

CITIZENS & NORTHERN CORP
Form 10-Q
August 04, 2016

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 **June 30, 2016**

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 (I.R.S. Employer

incorporation or organization) 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 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, 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 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

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) 12,068,583 Shares Outstanding on August 1, 2016

CITIZENS & NORTHERN CORPORATION – FORM 10-Q

CITIZENS & NORTHERN CORPORATION

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CITIZENS & NORTHERN CORPORATION – FORM 10-QITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED BALANCE SHEETS

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

	June 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks:		
Noninterest-bearing	\$ 14,567	\$ 14,710
Interest-bearing	12,869	21,351
Total cash and due from banks	27,436	36,061
Available-for-sale securities, at fair value	417,205	420,290
Loans held for sale	381	280
Loans receivable	727,842	704,880
Allowance for loan losses	(7,929)	(7,889)
Loans, net	719,913	696,991
Bank-owned life insurance	19,511	20,764
Accrued interest receivable	3,837	3,768
Bank premises and equipment, net	15,339	15,406
Foreclosed assets held for sale	2,052	1,260
Deferred tax asset, net	425	3,115
Intangible asset - Core deposit intangibles	24	30
Intangible asset - Goodwill	11,942	11,942
Other assets	12,953	13,510
TOTAL ASSETS	\$ 1,231,018	\$ 1,223,417
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 215,004	\$ 211,041
Interest-bearing	752,947	724,574
Total deposits	967,951	935,615
Short-term borrowings	25,702	53,496
Long-term borrowings	38,615	38,767
Accrued interest and other liabilities	8,220	8,052
TOTAL LIABILITIES	1,040,488	1,035,930
STOCKHOLDERS' EQUITY		
Preferred stock, \$1,000 par value; authorized 30,000 shares; \$1,000 liquidation preference per share; no shares issued at June 30, 2016 and December 31, 2015	0	0
Common stock, par value \$1.00 per share; authorized 20,000,000 shares in 2016 and 2015; issued 12,655,171 at June 30, 2016 and December 31, 2015; outstanding 12,070,195 at June 30, 2016 and 12,180,623 December 31, 2015	12,655	12,655
Paid-in capital	71,391	71,654
Retained earnings	110,677	109,454
Treasury stock, at cost; 584,976 shares at June 30, 2016 and 474,548 shares at December 31, 2015	(11,087)	(8,804)
Sub-total	183,636	184,959
Accumulated other comprehensive income:		

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Unrealized gain on available-for-sale securities	6,849	2,493
Defined benefit plans gain	45	35
Total accumulated other comprehensive income	6,894	2,528
TOTAL STOCKHOLDERS' EQUITY	190,530	187,487
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	\$1,231,018	\$ 1,223,417

