

CITIZENS & NORTHERN CORP  
Form 10-Q  
May 06, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011  
or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 000-16084

CITIZENS & NORTHERN CORPORATION

(Exact name of Registrant as specified in its charter)

PENNSYLVANIA  
(State or other jurisdiction of  
incorporation or organization)

23-2451943  
(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  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 (§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

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

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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)

12,182,292 Shares Outstanding on May 5, 2011

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CITIZENS & NORTHERN CORPORATION  
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## CITIZENS &amp; NORTHERN CORPORATION – FORM 10-Q

## PART 1 - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEET (Unaudited)

(In Thousands Except Share Data)

March 31, December 31,  
2011 2010**ASSETS**

Cash and due from banks:

Noninterest-bearing	\$ 14,797	\$ 16,840
Interest-bearing	44,481	29,461
Total cash and cash equivalents	59,278	46,301
Available-for-sale securities	452,974	443,956
Loans held for sale	135	5,247
Loans receivable	718,959	730,411
Allowance for loan losses	(8,846 )	(9,107 )
Loans, net	710,113	721,304
Bank-owned life insurance	21,944	21,822
Accrued interest receivable	5,357	4,960
Bank premises and equipment, net	22,186	22,636
Foreclosed assets held for sale	707	537
Deferred tax asset, net	12,807	16,054
Intangible asset - Core deposit intangibles	297	326
Intangible asset - Goodwill	11,942	11,942
Other assets	18,469	21,503
<b>TOTAL ASSETS</b>	<b>\$ 1,316,209</b>	<b>\$ 1,316,588</b>

**LIABILITIES**

Deposits:

Noninterest-bearing	\$ 180,824	\$ 158,767
Interest-bearing	829,177	845,581
Total deposits	1,010,001	1,004,348
Short-term borrowings	16,068	18,413
Long-term borrowings	138,340	148,495
Accrued interest and other liabilities	5,747	6,388
<b>TOTAL LIABILITIES</b>	<b>1,170,156</b>	<b>1,177,644</b>

**STOCKHOLDERS' EQUITY**

Common stock, par value \$1.00 per share; authorized 20,000,000 shares in 2011 and 2010; issued 12,420,365 at March 31, 2011 and 12,408,212 at December 31, 2010	12,420	12,408
Paid-in capital	66,739	66,648
Retained earnings	69,894	65,920
Treasury stock, at cost; 238,953 shares at March 31, 2011 and 254,614 shares at December 31, 2010	(4,158 )	(4,431 )
Sub-total	144,895	140,545
Accumulated other comprehensive income (loss):		

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Unrealized gains (losses) on available-for-sale securities	1,478	(1,351 )
Defined benefit plans	(320 )	(250 )
Total accumulated other comprehensive income (loss)	1,158	(1,601 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>146,053</b>	<b>138,944</b>
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>	<b>\$1,316,209</b>	<b>\$ 1,316,588</b>

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

## CITIZENS &amp; NORTHERN CORPORATION – FORM 10-Q

## CONSOLIDATED STATEMENT OF OPERATIONS

(In Thousands, Except Per Share Data) (Unaudited)

