CITIZENS & NORTHERN CORP
Form 10-Q
May 09, 2014

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, 2014**

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) 12,430,482 Shares Outstanding on May 7, 2014

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ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Data) (Unaudited)	**March 31, 2014**	**December 31, 2013**
ASSETS		
Cash and due from banks:		
Noninterest-bearing	$22,478	$15,917
Interest-bearing	38,609	28,702
Total cash and due from banks	61,087	44,619
Available-for-sale securities, at fair value	484,014	482,658
Loans held for sale	133	54
Loans receivable	625,818	644,303
Allowance for loan losses	(8,343)	(8,663)
Loans, net	617,475	635,640
Bank-owned life insurance	21,831	21,743
Accrued interest receivable	3,954	4,146
Bank premises and equipment, net	17,022	17,430
Foreclosed assets held for sale	1,321	892
Deferred tax asset, net	3,818	6,344
Intangible asset - Core deposit intangibles	78	87
Intangible asset - Goodwill	11,942	11,942
Other assets	12,464	12,140
TOTAL ASSETS	$1,235,139	$1,237,695
LIABILITIES		
Deposits:		
Noninterest-bearing	$210,891	$191,245
Interest-bearing	750,942	763,271
Total deposits	961,833	954,516
Short-term borrowings	4,730	23,385
Long-term borrowings	73,270	73,338
Accrued interest and other liabilities	10,544	6,984
TOTAL LIABILITIES	1,050,377	1,058,223
STOCKHOLDERS' EQUITY		
Preferred stock, $1,000 par value; authorized 30,000 shares; $1,000 liquidation preference per share; no shares issued at March 31, 2014 and December 31, 2013	0	0
Common stock, par value $1.00 per share; authorized 20,000,000 shares in 2014 and 2013; issued 12,616,059 at March 31, 2014 and 12,596,540 at December 31, 2013	12,616	12,596
Paid-in capital	70,421	70,105
Retained earnings	102,311	101,216
Treasury stock, at cost; 187,059 shares at March 31, 2014 and 206,477 shares at December 31, 2013	(3,128)	(3,452)
Sub-total	182,220	180,465
Accumulated other comprehensive income (loss):		
Unrealized gain (loss) on available-for-sale securities	2,442	(1,004)
Defined benefit plans gain	100	11

Total accumulated other comprehensive income (loss)	2,542	(993)
TOTAL STOCKHOLDERS' EQUITY	184,762	179,472
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$1,235,139	$1,237,695

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, 2014**	**March 31, 2013**
INTEREST INCOME		
Interest and fees on loans	$7,998	$9,225
Interest on balances with depository institutions	30	28
Interest on loans to political subdivisions	373	362
Interest on mortgages held for sale	3	21
Income from available-for-sale securities:		
Taxable	1,802	1,717
Tax-exempt	1,111	1,212
Dividends	89	82
Total interest and dividend income	11,406	12,647
INTEREST EXPENSE		
Interest on deposits	554	778
Interest on short-term borrowings	5	1
Interest on long-term borrowings	729	821
Total interest expense	1,288	1,600
Net interest income	10,118	11,047
(Credit) provision for loan losses	(311)	183
Net interest income after (credit) provision for loan losses	10,429	10,864
OTHER INCOME		
Service charges on deposit accounts	1,223	1,226
Service charges and fees	127	134
Trust and financial management revenue	1,047	944
Brokerage revenue	227	144
Insurance commissions, fees and premiums	32	45
Interchange revenue from debit card transactions	453	464
Net gains from sale of loans	151	504
Increase in fair value of servicing rights	105	8
Increase in cash surrender value of life insurance	88	93
Other operating income	298	281
Sub-total	3,751	3,843
Total other-than-temporary impairment losses on available-for-sale securities	0	(25)
Portion of (gain) recognized in other comprehensive loss (before taxes)	0	0
Net impairment losses recognized in earnings	0	(25)
Realized gains on available-for-sale securities, net	31	1,184
Total other income	3,782	5,002
OTHER EXPENSES		
Salaries and wages	3,565	3,600
Pensions and other employee benefits	1,319	1,255
Occupancy expense, net	715	634
Furniture and equipment expense	472	494
FDIC Assessments	147	152
Pennsylvania shares tax	341	350
Professional fees	148	157