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

CITIZENS & NORTHERN CORPORATION – FORM 10-Q

Consolidated Statements of Income (In Thousands Except Per Share Data) (Unaudited)	3 Months Ended		6 Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
INTEREST INCOME				
Interest and fees on loans	\$8,086	\$7,753	\$16,060	\$15,462
Interest on balances with depository institutions	36	25	60	51
Interest on loans to political subdivisions	452	391	900	740
Interest on mortgages held for sale	8	3	14	5
Income from available-for-sale securities:				
Taxable	1,490	1,934	3,045	3,908
Tax-exempt	847	1,013	1,743	2,029
Dividends	5	67	39	154
Total interest and dividend income	10,924	11,186	21,861	22,349
INTEREST EXPENSE				
Interest on deposits	522	479	1,001	965
Interest on short-term borrowings	41	5	103	6
Interest on long-term borrowings	362	692	725	1,418
Total interest expense	925	1,176	1,829	2,389
Net interest income	9,999	10,010	20,032	19,960
Provision for loan losses	318	221	686	224
Net interest income after provision for loan losses	9,681	9,789	19,346	19,736
OTHER INCOME				
Service charges on deposit accounts	1,164	1,305	2,302	2,327
Service charges and fees	123	123	217	236
Trust and financial management revenue	1,251	1,241	2,395	2,355
Brokerage revenue	180	206	353	425
Insurance commissions, fees and premiums	27	23	48	63
Interchange revenue from debit card transactions	487	500	950	974
Net gains from sale of loans	295	183	463	330
Decrease in fair value of servicing rights	(108)	(33)	(179)	(150)
Increase in cash surrender value of life insurance	93	102	189	199
Other operating income	394	312	858	759
Sub-total	3,906	3,962	7,596	7,518
Realized gains on available-for-sale securities, net	122	932	505	1,006
Total other income	4,028	4,894	8,101	8,524
OTHER EXPENSES				
Salaries and wages	3,913	3,603	7,800	7,090
Pensions and other employee benefits	1,002	935	2,439	2,320
Occupancy expense, net	560	640	1,169	1,362
Furniture and equipment expense	439	467	866	921
FDIC Assessments	155	148	297	299
Pennsylvania shares tax	323	317	645	635
Professional fees	282	140	571	296
Automated teller machine and interchange expense	267	255	516	501
Software subscriptions	251	211	492	408
Loss on prepayment of debt	0	910	0	910
Other operating expense	1,343	1,248	2,812	2,665

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Total other expenses	8,535	8,874	17,607	17,407
Income before income tax provision	5,174	5,809	9,840	10,853
Income tax provision	1,303	1,452	2,396	2,681
NET INCOME	\$3,871	\$4,357	\$7,444	\$8,172
NET INCOME PER SHARE - BASIC	\$0.32	\$0.36	\$0.61	\$0.67
NET INCOME PER SHARE - DILUTED	\$0.32	\$0.36	\$0.61	\$0.67

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

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Consolidated Statements of Comprehensive Income (In Thousands)	3 Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
Net income	\$3,871	\$4,357	\$7,444	\$8,172
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding gains (losses) on available-for-sale securities	2,431	(4,572)	7,205	(847)
Reclassification adjustment for gains realized in income	(122)	(932)	(505)	(1,006)
Other comprehensive gain (loss) on available-for-sale securities	2,309	(5,504)	6,700	(1,853)
Unfunded pension and postretirement obligations:				
Changes from plan amendments and actuarial gains and losses included in accumulated other comprehensive gain (loss)	0	0	26	(100)
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(5)	(5)	(10)	(8)
Other comprehensive (loss) gain on unfunded retirement obligations	(5)	(5)	16	(108)
Other comprehensive income (loss) before income tax	2,304	(5,509)	6,716	(1,961)
Income tax related to other comprehensive income (loss)	(806)	1,929	(2,350)	687
Net other comprehensive income (loss)	1,498	(3,580)	4,366	(1,274)
Comprehensive income	\$5,369	\$777	\$11,810	\$6,898

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS (In Thousands) (Unaudited)	6 Months Ended	
	June 30, 2016	June 30, 2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$7,444	\$8,172
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	686	224
Realized gains on available-for-sale securities, net	(505)	(1,006)
Loss on prepayment of debt	0	910
Realized loss (gain) on foreclosed assets	67	(61)
Depreciation expense	787	958
Accretion and amortization on securities, net	660	791
Accretion and amortization on loans and deposits, net	(8)	(10)
Decrease in fair value of servicing rights	179	150
Increase in cash surrender value of life insurance	(189)	(199)
Stock-based compensation	325	307
Amortization of core deposit intangibles	6	11
Deferred income taxes	340	424
Gains on sales of loans, net	(463)	(330)
Origination of loans for sale	(12,698)	(10,029)
Proceeds from sales of loans	12,953	10,089
Increase in accrued interest receivable and other assets	(708)	(1,225)
(Decrease) increase in accrued interest payable and other liabilities	(296)	681
Net Cash Provided by Operating Activities	8,580	9,857
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities of certificates of deposit	100	0
Purchase of certificates of deposit	(340)	0
Proceeds from sales of available-for-sale securities	19,387	11,255
Proceeds from calls and maturities of available-for-sale securities	37,009	41,777
Purchase of available-for-sale securities	(46,766)	(35,200)
Redemption of Federal Home Loan Bank of Pittsburgh stock	2,642	2,042
Purchase of Federal Home Loan Bank of Pittsburgh stock	(1,600)	(2,960)
Net increase in loans	(24,751)	(34,153)
Proceeds from bank owned life insurance	1,442	1,442
Purchase of premises and equipment	(720)	(539)
Return of principal on limited liability entity investments	82	99
Proceeds from sale of foreclosed assets	292	657
Net Cash Used in Investing Activities	(13,223)	(15,580)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	32,336	10,460
Net (decrease) increase in short-term borrowings	(27,794)	14,269
Repayments of long-term borrowings	(152)	(11,054)
Purchase of treasury stock	(3,723)	(3,415)
Sale of treasury stock	100	378
Tax benefit from compensation plans	88	78
Common dividends paid	(5,557)	(5,635)
Net Cash (Used in) Provided by Financing Activities	(4,702)	5,081