Three Months Ended  
March 31, 2011 March 31, 2010

	March 31, 2011	March 31, 2010
<b>INTEREST INCOME</b>		
Interest and fees on loans	\$ 10,868	\$ 10,950
Interest on balances with depository institutions	16	38
Interest on loans to political subdivisions	375	398
Interest on trading securities	0	1
Income from available-for-sale and held-to-maturity securities:		
Taxable	2,693	3,085
Tax-exempt	1,284	1,181
Dividends	62	80
Total interest and dividend income	15,298	15,733
<b>INTEREST EXPENSE</b>		
Interest on deposits	2,568	3,157
Interest on short-term borrowings	6	100
Interest on long-term borrowings	1,442	2,003
Total interest expense	4,016	5,260
Net interest income	11,282	10,473
(Credit) provision for loan losses	(192 )	207
Net interest income after (credit) provision for loan losses	11,474	10,266
<b>OTHER INCOME</b>		
Service charges on deposit accounts	1,131	1,093
Service charges and fees	218	193
Trust and financial management revenue	877	899
Interchange revenue from debit card transactions	452	375
Net gains from sale of loans	259	66
Increase in cash surrender value of life insurance	122	112
Insurance commissions, fees and premiums	68	60
Impairment loss on limited partnership investment	(948 )	0
Other operating income	376	750
Sub-total	2,555	3,548
Total other-than-temporary impairment losses on available-for-sale securities	0	(381 )
Portion of (gain) recognized in other comprehensive income (before taxes)	0	(50 )
Net impairment losses recognized in earnings	0	(431 )
Realized gains on available-for-sale securities, net	1,839	489
Net realized gains on available-for-sale securities	1,839	58
Total other income	4,394	3,606
<b>OTHER EXPENSES</b>		
Salaries and wages	3,401	3,078
Pensions and other employee benefits	1,306	939
Occupancy expense, net	732	699
Furniture and equipment expense	484	568
FDIC Assessments	325	404
Pennsylvania shares tax	319	305
Other operating expense	1,696	2,004
Total other expenses	8,263	7,997

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Income before income tax provision	7,605	5,875
Income tax provision	2,064	1,437
Net income	5,541	4,438
U.S. Treasury preferred dividends	0	373
<b>NET INCOME AVAILABLE TO COMMON SHAREHOLDERS</b>	<b>\$5,541</b>	<b>\$ 4,065</b>
<b>NET INCOME PER SHARE - BASIC</b>	<b>\$0.46</b>	<b>\$ 0.34</b>
<b>NET INCOME PER SHARE - DILUTED</b>	<b>\$0.45</b>	<b>\$ 0.34</b>

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

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CONSOLIDATED STATEMENT OF CASH FLOWS (In Thousands) (Unaudited)	Three Months Ended March 31,	
	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 5,541	\$ 4,438
Adjustments to reconcile net income to net cash provided by operating activities:		
(Credit) provision for loan losses	(192 )	207
Realized gains on available-for-sale securities, net	(1,839 )	(58 )
Loss on sale of foreclosed assets, net	19	38
Depreciation expense	536	612
Gain on disposition of premises and equipment	0	(430 )
Accretion and amortization on securities, net	446	609
Accretion and amortization on loans, deposits and borrowings, net	(8 )	(76 )
Amortization of mortgage servicing rights	13	0
Impairment loss on limited partnership investment	948	0
Increase in cash surrender value of life insurance	(122 )	(112 )
Stock-based compensation	192	13
Amortization of core deposit intangibles	29	44
Deferred income taxes	1,826	128
Gains on sales of mortgage loans, net	(259 )	(66 )
Origination of mortgage loans for sale	(4,529 )	(5,606 )
Proceeds from sales of mortgage loans	9,798	5,718
Net decrease in trading securities	0	1,045
Decrease (increase) in accrued interest receivable and other assets	1,396	(164 )
(Decrease) in accrued interest payable and other liabilities	(844 )	(32 )
<b>Net Cash Provided by Operating Activities</b>	<b>12,951</b>	<b>6,308</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturity of held-to-maturity securities	0	300
Proceeds from sales of available-for-sale securities	15,950	9,140
Proceeds from calls and maturities of available-for-sale securities	26,781	44,617
Purchase of available-for-sale securities	(46,069 )	(97,858 )
Redemption of Federal Home Loan Bank of Pittsburgh stock	408	0
Net decrease in loans	11,207	1,054
Purchase of premises and equipment	(86 )	(228 )
Proceeds from disposition of premises and equipment	0	100
Return of principal on limited partnership investment	70	13
Proceeds from sale of foreclosed assets	0	221
<b>Net Cash Provided by (Used in) Investing Activities</b>	<b>8,261</b>	<b>(42,641 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in deposits	5,648	25,677
Net decrease in short-term borrowings	(2,345 )	(2,786 )
Proceeds from long-term borrowings	0	0
Repayments of long-term borrowings	(10,155 )	(149 )
Sale of treasury stock	3	0
Tax benefit from compensation plans	15	0
US Treasury preferred dividends paid	0	(331 )
Common dividends paid	(1,401 )	(969 )
<b>Net Cash (Used in) Provided by Financing Activities</b>	<b>(8,235 )</b>	<b>21,442</b>



