $662,000 at March 31, 2013 and December 31, 2012. Based on the estimated value of the underlying collateral, net of estimated costs to sell the collateral, the Corporation determined that no allowance for loan losses was required at March 31, 2013 and December 31, 2012 on this loan.

8. BORROWED FUNDS

SHORT-TERM BORROWINGS

Short-term borrowings include the following:

(In Thousands)	**Mar. 31, 2013**	**Dec. 31, 2012**
Customer repurchase agreements	$4,637	$5,567

The Corporation engages in repurchase agreements with certain commercial customers. These agreements provide that the Corporation sells specified investment securities to the customers on an overnight basis and repurchases them on the following business day. The weighted average rate paid by the Corporation on customer repurchase agreements was 0.10% at March 31, 2013 and December 31, 2012. The carrying value of the underlying securities was $10,967,000 at March 31, 2013 and $11,179,000 at December 31, 2012.

LONG-TERM BORROWINGS

Long-term borrowings are as follows:

(In Thousands)	**Mar. 31, 2013**	**Dec. 31, 2012**
FHLB-Pittsburgh borrowings	$15,661	$15,812
Repurchase agreements	61,000	68,000
Total long-term borrowings	$76,661	$83,812

Long-term borrowings from FHLB - Pittsburgh are as follows:

(In Thousands)	**Mar. 31, 2013**	**Dec. 31, 2012**
Loans maturing in 2013 with rates ranging from 2.86% to 3.62%	$3,123	$3,211
Loan maturing in 2016 with a rate of 6.86%	186	196
Loan maturing in 2017 with a rate of 6.83%	26	27
Loan maturing in 2017 with a rate of 3.81%	10,000	10,000
Loan maturing in 2020 with a rate of 4.79%	1,260	1,297
Loan maturing in 2025 with a rate of 4.91%	1,066	1,081
Total long-term FHLB-Pittsburgh borrowings	$15,661	$15,812

The FHLB-Pittsburgh loan facilities are collateralized by qualifying loans secured by real estate with a book value totaling $464,916,000 at March 31, 2013 and $471,731,000 at December 31, 2012. Also, the FHLB-Pittsburgh loan facilities require the Corporation to invest in established amounts of FHLB-Pittsburgh stock. The carrying values of the Corporation's holdings of FHLB-Pittsburgh stock (included in Other Assets) were $4,019,000 at March 31, 2013 and $4,712,000 at December 31, 2012.

Repurchase agreements included in long-term borrowings are as follows:

(In Thousands)	**Mar. 31, 2013**	**Dec. 31, 2012**
Agreement maturing in 2017 with a rate of 3.595%	$27,000	$34,000
Agreement maturing in 2017 with a rate of 4.265%	34,000	34,000
Total long-term repurchase agreements	$61,000	$68,000

The Corporation incurred a loss of $1,023,000 in the first quarter 2013 on prepayment of $7,000,000 of the agreement with an interest rate of 3.595% that is contractually scheduled to mature in 2017.

In December 2007, the Corporation entered into two repurchase agreements of $40,000,000 each with embedded caps. These repurchase agreements mature in 2017. In the third quarter 2012, the Corporation paid off principal totaling $6,000,000 on each of these agreements, incurring a loss from prepayment of $2,190,000 and leaving a balance of $34,000,000 outstanding for each agreement at December 31, 2012. The borrowing with an interest rate of 3.595% became putable by the issuer at quarterly intervals starting in December 2010. The other borrowing has an interest rate of 4.265% and became putable by the issuer at quarterly intervals starting in December 2012. Each of these borrowings contained an embedded cap, providing that on the quarterly anniversary of the transaction settlement date, if three-month LIBOR were higher than 5.15%, the Corporation's interest rate payable would decrease by twice the amount of the excess, down to a minimum rate of 0%. The embedded cap on one of the agreements expired in December 2010, and the embedded cap on the other agreement expired in December 2012.

Securities sold under repurchase agreements were delivered to the broker-dealer who is the counter-party to the transactions. The broker-dealer may have sold, loaned or otherwise disposed of such securities to other parties in the normal course of their operations, and has agreed to resell to the Corporation substantially identical securities at the maturities of the agreements. The Master Repurchase Agreement between the Corporation and the broker-dealer provides that the Agreement constitutes a “netting contract,” as defined; however, the Corporation and the broker-dealer have no other obligations to one another and accordingly, no netting has occurred. The carrying value of the underlying securities was $76,057,000 at March 31, 2013 and $89,428,000 at December 31, 2012.