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DECREASE IN CASH AND CASH EQUIVALENTS	(9,345)	(642)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	33,313	31,619
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$23,968	\$30,977

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Accrued purchase of certificates of deposit	\$480	\$0
Assets acquired through foreclosure of real estate loans	\$1,151	\$630
Interest paid	\$1,826	\$2,404
Income taxes paid	\$1,485	\$1,645

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

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Consolidated Statements of Changes in Stockholders' Equity

(In Thousands Except Share and Per Share Data)

(Unaudited)

	Common Shares	Treasury Shares	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Six Months Ended								
June 30, 2016								
Balance, December 31, 2015	12,655,171	474,548	\$ 12,655	\$ 71,654	\$ 109,454	\$ 2,528	\$(8,804)	\$ 187,487
Net income					7,444			7,444
Other comprehensive income, net						4,366		4,366
Cash dividends declared on common stock, \$0.52 per share					(6,298)			(6,298)
Shares issued for dividend reinvestment plan		(36,771)		48			693	741
Treasury stock purchased		187,075					(3,723)	(3,723)
Shares issued from treasury for exercise of stock options		(5,556)		(9)			109	100
Restricted stock granted		(35,427)		(658)			658	0
Forfeiture of restricted stock		1,107		20			(20)	0
Stock-based compensation expense				325				325
Tax effect of stock option exercises				(1)				(1)
Tax benefit from dividends on restricted stock				12				12
Tax benefit from employee benefit plan					77			77
Balance, June 30, 2016	12,655,171	584,976	\$ 12,655	\$ 71,391	\$ 110,677	\$ 6,894	\$(11,087)	\$ 190,530
Six Months Ended								
June 30, 2015								
Balance, December 31, 2014	12,655,171	375,191	\$ 12,655	\$ 71,541	\$ 105,550	\$ 5,360	\$(6,744)	\$ 188,362
Net income					8,172			8,172
Other comprehensive loss, net						(1,274)		(1,274)

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Cash dividends declared on common stock, \$0.52 per share								(6,373)	(6,373)
Shares issued for dividend reinvestment plan	(37,758)		25				713		738
Treasury stock purchased	176,000						(3,415)		(3,415)
Shares issued from treasury for exercise of stock options	(22,235)		(26)				404		378
Restricted stock granted	(34,800)		(627)				627		0
Forfeiture of restricted stock	1,943		33				(33)		0
Stock-based compensation expense			307						307
Tax effect of stock option exercises			(6)						(6)
Tax benefit from dividends on restricted stock			11						11
Tax benefit from employee benefit plan						73			73
Balance, June 30, 2015	12,655,171	458,341	\$ 12,655	\$ 71,258	\$ 107,422	\$ 4,086		\$(8,448)	\$ 186,973

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

CITIZENS & NORTHERN CORPORATION – FORM 10-Q**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, 2015, 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 2015 information has been reclassified for consistency with the 2016 presentation.