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INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12,977	(14,891 )
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	46,301	92,065
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 59,278	\$ 77,174

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Assets acquired through foreclosure of real estate loans	\$ 189	\$ 55
Interest paid	\$ 4,049	\$ 5,340
Income taxes paid	\$ 4	\$ 28

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

## CITIZENS &amp; NORTHERN CORPORATION – FORM 10-Q

## Consolidated Statement of Changes in Stockholders' Equity

Three Months Ended March 31, 2011 and 2010

(In Thousands

Except Per Share

Data)

(Unaudited)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Comprehensive Income (Loss)	Treasury Stock	Total
Three Months Ended March 31, 2011:							
Balance, December 31, 2010	\$ 0	\$ 12,408	\$ 66,648	\$ 65,920	\$ (1,601 )	\$ (4,431 )	\$ 138,944
Comprehensive income:							
Net income				5,541			5,541
Unrealized gain on securities, net of reclassification and tax					2,829		2,829
Other comprehensive loss related to defined benefit plans					(70 )		(70 )
Total comprehensive income							8,300
Cash dividends declared on common stock, \$.13 per share				(1,582 )			(1,582 )
Shares issued for dividend reinvestment plan		12	169				181
Shares issued from treasury related to exercise of stock options			(1 )			4	3
Restricted stock granted			(272 )			272	0
Forfeiture of restricted stock			3			(3 )	0
Stock-based compensation expense			192				192
Tax benefit from employee benefit plan				15			15
Balance, March 31, 2011	\$ 0	\$ 12,420	\$ 66,739	\$ 69,894	\$ 1,158	\$ (4,158 )	\$ 146,053
Three Months Ended March 31, 2010:							

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Balance, December 31, 2009	\$ 25,749	\$ 12,374	\$ 66,726	\$ 53,027	\$ (891 )	\$ (4,575 )	\$ 152,410
Comprehensive income:							
Net income				4,438			4,438
Unrealized loss on securities, net of reclassification and tax					(196 )		(196 )
Other comprehensive income related to defined benefit plans					119		119
Total comprehensive income							4,361
Accretion of discount associated with U.S. Treasury preferred stock	42			(42 )			0
Cash dividends on U.S. Treasury preferred stock				(331 )			(331 )
Cash dividends declared on common stock, \$.08 per share				(969 )			(969 )
Restricted stock granted			(159 )			159	0
Forfeiture of restricted stock			13			(13 )	0
Stock-based compensation expense			13				13
Balance, March 31, 2010	\$ 25,791	\$ 12,374	\$ 66,593	\$ 56,123	\$ (968 )	\$ (4,429 )	\$ 155,484

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

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## Notes to 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, 2010, 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, 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 2010 information has been reclassified for consistency with the 2011 presentation.

Operating results reported for the three-months ended March 31, 2011 might not be indicative of the results for the year ending December 31, 2011. The Corporation evaluates subsequent events through the date of filing with the Securities and Exchange Commission.

## 2. PER COMMON SHARE DATA

Net income per share is based on the weighted-average number of shares of common stock outstanding. The following data show the amounts used in computing basic and diluted net income per share. As shown in the table that follows, diluted earnings per share is computed using weighted average common shares outstanding, plus weighted-average common shares available from the exercise of all dilutive stock options, less the number of shares that could be repurchased with the proceeds of stock option exercises based on the average share price of the Corporation's common stock during the period. Weighted average common shares available from stock options and a warrant totaling 226,426 shares in the three-month period ended March 31, 2011 and 480,408 shares in the three-month period March 31, 2010 were not included in the calculation because their effects were anti-dilutive.