Automated teller machine and interchange expense	211	272
Software subscriptions	190	223
Loss on prepayment of debt	0	1,023
Other operating expense	1,416	1,416
Total other expenses	8,524	9,576
Income before income tax provision	5,687	6,290
Income tax provision	1,399	1,584
NET INCOME	$4,288	$4,706
NET INCOME PER SHARE - BASIC	$0.35	$0.38
NET INCOME PER SHARE - DILUTED	$0.34	$0.38

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

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Consolidated Statements of Comprehensive Income
(In Thousands) (Unaudited)

	3 Months Ended	
	March 31, 2014	**March 31, 2013**
Net income	$4,288	$4,706
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains (losses) on available-for-sale securities	5,334	(2,447)
Reclassification adjustment for (gains) realized in income	(31)	(1,159)
Other comprehensive gain (loss) on available-for-sale securities	5,303	(3,606)
Unfunded pension and postretirement obligations:		
Changes from plan amendments and actuarial gains and losses included in accumulated other comprehensive gain	141	636
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(4)	0
Other comprehensive gain on unfunded retirement obligations	137	636
Other comprehensive income (loss) before income tax	5,440	(2,970)
Income tax related to other comprehensive (income) loss	(1,905)	1,038
Net other comprehensive income (loss)	3,535	(1,932)
Comprehensive income	$7,823	$2,774

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS	**Three Months Ended March 31,**	
(In Thousands) (Unaudited)	**2014**	**2013**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$4,288	$4,706
Adjustments to reconcile net income to net cash provided by operating activities:		
(Credit) provision for loan losses	(311)	183
Realized gains on available-for-sale securities, net	(31)	(1,159)
Loss on prepayment of debt	0	1,023
Realized loss on foreclosed assets	31	3
Depreciation expense	498	511
Accretion and amortization on securities, net	356	513
Accretion and amortization on loans and deposits, net	(7)	(8)
Increase in fair value of mortgage servicing rights	(105)	(8)
Increase in cash surrender value of life insurance	(88)	(93)
Stock-based compensation	212	287
Amortization of core deposit intangibles	9	13
Deferred income taxes	621	1,270
Gains on sales of loans, net	(151)	(504)
Origination of loans for sale	(4,773)	(16,346)
Proceeds from sales of loans	4,805	18,471
Increase in accrued interest receivable and other assets	(864)	(1,009)
Increase (decrease) in accrued interest payable and other liabilities	1,961	(970)
Net Cash Provided by Operating Activities	6,451	6,883
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities of certificates of deposit	240	0
Proceeds from sales of available-for-sale securities	27,514	23,024
Proceeds from calls and maturities of available-for-sale securities	13,848	22,614
Purchase of available-for-sale securities	(36,004)	(35,065)
Redemption of Federal Home Loan Bank of Pittsburgh stock	955	693
Purchase of Federal Home Loan Bank of Pittsburgh stock	(120)	0
Net decrease in loans	17,753	17,202
Purchase of premises and equipment	(90)	(263)
Purchase of investment in limited liability entity	0	(26)
Return of principal on limited liability entity investments	42	37
Proceeds from sale of foreclosed assets	270	9
Net Cash Provided by Investing Activities	24,408	28,225
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	7,317	(38,132)
Net decrease in short-term borrowings	(18,655)	(930)
Repayments of long-term borrowings	(68)	(8,174)
Sale of treasury stock	62	53
Tax benefit from compensation plans	40	28
Common dividends paid	(2,847)	(2,720)
Net Cash Used in Financing Activities	(14,151)	(49,875)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	16,708	(14,767)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	38,591	55,016
CASH AND CASH EQUIVALENTS, END OF PERIOD	$55,299	$40,249

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Assets acquired through foreclosure of real estate loans	$730	$48
Accrued purchase of available-for-sale securities	$1,736	$811
Interest paid	$1,290	$1,609
Income taxes paid	$270	$200

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, 2014 and 2013
(In Thousands Except Share and Per Share Data)
(Unaudited)