9. DEFINED BENEFIT PLANS

The Corporation sponsors a defined benefit health care plan that provides postretirement medical benefits and life insurance to employees who meet certain age and length of service requirements. Effective January 1, 2013, this plan was amended so that full-time employees no longer accrue service time toward the Corporation-subsidized portion of the medical benefits. The plan was also amended effective January 1, 2013 to change some of the age and length-of-service requirements for participants to receive some of the benefits provided under the plan. This plan contains a cost-sharing feature, which causes participants to pay for all future increases in costs related to benefit coverage. Accordingly, actuarial assumptions related to health care cost trend rates do not significantly affect the liability balance at March 31, 2013 and December 31, 2012, and are not expected to significantly affect the Corporation's future expenses. The Corporation uses a December 31 measurement date for the postretirement plan.

In an acquisition in 2007, the Corporation assumed the Citizens Trust Company Retirement Plan, a defined benefit pension plan. This plan covers certain employees who were employed by Citizens Trust Company on December 31, 2002, when the plan was amended to discontinue admittance of any future participant and to freeze benefit accruals. Information related to the Citizens Trust Company Retirement Plan has been included in the tables that follow. The Corporation uses a December 31 measurement date for this plan.

The components of net periodic benefit costs from these defined benefit plans are as follows:

Defined Benefit Plans (In Thousands)	**Pension Three Months Ended March 31,**		**Postretirement Three Months Ended March 31,**	
	2013	**2012**	**2013**	**2012**
Service cost	$0	$0	$10	$23
Interest cost	18	18	14	20
Expected return on plan assets	(23)	(18)	0	0
Amortization of transition (asset) obligation	0	0	0	9
Amortization of prior service cost	0	0	(8)	4
Recognized net actuarial loss	8	7	0	0
Net periodic benefit cost	$3	$7	$16	$56

In the first three months of 2013, the Corporation funded postretirement contributions totaling $15,000, with estimated annual postretirement contributions of $60,000 expected in 2013 for the full year. The Corporation made no contribution to the defined benefit pension plan in the first quarter 2013. Based upon the related actuarial reports, no defined benefit pension contributions are required in 2013, though the Corporation may make discretionary contributions.

10. STOCK-BASED COMPENSATION PLANS

In January 2013, the Corporation granted options to purchase a total of 64,050 shares of common stock through its Stock Incentive and Independent Directors Stock Incentive Plans. In January 2012, the Corporation granted options to purchase a total of 64,757 shares of common stock. The exercise price for the 2013 awards is $19.21 per share, and the exercise price for the 2012 awards is $18.54 per share, based on the market price as of the date of grant. Stock option expense is recognized over the vesting period of each option. The Corporation expects total stock option expense for the year ending December 31, 2013 will be $262,000, and total stock option expense for the year ended December 31, 2012 was $247,000.

The Corporation records stock option expense based on estimated fair value calculated using an option valuation model. In calculating the 2013 and 2012 fair values, the Corporation utilized the Black-Scholes-Merton option-pricing model. The calculated fair value of each option granted, and significant assumptions used in the calculations, are as follows:

	2013	**2012**
Fair value of each option granted	$5.56	$5.15
Volatility	41%	41%
Expected option lives	8 Years	7 Years
Risk-free interest rate	1.60%	1.53%
Dividend yield	3.69%	3.97%

In calculating the estimated fair value of stock option awards, management based its estimates of volatility and dividend yield on the Corporation's experience over the immediately prior period of time consistent with the estimated lives of the options. The risk-free interest rate was based on the published yield of zero-coupon U.S. Treasury strips with an applicable maturity as of the grant dates. The expected option lives were based on management's estimates of the average term for all options issued under both plans. In 2013 and 2012, management assumed a 33% forfeiture rate for options granted under the Stock Incentive Plan, and a 0% forfeiture rate for the Directors Stock Incentive Plan. These estimated forfeiture rates were determined based on the Corporation's historical experience.

In January 2013, the Corporation awarded a total of 37,886 shares of restricted stock under the Stock Incentive and Independent Directors Stock Incentive Plans. In January 2012, a total of 42,552 shares of restricted stock were awarded under the Plans. Compensation cost related to restricted stock is recognized based on the market price of the stock at the grant date over the vesting period. For restricted stock awards granted under the Stock Incentive Plan, the Corporation must meet an annual targeted return on average equity ("ROAE") performance ratio, as defined, in order for participants to vest. Management has estimated restricted stock expense in the first quarter 2013 based on an assumption that the ROAE target for 2013 will be met.

Total stock-based compensation expense is as follows:

(In Thousands)	**3 Months Ended**	
	March 31, 2013	**March 31, 2012**
Stock options	$166	$159
Restricted stock	121	82
Total	$287	$241

11. INCOME TAXES

The net deferred tax asset at March 31, 2013 and December 31, 2012 represents the following temporary difference components:

(In Thousands)	**Mar. 31, 2013**	**Dec. 31, 2012**
Deferred tax assets:		
Defined benefit plans - ASC 835	$82	$305
Net realized losses on securities		