	Net Income	Weighted- Average Common Shares	Earnings Per Share
Quarter Ended March 31, 2011			
Earnings per common share – basic	\$ 5,541,000	12,174,935	\$ 0.46
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		255,727	
Hypothetical share repurchase at \$ 15.58		(252,563 )	
Earnings per common share – diluted	\$ 5,541,000	12,178,099	\$ 0.45
Quarter Ended March 31, 2010			
Earnings per common share – basic and diluted	\$ 4,065,000	12,113,584	\$ 0.34

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

(In Thousands)	3 Months Ended March 31,	
	2011	2010
Net income	\$ 5,541	\$ 4,438
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains (losses) on available-for-sale securities	6,125	(247 )
Reclassification adjustment for gains realized in income	(1,839 )	(58 )
Other comprehensive gain (loss) before income tax	4,286	(305 )
Income tax related to other comprehensive gain (loss)	1,457	(109 )
Other comprehensive gain (loss) on available-for-sale securities	2,829	(196 )
Unfunded pension and postretirement obligations:		
Change in items from defined benefit plans included in accumulated other comprehensive income	(119 )	166
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	13	14
Other comprehensive (loss) gain before income tax	(106 )	180
Income tax related to other comprehensive (loss) gain	(36 )	61
Other comprehensive (loss) gain on unfunded retirement obligations	(70 )	119
Net other comprehensive gain (loss)	2,759	(77 )
Total comprehensive income	\$ 8,300	\$ 4,361

In the three months ended March 31, 2010, the Corporation recognized other comprehensive income of \$50,000 before income tax (\$33,000 after income tax) related to available-for-sale debt securities for which a portion of an other-than-temporary impairment (OTTI) loss has been recognized in earnings.

## 4. FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

available.

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

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

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

(In Thousands)	Quoted Prices in Active Markets (Level 1)	March 31, 2011 Market Values Based on:		Total Fair Value
		Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	
<b>AVAILABLE-FOR-SALE SECURITIES:</b>				
Obligations of U.S. Government agencies	\$ 0	\$37,129	\$ 0	\$37,129
<b>Obligations of states and political subdivisions:</b>				
Tax-exempt	0	121,789	0	121,789
Taxable	0	11,507	0	11,507
Mortgage-backed securities	0	103,627	0	103,627
<b>Collateralized mortgage obligations, Issued by U.S.</b>				
Government agencies	0	153,558	0	153,558
Corporate bonds	0	1,019	0	1,019
Trust preferred securities issued by individual institutions	0	8,040	0	8,040
<b>Collateralized debt obligations:</b>				
Pooled trust preferred securities - senior tranches	0	0	9,038	9,038
Other collateralized debt obligations	0	681	0	681
<b>Total debt securities</b>	<b>0</b>	<b>437,350</b>	<b>9,038</b>	<b>446,388</b>
Marketable equity securities	6,586	0	0	6,586
<b>Total available-for-sale securities</b>	<b>\$ 6,586</b>	<b>\$437,350</b>	<b>\$ 9,038</b>	<b>\$452,974</b>

(In Thousands)	Quoted Prices in Active Markets (Level 1)	December 31, 2010 Market Values Based on:		Total Fair Value
		Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	
<b>AVAILABLE-FOR-SALE SECURITIES:</b>				
Obligations of U.S. Government agencies	\$ 0	\$44,247	\$ 0	\$44,247
<b>Obligations of states and political subdivisions:</b>				
Tax-exempt	4,574	115,301	0	119,875
Taxable	1,125	6,542	0	7,667
Mortgage-backed securities	0	118,386	0	118,386
<b>Collateralized mortgage obligations, Issued by U.S.</b>				
Government agencies	9,117	121,709	0	130,826
Corporate bonds	0	1,027	0	1,027
Trust preferred securities issued by individual institutions	0	7,838	0	7,838
<b>Collateralized debt obligations:</b>				
Pooled trust preferred securities - senior tranches	0	0	7,400	7,400
Other collateralized debt obligations	0	681	0	681