	Common Shares	Treasury Shares	Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Comprehensive (Loss) Income	Treasury Stock	Total
Three Months Ended March 31, 2014:								
Balance, December 31, 2013	**12,596,540**	**206,477**	**$12,596**	**$70,105**	**$101,216**	**($993)**	**($3,452)**	**$179,472**
Net income					4,288			4,288
Other comprehensive income, net						3,535		3,535
Cash dividends declared on common stock, $.26 per share					(3,227)			(3,227)
Shares issued for dividend reinvestment plan	19,519		20	360				380
Shares issued from treasury related to exercise of stock options		(4,095)		(6)			68	62
Restricted stock granted		(16,711)		(279)			279	0
Forfeiture of restricted stock		1,388		23			(23)	0
Stock-based compensation expense				212				212
Tax effect of stock option exercises				1				1
Tax benefit from dividends on restricted stock				5				5
Tax benefit from employee benefit plan					34			34
Balance, March 31, 2014	**12,616,059**	**187,059**	**$12,616**	**$70,421**	**$102,311**	**$2,542**	**($3,128)**	**$184,762**
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)**	**$182,786**
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)**	**$183,208**

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

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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, 2013, 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 2013 information has been reclassified for consistency with the 2014 presentation.

Operating results reported for the three-month period ended March 31, 2014 might not be indicative of the results for the year ending December 31, 2014. 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**
Three Months Ended March 31, 2014			
Earnings per share – basic	$4,288,000	12,417,627	$0.35
Dilutive effect of potential common stock arising from stock options:			
Exercise of outstanding stock options		240,960	
Hypothetical share repurchase at $19.71		(213,790)	
Earnings per share – diluted	$4,288,000	12,444,797	$0.34

Three Months 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

Stock options that were anti-dilutive were excluded from net income per share calculations. Weighted-average common shares available from anti-dilutive instruments totaled 138,643 shares in the three-month period ended March 31, 2014 and 121,878 shares in the three-month period ended March 31, 2013.

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, 2014:			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$5,334	($1,868)	$3,466
Reclassification adjustment for (gains) realized in income	(31)	11	(20)
Other comprehensive gain on available-for-sale securities	5,303	(1,857)	3,446
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	141	(49)	92
Amortization of net transition obligation, prior service cost and net actuarial loss included in net periodic benefit cost	(4)	1	(3)
Other comprehensive gain on unfunded retirement obligations	137	(48)	89
Total other comprehensive gain	$5,440	($1,905)	$3,535

(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)

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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 (Losses) on Securities	Unfunded Pension and Postretirement Obligations	Accumulated Other Comprehensive Income
Three Months Ended March 31, 2014			
Balance, beginning of period	($1,004)	$11	($993)
Other comprehensive income before reclassifications	3,466	92	3,558
Amounts reclassified from accumulated other comprehensive income	(20)	(3)	(23)
Other comprehensive income	3,446	89	3,535
Balance, end of period	$2,442	$100	$2,542
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

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

For the Three Months Ended March 31, 2014
(In Thousands)

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	($31)	Realized gains on available-for-sale securities, net
	11	Income tax provision
	(20)	Net of tax
Amortization of defined benefit pension and postretirement items		
Prior service cost	(8)	Pensions and other employee benefits
Actuarial loss	4	Pensions and other employee benefits
	(4)	Total before tax
	1	Income tax provision
	(3)	Net of tax

Total reclassifications for the period	($23)

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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 provision
	(753)	Net of tax
Amortization of defined benefit pension and postretirement items		
Prior service cost	(8)	Pensions and other employee bene
Actuarial loss	8	Pensions and other employee bene
	0	Total before tax
	0	Income tax provision
	0	Net of tax
Total reclassifications for the period	($753)	

4. CASH AND DUE FROM BANKS

Cash and due from banks at March 31, 2014 and December 31, 2013 include the following:

(In thousands)	**March 31, 2014**	**Dec. 31, 2013**
Cash and cash equivalents	$55,299	$38,591
Certificates of deposit	5,788	6,028
Total cash and due from banks	$61,087	$44,619

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 $13,937,000 at March 31, 2014 and $15,318,000 at

December 31, 2013.

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.