Operating results reported for the three-month and six-month periods ended June 30, 2016 might not be indicative of the results for the year ending December 31, 2016. 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
Six Months Ended June 30, 2016			
Earnings per share – basic	\$7,444,000	12,108,743	\$ 0.61
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		197,817	
Hypothetical share repurchase at \$20.11		(176,659)	
Earnings per share – diluted	\$7,444,000	12,129,901	\$ 0.61

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Six Months Ended June 30, 2015

Earnings per share – basic	\$8,172,000	12,233,964	\$ 0.67
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		218,115	
Hypothetical share repurchase at \$19.97		(196,407)	
Earnings per share – diluted	\$8,172,000	12,255,672	\$ 0.67

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	Net Income	Weighted- Average Common Shares	Earnings Per Share
Three Months Ended June 30, 2016			
Earnings per share – basic	\$3,871,000	12,062,376	\$ 0.32
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		196,646	
Hypothetical share repurchase at \$20.17		(175,106)	
Earnings per share – diluted	\$3,871,000	12,083,916	\$ 0.32
Three Months Ended June 30, 2015			
Earnings per share – basic	\$4,357,000	12,199,996	\$ 0.36
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		205,024	
Hypothetical share repurchase at \$20.15		(182,494)	
Earnings per share – diluted	\$4,357,000	12,222,526	\$ 0.36

Stock options that were anti-dilutive were excluded from net income per share calculations. Weighted-average common shares available from anti-dilutive instruments totaled 47,224 shares in the six-month period ended June 30, 2016, 75,539 shares in the six-month period ended June 30, 2015, 47,139 shares in the second quarter 2016 and 47,974 shares in the second quarter 2015.

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
Six Months Ended June 30, 2016			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	\$ 7,205	\$ (2,521)	\$ 4,684
Reclassification adjustment for (gains) realized in income	(505)	177	(328)
Other comprehensive income on available-for-sale securities	6,700	(2,344)	4,356
Unfunded pension and postretirement obligations:			
	26	(9)	17

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Changes from plan amendments and actuarial gains and losses included in other comprehensive income			
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(10	) 3	(7)
Other comprehensive income on unfunded retirement obligations	16	(6)	10
Total other comprehensive income	\$ 6,716	\$ (2,350)	\$ 4,366

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(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Six Months Ended June 30, 2015			
Unrealized losses on available-for-sale securities:			
Unrealized holding losses on available-for-sale securities	\$ (847)	\$ 297	\$ (550)
Reclassification adjustment for (gains) realized in income	(1,006)	352	(654)
Other comprehensive loss on available-for-sale securities	(1,853)	649	(1,204)
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	(100)	35	(65)
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(8)	3	(5)
Other comprehensive loss on unfunded retirement obligations	(108)	38	(70)
Total other comprehensive loss	\$ (1,961)	\$ 687	\$ (1,274)

(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Three Months Ended June 30, 2016			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	\$ 2,431	\$ (850)	\$ 1,581
Reclassification adjustment for (gains) realized in income	(122)	43	(79)
Other comprehensive income on available-for-sale securities	2,309	(807)	1,502
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	0	0	0
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(5)	1	(4)
Other comprehensive loss on unfunded retirement obligations	(5)	1	(4)
Total other comprehensive income	\$ 2,304	\$ (806)	\$ 1,498

(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
Three Months Ended June 30, 2015			
Unrealized losses on available-for-sale securities:			
Unrealized holding losses on available-for-sale securities	\$ (4,572)	\$ 1,601	\$ (2,971)
Reclassification adjustment for (gains) realized in income	(932)	326	(606)
Other comprehensive loss on available-for-sale securities	(5,504)	1,927	(3,577)

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Unfunded pension and postretirement obligations:

Changes from plan amendments and actuarial gains and losses included in other comprehensive income	0	0	0
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(5)	2	(3)
Other comprehensive loss on unfunded retirement obligations	(5)	2	(3)
Total other comprehensive loss	\$ (5,509)	\$ 1,929	\$ (3,580)