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Total debt securities	14,816	415,731	7,400	437,947
Marketable equity securities	6,009	0	0	6,009
Total available-for-sale securities	\$ 20,825	\$415,731	\$ 7,400	\$443,956

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

Management determined there have been few trades of pooled trust-preferred securities since the first half of 2008, except for a limited number of transactions that have taken place as a result of bankruptcies, forced liquidations or similar circumstances. Also, in management's judgment, there were no available quoted market prices in active markets for assets sufficiently similar to the Corporation's pooled trust-preferred securities to be reliable as observable inputs. Accordingly, in the third quarter of 2008, the Corporation changed its method of valuing pooled trust-preferred securities from a Level 2 methodology that had been used in prior periods, based on price quotes received from pricing services, to a Level 3 methodology, using discounted cash flows.

Management has calculated the fair value of the Corporation's senior tranche pooled trust-preferred security by applying a discount rate to the estimated cash flows. At March 31, 2011, the estimate of cash flows from the senior tranche security changed significantly from the estimate as of December 31, 2010 based on the level and timing of assumed prepayments that changed for some of the underlying issuers. The change in prepayments resulted in an increase in fair value at March 31, 2011 as compared to December 31, 2010 as reflected in the unrealized gain on Level 3 assets of \$1,658,000 in the first quarter 2011 in the table below. Management used the cash flow estimates determined using the process described in Note 5 for evaluating pooled trust-preferred securities 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) adjustment to the year-end 2007 discount rate for the change in the spread between indicative market rates over corresponding risk-free rates; and (3) an additional adjustment – an increase of 2% in the discount rate – for liquidity risk. Management considered the additional 2% increase in the discount rate necessary in order to give some consideration to price estimates based on trades made under distressed conditions, as reported by brokers and pricing services. Management's estimate of cash flows and the discount rate used to calculate the fair value of the pooled trust-preferred security were based on sensitive assumptions, and market participants might use substantially different assumptions, which could result in calculations of a fair value that would be substantially different than the amount calculated by management.

Following is a reconciliation of activity for available-for-sale securities measured at fair value based on significant unobservable information:

	Three Months Ended	
	Mar. 31, 2011 (Current)	Mar. 31, 2010 (Prior Year)
Balance, beginning of period	\$ 7,400	\$ 9,114
Accretion and amortization, net	(20 )	(178 )
Proceeds from sales	(25 )	0
Realized gains, net	25	0
Unrealized losses included in earnings	0	(421 )
Unrealized gains included in other comprehensive income	1,658	37
Balance, end of period	\$ 9,038	\$ 8,552

Unrealized losses included in earnings are from the Corporation's other-than-temporary impairment analysis of securities, as described in Note 5, and are included in net impairment losses recognized in earnings in the consolidated statement of operations.

Assets measured at fair value on a nonrecurring basis include impaired commercial loans, foreclosed real estate assets held for sale and servicing rights. All of the Corporation's impaired commercial loans for which a valuation allowance was necessary at March 31, 2011 and December 31, 2010 were valued based on the estimated amount of net proceeds from liquidation of real estate and other collateral, or based on the estimated present value of cash flows to be received. The Corporation considers the fair value of such impaired commercial loans to be based on unobservable inputs (Level 3), and the balance of impaired loans for which a valuation allowance was recorded, net of allowance for loan losses, was \$2,841,000 at March 31, 2011 and \$3,169,000 at December 31, 2010. Similarly, the carrying values of foreclosed real estate assets held for sale were based on unobservable inputs (Level 3), with a balance of \$707,000 at March 31, 2011 and \$537,000 at December 31, 2010. The carrying value of servicing rights was also based on unobservable inputs (Level 3) and was \$293,000 at March 31, 2011 and \$204,000 at December 31, 2010.

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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.

**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 sales price available under the Federal Home Loan Banks' MPF Xtra program.

**LOANS**