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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, 2014 and December 31, 2013, assets measured at fair value and the valuation methods used are as follows:

		March 31, 2014		
(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	$28,523	$0	$28,523
Obligations of states and political subdivisions:				
Tax-exempt	0	127,179	0	127,179
Taxable	0	33,624	0	33,624
Mortgage-backed securities	0	92,930	0	92,930
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	0	192,066	0	192,066
Collateralized debt obligations	0	660	0	660
Total debt securities	0	474,982	0	474,982
Marketable equity securities	9,032	0	0	9,032
Total available-for-sale securities	9,032	474,982	0	484,014
Servicing rights	0	0	1,268	1,268
Total recurring fair value measurements	$9,032	$474,982	$1,268	$485,282
Nonrecurring fair value measurements				

Impaired loans with a valuation allowance	$0	$0	$9,576	$9,576
Valuation allowance	0	0	(2,190)	(2,190)
Impaired loans, net	0	0	7,386	7,386
Foreclosed assets held for sale	0	0	1,321	1,321
Total nonrecurring fair value measurements	$0	$0	$8,707	$8,707

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(In Thousands)	Quoted Prices in Active Markets (Level 1)	December 31, 2013 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	$45,877	$0	$45,877
Obligations of states and political subdivisions:				
Tax-exempt	0	128,426	0	128,426
Taxable	0	34,471	0	34,471
Mortgage-backed securities	0	86,208	0	86,208
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	0	178,092	0	178,092
Collateralized debt obligations	0	660	0	660
Total debt securities	0	473,734	0	473,734
Marketable equity securities	8,924	0	0	8,924
Total available-for-sale securities	8,924	473,734	0	482,658
Servicing rights	0	0	1,123	1,123
Total recurring fair value measurements	$8,924	$473,734	$1,123	$483,781
Nonrecurring fair value measurements				
Impaired loans with a valuation allowance	$0	$0	$9,889	$9,889
Valuation allowance	0	0	(2,333)	(2,333)
Impaired loans, net	0	0	7,556	7,556
Foreclosed assets held for sale	0	0	892	892
Total nonrecurring fair value measurements	$0	$0	$8,448	$8,448

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, 2014 and December 31, 2013, quantitative information regarding significant techniques and inputs used for assets measured on a recurring basis using unobservable inputs (Level 3 methodologies) are as follows:

Fair Value at

Asset	3/31/14 (In Thousands)	Valuation Technique	Unobservable Input(s)	Method or Value As of 3/31/14	
Servicing rights	$1,268	Discounted cash flow	Discount rate	10.00%	Rate used through modeling period
			Loan prepayment speeds	150.00%	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 12/31/13 (In Thousands)	Valuation Technique	Unobservable Input(s)	Method or Value As of 12/31/13	
Servicing rights	$1,123	Discounted cash flow	Discount rate	12.00%	Rate used through modeling period
			Loan prepayment speeds	152.00%	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

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, 2014

In Thousands)	Servicing Rights
Balance, beginning of period	$1,123
Issuances of servicing rights	40
Unrealized gains included in earnings	105
Balance, end of period	$1,268

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	125	125

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 gains included in earnings	0	0	8	8
Unrealized gains included in other comprehensive income	47	0	0	47
Balance, end of period	$1,659	$0	$738	$2,397

No other-than-temporary impairment losses (OTTI) on securities valued using Level 3 methodologies were recorded in 2014 or 2013.

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, 2014 and December 31, 2013. 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.

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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, 2014 Carrying Amount**	**Fair Value**	**December 31, 2013 Carrying Amount**	**Fair Value**
Financial assets:					
Cash and cash equivalents	Level 1	$55,299	$55,299	$38,591	$38,591
Certificates of deposit	Level 2	5,788	5,819	6,028	6,057
Available-for-sale securities	See Above	484,014	484,014	482,658	482,658
Restricted equity securities (included in Other Assets)	Level 2	2,951	2,951	3,786	3,786
Loans held for sale	Level 1	133	133	54	54
Loans, net	Level 3	617,475	619,438	635,640	634,937
Accrued interest receivable	Level 1	3,954	3,954	4,146	4,146
Servicing rights	Level 3	1,268	1,268	1,123	1,123
Financial liabilities:					
Deposits with no stated maturity	Level 1	705,408	705,408	693,479	693,479
Time deposits	Level 3	256,425	257,692	261,037	262,376
Short-term borrowings	Level 3	4,730	4,693	23,385	23,356
Long-term borrowings	Level 3	73,270	80,824	73,338	79,400
Accrued interest payable	Level 1	118	118	120	120

6. SECURITIES

Amortized cost and fair value of available-for-sale securities at March 31, 2014 and December 31, 2013 are summarized as follows:

		March 31, 2014		
(In Thousands)	**Amortized Cost**	**Gross Unrealized Holding Gains**	**Gross Unrealized Holding Losses**	**Fair Value**
Obligations of U.S. Government agencies	$29,667	$73	($1,217)	$28,523
Obligations of states and political subdivisions:				
Tax-exempt	124,282	3,785	(888)	127,179
Taxable	33,833	247	(456)	33,624
Mortgage-backed securities	91,178	2,078	(326)	92,930
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	194,508	1,099	(3,541)	192,066
Collateralized debt obligations	660	0	0	660

Total debt securities	474,128	7,282	(6,428)	474,982
Marketable equity securities	6,128	2,904	0	9,032
Total	$480,256	$10,186	($6,428)	$484,014

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(In Thousands)	Amortized Cost	December 31, 2013 Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of U.S. Government agencies	$47,382	$282	($1,787)	$45,877
Obligations of states and political subdivisions:				
Tax-exempt	127,748	2,766	(2,088)	128,426
Taxable	35,154	206	(889)	34,471
Mortgage-backed securities	84,849	1,819	(460)	86,208
Collateralized mortgage obligations,				
Issued by U.S. Government agencies	182,372	761	(5,041)	178,092
Collateralized debt obligations:	660	0	0	660
Total debt securities	478,165	5,834	(10,265)	473,734
Marketable equity securities	6,038	2,886	0	8,924
Total	$484,203	$8,720	($10,265)	$482,658

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, 2014 and December 31, 2013:

March 31, 2014 (In Thousands)	Less Than 12 Months Fair Value	Unrealized Losses	12 Months or More Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
Obligations of U.S. Government agencies	$18,714	($891)	$4,721	($326)	$23,435	($1,217)
Obligations of states and political subdivisions:						
Tax-exempt	29,424	(500)	6,303	(388)	35,727	(888)
Taxable	14,397	(369)	2,744	(87)	17,141	(456)
Mortgage-backed securities	19,357	(326)	0	0	19,357	(326)
Collateralized mortgage obligations,						
Issued by U.S. Government agencies	118,960	(2,885)	17,260	(656)	136,220	(3,541)
Total temporarily impaired available-for-sale securities	$200,852	($4,971)	$31,028	($1,457)	$231,880	($6,428)

December 31, 2013 (In Thousands)	Less Than 12 Months Fair Value	Unrealized Losses	12 Months or More Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
Obligations of U.S. Government agencies	$22,489	($1,337)	$4,598	($450)	$27,087	($1,787)
Obligations of states and political subdivisions:						

Tax-exempt	44,285	(1,425)	5,808	(663)	50,093	(2,088)
Taxable	20,873	(766)	2,378	(123)	23,251	(889)
Mortgage-backed securities	34,377	(460)	0	0	34,377	(460)
Collateralized mortgage obligations,						
Issued by U.S. Government agencies	113,204	(4,608)	7,399	(433)	120,603	(5,041)
Total temporarily impaired available-for-sale securities	$235,228	($8,596)	$20,183	($1,669)	$255,411	($10,265)

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

(In Thousands)	**3 Months Ended**	
	March 31, 2014	**March 31, 2013**
Gross realized gains from sales	$202	$1,302
Gross realized losses from sales	(171)	(118)
Losses from OTTI impairment	0	(25)
Net realized gains	$31	$1,159

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, 2014. 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	$11,939	$12,066
Due from one year through five years	47,914	48,306
Due from five years through ten years	68,434	67,384
Due after ten years	60,155	62,230
Subtotal	188,442	189,986
Mortgage-backed securities	91,178	92,930
Collateralized mortgage obligations,		
Issued by U.S. Government agencies	194,508	192,066
Total	$474,128	$474,982

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 $328,714,000 at March 31, 2014 and $323,613,000 at December 31, 2013 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, 2014 is provided below.

Debt Securities

At March 31, 2014, 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, 2014 to be temporary.

The credit rating agencies have withdrawn their ratings on numerous municipal bonds held by the Corporation. At March 31, 2014, the total amortized cost basis of municipal bonds with no external credit ratings was $19,080,000, with an aggregate unrealized loss of $178,000. At the time of purchase, each of these bonds was considered investment grade and had been rated by at least one credit rating agency. Most of the bonds for which credit rating agencies have withdrawn their ratings were 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. In the third quarter 2013, a credit rating agency withdrew its ratings on several bonds due to changes in its rating methodology related to credit enhancement programs provided by issuers’ state governments. However, the credit enhancement remains in effect on the bonds. None of the unrated municipal bonds has failed to make a scheduled payment.