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

(In Thousands)	Unrealized Holding Gains on Securities	Unfunded Pension and Postretirement Obligations	Accumulated Other Comprehensive Income
Six Months Ended June 30, 2016			
Balance, beginning of period	\$ 2,493	\$ 35	\$ 2,528
Other comprehensive income before reclassifications	4,684	17	4,701
Amounts reclassified from accumulated other comprehensive income	(328)	(7)	(335)
Other comprehensive income	4,356	10	4,366
Balance, end of period	\$ 6,849	\$ 45	\$ 6,894
Six Months Ended June 30, 2015			
Balance, beginning of period	\$ 5,281	\$ 79	\$ 5,360
Other comprehensive loss before reclassifications	(550)	(65)	(615)
Amounts reclassified from accumulated other comprehensive income	(654)	(5)	(659)
Other comprehensive loss	(1,204)	(70)	(1,274)
Balance, end of period	\$ 4,077	\$ 9	\$ 4,086
Three Months Ended June 30, 2016			
Balance, beginning of period	\$ 5,347	\$ 49	\$ 5,396
Other comprehensive income before reclassifications	1,581	0	1,581
Amounts reclassified from accumulated other comprehensive income	(79)	(4)	(83)
Other comprehensive income	1,502	(4)	1,498
Balance, end of period	\$ 6,849	\$ 45	\$ 6,894
Three Months Ended June 30, 2015			
Balance, beginning of period	\$ 7,654	\$ 12	\$ 7,666
Other comprehensive loss before reclassifications	(2,971)	0	(2,971)
Amounts reclassified from accumulated other comprehensive income	(606)	(3)	(609)
Other comprehensive loss	(3,577)	(3)	(3,580)
Balance, end of period	\$ 4,077	\$ 9	\$ 4,086

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

For the Six Months Ended June 30, 2016
(In Thousands)

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Details about Accumulated Other Comprehensive Income Components	Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Consolidated Statements of Income
Unrealized gains and losses on available-for-sale securities	\$ (505)	) Realized gains on available-for-sale securities, net
	177	) Income tax provision
	(328)	) Net of tax
Amortization of defined benefit pension and postretirement items:		
Prior service cost	(15)	) Pensions and other employee benefits
Actuarial loss	5	) Pensions and other employee benefits
	(10)	) Total before tax
	3) Income tax provision
	(7)) Net of tax
Total reclassifications for the period	\$ (335))

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For the Six Months Ended June 30, 2015
(In Thousands)

Details about Accumulated Other	Reclassified from Accumulated Other	Affected Line Item in the Consolidated
Comprehensive Income Components	Comprehensive Income	Statements of Income
Unrealized gains and losses on available-for-sale securities	\$ (1,006	) Realized gains on available-for-sale securities, net
	352	) Income tax provision
	(654	) Net of tax
Amortization of defined benefit pension and postretirement items:		
Prior service cost	(15	) Pensions and other employee benefits
Actuarial loss	7	) Pensions and other employee benefits
	(8	) Total before tax
	3	) Income tax provision
	(5	) Net of tax
Total reclassifications for the period	\$ (659)

For the Three Months Ended June 30, 2016
(In Thousands)

Details about Accumulated Other	Reclassified from Accumulated Other	Affected Line Item in the Consolidated
Comprehensive Income Components	Comprehensive Income	Statements of Income
Unrealized gains and losses on available-for-sale securities	\$ (122	) Realized gains on available-for-sale securities, net
	43	) Income tax provision
	(79	) Net of tax
Amortization of defined benefit pension and postretirement items:		
Prior service cost	(7	) Pensions and other employee benefits
Actuarial loss	2	) Pensions and other employee benefits
	(5	) Total before tax
	1	) Income tax provision
	(4	) Net of tax
Total reclassifications for the period	\$ (83)

For the Three Months Ended June 30, 2015
(In Thousands)

Details about Accumulated Other	Reclassified from Accumulated Other	Affected Line Item in the Consolidated

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Comprehensive Income Components	Comprehensive Income	Statements of Income
Unrealized gains and losses on available-for-sale securities	\$ (932)	) Realized gains on available-for-sale securities, net
	326	) Income tax provision
	(606)	) Net of tax
Amortization of defined benefit pension and postretirement items:		
Prior service cost	(8)	) Pensions and other employee benefits
Actuarial loss	3	) Pensions and other employee benefits
	(5)	) Total before tax
	2	) Income tax provision
	(3)	) Net of tax
Total reclassifications for the period	\$ (609))

CITIZENS & NORTHERN CORPORATION – FORM 10-Q**4. CASH AND DUE FROM BANKS**

Cash and due from banks at June 30, 2016 and December 31, 2015 include the following:

(In thousands)	June 30, 2016	Dec. 31, 2015
Cash and cash equivalents	\$23,968	\$33,313
Certificates of deposit	3,468	2,748
Total cash and due from banks	\$27,436	\$36,061

Certificates of deposit are issued 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 \$12,532,000 at June 30, 2016 and \$15,327,000 at December 31, 2015.

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.

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At June 30, 2016 and December 31, 2015, assets measured at fair value and the valuation methods used are as follows:

(In Thousands)	Quoted Prices in Active Markets (Level 1)	June 30, 2016		Total Fair Value
		Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	
Recurring fair value measurements				
AVAILABLE-FOR-SALE SECURITIES:				
Obligations of U.S. Government agencies	\$ 0	\$9,781	\$ 0	\$9,781
Obligations of states and political subdivisions:				
Tax-exempt	0	116,056	0	116,056
Taxable	0	35,132	0	35,132
Mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored agencies:				
Residential pass-through securities	0	65,407	0	65,407
Residential collateralized mortgage obligations	0	177,980	0	177,980
Commercial mortgage-backed securities	0	11,239	0	11,239
Collateralized debt obligations	0	1	0	1
Total debt securities	0	415,596	0	415,596
Marketable equity securities	1,609	0	0	1,609
Total available-for-sale securities	1,609	415,596	0	417,205
Servicing rights	0	0	1,224	1,224
Total recurring fair value measurements	\$ 1,609	\$415,596	\$ 1,224	\$418,429
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	\$ 0	\$0	\$ 1,275	\$1,275
Valuation allowance	0	0	(253)	(253)
Impaired loans, net	0	0	1,022	1,022
Foreclosed assets held for sale	0	0	2,052	2,052
Total nonrecurring fair value measurements	\$ 0	\$0	\$ 3,074	\$3,074

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(In Thousands)	Quoted Prices in Active Markets (Level 1)	December 31, 2015		
		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	\$ 10,483	\$ 0	\$ 10,483
Obligations of states and political subdivisions:				
Tax-exempt	0	107,757	0	107,757
Taxable	0	34,597	0	34,597
Mortgage-backed securities	0	73,343	0	73,343
Collateralized mortgage obligations, Issued by U.S. Government agencies	0	191,715	0	191,715
Collateralized debt obligations	0	9	0	9
Total debt securities	0	417,904	0	417,904
Marketable equity securities	2,386	0	0	2,386
Total available-for-sale securities	2,386	417,904	0	420,290
Servicing rights	0	0	1,296	1,296
Total recurring fair value measurements	\$ 2,386	\$ 417,904	\$ 1,296	\$ 421,586
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	\$ 0	\$ 0	\$ 1,933	\$ 1,933
Valuation allowance	0	0	(820)	(820)
Impaired loans, net	0	0	1,113	1,113
Foreclosed assets held for sale	0	0	1,260	1,260
Total nonrecurring fair value measurements	\$ 0	\$ 0	\$ 2,373	\$ 2,373

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 June 30, 2016 and December 31, 2015, 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 6/30/16 (In Thousands)	Valuation Technique	Unobservable Input(s)	Method or Value As of 6/30/16
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Servicing rights	\$ 1,224	Discounted cash flow	Discount rate	10.00 %	Rate used through modeling period
			Loan prepayment speeds	181.00%	Weighted-average PSA
			Servicing fees	0.25 %	of loan balances
				4.00 %	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 12/31/15 (In Thousands)	Valuation Technique	Unobservable Input(s)	Method or Value As of 12/31/15
Servicing rights	\$ 1,296	Discounted cash flow	Discount rate	10.00 % Rate used through modeling period
			Loan prepayment speeds	146.00% Weighted-average PSA
			Servicing fees	0.25 % of loan balances
				4.00 % of payments are late
				5.00 % late fees assessed
			Servicing costs	\$1.94 Miscellaneous fees per account per month
				\$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

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:

(In Thousands)	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Servicing rights balance, beginning of period	\$ 1,261	\$ 1,195	\$ 1,296	\$ 1,281
Issuances of servicing rights	71	47	107	78
Unrealized losses included in earnings	(108)	(33)	(179)	(150)
Servicing rights balance, end of period	\$ 1,224	\$ 1,209	\$ 1,224	\$ 1,209

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. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

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At June 30, 2016 and December 31, 2015, quantitative information regarding significant techniques and inputs used for nonrecurring fair value measurements using unobservable inputs (Level 3 methodologies) are as follows:

(In Thousands, Except Percentages)						Value at 6/30/16 (Weighted Average)
Asset	Balance at 6/30/16	Valuation Allowance at 6/30/16	Fair Value at 6/30/16	Valuation Technique	Unobservable Inputs	
Impaired loans:						
Commercial:						
Commercial loans secured by real estate	\$ 413	\$ 125	\$ 288	Sales comparison	Discount to appraised value	44 %
Commercial and industrial	354	77	277	Sales comparison	Discount to appraised value	54 %
Loans secured by farmland	508	51	457	Sales comparison	Discount to appraised value	55 %
Total impaired loans	\$ 1,275	\$ 253	\$ 1,022			
Foreclosed assets held for sale - real estate:						
Residential (1-4 family)	\$ 1,005	\$ 0	\$ 1,005	Sales comparison	Discount to appraised value	34 %
Land	1,047	0	1,047	Sales comparison	Discount to appraised value	39 %
Total foreclosed assets held for sale	\$ 2,052	\$ 0	\$ 2,052			

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(In Thousands, Except Percentages)	Balance at 12/31/15	Valuation Allowance at 12/31/15	Fair Value at 12/31/15	Valuation Technique	Unobservable Inputs	Value at 12/31/15 (Weighted Average)
Asset						
Impaired loans:						
Residential mortgage loans - first liens	\$ 42	\$ 1	\$ 41	Sales comparison	Discount to appraised value	31 %
Commercial:						
Commercial loans secured by real estate	317	97	220	Sales comparison	Discount to appraised value	46 %
Commercial and industrial	75	75	0	Sales comparison	Discount to appraised value	31 %
Loans secured by farmland	512	52	460	Sales comparison	Discount to appraised value	49 %
Multi-family (5 or more) residential	987	595	392	Sales comparison	Discount to appraised value	41 %
Total impaired loans	\$ 1,933	\$ 820	\$ 1,113			
Foreclosed assets held for sale -real estate:						
Residential (1-4 family)	\$ 556	\$ 0	\$ 556	Sales comparison	Discount to appraised value	32 %
Land	704	0	704	Sales comparison	Discount to appraised value	29 %
Total foreclosed assets held for sale	\$ 1,260	\$ 0	\$ 1,260			

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 and MPF Original programs.

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.

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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 June 30, 2016 and December 31, 2015. 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	June 30, 2016		December 31, 2015	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:					
Cash and cash equivalents	Level 1	\$23,968	\$23,968	\$33,313	\$33,313
Certificates of deposit	Level 2	3,468	3,500	2,748	2,752
Available-for-sale securities	See Above	417,205	417,205		