Equity Securities

The Corporation's marketable equity securities at March 31, 2014 and December 31, 2013 consisted exclusively of stocks of banking companies. In the first quarter 2014, the Corporation had no realized gains or losses from the sale of equity securities. In the first quarter 2013, the Corporation recognized an other-than-temporary impairment loss related to a bank stock of $25,000. At March 31, 2014, none of the Corporations bank stock holdings were impaired.

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 $2,821,000 at March 31, 2014 and $3,656,000 at December 31, 2013. The Corporation evaluated its holding of FHLB-Pittsburgh stock for impairment and deemed the stock to not be impaired at March 31, 2014 and December 31, 2013. 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, 2014 and December 31, 2013 are summarized as follows:

Summary of Loans by Type **(In Thousands)**	**Mar. 31, 2014**	**Dec. 31, 2013**
Residential mortgage:		
Residential mortgage loans - first liens	$295,869	$299,831
Residential mortgage loans - junior liens	23,048	23,040
Home equity lines of credit	34,755	34,530
1-4 Family residential construction	12,635	13,909
Total residential mortgage	366,307	371,310

Commercial:		
Commercial loans secured by real estate	146,569	147,215
Commercial and industrial	40,477	42,387
Political subdivisions	10,436	16,291
Commercial construction and land	14,692	17,003
Loans secured by farmland	8,602	10,468
Multi-family (5 or more) residential	10,906	10,985
Agricultural loans	3,159	3,251
Other commercial loans	14,343	14,631
Total commercial	249,184	262,231
Consumer	10,327	10,762
Total	625,818	644,303
Less: allowance for loan losses	(8,343)	(8,663)
Loans, net	$617,475	$635,640

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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, 2014 or December 31, 2013.

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, 2014 and December 31, 2013, management determined that no allowance for credit losses related to unfunded loan commitments was required.

Activity within the allowance for loan losses, summarized by segment and class, for the three-month periods ended March 31, 2014 and 2013 was as follows:

Three Months Ended March 31, 2014	**December 31, 2013**			**Provision**	**March 31, 2014**
(In Thousands)	**Balance**	**Charge-offs**	**Recoveries**	**(Credit)**	**Balance**
Allowance for Loan Losses:					
Residential mortgage:					
Residential mortgage loans - first liens	$2,974	($19)	$0	($92)	$2,863
Residential mortgage loans - junior liens	294	0	0	(14)	280
Home equity lines of credit	269	0	0	2	271
1-4 Family residential construction	168	0	0	(15)	153
Total residential mortgage	3,705	(19)	0	(119)	3,567
Commercial:					
Commercial loans secured by real estate	3,123	(35)	250	(257)	3,081
Commercial and industrial	591	(24)	1	(13)	555
Political subdivisions	0	0	0	0	0
Commercial construction and land	267	(170)	0	150	247
Loans secured by farmland	115	0	0	(17)	98
Multi-family (5 or more) residential	103	0	0	2	105
Agricultural loans	30	0	0	0	30
Other commercial loans	138	0	0	0	138
Total commercial	4,367	(229)	251	(135)	4,254

Consumer	193	(26)	14	(53)	128
Unallocated	398	0	0	(4)	394
Total Allowance for Loan Losses	$8,663	($274)	$265	($311)	$8,343

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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

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, 2014 and December 31, 2013:

March 31, 2014: **(In Thousands)**	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Residential Mortgage:					
Residential mortgage loans - first liens	$282,285	$1,711	$11,789	$84	$295,869
Residential mortgage loans - junior liens	21,789	301	958	0	23,048
Home equity lines of credit	34,012	301	442	0	34,755
1-4 Family residential construction	12,635	0	0	0	12,635
Total residential mortgage	350,721	2,313	13,189	84	366,307
Commercial:					
Commercial loans secured by real estate	132,539	2,493	11,537	235	146,569
Commercial and Industrial	31,103	6,152	2,987	0	40,477
Political subdivisions	10,436	0	0	0	10,436
Commercial construction and land	12,165	326	2,115	86	14,692
Loans secured by farmland	6,429	516	1,628	29	8,602
Multi-family (5 or more) residential	10,593	310	3	0	10,906
Agricultural loans	3,080	33	46	0	3,159
Other commercial loans	14,248	95	0	0	14,343
Total commercial	220,593	9,925	18,316	350	249,184
Consumer	10,203	3	120	1	10,327
Totals	$581,517	$12,241	$31,625	$435	$625,818

December 31, 2013: **(In Thousands)**	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Residential Mortgage:					
Residential mortgage loans - first liens	$286,144	$1,876	$11,629	$182	$299,831
Residential mortgage loans - junior liens	21,694	351	995	0	23,040
Home equity lines of credit	33,821	295	414	0	34,530
1-4 Family residential construction	13,837	0	72	0	13,909
Total residential mortgage	355,496	2,522	13,110	182	371,310
Commercial:					
Commercial loans secured by real estate	129,834	5,866	11,368	147	147,215
Commercial and Industrial	32,317	6,697	3,138	235	42,387
Political subdivisions	16,291	0	0	0	16,291
Commercial construction and land	13,792	427	2,036	748	17,003
Loans secured by farmland	8,279	758	1,402	29	10,468
Multi-family (5 or more) residential	10,665	316	4	0	10,985
Agricultural loans	3,169	34	48	0	3,251
Other commercial loans	14,532	99	0	0	14,631
Total commercial	228,879	14,197	17,996	1,159	262,231
Consumer	10,587	6	169	0	10,762

Totals	$594,962	$16,725	$31,275	$1,341	$644,303

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. Qualified 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 73% at March 30, 2014) 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, 2014 and December 31, 2013.

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, 2014 and December 31, 2013:

March 31, 2014 (In Thousands)	**Loans:**			**Allowance for Loan Losses:**		
	Individually Evaluated	**Collectively Evaluated**	**Totals**	**Individually Evaluated**	**Collectively Evaluated**	**Totals**
Residential mortgage:						
Residential mortgage loans - first liens	$2,602	$293,267	$295,869	$371	$2,492	$2,863
Residential mortgage loans - junior liens	181	22,867	23,048	100	180	280
Home equity lines of credit	0	34,755	34,755	0	271	271
1-4 Family residential construction	0	12,635	12,635	0	153	153
Total residential mortgage	2,783	363,524	366,307	471	3,096	3,567
Commercial:						
Commercial loans secured by real estate	7,845	138,724	146,569	1,527	1,554	3,081
Commercial and industrial	905	39,572	40,477	92	463	555
Political subdivisions	0	10,436	10,436	0	0	0
Commercial construction and land	2,114	12,578	14,692	72	175	247
Loans secured by farmland	1,312	7,290	8,602	28	70	98
Multi-family (5 or more) residential	0	10,906	10,906	0	105	105
Agricultural loans	46	3,113	3,159	0	30	30
Other commercial loans	0	14,343	14,343	0	138	138
Total commercial	12,222	236,962	249,184	1,719	2,535	4,254
Consumer	1	10,326	10,327	0	128	128
Unallocated						394
Total	$15,006	$610,812	$625,818	$2,190	$5,759	$8,343

December 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	$2,727	$297,104	$299,831	$449	$2,525	$2,974
Residential mortgage loans - junior liens	183	22,857	23,040	100	194	294
Home equity lines of credit	0	34,530	34,530	0	269	269
1-4 Family residential construction	0	13,909	13,909	0	168	168
Total residential mortgage	2,910	368,400	371,310	549	3,156	3,705
Commercial:						
Commercial loans secured by real estate	7,988	139,227	147,215	1,577	1,546	3,123
Commercial and industrial	1,276	41,111	42,387	106	485	591
Political subdivisions	0	16,291	16,291	0	0	0
Commercial construction and land	2,776	14,227	17,003	72	195	267
Loans secured by farmland	1,318	9,150	10,468	29	86	115
Multi-family (5 or more) residential	0	10,985	10,985	0	103	103

Agricultural loans	48	3,203	3,251	0	30	30
Other commercial loans	0	14,631	14,631	0	138	138
Total commercial	13,406	248,825	262,231	1,784	2,583	4,367
Consumer	5	10,757	10,762	0	193	193
Unallocated						398
Total	$16,321	$627,982	$644,303	$2,333	$5,932	$8,663

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

(In Thousands)	**3 Months Ended March 31,**	
	2014	**2013**
Average investment in impaired loans	$15,663	$7,451
Interest income recognized on impaired loans	163	70
Interest income recognized on a cash basis on impaired loans	163	70

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: