CITIZENS & NORTHERN CORP
Form 10-K
February 16, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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: 0-16084

CITIZENS & NORTHERN CORPORATION

(Exact name of Registrant as specified in its charter)

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

90-92 MAIN STREET, WELLSBORO, PA 16901

(Address of principal executive offices) (Zip code)

570-724-3411

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Exchange Where Registered**
Common Stock Par Value $1.00	The NASDAQ Stock Market LLC

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

(Check one:) Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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

Yes ¨ No x

The aggregate market value of the registrant's common stock held by non-affiliates at June 30, 2016, the registrant's most recently completed second fiscal quarter, was $237,079,156.

The number of shares of common stock outstanding at February 9, 2017 was 12,143,776.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the annual meeting of its shareholders to be held April 20, 2017 are incorporated by reference into Parts III and IV of this report.

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PART I

ITEM 1. BUSINESS

Citizens & Northern Corporation (“Corporation”) is a holding company whose principal activity is community banking. The Corporation’s principal office is located in Wellsboro, Pennsylvania. The largest subsidiary is Citizens & Northern Bank (“C&N Bank” or the “Bank”). The Corporation’s other wholly-owned subsidiaries are Citizens & Northern Investment Corporation and Bucktail Life Insurance Company (“Bucktail”). Citizens & Northern Investment Corporation was formed in 1999 to engage in investment activities. Bucktail reinsures credit and mortgage life and accident and health insurance on behalf of C&N Bank.

C&N Bank is a Pennsylvania banking institution that was formed by the consolidation of Northern National Bank of Wellsboro and Citizens National Bank of Towanda on October 1, 1971. Subsequent mergers included: First National Bank of Ralston in May 1972; Sullivan County National Bank in October 1977; Farmers National Bank of Athens in January 1984; and First National Bank of East Smithfield in May 1990. In 2005, the Corporation acquired Canisteo Valley Corporation and its subsidiary, First State Bank, a New York State chartered commercial bank with offices in Canisteo and South Hornell, NY. In 2010, the First State Bank operations were merged into C&N Bank and Canisteo Valley Corporation was merged into the Corporation. On May 1, 2007, the Corporation acquired Citizens Bancorp, Inc. (“Citizens”), with banking offices in Coudersport, Emporium and Port Allegany, Pennsylvania. Citizens Trust Company, the banking subsidiary of Citizens, was merged with and into C&N Bank as part of the transaction. C&N Bank has held its current name since May 6, 1975, at which time C&N Bank changed its charter from a national bank to a Pennsylvania bank.

C&N Bank provides an extensive range of banking services, including deposit and loan products for personal and commercial customers. The Bank also maintains a trust division that provides a wide range of financial services, such as 401(k) plans, retirement planning, estate planning, estate settlements and asset management. In January 2000, C&N Bank formed a subsidiary, C&N Financial Services Corporation (“C&NFSC”). C&NFSC is a licensed insurance agency that provides insurance products to individuals and businesses. In 2001, C&NFSC added a broker-dealer division, which offers mutual funds, annuities, educational savings accounts and other investment products through registered agents. C&NFSC’s operations are not significant in relation to the total operations of the Corporation.

All phases of the Bank’s business are competitive. The Bank primarily competes in Tioga, Bradford, Sullivan, Lycoming, Potter, Cameron and McKean counties in Pennsylvania, and Steuben and Allegany counties in New York. The Bank competes with local commercial banks headquartered in our market area as well as other commercial banks with branches in our market area. Some of the banks that have branches in our market area are larger in overall size. With respect to lending activities and attracting deposits, the Bank also competes with savings banks, savings and loan associations, insurance companies, regulated small loan companies and credit unions. Also, the Bank competes with mutual funds for deposits. C&N Bank competes with insurance companies, investment counseling firms, mutual funds and other business firms and individuals for trust, investment management, brokerage and insurance services. The Bank is generally competitive with all financial institutions in our service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts and interest rates charged on loans. The Bank serves a diverse customer base, and is not economically dependent on any small group of customers or on any individual industry.

Major initiatives within the last 5 years included the following:

- in April 2012, re-opened the Athens, PA, facility, which was damaged by flooding in September 2011;
- in 2013, worked with consultants on projects which resulted in ongoing increases in revenues from service charges on deposit accounts, starting primarily in the fourth quarter 2013, and ongoing reductions in electronic funds processing expenses;
- in 2014, approved a treasury stock repurchase program for repurchase up to 622,500 shares of the Corporation's common stock, or approximately 5% of the Corporation's outstanding shares at July 16, 2014. In the first four months of 2016, the Corporation repurchased the remainder of the shares authorized under the program. In total, 622,500 shares were repurchased for a total cost of $12,140,000, at an average price of $19.50 per share;
- in 2015, began an organization-wide effort to enhance customer relationships, growth and profitability, including working with consultants on enhanced employee engagement and customer service training, and hiring additional lending personnel to provide more access to commercial and mortgage lending opportunities;

- in April 2016, approved a new treasury stock repurchase program authorizing repurchase of up to 600,000 shares of the Corporation's common stock or slightly less than 5% of the Corporation's issued and outstanding shares at April 19, 2016; and

- in 2016, submitted application for regulatory approval to establish a loan production office in Elmira, New York. Formal approval has been received, and the office is scheduled to open in the first quarter 2017.

Virtually all of the Corporation’s banking offices are located in the “Marcellus Shale,” an area extending across portions of New York State, Pennsylvania, Ohio, Maryland, West Virginia and Virginia. In recent years, most of the Pennsylvania counties in which the Corporation operates were significantly affected by an upsurge in natural gas exploration, as technological developments made exploration of the Marcellus Shale commercially feasible. After a surge of activity in 2009 through most of 2011, the market price of natural gas declined, causing Marcellus Shale natural gas exploration activity to slow, though some activity has continued to occur throughout the Corporation’s market area. Through December 31, 2016, the Corporation has not experienced significant credit issues as a result of the expansion and subsequent reduction in Marcellus Shale-related activity.

At December 31, 2016, C&N Bank had total assets of $1,228,026,000, total deposits of $990,241,000, net loans outstanding of $743,362,000 and 291 full-time equivalent employees.

Most activities of the Corporation and its subsidiaries are regulated by federal or state agencies. The primary regulatory relationships are described as follows:

- The Corporation is a bank holding company formed under the provisions of Section 3 of the Federal Reserve Act. The Corporation is under the direct supervision of the Federal Reserve and must comply with the reporting requirements of the Federal Bank Holding Company Act.

- C&N Bank is a state-chartered, nonmember bank, supervised by the Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking and Securities.

- C&NFSC is a Pennsylvania corporation. The Pennsylvania Department of Insurance regulates C&NFSC’s insurance activities. Brokerage products are offered through third party networking agreements.

- Bucktail is incorporated in the state of Arizona and supervised by the Arizona Department of Insurance.

A copy of the Corporation’s annual report on Form 10-K, quarterly reports on Form 10-Q, current events reports on Form 8-K, and amendments to these reports, will be furnished without charge upon written request to the Corporation’s Treasurer at P.O. Box 58, Wellsboro, PA 16901. Copies of these reports will be furnished as soon as reasonably possible, after they are filed electronically with the Securities and Exchange Commission. The information is also available through the Corporation’s web site at www.cnbankpa.com.

ITEM 1A. RISK FACTORS

The Corporation is subject to the many risks and uncertainties applicable to all banking companies, as well as risks specific to the Corporation’s geographic locations. Although the Corporation seeks to effectively manage risks, and maintains a level of equity that exceeds the banking regulatory agencies’ thresholds for being considered “well capitalized” (see Note 18 to the consolidated financial statements), management cannot predict the future and cannot eliminate the possibility of credit, operational or other losses. Accordingly, actual results may differ materially from management's expectations. Some of the Corporation’s significant risks and uncertainties are discussed below.

Credit Risk from Lending Activities - A significant source of risk is the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most of the Corporation’s loans are secured, but some loans are unsecured. With respect to secured loans, the collateral securing the repayment of these loans may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, wide-spread disease, terrorist activity, environmental contamination and other external events. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards may create the impression that a loan is adequately collateralized when it is not. The Corporation has adopted underwriting and credit monitoring procedures and policies, including regular reviews of appraisals and borrower financial statements, that management believes are appropriate to mitigate the risk of loss. Also, as discussed further in the “Provision and Allowance for Loan Losses” section of Management’s Discussion and Analysis, the Corporation attempts to estimate the amount of losses that may be inherent in the portfolio through a quarterly evaluation process that includes several members of management and that addresses specifically identified problem loans, as well as other quantitative data and qualitative factors. Such risk management and accounting policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Corporation’s financial condition, results of operations or liquidity.

Interest Rate Risk - Business risk arising from changes in interest rates is an inherent factor in operating a banking organization. The Corporation's assets are predominantly long-term, fixed-rate loans and debt securities. Funding for these assets comes principally from shorter-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation's financial instruments when interest rates change. Significant fluctuations in interest rates could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. For additional information regarding interest rate risk, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Breach of Information Security and Technology Dependence - The Corporation relies on software, communication, and information exchange on a variety of computing platforms and networks and over the Internet. Despite numerous safeguards, the Corporation cannot be certain that all of its systems are entirely free from vulnerability to attack or other technological difficulties or failures. The Corporation relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and the Corporation could be exposed to claims from customers. Any of these results could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Limited Geographic Diversification - The Corporation grants commercial, residential and personal loans to customers primarily in the Pennsylvania counties of Tioga, Bradford, Sullivan, Lycoming, Potter, Cameron and McKean, and in Steuben and Allegany Counties in New York State. Although the Corporation has a diversified loan portfolio, a significant portion of its debtors' ability to honor their contracts is dependent on the local economic conditions within the region. Deterioration in economic conditions could adversely affect the quality of the Corporation's loan portfolio and the demand for its products and services, and accordingly, could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Competition - All phases of the Corporation's business are competitive. Some competitors are much larger in total assets and capitalization than the Corporation, have greater access to capital markets and can offer a broader array of financial services. There can be no assurance that the Corporation will be able to compete effectively in its markets. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Government Regulation and Monetary Policy - The Corporation and the banking industry are subject to extensive regulation and supervision under federal and state laws and regulations. The requirements and limitations imposed by such laws and regulations limit the manner in which the Corporation conducts its business, undertakes new investments and activities and obtains financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit the Corporation's shareholders. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Corporation. Significant new laws or changes in, or repeals of, existing laws could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects short-term interest rates and credit conditions, and any unfavorable change in these conditions could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Mortgage Banking – In September 2009, the Corporation entered into an agreement to originate and sell residential mortgage loans to the secondary market through the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago. The Corporation’s mortgage sales activity under this program was not significant in 2009, but has subsequently increased. In 2014, the Corporation entered into an agreement and in June 2014 began to originate and sell residential mortgage loans to the secondary market through the MPFX Original program, which is also administered by the Federal Home Loan Banks of Pittsburgh and Chicago. At December 31, 2016, total residential mortgages sold and serviced through the two programs amounted to $163,296,000. The Corporation must strictly adhere to the MPF Xtra and MPFX Original program guidelines for origination, underwriting and servicing loans, and failure to do so may result in the Corporation being forced to repurchase loans or being dropped from the program. As of December 31, 2016, the total outstanding balance of residential mortgage loans the Corporation has repurchased as a result of identified instances of noncompliance amounted to $1,852,000. If the volume of such forced repurchases of loans were to increase significantly, or if the Corporation were to be dropped from the programs, it could have a material adverse effect on the Corporation’s financial condition, results of operations or liquidity.

Securities Markets – The fair value of the Corporation's available-for-sale securities, as well as the revenues the Corporation earns from its Trust and Financial Management and brokerage services, are sensitive to price fluctuations and market events.

Declines in the values of the Corporation's securities holdings, combined with adverse changes in the expected cash flows from these investments, could result in other-than-temporary impairment charges.

A portion of the Corporation's securities portfolio consists of obligations of states and political subdivisions (also known as municipal bonds). As discussed in more detail in the "Income Taxes" section of Management's Discussion and Analysis, the Trump Administration and the U.S. Congress have recently been discussing the possibility of lowering corporate income tax rates. If corporate income tax rates were lowered, fully taxable-equivalent yields on tax-exempt securities (municipal bonds) would decrease from their recent levels, which may result in a reduction in the fair value of such securities held at December 31, 2016.

For additional information regarding debt securities, see the "Securities" section of Management's Discussion and Analysis and Note 7 to the consolidated financial statements.

The Corporation's Trust and Financial Management revenue is determined, in part, from the value of the underlying investment portfolios. Accordingly, if the values of those investment portfolios decrease, whether due to factors influencing U.S. or international securities markets, in general, or otherwise, the Corporation's revenue could be negatively impacted. In addition, the Corporation's ability to sell its brokerage services is dependent, in part, upon consumers' level of confidence in securities markets.

The Federal Home Loan Bank of Pittsburgh - Through its subsidiary (C&N Bank), the Corporation is a member of the Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh), which is one of 11 regional Federal Home Loan Banks. The Corporation has a line of credit with the FHLB-Pittsburgh that is secured by a blanket lien on its loan portfolio. Access to this line of credit is critical if a funding need arises. However, there can be no assurance that the FHLB-Pittsburgh will be able to provide funding when needed, nor can there be assurance that the FHLB-Pittsburgh will provide funds specifically to the Corporation should its financial condition deteriorate and/or regulators prevent that access. The inability to access this source of funds could have a materially adverse effect on the Corporation's financial flexibility if alternate financing is not available at acceptable interest rates. The failure of the FHLB-Pittsburgh or the FHLB system in general, may materially impair the Corporation's ability to meet short- and long-term liquidity needs or to meet growth plans.

The Corporation owns common stock of the FHLB-Pittsburgh in order to qualify for membership in the FHLB system and access services from the FHLB-Pittsburgh. The FHLB-Pittsburgh faces a variety of risks in its operations including interest rate risk, counterparty credit risk, and adverse changes in its regulatory framework. In addition, the 11 Federal Home Loan Banks are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB cannot meet its obligations, other FHLBs can be called upon to make required payments. Such risks affecting the FHLB-Pittsburgh could adversely impact the value of the Corporation’s investment in the common stock of the FHLB-Pittsburgh and/or affect its access to credit.

Soundness of Other Financial Institutions - In addition to the FHLB-Pittsburgh, the Corporation maintains other credit facilities that provide it with additional liquidity. These facilities include secured and unsecured borrowings from the Federal Reserve Bank and third-party commercial banks. The Corporation believes that it maintains a strong liquidity position and that it is well positioned to withstand foreseeable market conditions. However, legal agreements with counterparties typically include provisions allowing them to restrict or terminate the Corporation’s access to these credit facilities with or without advance notice and at their sole discretion.

Financial institutions are interconnected as a result of trading, clearing, counterparty, and other relationships. Financial market conditions have been negatively impacted in the past and such disruptions or adverse changes in the Corporation's results of operations or financial condition could, in the future, have a negative impact on available sources of liquidity. Such a situation may arise due to circumstances that are outside the Corporation’s control, such as general market disruptions or operational problems affecting the Corporation or third parties. The Corporation’s efforts to monitor and manage liquidity risk may not be successful or sufficient to deal with dramatic or unanticipated reductions in available liquidity. In such events, the Corporation’s cost of funds may increase, thereby reducing net interest income, or the Corporation may need to sell a portion of its securities and/or loan portfolio, which, depending upon market conditions, could necessitate realizing a loss.

FDIC Insurance Assessments - In 2008 and 2009, higher levels of bank failures dramatically increased the resolution costs of the Federal Deposit Insurance Corporation, or the FDIC, and depleted the deposit insurance fund. In addition, the FDIC and the U.S. Congress increased federal deposit insurance coverage, placing additional stress on the deposit insurance fund. In order to maintain a strong funding position and restore reserve ratios of the deposit insurance fund, in 2009 the FDIC increased assessment rates. As a result of lowering assessment levels for the Corporation and other US banks, the Corporation’s 2016 FDIC assessment expense decreased to $488,000 from $603,000 in 2015. Although the Corporation’s total expenses from FDIC assessments have steadily decreased from $2,092,000 in 2009, the Corporation is generally unable to control the cost of the premiums. If a significant number of bank or financial institution failures occur, the Corporation may be required to pay higher FDIC premiums. Future increases in FDIC insurance premiums or additional special assessments may materially adversely affect the Corporation’s results of operations.

Bank Secrecy Act and Related Laws and Regulations - These laws and regulations have significant implications for all financial institutions. They increase due diligence requirements and reporting obligations for financial institutions, create new crimes and penalties, and require the federal banking agencies, in reviewing merger and other acquisition transactions, to consider the effectiveness of the parties to such transactions in combating money laundering activities. Even innocent noncompliance and inconsequential failure to follow the regulations could result in significant fines or other penalties, which could have a material adverse impact on the Corporation's financial condition, results of operations or liquidity.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

The Bank owns each of its properties, except for the branch facilities located at 130 Court Street, Williamsport, PA, and at 2 East Mountain Avenue, South Williamsport, PA, which are leased. All of the properties are in good condition. None of the owned properties are subject to encumbrance.

A listing of properties is as follows:

Main administrative offices:

90-92 Main Street Wellsboro, PA 16901	or	10 Nichols Street Wellsboro, PA 16901

Branch offices – Citizens & Northern Bank:

428 S. Main Street Athens, PA 18810	514 Main Street Laporte, PA 18626	2 East Mountain Avenue ** South Williamsport, PA 17702
10 North Main Street Coudersport, PA 16915	4534 Williamson Trail Liberty, PA 16930	41 Main Street Tioga, PA 16946
111 W. Main Street Dushore, PA 18614	1085 S. Main Street Mansfield, PA 16933	428 Main Street Towanda, PA 18848
563 Main Street East Smithfield, PA 18817	612 James Monroe Avenue Monroeton, PA 18832	64 Elmira Street Troy, PA 16947
104 W. Main Street Elkland, PA 16920	3461 Route 405 Highway Muncy, PA 17756	90-92 Main Street Wellsboro, PA 16901
135 East Fourth Street Emporium, PA 15834	100 Maple Street Port Allegany, PA 16743	1510 Dewey Avenue Williamsport, PA 17701
230 Railroad Street Jersey Shore, PA 17740	24 Thompson Street Ralston, PA 17763	130 Court Street ** Williamsport, PA 17701
102 E. Main Street Knoxville, PA 16928	1827 Elmira Street Sayre, PA 18840	1467 Golden Mile Road Wysox, PA 18854
3 Main Street Canisteo, NY 14823	6250 County Rte 64 Hornell, NY 14843	

Loan production office of Citizens & Northern Bank (opening first quarter 2017):

250 East Water Street

Elmira, NY 14901

Facilities management office:

13 Water Street

Wellsboro, PA 16901

** designates leased branch facility

ITEM 3. LEGAL PROCEEDINGS

The Corporation and the Bank are involved in various legal proceedings incidental to their business. Management believes the aggregate liability, if any, resulting from such pending and threatened legal proceedings will not have a material adverse effect on the Corporation's financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

QUARTERLY SHARE DATA

Trades of the Corporation's stock are executed through various brokers who maintain a market in the Corporation's stock. The Corporation's stock is listed on the NASDAQ Capital Market with the trading symbol CZNC. As of December 31, 2016, there were 2,260 shareholders of record of the Corporation's common stock.

The following table sets forth the high and low sales prices of the common stock during 2016 and 2015.

	2016			2015		
	High	Low	Dividend Declared per Quarter	High	Low	Dividend Declared per Quarter
First quarter	$20.99	$19.26	$ 0.26	$21.50	$19.01	$ 0.26
Second quarter	21.00	19.40	0.26	21.17	19.16	0.26
Third quarter	22.67	20.00	0.26	20.73	19.25	0.26
Fourth quarter	26.57	20.54	0.26	21.45	19.07	0.26

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. Also, the Corporation and C&N Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities. These restrictions are described in Note 18 to the consolidated financial statements.

Effective July 17, 2014, the Corporation established a treasury stock repurchase program authorizing repurchase of up to 622,500 shares of the Corporation's common stock, or approximately 5% of the Corporation's issued and outstanding shares at July 16, 2014. As permitted by securities laws and other legal requirements and subject to market conditions and other factors, purchases under the program could be made from time to time in the open market at prevailing prices, or through privately negotiated transactions. In the first four months of 2016, the Corporation repurchased the remainder of the shares authorized under the program. In total, 622,500 shares were repurchased for a total cost of $12,140,000, at an average price of $19.50 per share.

Effective April 21, 2016, the Corporation's Board of Directors approved a new treasury stock repurchase program. Under the newly approved stock repurchase program, the Corporation is authorized to repurchase up to 600,000 shares of the Corporation's common stock or slightly less than 5% of the Corporation's issued and outstanding shares at April 19, 2016. Consistent with the previous program, the Board of Directors' April 21, 2016 authorization provides that: (1) the new treasury stock repurchase program shall be effective when publicly announced and shall continue thereafter until suspended or terminated by the Board of Directors, in its sole discretion; and (2) all shares of common stock repurchased pursuant to the new program shall be held as treasury shares and be available for use and reissuance for purposes as and when determined by the Board of Directors including, without limitation, pursuant to the Corporation's Dividend Reinvestment and Stock Purchase Plan and its equity compensation program. To date, no purchases have been made under this repurchase program.

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The following table sets forth a summary of purchases by the Corporation, in the open market, of its equity securities during the fourth quarter 2016:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 1 - 31, 2016	0	$ -	0	600,000
November 1 - 30, 2016	0	$ -	0	600,000
December 1 - 31, 2016	0	$ -	0	600,000

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PERFORMANCE GRAPH

Set forth below is a chart comparing the Corporation's cumulative return to stockholders against the cumulative return of the Russell 2000 and a Peer Group Index of similar banking organizations selected by the Corporation for the five-year period commencing December 31, 2011 and ended December 31, 2016. The index values are market-weighted dividend-reinvestment numbers, which measure the total return for investing $100.00 five years ago. This meets Securities & Exchange Commission requirements for showing dividend reinvestment share performance over a five-year period and measures the return to an investor for placing $100.00 into a group of bank stocks and reinvesting any and all dividends into the purchase of more of the same stock for which dividends were paid.

	Period Ending					
Index	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Citizens & Northern Corporation	100.00	106.83	122.52	129.48	138.55	181.75
Russell 2000	100.00	116.35	161.52	169.43	161.95	196.45
CZNC Peer Group Index*	100.00	124.14	157.02	172.35	180.02	253.70

The Corporation's peer group consists of all publicly traded (who file financial statements with the Securities & Exchange Commission) commercial banks and thrifts within New Jersey, New York, Ohio and Pennsylvania with total assets between $750 million and $3.5 billion as of September 30, 2016.

The data for this graph was obtained from SNL Financial LC, Charlottesville, VA.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information concerning the Stock Incentive Plan and Independent Directors Stock Incentive Plan, both of which have been approved by the Corporation's shareholders. The figures shown in the table below are as of December 31, 2016.

	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted-average Exercise Price of Outstanding Options	Number of Securities Remaining for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by shareholders	202,037	$ 18.58	302,550
Equity compensation plans not approved by shareholders	0	N/A	0

More details related to the Corporation's equity compensation plans are provided in Notes 1 and 13 to the consolidated financial statements.

ITEM 6. SELECTED FINANCIAL DATA

	As of or for the Year Ended December 31,				
INCOME STATEMENT (In Thousands)	2016	2015	2014	2013	2012
Interest and fee income	$44,098	$44,519	$46,009	$48,914	$56,632
Interest expense	3,693	4,602	5,122	5,765	9,031
Net interest income	40,405	39,917	40,887	43,149	47,601
Provision for loan losses	1,221	845	476	2,047	288
Net interest income after provision for loan losses	39,184	39,072	40,411	41,102	47,313
Noninterest income excluding securities gains	15,511	15,478	15,420	16,451	16,383
Net impairment losses recognized in earnings from available-for-sale securities	0	0	0	(25)	(67)
Net realized gains on available-for-sale securities	1,158	2,861	1,104	1,743	2,749
Loss on prepayment of debt	0	2,573	0	1,023	2,333
Noninterest expense excluding loss on prepayment of debt	34,744	33,030	34,157	33,471	32,914
Income before income tax provision	21,109	21,808	22,778	24,777	31,131
Income tax provision	5,347	5,337	5,692	6,183	8,426
Net income	$15,762	$16,471	$17,086	$18,594	$22,705
PER COMMON SHARE:					
Basic earnings per share	$1.30	$1.35	$1.38	$1.51	$1.86
Diluted earnings per share	$1.30	$1.35	$1.38	$1.50	$1.85
Cash dividends declared per share	$1.04	$1.04	$1.04	$1.00	$0.84
Book value per common share at period-end	$15.36	$15.39	$15.34	$14.49	$14.89
Tangible book value per common share at period-end	$14.37	$14.41	$14.36	$13.51	$13.91
Weighted average common shares outstanding - basic	12,098,129	12,211,941	12,390,067	12,352,383	12,235,748
Weighted average common shares outstanding - diluted	12,128,364	12,233,773	12,412,050	12,382,790	12,260,208
END OF PERIOD BALANCES (Dollars In Thousands)					
Available-for-sale securities	$395,077	$420,290	$516,807	$482,658	$472,577
Gross loans	751,835	704,880	630,545	644,303	683,910
Allowance for loan losses	8,473	7,889	7,336	8,663	6,857
Total assets	1,242,292	1,223,417	1,241,963	1,237,695	1,286,907
Deposits	983,843	935,615	967,989	954,516	1,006,106
Borrowings	64,629	92,263	78,597	96,723	89,379
Stockholders' equity	186,008	187,487	188,362	179,472	182,786
Common shares outstanding	12,113,228	12,180,623	12,279,980	12,390,063	12,274,035

AVERAGE BALANCES (In Thousands)					
Total assets	1,229,866	1,243,209	1,239,897	1,237,096	1,305,163
Earning assets	1,147,549	1,159,298	1,155,401	1,145,340	1,199,538
Gross loans	723,076	657,727	627,753	656,495	700,241
Deposits	970,447	968,201	965,418	964,031	1,008,469
Stockholders' equity	188,373	188,905	185,469	181,412	175,822

ITEM 6. SELECTED FINANCIAL DATA (Continued)

	As of or for the Year Ended December 31,				
	2016	2015	2014	2013	2012
KEY RATIOS					
Return on average assets	1.28 %	1.32 %	1.38 %	1.50 %	1.74 %
Return on average equity	8.37 %	8.72 %	9.21 %	10.25%	12.91%
Average equity to average assets	15.32%	15.19%	14.96%	14.66%	13.47%
Net interest margin (1)	3.76 %	3.69 %	3.80 %	4.05 %	4.26 %
Efficiency (2)	59.22%	56.66%	57.59%	53.27%	48.82%
Cash dividends as a % of diluted earnings per share	80.00%	77.04%	75.36%	66.67%	45.41%
Tier 1 leverage	14.27%	14.31%	13.89%	13.78%	12.53%
Tier 1 risk-based capital	22.48%	23.29%	26.26%	25.15%	22.86%
Total risk-based capital	23.60%	24.40%	27.60%	26.60%	24.01%
Tangible common equity/tangible assets	14.15%	14.49%	14.34%	13.66%	13.39%
Nonperforming assets/total assets	1.43 %	1.31 %	1.34 %	1.53 %	0.82 %
Nonperforming loans/total loans	2.07 %	2.09 %	2.45 %	2.80 %	1.41 %
Allowance for loan losses/total loans	1.13 %	1.12 %	1.16 %	1.34 %	1.00 %
Net charge-offs/average loans	0.09 %	0.04 %	0.29 %	0.04 %	0.16 %

(1) Rates of return on tax-exempt securities and loans are calculated on a fully-taxable equivalent basis.

(2) The efficiency ratio is calculated by dividing: (a) total noninterest expense excluding losses from prepayment of debt, by (b) the sum of net interest income (including income from tax-exempt securities and loans on a fully-taxable equivalent basis) and noninterest income excluding securities gains or losses.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this section and elsewhere in this Annual Report on Form 10-K are forward-looking statements. Citizens & Northern Corporation and its wholly-owned subsidiaries (collectively, the Corporation) intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995. Forward-looking statements, which are not historical facts, are based on certain assumptions and describe future plans, business objectives and expectations, and are generally identifiable by the use of words such as, "should", “likely”, "expect", “plan”, "anticipate", “target”, “forecast”, and “goal”. These forward-looking statements are subject to risks and uncertainties that are difficult to predict, may be beyond management’s control and could cause results to differ materially from those expressed or implied by such forward-looking statements. Factors which could have a material, adverse impact on the operations and future prospects of the Corporation include, but are not limited to, the following:

- changes in monetary and fiscal policies of the Federal Reserve Board and the U.S. Government, particularly related to changes in interest rates
- changes in general economic conditions
- legislative or regulatory changes
- downturn in demand for loan, deposit and other financial services in the Corporation’s market area
- increased competition from other banks and non-bank providers of financial services
- technological changes and increased technology-related costs
- changes in accounting principles, or the application of generally accepted accounting principles.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

EARNINGS OVERVIEW

In 2016, net income totaled $15,762,000, or $1.30 per common share - basic and diluted, as compared to $1.35 per share – basic and diluted in 2015 and $1.38 per share - basic and diluted in 2014. The results for 2016 represented a return on average assets of 1.28% and a return on average equity of 8.37%.

2016 vs. 2015

Net income per share – diluted for 2016 was 3.7% lower than in 2015. Some of the more significant highlights related to annual earnings in 2016 as compared to 2015 are as follows:

- Net interest income was $488,000 (1.2%) higher than the comparable total for 2015. The net interest margin was 3.76%, which was 0.07% higher than the margin for 2015, reflecting the benefits of a lower cost of borrowed funds and a more favorable mix of earning assets. The average balance of total borrowed funds was $62,516,000 at an average interest rate of 2.57% in 2016, down from average borrowings of $77,642,000 at an average interest rate of 3.45% in 2015. Average total loans outstanding were higher by $65.3 million (9.9%) in 2016 as compared to 2015, while average total available-for-sale securities were lower by $74.2 million. Average total deposits increased $2.2 million (0.2%).

- The provision for loan losses was $1,221,000 in 2016, an increase of $376,000 over 2015. In 2016, the provision included the impact of increasing the allowance for loan losses for the effects of loan growth and slight increases in net charge-off experience and qualitative factors used in determining the collectively evaluated portion of the allowance. In comparison, in 2015 the provision also reflected the effects of loan growth, but the qualitative factors used in determining a portion of the collectively determined allowance decreased slightly during the period. Also in 2016, the provision included an increase of $148,000 as compared to 2015 from changes in specific allowances on loans individually identified as impaired, adjusted for the impact of net charge-offs.

- Total noninterest revenue for 2016 increased $33,000 (0.2%) over 2015. Net gains from sales of loans increased $294,000 (40.0%), reflecting higher volume of sales, and Trust and Financial Management revenue increased $134,000 (2.9%). Other operating income increased $35,000 (2.1%), including an increase of $148,000 from redemptions of tax credits and increases in lending-related fees of $80,000, while this category included a gain of $212,000 from a split-dollar life insurance policy in 2015. Service charges on deposit accounts decreased $169,000 (3.5%) in 2016, reflecting a reduction in consumer overdraft volume. The fair value of mortgage servicing rights decreased $282,000 in 2016, which was a larger decrease by $120,000 as compared to 2015. Brokerage revenue decreased $83,000 (9.9%), as the volume of sales of annuities declined.

- In 2016, realized gains from securities totaled $1,158,000, including gains from sales of bank stocks of $1,125,000. In 2015, the Corporation generated gains from sales of securities totaling $2,861,000, including gains from sales of bank stocks of $2,220,000, and also incurred losses of $2,573,000 from prepayments of a borrowing in the second and fourth quarters totaling $34 million. In the fourth quarter 2016, the Corporation completed its program of bank stock sales that had begun in 2015, and had no remaining investments in bank stocks at December 31, 2016.

- Noninterest expenses, excluding losses on prepayment of borrowings, in 2016 exceeded the amount for 2015 by $1,714,000 (5.2%). Salaries and wages expense increased $729,000 (5.0%). Several new positions were established in the latter portion of 2015 and early 2016, including new positions established for lending, lending support, information technology, training, human resources and marketing functions. Professional fees expense increased $488,000, including increases related to employee sales and service training, information technology and marketing. Other operating expense increased $399,000 (7.8%), including increases in other real estate expenses of $123,000, donations and public relations-related expenses of $94,000 and education and training-related expenses of $60,000. Also, other operating expense was reduced in 2015 by $69,000 as a result of a recovery of sales tax previously paid.

- The provision for income tax totaled $5,347,000 in 2016, or an effective tax rate of 25.3% of pre-tax income. In comparison, the provision for income tax of $5,337,000 in 2015 represented a 24.5% effective rate. The higher effective tax rate in 2016 included the impact of a $300,000 reduction in tax-exempt interest income and an increase in the provision for state income tax of $64,000 that resulted mainly from a catch-up adjustment to increase New York State taxes for the effect of changes in the tax methodology that first became effective in 2015.

2015 vs. 2014

Basic and diluted net income of $1.35 per share for 2015 was 2.2% lower than in 2014. Some of the more significant highlights related to annual earnings in 2015 as compared to 2014 are as follows:

- Net interest income totaled $39,917,000 in 2015, down $970,000 (2.4%) from 2014. In 2015, yields earned on securities and loans fell by more than the corresponding drop in interest rates paid on deposits and borrowings. The net interest margin was 3.69% in 2015, down from 3.80% in 2014.

- The provision for loan losses was $845,000 in 2015, up from $476,000 in 2014. The higher 2015 provision for loan losses reflected an increase in outstanding loans in the year which resulted in an increase in the collectively determined portion of the allowance for loan losses. Gross loans at December 31, 2015 were $74.3 million, or 11.8%, higher than the balance a year earlier.

- In 2015, noninterest revenue, excluding net realized gains on available-for-sale securities, totaled $15,478,000, which was up slightly from $15,420,000 in 2014 The most significant changes in components of noninterest revenue for the year ended December 31, 2015 as compared to the corresponding period in 2014 included the following: (1) decrease of $161,000 (3.2%) in service charges on deposit accounts, primarily as a result of lower overdraft fees; (2) reduction of $135,000 as the fair value of servicing rights declined $162,000 in 2015 as compared to $27,000 in 2014; (3) net increase in revenues from Trust and brokerage services of $74,000 (1.4%); and (4) an increase in other operating income of $380,000, including a gain of $212,000 from a life insurance arrangement in which benefits were split between the Corporation and the heirs of a former employee.

- Realized gains from available-for-sale securities totaled $2,861,000 and losses from prepayment of borrowings totaled $2,573,000 in 2015, while in 2014 realized gains from securities totaled $1,104,000 and there were no losses from prepayment of borrowings. In 2015, the Corporation sold a significant portion of its marketable equity securities portfolio, which was made up of bank stocks, generating realized gains of $2,220,000. Losses from prepayment of borrowings stemmed from pay-downs made in May and December 2015 totaling $34,000,000 on a long-term repurchase agreement with an interest rate of 4.265%.

- In 2015, noninterest expenses, excluding losses on prepayment of borrowings; totaled $33,030,000, which was $1,127,000 (3.3%) lower than total 2014 noninterest expenses. The reduction in noninterest expenses for the year ended December 31, 2015 as compared to the corresponding period in 2014 included the following: (1) a reduction in salaries and wages expenses of $439,000, mainly due to severance expenses in 2014; (2) a reduction in employee benefit-related expenses of $349,000 due to lower employee health insurance expense as a result of lower claims; (3) a reduction in professional fees expense of $161,000, as 2014 included expenses associated with an executive search; (4) a reduction in Pennsylvania shares tax expense of $102,000; and (5) a reduction in other expenses of $282,000, including reductions in expenses from loan collections and other real estate properties.

More detailed information concerning fluctuations in the Corporation's earnings results are provided in other sections of Management's Discussion and Analysis.

CRITICAL ACCOUNTING POLICIES

The presentation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates

A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. 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. Management believes the allowance for loan losses is adequate and reasonable. Notes 1 and 8 to the consolidated financial statements provide an overview of the process management uses for evaluating and determining the allowance for loan losses, and additional discussion of the allowance for loan losses is provided in a separate section later in Management's Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions, and could, therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation's debt securities. For most of the Corporation's debt securities, the Corporation receives estimated fair values of debt securities from an independent valuation service, or from brokers. In developing fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services.

As described in Note 7 to the consolidated financial statements, management evaluates securities for other-than-temporary impairment ("OTTI"). In making that evaluation, consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) whether the Corporation intends to sell the security or more likely than not will be required to sell the security before its anticipated recovery. Management's assessments of the likelihood and potential for recovery in value of securities are subjective and based on sensitive assumptions.

NET INTEREST INCOME

The Corporation's primary source of operating income is net interest income, which is equal to the difference between the amounts of interest income and interest expense. Tables I, II and III include information regarding the Corporation's net interest income in 2016, 2015, and 2014. In each of these tables, the amounts of interest income earned on tax-exempt securities and loans have been adjusted to a fully taxable-equivalent basis. Accordingly, the net interest income amounts reflected in these tables exceed the amounts presented in the consolidated financial statements. The discussion that follows is based on amounts in the tables.

The calculations of fully taxable-equivalent yields on tax-exempt loans and securities in Tables I, II and III reflect inherent tax benefit based on the Corporation's marginal federal income tax rate of 35% for all periods presented. As discussed in more detail in the "Income Taxes" section of Management's Discussion and Analysis, the Trump Administration and the U.S. Congress have recently been discussing the possibility of lowering corporate income tax rates. If corporate income tax rates were lowered, fully taxable-equivalent yields on tax-exempt loans and securities held at December 31, 2016 would decrease from their recent levels.

2016 vs. 2015

Fully taxable equivalent net interest income was $43,157,000 in 2016, which was $338,000 (0.8%) higher than in 2015. As shown in Table III, in 2016 compared to 2015, net changes in volume had the effect of increasing net interest income $2,754,000, and interest rate changes had the effect of decreasing net interest income $2,416,000. The most significant components of the volume-related increase in net interest income in 2016 was an increase in interest income of $3,255,000 attributable to an increase in the balance of loans receivable and a decrease in interest expense of $991,000 attributable to a reduction in the balance of borrowed funds, partially offset by a volume-related decrease in interest income on available-for-securities of $1,542,000. The most significant components of the rate-related change in net interest income in 2016 were a decrease in interest income of $1,560,000 attributable to lower rates earned on loans receivable and a decrease of $758,000 in interest income on available-for-sale securities. As presented in Table II, the “Interest Rate Spread” (excess of average rate of return on earning assets over average cost of funds on interest-bearing liabilities) was 3.63% in 2016 as compared to 3.54% in 2015.

INTEREST INCOME AND EARNING ASSETS

Interest income totaled $46,850,000 in 2016, a decrease of 1.2% from 2015. Although yields on securities and loans fell, overall yield on earning assets dropped only 0.01% due to a change in mix of earning assets to increase loans and decrease securities. Interest and fees on loans receivable increased $1,695,000, or 5.0%, while interest on available-for-sale securities decreased $2,300,000, or 17.1%. The average balance of gross loans receivable increased 9.9% to $723,076,000 in 2016 from $657,727,000 in 2015. The Corporation experienced significant growth in all loan categories, particularly in participation loans purchased of $19,664,000, residential mortgages of $16,405,000, commercial real estate loans of $13,452,000, and tax free municipal loans of $6,351,000. The Corporation’s average rate of return on loans receivable declined to 4.92% in 2016 from 5.15% in 2015 as average interest rates on new loans are lower, reflecting recent market conditions.

As indicated in Table II, average available-for-sale securities (at amortized cost) totaled $404,979,000 in 2016, a decrease of $74,169,000 (15.5%) from 2015. Funds generated from the net decrease in the Corporation’s available-for-sale securities portfolio were used, in part, to fund the loan growth described above. The Corporation’s yield on securities was lower in 2016 than in 2015, primarily due to higher-yielding securities maturing as the portfolio size was reduced. The average rate of return on available-for-sale securities was 2.75% in 2016 and 2.81% in 2015.

The average balance of interest-bearing due from banks decreased to $19,022,000 in 2016 from $22,201,000 in 2015. This has consisted primarily of balances held by the Federal Reserve and also includes other overnight deposits and FDIC-insured certificates of deposit issued by other financial institutions.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense fell $909,000, or 19.8%, to $3,693,000 in 2016 from $4,602,000 in 2015. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 0.45% in 2016 from 0.55% in 2015.

Total average deposits (interest-bearing and noninterest-bearing) increased slightly (0.2%) to $970,447,000 in 2016 from $968,201,000 in 2015. Decreases in the average balances of certificates of deposit and Individual Retirement Accounts were offset by increases in average balances of interest checking, money market accounts, savings accounts and noninterest-bearing demand deposits. The average rate paid on interest-bearing deposits increased slightly to 0.28% in 2016 from 0.26% in 2015.

Total average borrowed funds decreased $15,126,000 to $62,516,000 in 2016 from $77,642,000 in 2015. The average rate on borrowed funds was 2.57% in 2016 compared to 3.45% in 2015, reflecting a $27,604,000 reduction in the average balance of higher-rate, long-term borrowings resulting from prepayment in the second and fourth quarters of 2015 of a long-term repurchase agreement borrowing with an interest rate of 4.265%. The average balance of short-term borrowings increased $12,478,000 in 2016 over 2015, as average overnight borrowings were higher in 2016 and the Corporation funded the pay-off of the long-term repurchase agreement with a series of short-term advances from the FHLB-Pittsburgh that matured over the course of 2016.

2015 vs. 2014

Fully taxable equivalent net interest income was $42,819,000 in 2015, which was $1,074,000 (2.4%) lower than in 2014. As shown in Table III, in 2015 compared to 2014, interest rate changes had the effect of decreasing net interest income $2,283,000, and net changes in volume had the effect of increasing net interest income $1,209,000. The most significant components of the rate-related change in net interest income in 2015 were a decrease in interest income of $1,957,000 attributable to lower rates earned on loans receivable and a decrease of $468,000 in interest income on available-for-sale securities. The most significant components of the volume-related increase in net interest income in 2015 was an increase in interest income of $1,544,000 attributable to an increase in the balance of loans receivable, a decrease in interest expense of $270,000 attributable to a reduction in the balance of borrowed funds, and a decrease in interest expense of $117,000 attributable to a reduction in the balance of interest-bearing deposits (primarily certificates of deposit), partially offset by a volume-related decrease in interest income on available-for-securities of $681,000. As presented in Table II, the "Interest Rate Spread" (excess of average rate of return on earning assets over average cost of funds on interest-bearing liabilities) was 3.54% in 2015 as compared to 3.63% in 2014.

INTEREST INCOME AND EARNING ASSETS

Interest income totaled $47,421,000 in 2015, a decrease of 3.2% from 2014. Interest and fees on loans receivable decreased $413,000, or 1.2%. As indicated in Table II, average available-for-sale securities (at amortized cost) totaled $479,148,000 in 2015, a decrease of $15,786,000 (3.2%) from 2014. The net decrease in the Corporation's available-for-sale securities portfolio consisted of decreases in tax-exempt municipal securities, U.S. Government mortgage-backed securities, U.S. Government agency bonds, and equity securities. These decreases were partially offset by increases in the balances of collateralized mortgage obligations and taxable municipal securities. The Corporation's yield on securities was lower in 2015 than in 2014, primarily because of low market interest rates on new investments combined with higher-yielding securities maturing. The average rate of return on available-for-sale securities was 2.81% for 2015 and 2.95% in 2014.

The average balance of gross loans receivable increased 4.8% to $657,727,000 in 2015 from $627,753,000 in 2014. The Corporation experienced growth in the balances of tax free municipal loans, residential mortgages and participation loans purchased. These increases were partially offset by decreases in balances of commercial real estate loans. The Corporation's average rate of return on loans receivable declined to 5.15% in 2015 from 5.46% in 2014.

The average balance of interest-bearing due from banks decreased to $22,201,000 in 2015 from $32,510,000 in 2014. This has consisted primarily of balances held by the Federal Reserve and also includes other overnight deposits and FDIC-insured certificates of deposit issued by other financial institutions.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense fell $520,000, or 10.2%, to $4,602,000 in 2015 from $5,122,000 in 2014. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 0.55% in 2015 from 0.61% in 2014.

Total average deposits (interest-bearing and noninterest-bearing) increased 0.3%, to $968,201,000 in 2015 from $965,418,000 in 2014. Decreases in the average balances of certificates of deposit, Individual Retirement Accounts, and money market accounts were partially offset by increases in average balances of interest checking, savings accounts and non-interest bearing demand deposits. The average rate paid on interest-bearing deposits fell slightly to 0.26% in 2015 from 0.28% in 2014.

Total average borrowed funds decreased $2,298,000 to $77,642,000 in 2015 from $79,940,000 in 2014. The average rate on borrowed funds was 3.45% in 2015 compared to 3.70% in 2014, reflecting a $6,982,000 reduction in the average balance of higher-rate, long-term borrowings resulting from pre-payment of a long-term repurchase agreement borrowing with an interest rate of 4.265%. The Corporation paid off $10 million of principal on this borrowing in May 2015, and $24 million in December 2015, leaving no remaining balance outstanding at December 31, 2015. (The pre-payment of long-term borrowings is described in the Earnings Overview section.) The average balance of short-term borrowings increased $4,684,000 in 2015 over 2014, as average overnight borrowings were higher in 2015 and the Corporation funded the pay-off of the long-term repurchase agreement in December 2015 with funds from a series of short-term advances from the FHLB-Pittsburgh totaling $25,072,000 at an average rate of 0.86%.

TABLE I - ANALYSIS OF INTEREST INCOME AND EXPENSE

(In Thousands)	Years Ended December 31, 2016	2015	2014	Increase/(Decrease) 2016/2015	2015/2014
INTEREST INCOME					
Available-for-sale securities:					
Taxable	$5,916	$7,587	$8,028	$(1,671)	$(441)
Tax-exempt	5,240	5,869	6,577	(629)	(708)
Total available-for-sale securities	11,156	13,456	14,605	(2,300)	(1,149)
Interest-bearing due from banks	116	93	125	23	(32)
Loans held for sale	27	16	16	11	0
Loans receivable:					
Taxable	32,827	31,311	32,127	1,516	(816)
Tax-exempt	2,724	2,545	2,142	179	403
Total loans receivable	35,551	33,856	34,269	1,695	(413)
Total Interest Income	46,850	47,421	49,015	(571)	(1,594)
INTEREST EXPENSE					
Interest-bearing deposits:					
Interest checking	293	214	216	79	(2)
Money market	342	299	286	43	13
Savings	133	128	121	5	7
Certificates of deposit	882	831	1,069	51	(238)
Individual Retirement Accounts	434	451	470	(17)	(19)
Other time deposits	1	1	1	0	0
Total interest-bearing deposits	2,085	1,924	2,163	161	(239)
Borrowed funds:					
Short-term	155	32	9	123	23
Long-term	1,453	2,646	2,950	(1,193)	(304)
Total borrowed funds	1,608	2,678	2,959	(1,070)	(281)
Total Interest Expense	3,693	4,602	5,122	(909)	(520)
Net Interest Income	$43,157	$42,819	$43,893	$338	$(1,074)

(1) Interest income from tax-exempt securities and loans has been adjusted to a fully taxable-equivalent basis, using the Corporation’s marginal federal income tax rate of 35%.

(2) Fees on loans are included with interest on loans and amounted to $1,000,000 in 2016, $1,004,000 in 2015, and $1,013,000 in 2014.

TABLE II - ANALYSIS OF AVERAGE DAILY BALANCES AND RATES

(Dollars in Thousands)

	Year Ended 12/31/2016 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2015 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2014 Average Balance	Rate of Return/ Cost of Funds %
EARNING ASSETS						
Available-for-sale securities, at amortized cost:						
Taxable	$293,636	2.01 %	$366,448	2.07 %	$371,125	2.16 %
Tax-exempt	111,343	4.71 %	112,700	5.21 %	123,809	5.31 %
Total available-for-sale securities	404,979	2.75 %	479,148	2.81 %	494,934	2.95 %
Interest-bearing due from banks	19,022	0.61 %	22,201	0.42 %	32,510	0.38 %
Federal funds sold	0	0.00 %	0	0.00 %	0	0.00 %
Loans held for sale	472	5.72 %	222	7.21 %	204	7.84 %
Loans receivable:						
Taxable	662,769	4.95 %	603,771	5.19 %	589,120	5.45 %
Tax-exempt	60,307	4.52 %	53,956	4.72 %	38,633	5.54 %
Total loans receivable	723,076	4.92 %	657,727	5.15 %	627,753	5.46 %
Total Earning Assets	1,147,549	4.08 %	1,159,298	4.09 %	1,155,401	4.24 %
Cash	16,570		16,639		16,865	
Unrealized gain/loss on securities	7,166		8,871		6,350	
Allowance for loan losses	(8,082)		(7,380)		(7,992)	
Bank premises and equipment	15,413		15,911		16,789	
Intangible Asset - Core Deposit Intangible	24		41		70	
Intangible Asset – Goodwill	11,942		11,942		11,942	
Other assets	39,284		37,887		40,472	
Total Assets	$1,229,866		$1,243,209		$1,239,897	
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	$201,357	0.15 %	$195,940	0.11 %	$183,874	0.12 %
Money market	199,405	0.17 %	196,585	0.15 %	198,990	0.14 %
Savings	132,679	0.10 %	128,355	0.10 %	121,685	0.10 %
Certificates of deposit	117,130	0.75 %	121,803	0.68 %	134,732	0.79 %
Individual Retirement Accounts	103,467	0.42 %	110,659	0.41 %	120,016	0.39 %
Other time deposits	1,036	0.10 %	1,031	0.10 %	1,039	0.10 %
Total interest-bearing deposits	755,074	0.28 %	754,373	0.26 %	760,336	0.28 %
Borrowed funds:						

Short-term	23,906	0.65 %	11,428	0.28 %	6,744	0.13 %
Long-term	38,610	3.76 %	66,214	4.00 %	73,196	4.03 %
Total borrowed funds	62,516	2.57 %	77,642	3.45 %	79,940	3.70 %
Total Interest-bearing Liabilities	817,590	0.45 %	832,015	0.55 %	840,276	0.61 %
Demand deposits	215,373		213,828		205,082	
Other liabilities	8,530		8,461		9,070	
Total Liabilities	1,041,493		1,054,304		1,054,428	
Stockholders' equity, excluding accumulated other comprehensive income	183,671		183,125		181,271	
Accumulated other comprehensive income	4,702		5,780		4,198	
Total Stockholders' Equity	188,373		188,905		185,469	
Total Liabilities and Stockholders' Equity	$1,229,866		$1,243,209		$1,239,897	
Interest Rate Spread		3.63 %		3.54 %		3.63 %
Net Interest Income/Earning Assets		3.76 %		3.69 %		3.80 %
Total Deposits (Interest-bearing and Demand)	$970,447		$968,201		$965,418	

(1) Annualized rates of return on tax-exempt securities and loans are presented on a fully taxable-equivalent basis, using the Corporation’s marginal federal income tax rate of 35%.

(2) Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.

(3) Rates of return on earning assets and costs of funds are presented on an annualized basis.

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TABLE III - ANALYSIS OF VOLUME AND RATE CHANGES

(In Thousands)

	Year Ended 12/31/16 vs. 12/31/15			Year Ended 12/31/15 vs. 12/31/14		
	Change in Volume	Change in Rate	Total Change	Change in Volume	Change in Rate	Total Change
EARNING ASSETS						
Available-for-sale securities:						
Taxable	$(1,472)	$(199)	$(1,671)	$(100)	$(341)	$(441)
Tax-exempt	(70)	(559)	(629)	(581)	(127)	(708)
Total available-for-sale securities	(1,542)	(758)	(2,300)	(681)	(468)	(1,149)
Interest-bearing due from banks	(14)	37	23	(42)	10	(32)
Loans held for sale	15	(4)	11	1	(1)	0
Loans receivable:						
Taxable	2,965	(1,449)	1,516	786	(1,602)	(816)
Tax-exempt	290	(111)	179	758	(355)	403
Total loans receivable	3,255	(1,560)	1,695	1,544	(1,957)	(413)
Total Interest Income	1,714	(2,285)	(571)	822	(2,416)	(1,594)
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	6	73	79	14	(16)	(2)
Money market	4	39	43	(3)	16	13
Savings	4	1	5	7	0	7
Certificates of deposit	(33)	84	51	(97)	(141)	(238)
Individual Retirement Accounts	(30)	13	(17)	(38)	19	(19)
Other time deposits	0	0	0	0	0	0
Total interest-bearing deposits	(49)	210	161	(117)	(122)	(239)
Borrowed funds:						
Short-term	56	67	123	9	14	23
Long-term	(1,047)	(146)	(1,193)	(279)	(25)	(304)
Total borrowed funds	(991)	(79)	(1,070)	(270)	(11)	(281)
Total Interest Expense	(1,040)	131	(909)	(387)	(133)	(520)
Net Interest Income	$2,754	$(2,416)	$338	$1,209	$(2,283)	$(1,074)

(1) Changes in income on tax-exempt securities and loans are presented on a fully taxable-equivalent basis, using the Corporation's marginal federal income tax rate of 35%.

(2) The change in interest due to both volume and rates has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

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NONINTEREST INCOME

Years Ended December 31, 2016, 2015 and 2014

The table below presents a comparison of noninterest income and excludes realized gains on available-for-sale securities, which are discussed in the "Earnings Overview" section of Management's Discussion and Analysis.

TABLE IV - COMPARISON OF NONINTEREST INCOME

(In Thousands)

	Years Ended December 31, 2016	2015	$ Change	% Change
Service charges on deposit accounts	$4,695	$4,864	$(169)	(3.5)
Service charges and fees	439	494	(55)	(11.1)
Trust and financial management revenue	4,760	4,626	134	2.9
Brokerage revenue	756	839	(83)	(9.9)
Insurance commissions, fees and premiums	102	109	(7)	(6.4)
Interchange revenue from debit card transactions	1,943	1,935	8	0.4
Net gains from sales of loans	1,029	735	294	40.0
Decrease in fair value of servicing rights	(282)	(162)	(120)	74.1
Increase in cash surrender value of life insurance	382	386	(4)	(1.0)
Other operating income	1,687	1,652	35	2.1
Total other operating income before realized gains on available-for-sale securities, net	$15,511	$15,478	$33	0.2

	Years Ended December 31, 2015	2014	$ Change	% Change
Service charges on deposit accounts	$4,864	$5,025	$(161)	(3.2)
Service charges and fees	494	538	(44)	(8.2)
Trust and financial management revenue	4,626	4,490	136	3.0
Brokerage revenue	839	901	(62)	(6.9)
Insurance commissions, fees and premiums	109	118	(9)	(7.6)
Interchange revenue from debit card transactions	1,935	1,959	(24)	(1.2)
Net gains from sales of loans	735	768	(33)	(4.3)
Decrease in fair value of servicing rights	(162)	(27)	(135)	500.0
Increase in cash surrender value of life insurance	386	376	10	2.7
Other operating income	1,652	1,272	380	29.9

Total other operating income before realized gains on available-for-sale securities, net	$15,478	$15,420	$ 58	0.4

Total noninterest income, excluding realized gains on available-for-sale securities, increased $33,000 in 2016 compared to 2015. In 2015, total noninterest income increased $58,000 from 2014. Changes of significance are discussed in the narrative that follows.

2016 vs. 2015

Net gains from sales of loans increased $294,000 (40.0%), reflecting higher volume of sales. The increase in volume in 2016 included the impact of employing one additional mortgage lender in a dedicated, full-time capacity throughout most of 2016 as compared to 2015.

Trust and Financial Management revenue increased $134,000 (2.9%). The increase in Trust revenue in 2016 reflected, in part, the effect of higher value of U.S. equity markets in the latter portion of the year.

Other operating income increased $35,000 (2.1%), including an increase of $148,000 from redemptions of tax credits and increases in lending-related fees of $80,000, while this category included a gain of $212,000 from a split-dollar life insurance policy in 2015.

Service charges on deposit accounts decreased $169,000 (3.5%) in 2016, including a $131,000 reduction in consumer overdraft fees due to a lower volume of overdrafts.

The fair value of mortgage servicing rights decreased $282,000 in 2016, as their valuation was negatively impacted by a reduction in demand by banks for purchasing servicing rights resulting from regulatory changes that have generally increased their risk-based capital weighting. In comparison, the fair value of mortgage servicing rights decreased $162,000 in 2015.

Brokerage revenue decreased $83,000 (9.9%), as the volume of sales of annuities declined.

2015 vs. 2014

Service charges on deposit accounts were $161,000 lower in 2015 than 2014. Total consumer and business overdraft and uncollected funds fees decreased $387,000 in 2015 as compared to 2014. These decreases were partially offset by revenues resulting from adjustments to the existing fee structure of certain checking products in April 2015.

The fair value of servicing rights decreased $162,000 in 2015 as compared to a decrease of $27,000 in 2014. The greater decline in fair value in 2015 reflected the impact of a reduction in the outstanding balance of mortgage loans sold and serviced in 2015, as compared to an increase in the balance of loans serviced in 2014 over 2013.

Included in the $380,000 increase in other operating revenue in 2015 is the effect of a $212,000 gain recognized from a life insurance arrangement in which the benefits were split between Corporation and the heirs of the former employee. In addition, dividend income from Federal Home Loan Bank of Pittsburgh stock increased $36,000, and revenue from merchant services increased $28,000, in 2015 as compared to 2014.

In 2015, Trust and financial management revenue increased $136,000, or 3.0%. This increase was primarily in retirement services revenue.

NONINTEREST EXPENSE

Years Ended December 31, 2016, 2015 and 2014

Total noninterest expense decreased $859,000, or 2.4%, in 2016 as compared to 2015; however, excluding losses from prepayment of borrowings in 2015, noninterest expense was $1,714,000 (5.2%) higher in 2016 as compared to 2015. Excluding losses from prepayment of debt in 2015, total noninterest expense decreased $1,127,000 (3.3%) in 2015 as compared to 2014. In 2015, the Corporation incurred losses totaling $2,573,000 from prepayment of borrowings (repurchase agreements). There were no losses from prepayment of borrowings incurred in 2016 or 2014. Changes of significance (other than the previously discussed losses on prepayment of debt) are discussed in the narrative that follows.

TABLE V - COMPARISON OF NONINTEREST EXPENSE

(In Thousands)

	Years Ended December 31,		$	%
	2016	2015	Change	Change
Salaries and wages	$15,411	$14,682	$729	5.0
Pensions and other employee benefits	4,717	4,420	297	6.7
Occupancy expense, net	2,340	2,574	(234)	(9.1)
Furniture and equipment expense	1,730	1,860	(130)	(7.0)
FDIC Assessments	488	603	(115)	(19.1)
Pennsylvania shares tax	1,274	1,248	26	2.1
Professional fees	1,126	638	488	76.5
Automated teller machine and interchange expense	1,137	988	149	15.1
Software subscriptions	981	876	105	12.0
Loss on prepayment of borrowings	0	2,573	(2,573)	(100.0)
Other operating expense	5,540	5,141	399	7.8
Total Other Expense	$34,744	$35,603	$(859)	(2.4)

	Years Ended December 31, 2015	2014	$ Change	% Change
Salaries and wages	$14,682	$15,121	$(439)	(2.9)
Pensions and other employee benefits	4,420	4,769	(349)	(7.3)
Occupancy expense, net	2,574	2,628	(54)	(2.1)
Furniture and equipment expense	1,860	1,859	1	0.1
FDIC Assessments	603	600	3	0.5
Pennsylvania shares tax	1,248	1,350	(102)	(7.6)
Professional fees	638	699	(61)	(8.7)
Automated teller machine and interchange expense	988	924	64	6.9
Software subscriptions	876	784	92	11.7
Loss on prepayment of borrowings	2,573	0	2,573	100.0
Other operating expense	5,141	5,423	(282)	(5.2)
Total Other Expense	$35,603	$34,157	$1,446	4.2

2016 vs 2015

Salaries and wages expense increased $729,000 (5.0%), reflecting an increase in number of employees. The average number of full-time equivalent employees was 287 in 2016, up from 281 in 2015, including new positions established for lending, lending support, information technology, training and marketing functions.

Pension and other employee benefits expense increased $297,000 (6.7%). The increase resulted mainly from an increase of $214,000 in healthcare expense as a result of increased healthcare claims. The Corporation is self-insured for health insurance, up to a cap for catastrophic levels of losses, which are insured by a third party. Payroll taxes and other expenses within this category increased in 2016, as well, due to the increase in number of employees described above.

Professional fees expense increased $488,000, including increases related to employee sales and service training, information technology and marketing.

Automated teller machine and interchange expense increased $149,000, including the costs of purchasing new debit cards with EMV functionality.

Software subscriptions increased $105,000 as a result of enhancements and new applications initiated in 2015 and continuing into 2016 including costs associated with the network operating system, automated document signatures and marketing-related functionality.

Other operating expense increased $399,000 (7.8%), including increases in other real estate expenses of $123,000, donations and public relations-related expenses of $94,000 and education and training-related expenses of $60,000. Also, other operating expense was reduced in 2015 by $69,000 as a result of a recovery of sales tax previously paid.

Occupancy expenses in 2016 were $234,000 under 2015 primarily as a result lower depreciation costs as well as lower winter-related expenses such as snow removal and fuel costs.

Furniture and equipment expenses in 2016 were $130,000 under 2015 primarily as a result lower depreciation costs.

FDIC insurance decreased $115,000 in 2016 reflecting lower assessment levels beginning in the third quarter of 2016.

2015 vs 2014

Salaries and wages decreased $439,000 (2.9%). As noted in the Earnings Overview section, this decrease is primarily the result of severance benefits incurred and paid in 2014. The decrease from severance benefits was partially offset by annual merit-based pay increases, an increase in incentive and other bonuses of $168,000 and the addition of new lending and other personnel.

Pensions and other employee benefits decreased $349,000 (7.3%). Health care expense decreased $342,000 as the amount of claims incurred during 2015 was lower than in 2014. In addition, pension expense decreased $111,000 as the result of a charge in 2014 related to a distribution from a defined benefit plan. These decreases were partially offset by annual increases in other benefit and administrative costs.

Other operating expense decreased $282,000 (5.2%). The reduction included a $191,000 decrease in loan collection expenses and an $86,000 decrease in other real estate expenses.

INCOME TAXES

The effective income tax rate was 25.3% of pre-tax income in 2016, 24.5% in 2015 and 25.0% in 2014. The Corporation's effective tax rates differ from the statutory rate of 35% principally because of the effects of tax-exempt interest income.

The Corporation recognizes deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax basis of assets and liabilities. At December 31, 2016, the net deferred tax asset was $5,117,000, an increase from the balance at December 31, 2015 of $3,115,000. The largest change in temporary difference components was a change to a deferred tax asset of $512,000 on the aggregate unrealized loss on available-for-sale securities at December 31, 2016 from a deferred tax liability of $1,342,000 on the aggregate unrealized gain on available-for-sale securities at December 31, 2015. The decline in fair values of available-for-sale securities was mainly due to an increase in interest rates in the last few months of 2016.

The Corporation uses currently enacted tax rates to value deferred tax assets and liabilities. The Trump Administration and the U.S. Congress are in the process of evaluating possible tax changes which may include a reduction in U.S. corporate income tax rates. If corporate tax rates were reduced, management expects the Corporation would record an initial charge against earnings to lower the carrying amount of the net deferred tax asset, and then would record a lower tax provision going forward on an ongoing basis.

The following schedule estimates the amount of initial reduction in the net deferred tax asset that would be recognized, at varying marginal federal income tax rates, based on the Corporation's temporary difference components at December 31, 2016. The schedule also shows the pro forma impact on the 2016 provision for income taxes, assuming the alternative tax rates presented had been in effect throughout the year, without adjustment for reinvestment of additional funds and assuming no other changes in the composition of the Corporation's assets and liabilities.

(Dollars in Thousands)

	Valuation at Marginal Federal Tax Rate of:			
	35% (Actual)	25%	20%	15%
Carrying Value of Deferred Tax Asset at 12/31/16:				
Accumulated Other Comprehensive Items, Net	$ 485	$ 347	$ 278	$ 207
Other Items, Net	4,632	3,309	2,647	1,985
Total	$ 5,117	$ 3,656	$ 2,925	$ 2,192
Pro Forma Reduction in Carrying Value of Deferred Tax Asset from 12/31/16:				
Accumulated Other Comprehensive Items, Net		$ (138)	$ (207)	$ (278)
Other Items, Net (Initial Charge to Earnings)		(1,323)	(1,985)	(2,647)
Total		$ (1,461)	$ (2,192)	$ (2,925)

	For the Year Ended 12/31/16 at Marginal Federal Tax Rate of:			
	35% (Actual)	25%	20%	15%
Income Tax Provision	$5,347	$3,797	$3,025	$2,250
Income Tax Provision as % of Pre-tax Income	25.3 %	18.0 %	14.3 %	10.7 %
Pro Forma Reduction in 2016 Annual Income Tax Provision if Alternative Rate Were in Effect Throughout 2016		$(1,550)	$(2,322)	$(3,097)

The Corporation regularly reviews deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. Further, as discussed above, realization of deferred tax assets would be impacted if income tax rates are lowered from currently enacted levels.

Management believes the recorded net deferred tax asset at December 31, 2016 is fully realizable; however, if management determines the Corporation will be unable to realize all or part of the net deferred tax asset, the Corporation would adjust the deferred tax asset, which would negatively impact earnings.

Additional information related to income taxes is presented in Note 14 to the consolidated financial statements.

SECURITIES

Table VI shows the composition of the investment portfolio at December 31, 2016, 2015 and 2014. Comparison of the amortized cost totals of available-for-sale securities at each year-end presented reflects a decrease of $92,227,000 to $416,455,000 at December 31, 2015 from December 31, 2014. This change was followed by a decrease of $19,917,000 to $396,538,000 at December 31, 2016. The continued decrease in securities in 2016 reflects the use of cash generated from the investment portfolio to help fund the increase in loans outstanding. The Corporation's holdings of mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored agencies have decreased to $237,654,000 at December 31, 2016 from $266,372,000 at December 31, 2015 and $322,099,000 at December 31, 2014. Within that overall category, in 2016, the Corporation added some commercial mortgage-backed securities for which the underlying collateral consists of multi-family properties. The total amortized cost of commercial mortgage-backed securities held at December 31, 2016 was $30,817,000.

As reflected in Table VI, the fair value of available-for-sale securities as of December 31, 2016 was $1,461,000, or 0.37%, less than the total amortized cost basis. The aggregate unrealized loss position at December 31, 2016 was down from an unrealized gain of $3,835,000 at December 31, 2015, partly due to an increase in interest rates in the last few months of 2016. Changes in intermediate-term and long-term interest rates have a significant impact on changes in fair values of debt securities. The fair values of tax-exempt municipal bonds at December 31, 2016 may have been negatively impacted, as well, by the market's perception that U.S. corporate income tax rates may be reduced within the next 1-2 years. The aggregate unrealized gain on tax-exempt municipal bonds was $897,000, or 0.8% of amortized cost, at December 31, 2016. In comparison, the aggregate unrealized gain on tax-exempt municipal bonds held at December 31, 2015 was $4,343,000, or 4.2%. The aggregate unrealized loss on debt securities at December 31, 2016 was 0.36% of the amortized cost basis, down from net unrealized gains on debt securities of 0.75% at December 31, 2015 and 1.01% at December 31, 2014. Also contributing to the reduction in aggregate unrealized gain (loss) was the liquidation of the bank stock portfolio in 2015 and 2016 as the Corporation realized gains from the sale of bank stocks. As discussed in more detail in Note 7 to the consolidated financial statements, the Corporation reported net realized gains from available-for-sale securities of $1,158,000 in 2016, including realized gains from sales of equity securities (bank stocks) of $1,125,000. In comparison, net realized gains from available-for-sale securities totaled $2,861,000 in 2015 and $1,104,000 in 2014.

Management has reviewed the Corporation's holdings as of December 31, 2016 and concluded that unrealized losses on all of the securities in an unrealized loss position are considered temporary. Notes 6 and 7 to the consolidated financial statements provide more detail concerning the Corporation's processes for evaluating securities for other-than-temporary impairment. Management will continue to closely monitor the status of impaired securities in 2017.

TABLE VI - INVESTMENT SECURITIES

	As of December 31,					
	2016		2015		2014	
(In Thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
AVAILABLE-FOR-SALE SECURITIES:						
Obligations of U.S. Government agencies	$9,671	$9,541	$10,663	$10,483	$27,221	$26,676
Obligations of states and political subdivisions:						
Tax-exempt	118,140	119,037	103,414	107,757	120,086	124,839
Taxable	30,073	30,297	34,317	34,597	33,637	33,878
Mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored agencies:						
Residential pass-through securities	58,922	58,404	73,227	73,343	82,479	83,903
Residential collateralized mortgage obligations	147,915	146,608	193,145	191,715	239,620	238,823
Commercial mortgage-backed securities	30,817	30,219	0	0	0	0
Other collateralized debt obligations	0	0	9	9	34	34
Total debt securities	395,538	394,106	414,775	417,904	503,077	508,153
Marketable equity securities	1,000	971	1,680	2,386	5,605	8,654
Total	$396,538	$395,077	$416,455	$420,290	$508,682	$516,807

The following table presents the contractual maturities and the weighted-average yields (calculated based on amortized cost) of investment securities as of December 31, 2016. Yields on tax-exempt securities are presented on a nominal basis, that is, the yields are not presented on a fully taxable-equivalent basis. 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, Except for Percentages)	Within One Year	Yield	One-Five Years	Yield	Five-Ten Years	Yield	After Ten Years	Yield	Total	Yield
AVAILABLE-FOR-SALE SECURITIES:										
Obligations of U.S. Government agencies	$1,637	1.36%	$8,034	1.42%	$0	0.00%	$0	0.00%	$9,671	1.41%
Obligations of states and political subdivisions:										
Tax-exempt	13,429	3.13%	43,417	2.80%	36,175	2.22%	25,119	3.77%	118,140	2.86%
Taxable	3,613	1.81%	18,108	2.25%	8,352	3.07%	0	0.00%	30,073	2.43%

Sub-total	$18,679	2.72%	$69,559	2.50%	$44,527	2.38%	$25,119	3.77%	157,884	2.69%
Mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored agencies:										
Residential pass-through securities									58,922	2.07%
Residential collateralized mortgage obligations									147,915	1.96%
Commercial mortgage-backed securities									30,817	2.34%
Total									$395,538	2.12%

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. As rates increase, cash flows generally decrease as prepayments on the underlying mortgage loans decrease. As rates decrease, cash flows generally increase as prepayments increase due to increased refinance activity and other factors. In the table above, the entire balances and weighted-average rates for mortgage-backed securities and collateralized mortgage obligations are shown in one period.

FINANCIAL CONDITION

Gross loans outstanding (excluding mortgage loans held for sale) were $751,835,000 at December 31, 2016, up 6.7% from $704,880,000 at December 31, 2015. The total outstanding balances of residential mortgage segment loans at December 31, 2016 increased $34,683,000 (9.0%) as compared to December 31, 2015, and the total outstanding balances of commercial segment loans at December 31, 2016 increased $9,206,000 (3.0%) as compared to December 31, 2015. The 2016 loan growth followed significant growth in loans outstanding in 2015, as gross loans outstanding at December 31, 2015 were up 11.8% from December 31, 2014. Total outstanding commercial loans were higher by $54,239,000 (21.4%), and residential mortgage segment loans were up $19,674,000 (5.4%), at December 31, 2015 as compared to December 31, 2014.

The increases in loans outstanding in 2015 and 2016 included increases in commercial participation loans. Participation loans represent portions of larger commercial transactions for which other institutions are the “lead banks”. Although not the lead bank, the Corporation conducts detailed underwriting and monitoring of participation loan opportunities. Participation loans are included in the “Commercial and industrial,” “Commercial loans secured by real estate” and “Political subdivisions” classes in the loan tables presented in this Form 10-K. Total participation loans outstanding amounted to $47,508,000 at December 31, 2016, up from $44,456,000 at December 31, 2015. At December 31, 2016, the balance of participation loans outstanding includes a total of $34,890,000 to businesses located outside of the Corporation’s market area, including $11,967,000 from participations in loans originated through the Corporation’s membership in a network that originates loans throughout the U.S. The Corporation’s participation loans originated through the network consist of loans to businesses that are larger than the Corporation’s typical commercial customer base. The loans originated through the network are considered “leveraged loans,” meaning the businesses typically have minimal tangible book equity and the extent of collateral available is limited, though the businesses have demonstrated strong cash flow performance in their recent histories. At December 31, 2016, total leveraged participation loans, including loans originated through the network and two loans to one borrower originated through another lead institution, totaled $15,207,000.

Table VIII presents loan maturity data as of December 31, 2016. The interest rate simulation model classifies certain loans under different categories from the categories that appear in Table VII. Fixed-rate loans are shown in Table VIII based on their contractually scheduled principal repayments, and variable-rate loans are shown based on the date of the next change in rate. Table VIII shows that fixed-rate loans are approximately 38% of the loan portfolio. Of the 62% of the portfolio made up of variable-rate loans, a significant portion (36%) will re-price after more than one year. Variable-rate loans re-pricing after more than one year include residential and commercial real estate secured loans. The Corporation’s substantial investment in long-term, fixed-rate loans and variable-rate loans with extended periods until re-pricing is one of the concerns management attempts to address through interest rate risk management practices. See Part II, Item 7A for a more detailed discussion of the Corporation’s interest rate risk.

Other significant changes in the average balances of the Corporation’s earning assets and interest-bearing liabilities are described in the “Net Interest Income” section of Management’s Discussion and Analysis. Other significant balance sheet items, including securities, the allowance for loan losses and stockholders' equity, are discussed in separate sections of Management's Discussion and Analysis.

Total purchases of bank premises and equipment in 2017 are estimated at approximately $2.5 million. Management does not expect the amount of purchases of bank premises and equipment to have a material, detrimental effect on the Corporation's financial condition in 2017.

Since 2009, the Corporation has originated and sold residential mortgage loans to the secondary market through the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago. Residential mortgages originated and sold through the MPF Xtra program consist primarily of conforming, prime loans sold to the Federal National Mortgage Association (Fannie Mae), a quasi-government entity. In 2014, the Corporation began to originate and sell residential mortgage loans to the secondary market through the MPF Original program, which is also administered by the Federal Home Loan Banks of Pittsburgh and Chicago. Residential mortgages originated and sold through the MPF Original program consist primarily of conforming, prime loans sold to the Federal Home Loan Bank of Pittsburgh.

For loan sales originated under the MPF Xtra and Original programs, the Corporation provides customary representations and warranties to investors that specify, among other things, that the loans have been underwritten to the standards established by the investor. The Corporation may be required to repurchase a loan and reimburse a portion of fees received, or reimburse the investor for a credit loss incurred on a loan, if it is determined that the representations and warranties have not been met. Such repurchases or reimbursements generally result from an underwriting or documentation deficiency. At December 31, 2016, the total outstanding balance of loans the Corporation has repurchased as a result of identified instances of noncompliance amounted to $1,852,000, and the corresponding total outstanding balance repurchased at December 31, 2015 was $1,968,000.

At December 31, 2016, outstanding balances of loans sold and serviced through the two programs totaled $163,296,000, including loans sold through the MPF Xtra program of $116,978,000 and loans sold through the Original program of $46,318,000. At December 31, 2015, outstanding balances of loans sold and serviced through the two programs totaled $152,448,000, including loans sold through the MPF Xtra program of $125,571,000 and loans sold through the Original Program of $26,877,000. Based on the fairly limited volume of required repurchases to date, no allowance has been established for representation and warranty exposures as of December 31, 2016 and December 31, 2015.

For loans sold under the Original program, the Corporation provides a credit enhancement whereby the Corporation would assume credit losses in excess of a defined First Loss Account ("FLA") balance, up to specified amounts. The FLA is funded by the Federal Home Loan Bank of Pittsburgh based on a percentage of the outstanding balance of loans sold. At December 31, 2016, the Corporation's maximum credit enhancement obligation under the MPF Original Program was $4,664,000, and the Corporation has recorded a related allowance for credit losses in the amount of $196,000 which is included in "Accrued interest and other liabilities" in the accompanying consolidated balance sheets. There was no allowance recorded at December 31, 2015. The Corporation does not provide a credit enhancement for loans sold through the Xtra program.

Table VII – Summary of Loans by Type
(In Thousands)

	2016	%	2015	%	2014	%	2013	%	2012	%
Residential mortgage:										
Residential mortgage loans - first liens	$334,102	44.4	$304,783	43.2	$291,882	46.3	$299,831	46.5	$311,627	45.6
Residential mortgage loans - junior liens	23,706	3.2	21,146	3.0	21,166	3.4	23,040	3.6	26,748	3.9
Home equity lines of credit	38,057	5.1	39,040	5.5	36,629	5.8	34,530	5.4	33,017	4.8
1-4 Family residential construction	24,908	3.3	21,121	3.0	16,739	2.7	13,909	2.2	12,842	1.9
Total residential mortgage	420,773	56.0	386,090	54.8	366,416	58.1	371,310	57.6	384,234	56.2
Commercial:										
Commercial loans secured by real estate	150,468	20.0	154,779	22.0	145,878	23.1	147,215	22.8	158,413	23.2
Commercial and industrial	83,854	11.2	75,196	10.7	50,157	8.0	42,387	6.6	48,442	7.1
	38,068	5.1	40,007	5.7	17,534	2.8	16,291	2.5	31,789	4.6

Political subdivisions										
Commercial construction	14,287	1.9	5,122	0.7	6,938	1.1	17,003	2.6	28,200	4.1
Loans secured by farmland	7,294	1.0	7,019	1.0	7,916	1.3	10,468	1.6	11,403	1.7
Multi-family (5 or more) residential	7,896	1.1	9,188	1.3	8,917	1.4	10,985	1.7	6,745	1.0
Agricultural loans	3,998	0.5	4,671	0.7	3,221	0.5	3,251	0.5	3,053	0.4
Other commercial loans	11,475	1.5	12,152	1.7	13,334	2.1	14,631	2.3	362	0.1
Total commercial	317,340	42.2	308,134	43.7	253,895	40.3	262,231	40.7	288,407	42.2
Consumer	13,722	1.8	10,656	1.5	10,234	1.6	10,762	1.7	11,269	1.6
Total	751,835	100.0	704,880	100.0	630,545	100.0	644,303	100.0	683,910	100.0
Less: allowance for loan losses	(8,473)		(7,889)		(7,336)		(8,663)		(6,857)	
Loans, net	$743,362		$696,991		$623,209		$635,640		$677,053	

TABLE VIII – LOAN MATURITY DISTRIBUTION

(In Thousands) As of December 31, 2016

	Fixed-Rate Loans				Variable- or Adjustable-Rate Loans			
	1 Year or Less	1-5 Years	>5 Years	Total	1 Year or Less	1-5 Years	>5 Years	Total
Real Estate	$4,027	$22,376	$170,014	$196,417	$144,585	$152,883	$94,394	$391,862
Commercial	8,814	39,959	23,926	72,699	54,631	21,798	985	77,414
Consumer	1,733	8,432	3,218	13,383	60	0	0	60
Total	$14,574	$70,767	$197,158	$282,499	$199,276	$174,681	$95,379	$469,336

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PROVISION AND ALLOWANCE FOR LOAN LOSSES

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. Notes 1 and 8 to the consolidated financial statements provide an overview of the process management uses for evaluating and determining the allowance for loan losses.

While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for loan losses was $8,473,000 at December 31, 2016, up from $7,889,000 at December 31, 2015. As shown in Table X, specific allowances on impaired loans totaled $674,000 at December 31, 2016, which was $146,000 lower than the total of specific allowances on impaired loans at December 31, 2015. Table X shows the collectively determined component of the allowance for residential mortgages was $473,000 higher at December 31, 2016 than at December 31, 2015, reflecting growth in outstanding loans and use of slightly higher qualitative factors to estimate the required allowance. Also, the collectively determined component of the allowance for commercial loans was $270,000 higher at December 31, 2016 than at December 31, 2015, reflecting the effects of growth in outstanding loans and increases in the average net charge-offs experience and qualitative factors used to estimate the required allowance.

The provision for loan losses by segment for 2016, 2015 and 2014 is as follows:

(In Thousands)

	2016	2015	2014
Residential mortgage	$542	$(19)	$250
Commercial	687	816	227
Consumer	21	16	2
Unallocated	(29)	32	(3)
Total	$1,221	$845	$476

As shown in Table XII, the average provision for loan losses for the five-year period ended December 31, 2016 was $975,000. The total amount of the provision for loan losses for each period is determined based on the amount required to maintain an appropriate allowance.

The $542,000 provision for the residential mortgage segment in 2016 included the $473,000 increase in the collectively determined allowance, as noted above, and a net charge of $69,000 related to the change in total specific allowances on impaired loans, as adjusted for net charge-offs during the period. In 2015, the $19,000 credit for loan losses in the residential mortgage segment resulted mainly from a reduction in the specific allowance related to one loan relationship, partially offset by the effects of an increase of $122,000 in the collectively determined allowance due to loan growth. The provision for the residential segment of $250,000 in 2014 included the effects of an increase in the collectively determined allowance of $139,000, mainly due to loan growth.

In 2016, the $687,000 provision for loan losses for the commercial segment included $417,000 from the net change in total specific allowances on impaired loans, as adjusted for net charge-offs during the period, and $270,000 from the net increase in the collectively determined allowance as described above. In comparison, the $816,000 provision for the commercial segment in 2015 included $445,000 from the net change in total specific allowances on impaired loans, as adjusted for net charge-offs during the period, and $371,000 from the net increase in the collectively determined allowance, with growth in the collectively determined allowance in 2015 caused by growth in outstanding loans. The provision for the commercial segment of $227,000 in 2014 included the effects of an increase in the collectively determined allowance of $149,000, reflecting loan growth and a slight increase in qualitative factors used to estimate the required allowance.

Table XI presents information related to past due and impaired loans, and loans that have been modified under terms that are considered troubled debt restructurings (TDRs). Total nonperforming loans as a percentage of outstanding loans was 2.07% at December 31, 2016, down slightly from 2.09% at December 31, 2015, and nonperforming assets as a percentage of total assets was 1.43% at December 31, 2016, up from 1.31% at December 31, 2015. Table XI presents data at the end of each of the years ended December 31, 2012 through 2016. For the range of dates presented in Table XI, total nonperforming loans as a percentage of loans has ranged from a low of 1.41% at December 31, 2012 to a high of 2.80% at December 31, 2013, and total nonperforming assets as a percentage of assets has ranged from a low of 0.82% at December 31, 2012 to a high of 1.53% at December 31, 2013.

Total impaired loans of $10,860,000 at December 31, 2016, are up $886,000 from the corresponding amount at December 31, 2015 of $9,974,000, including an increase in impaired loans with a valuation allowance of $1,439,000. In 2016, the Corporation recorded an allowance of $528,000 related to one real estate secured commercial loan relationship with an outstanding balance of $2,773,000 that was classified as impaired with a valuation allowance at December 31, 2016. Table XI shows that over the period 2012-2016, the year-end total outstanding balance of impaired loans has ranged from a low of $7,429,000 in 2012 to a high of $16,321,000 in 2013.

Total nonperforming assets of $17,754,000 at December 31, 2016 are up $1,748,000 from the corresponding amount at December 31, 2015. A summary of changes in the components of nonperforming assets at December 31, 2016 as compared to December 31, 2015 is as follows:

- Nonaccrual loans totaled $8,736,000 at December 31, 2016, down from $11,517,000 at December 31, 2015. As described in more detail below, the net reduction in nonaccrual loans included the effect of moving loans to one commercial borrower with recorded investments totaling $4,786,000 to full accrual status in the fourth quarter 2016. The net change in nonaccrual loans also included the effect of classifying the real estate secured commercial loan noted above with an outstanding balance at December 31, 2016 of $2,773,000 as nonaccrual in 2016.

- Total loans past due 90 days or more and still accruing interest amounted to $6,838,000 at December 31, 2016, an increase of $3,609,000 from $3,229,000 at December 31, 2015. The increase in 2016 in the balance of loans past due 90 days or more and still accruing interest included a commercial loan with a balance of $2,677,000 at December 31, 2016 that was deemed by management to be well secured and in the process of collection. At December 31, 2016, in addition to this commercial loan, total residential mortgage loans that were more than 90 days past due but deemed to be well secured and in the process of collection amounted to $3,022,000, up from $2,381,000 at December 31, 2015. The Corporation reviews the status of loans past due 90 days or more each quarter to determine if it is appropriate to continue to accrue interest, and has determined the loans included in this category are well secured and that ultimate collection of all principal and interest is probable.

- Foreclosed assets held for sale consisted of real estate, and totaled $2,180,000 at December 31, 2016, an increase of $920,000 from $1,260,000 at December 31, 2015. At December 31, 2016, the Corporation held 19 such properties for sale, with total carrying values of $1,102,000 related to residential real estate, $650,000 of land and $428,000 related to commercial real estate. At December 31, 2015, the Corporation held 12 such properties for sale, with total carrying values of $556,000 related to residential real estate and $704,000 of land. The Corporation evaluates the carrying values of foreclosed assets each quarter based on the most recent market activity or appraisals for each property.

As shown in Table XI, loans classified as TDRs increased to $8,677,000 at December 31, 2016 from $6,364,000 at December 31, 2015. The increase resulted primarily from a concession granted to one commercial customer with a loan balance of $2,773,000 at December 31, 2016. The Corporation entered into a forbearance agreement with this customer which includes extending the period to twelve months for which required monthly payments will include interest only. Table XI shows that over the period 2012-2016, the year-end total outstanding balance of TDRs has ranged from a low of $2,061,000 in 2012 to a high of $8,677,000 in 2016.

Recorded investments in impaired loans without a valuation allowance and performing TDRs at December 31, 2016 include $4,786,000 from loans to one commercial entity. In 2014, the Corporation entered into a forbearance agreement with this commercial borrower which included a reduction in monthly payment amounts over a fifteen-month period. At the end of the fifteen-month period, the monthly payment amounts would revert to the original amounts, unless the forbearance agreement was extended or the payment requirements otherwise modified. The forbearance agreement was extended for two additional twelve-month periods, most recently in July 2016. The Corporation recorded a charge-off of $1,486,000 in 2014 as a result of these modifications, as the payment amounts based on the forbearance agreement were not sufficient to fully amortize the contractual amount of principal outstanding on the loans. In December 2016, the Corporation and the borrower entered into a modification agreement, terminating the forbearance agreement and establishing loan terms with essentially the same interest rate and monthly payment amounts as had been in effect under the forbearance agreement. The weighted average maturity of the loan contracts has been extended under the modification agreement as compared to the maturities provided for in the original loan contracts. At December 31, 2016, the outstanding contractual balances of these loans total $6,529,000, and the recorded investments total $4,786,000. These loans are still classified as TDRs at December 31, 2016. The borrower made all required payments on the loans in accordance with the terms of the forbearance agreement, as extended, and (as noted above), the loans were restored to full accrual status at December 31, 2016.

Over the period 2012-2016, each period includes a few large commercial relationships that have required significant monitoring and workout efforts. As a result, a limited number of relationships may significantly impact the total amount of allowance required on impaired loans, and may significantly impact the amount of total charge-offs reported in any one period.

Management believes it has been conservative in its decisions concerning identification of impaired loans, estimates of loss, and nonaccrual status; however, the actual losses realized from these relationships could vary materially from the allowances calculated as of December 31, 2016. Management continues to closely monitor its commercial loan relationships for possible credit losses, and will adjust its estimates of loss and decisions concerning nonaccrual status, if appropriate.

Tables IX through XII present historical data related to the allowance for loan losses.

TABLE IX - ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

(Dollars In Thousands)	Years Ended December 31,				
	2016	2015	2014	2013	2012
Balance, beginning of year	$7,889	$7,336	$8,663	$6,857	$7,705
Charge-offs:					
Residential mortgage	(73)	(217)	(327)	(95)	(552)
Commercial	(597)	(251)	(1,715)	(459)	(498)
Consumer	(87)	(94)	(97)	(117)	(171)
Total charge-offs	(757)	(562)	(2,139)	(671)	(1,221)
Recoveries:					
Residential mortgage	3	1	25	24	18
Commercial	35	214	264	348	8
Consumer	82	55	47	58	59
Total recoveries	120	270	336	430	85
Net charge-offs	(637)	(292)	(1,803)	(241)	(1,136)
Provision for loan losses	1,221	845	476	2,047	288
Balance, end of period	$8,473	$7,889	$7,336	$8,663	$6,857
Net charge-offs as a % of average loans	0.09 %	0.04 %	0.29 %	0.04 %	0.16 %

TABLE X - COMPONENTS OF THE ALLOWANCE FOR LOAN LOSSES
(In Thousands)

	As of December 31,				
	2016	2015	2014	2013	2012
ASC 310 - Impaired loans	$674	$820	$769	$2,333	$623
ASC 450 - Collective segments:					
Commercial	3,373	3,103	2,732	2,583	2,594
Residential mortgage	3,890	3,417	3,295	3,156	3,011
Consumer	138	122	145	193	188
Unallocated	398	427	395	398	441
Total Allowance	$8,473	$7,889	$7,336	$8,663	$6,857

TABLE XI - PAST DUE AND IMPAIRED LOANS, NONPERFORMING ASSETS AND TROUBLED DEBT RESTRUCTURINGS (TDRs)
(Dollars In Thousands)

	As of December 31, 2016		2015		2014		2013		2012	
Impaired loans with a valuation allowance	$3,372		$1,933		$3,241		$9,889		$2,710	
Impaired loans without a valuation allowance	7,488		8,041		9,075		6,432		4,719	
Total impaired loans	$10,860		$9,974		$12,316		$16,321		$7,429	
Total loans past due 30-89 days and still accruing	$7,735		$7,057		$7,121		$8,305		$7,756	
Nonperforming assets:										
Total nonaccrual loans	$8,736		$11,517		$12,610		$14,934		$7,353	
Total loans past due 90 days or more and still accruing	6,838		3,229		2,843		3,131		2,311	
Total nonperforming loans	15,574		14,746		15,453		18,065		9,664	
Foreclosed assets held for sale (real estate)	2,180		1,260		1,189		892		879	
Total nonperforming assets	$17,754		$16,006		$16,642		$18,957		$10,543	
Loans subject to troubled debt restructurings (TDRs):										
Performing	$5,803		$1,186		$1,807		$3,267		$906	
Nonperforming	2,874		5,178		5,388		908		1,155	
Total TDRs	$8,677		$6,364		$7,195		$4,175		$2,061	
Total nonperforming loans as a % of loans	2.07	%	2.09	%	2.45	%	2.80	%	1.41	%
Total nonperforming assets as a % of assets	1.43	%	1.31	%	1.34	%	1.53	%	0.82	%
Allowance for loan losses as a % of total loans	1.13	%	1.12	%	1.16	%	1.34	%	1.00	%
Allowance for loan losses as a % of nonperforming loans	54.40	%	53.50	%	47.47	%	47.95	%	70.95	%

TABLE XII - FIVE-YEAR HISTORY OF LOAN LOSSES
(Dollars In Thousands)

	2016		2015		2014		2013		2012		Average	
Average gross loans	$723,076		$657,727		$627,753		$656,495		$700,241		$673,058	
Year-end gross loans	751,835		704,880		630,545		644,303		683,910		683,095	
Year-end allowance for loan losses	8,473		7,889		7,336		8,663		6,857		7,844	
Year-end nonaccrual loans	8,736		11,517		12,610		14,934		7,353		11,030	
Year-end loans 90 days or more past due and still accruing	6,838		3,229		2,843		3,131		2,311		3,670	
Net charge-offs	637		292		1,803		241		1,136		822	
Provision for loan losses	1,221		845		476		2,047		288		975	
Earnings coverage of charge-offs	37	x	85	x	14	x	116	x	30	x	33	x
Allowance coverage of charge-offs	13	x	27	x	4	x	36	x	6	x	10	x
Net charge-offs as a % of provision for loan losses	52.17	%	34.56	%	378.78	%	11.77	%	394.44	%	84.31	%

Net charge-offs as a % of average gross loans	0.09 %	0.04 %	0.29 %	0.04 %	0.16 %	0.12 %
Income before income taxes on a fully taxable equivalent basis	23,861	24,710	25,784	28,012	34,571	27,388

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

Table XIII presents the Corporation's significant fixed and determinable contractual obligations as of December 31, 2016 by payment date. The payment amounts represent the principal amounts of time deposits and borrowings and do not include interest.

TABLE XIII – CONTRACTUAL OBLIGATIONS

(In Thousands)

	1 Year or Less	1-3 Years	3-5 Years	Over 5 Years	Total
Time deposits	$113,974	$76,828	$21,168	$248	$212,218
Short-term borrowings:					
Federal Home Loan Bank of Pittsburgh	21,000	0	0	0	21,000
Customer repurchase agreements	5,175	0	0	0	5,175
Long-term borrowings:					
Federal Home Loan Bank of Pittsburgh	10,004	0	646	804	11,454
Repurchase agreements	27,000	0	0	0	27,000
Total	$177,153	$76,828	$21,814	$1,052	$276,847

In addition to the amounts described in Table XIII, the Corporation has obligations related to deposits without a stated maturity with outstanding principal balances totaling $771,625,000 at December 31, 2016.

The Corporation's operating lease and other commitments at December 31, 2016 are immaterial. The Corporation's significant off-balance sheet arrangements include commitments to extend credit and standby letters of credit. Off-balance sheet arrangements are described in Note 16 to the consolidated financial statements.

As described in more detail in the "Financial Condition" section of Management's Discussion and Analysis, the Corporation sells residential mortgage loans for which the Corporation provides customary representations and warranties to investors that specify, among other things, that the loans have been underwritten to the standards established by the investor. The Corporation may be required to repurchase a loan and reimburse a portion of fees received, or reimburse the investor for a credit loss incurred on a loan, if it is determined that the representations and warranties have not been met. At December 31, 2016, outstanding balances of such loans sold totaled $163,296,000.

Also, for loans sold under the MPF Original program, the Corporation provides a credit enhancement. At December 31, 2016, the Corporation's maximum credit enhancement obligation under the MPF Original Program was $4,664,000, and the Corporation has recorded a related allowance for credit losses in the amount of $196,000 which is included in "Accrued interest and other liabilities" in the accompanying consolidated balance sheets.

LIQUIDITY

Liquidity is the ability to quickly raise cash at a reasonable cost. An adequate liquidity position permits the Corporation to pay creditors, compensate for unforeseen deposit fluctuations and fund unexpected loan demand. At December 31, 2016, the Corporation maintained overnight interest-bearing deposits with the Federal Reserve Bank of Philadelphia and other correspondent banks totaling $11,070,000.

The Corporation maintains overnight borrowing facilities with several correspondent banks that provide a source of day-to-day liquidity. Also, the Corporation maintains borrowing facilities with the Federal Home Loan Bank of Pittsburgh, secured by various mortgage loans.

The Corporation has a line of credit with the Federal Reserve Bank of Philadelphia's Discount Window. Management intends to use this line of credit as a contingency funding source. As collateral for the line, the Corporation has pledged available-for-sale securities with a carrying value of $17,690,000 at December 31, 2016.

The Corporation's outstanding, available, and total credit facilities at December 31, 2016 and December 31, 2015 are as follows:

	Outstanding		Available		Total Credit	
(In Thousands)	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Federal Home Loan Bank of Pittsburgh	$32,454	$60,348	$306,767	$262,361	$339,221	$322,709
Federal Reserve Bank Discount Window	0	0	15,636	19,606	15,636	19,606
Other correspondent banks	0	0	45,000	45,000	45,000	45,000
Total credit facilities	$32,454	$60,348	$367,403	$326,967	$399,857	$387,315

At December 31, 2016, the Corporation's outstanding credit facilities with the Federal Home Loan Bank of Pittsburgh consisted of overnight borrowings of $21,000,000 and long-term borrowings with a total amount of $11,454,000. At December 31, 2015, the Corporation's outstanding credit facilities with the Federal Home Loan Bank of Pittsburgh consisted of overnight borrowings of $23,500,000, short-term borrowings of $25,081,000, and long-term borrowings with a total amount of $11,767,000. Additional information regarding borrowed funds is included in Note 12 to the consolidated financial statements.

Additionally, the Corporation uses repurchase agreements placed with brokers to borrow funds secured by investment assets and "RepoSweep" arrangements to borrow funds from commercial banking customers on an overnight basis. If required to raise cash in an emergency situation, the Corporation could sell available-for-sale securities to meet its obligations. At December 31, 2016, the carrying value of available-for-sale securities in excess of amounts required to meet pledging or repurchase agreement obligations was $199,364,000.

Management believes the Corporation is well-positioned to meet its short-term and long-term obligations.

STOCKHOLDERS' EQUITY AND CAPITAL ADEQUACY

The Corporation and C&N Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Details concerning regulatory capital amounts and ratios are presented in Note 18 to the consolidated financial statements. As reflected in Note 18, at December 31, 2016 and 2015, the Corporation and C&N Bank meet all capital adequacy requirements to which they are subject and maintain capital conservation buffers that allow the Corporation and C&N Bank to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to certain executive officers.

In July 2013, the federal regulatory authorities issued a new capital rule based, in part, on revisions developed by the Basel Committee on Banking Supervision to the Basel capital framework (Basel III). The Corporation and C&N Bank were subject to the new rule on January 1, 2015. Generally, the new rule implements higher minimum capital requirements, revises the definition of regulatory capital components and related calculations, adds a new common equity tier 1 capital ratio, implements a new capital conservation buffer, increases the risk weighting for past due loans and provides a transition period for several aspects of the new rule.

The new capital rule provides that, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to risk-weighted assets. Phase-in of the capital conservation buffer requirements began January 1, 2016. The transition schedule for new ratios, including the capital conservation buffer, is as follows:

	As of January 1:				
	2015	2016	2017	2018	2019
Minimum common equity tier 1 capital ratio	4.5 %	4.5 %	4.5 %	4.5 %	4.5 %
Common equity tier 1 capital conservation buffer	N/A	0.625 %	1.25 %	1.875 %	2.5 %
Minimum common equity tier 1 capital ratio plus capital conservation buffer	4.5 %	5.125 %	5.75 %	6.375 %	7.0 %
Phase-in of most deductions from common equity tier 1 capital	40 %	60 %	80 %	100 %	100 %
Minimum tier 1 capital ratio	6.0 %	6.0 %	6.0 %	6.0 %	6.0 %
Minimum tier 1 capital ratio plus capital conservation buffer	N/A	6.625 %	7.25 %	7.875 %	8.5 %
Minimum total capital ratio	8.0 %	8.0 %	8.0 %	8.0 %	8.0 %
Minimum total capital ratio plus capital conservation buffer	N/A	8.625 %	9.25 %	9.875 %	10.5 %

As fully phased in, a banking organization with a buffer greater than 2.5% would not be subject to additional limits on dividend payments or discretionary bonus payments; however, a banking organization with a buffer less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The new rule also prohibits a banking organization from making dividend payments or discretionary bonus payments if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% as of the beginning of that quarter. Eligible net income is defined as net income for the four calendar quarters preceding the current calendar quarter, net of any distributions and associated tax effects not already reflected in net income. A summary of payout restrictions based on the capital conservation buffer is as follows:

Capital Conservation Buffer (as a % of risk-weighted assets)	**Maximum Payout (as a % of eligible retained income)**
Greater than 2.5%	No payout limitation applies
≤2.5% and >1.875%	60%
≤1.875% and >1.25%	40%
≤1.25% and >0.625%	20%
≤0.625%	0%

At December 31, 2016, the Corporation's Capital Conservation Buffer, determined based on the minimum total capital ratio, was 15.60%. C&N Bank's Capital Conservation Buffer (also determined based on the minimum total capital ratio) was 13.03%.

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. In addition, the Corporation and C&N Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities. These restrictions are described in Note 18 to the consolidated financial statements.

Management expects the Corporation and C&N Bank to maintain capital levels that exceed the regulatory standards for well-capitalized institutions for the next 12 months and for the foreseeable future. Planned capital expenditures are not expected to have a significantly detrimental effect on capital ratios.

The Corporation's total stockholders' equity is affected by fluctuations in the fair values of available-for-sale securities. The difference between amortized cost and fair value of available-for-sale securities, net of deferred income tax, is included in Accumulated Other Comprehensive Income (Loss) within stockholders' equity. The balance in Accumulated Other Comprehensive Income (Loss) related to unrealized gains (losses) on available-for-sale securities, net of deferred income tax, amounted to ($949,000) at December 31, 2016, $2,493,000 at December 31, 2015 and $5,281,000 at December 31, 2014. Changes in accumulated other comprehensive income (loss) are excluded from earnings and directly increase or decrease stockholders' equity. If available-for-sale securities are deemed to be other-than-temporarily impaired, unrealized losses are recorded as a charge against earnings, and amortized cost for the affected securities is reduced. Note 7 to the consolidated financial statements provides additional information concerning management's evaluation of available-for-sale securities for other-than-temporary impairment at December 31, 2016.

Stockholders' equity is also affected by the underfunded or overfunded status of defined benefit pension and postretirement plans. The balance in Accumulated Other Comprehensive Income (Loss) related to defined benefit plans, net of deferred income tax, was $51,000 at December 31, 2016, $35,000 at December 31, 2015 and $79,000 at December 31, 2014.

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. Changes in the components of Accumulated Other Comprehensive Income (Loss) are included in Other Comprehensive Income, and for the Corporation, consist of changes in unrealized gains or losses on available-for-sale securities and changes in underfunded or overfunded defined benefit plans.

Comprehensive Income totaled $12,336,000 in 2016 as compared to $13,639,000 in 2015 and $23,439,000 in 2014. In 2016, Comprehensive Income included: (1) Net Income of $15,762,000, which was $709,000 lower than in 2015 and $1,324,000 lower than in 2014; (2) Other Comprehensive Loss from unrealized losses on available-for-sale securities, net of deferred income tax, of ($3,442,000) as compared to Other Comprehensive Loss of ($2,788,000) in 2015 and Other Comprehensive Income of $6,285,000 in 2014; and (3) Other Comprehensive Income from defined benefit plans of $16,000 in 2016 as compared to Other Comprehensive Loss of ($44,000) in 2015 and Other Comprehensive Income of $68,000 in 2014. Fluctuations in interest rates significantly affected fair values of available-for-sale securities in 2014 through 2016, and accordingly had an effect on Other Comprehensive Income (Loss) in each year.

INFLATION

The Corporation is significantly affected by the Federal Reserve Board's efforts to control inflation through changes in short-term interest rates. Beginning in September 2007, in response to concerns about weakness in the U.S. economy, the Federal Reserve lowered the fed funds target rate numerous times; in December 2008, it established a target range of 0% to 0.25%, which it maintained through mid-December 2015. On December 16, 2015, the Federal Reserve raised their target for the federal funds rate to 0.25% to 0.50%. The Federal Reserve then raised the target rate to 0.50% to 0.75% on December 14, 2016. The most recent decision was based on data available that suggested economic activity had been expanding at a moderate pace and the labor market had continued to strengthen since mid-year. The Fed noted that the data indicated an increase in household spending, though business fixed investments had remained soft. While inflation increased from the beginning of 2016, it is still below the Federal Open Market Committee's (FOMC) 2.00% longer run objective. This was partly due to declines in energy prices and in prices of non-energy imports. The FOMC expects to continue gradual adjustments in the stance of monetary policy, which will allow economic activity to expand at a moderate pace with inflation reaching the forecasted 2.00% over the medium term.

Also, throughout the period of low interest rates, the Federal Reserve has injected massive amounts of liquidity into the nation's monetary system through a variety of programs. The Federal Reserve has purchased large amounts of securities in an effort to keep interest rates low and stimulate economic growth. Beginning in late 2013, the Federal Reserve began reducing the amount of securities purchased under its asset purchase program and then ended the program in October 2014, though still reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and continued to roll over maturing Treasury securities at auction. The Federal Reserve maintained their commitment to this policy in their December 14, 2016 statement and anticipates doing so until normalization of the level of the federal funds rate is well under way.

Despite the current low short-term rate environment, inflation statistics indicate that the overall rate of inflation is unlikely to significantly affect the Corporation's operations within the near future. Although management cannot predict future changes in the rates of inflation, management monitors the impact of economic trends, including any indicators of inflationary pressures, in managing interest rate and other financial risks.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 2 to the consolidated financial statements for a description of recent accounting pronouncements and their recent or potential future effects on the Corporation’s financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

Market risk is the risk of loss arising from adverse changes in market rates and prices of the Corporation’s financial instruments. In addition to the effects of interest rates, the market prices of the Corporation’s debt securities within the available-for-sale securities portfolio are affected by fluctuations in the risk premiums (amounts of spread over risk-free rates) demanded by investors. Management attempts to limit the risk that economic conditions would force the Corporation to sell securities for realized losses by maintaining a strong capital position (discussed in the “Stockholders’ Equity and Capital Adequacy” section of Management’s Discussion and Analysis) and ample sources of liquidity (discussed in the “Liquidity” section of Management’s Discussion and Analysis).

The Corporation’s major category of market risk, interest rate risk, is discussed in the following section.

INTEREST RATE RISK

Business risk arising from changes in interest rates is an inherent factor in operating a bank. A significant portion of the Corporation’s assets are long-term, fixed-rate loans and debt securities. Funding for these assets comes principally from shorter-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation’s financial instruments when interest rates change.

The Corporation uses a simulation model to calculate the potential effects of interest rate fluctuations on net interest income and the market value of portfolio equity. For purposes of these calculations, the market value of portfolio equity includes the fair values of financial instruments, such as securities, loans, deposits and borrowed funds, and the book values of nonfinancial assets and liabilities, such as premises and equipment and accrued expenses. The model measures and projects potential changes in net interest income, and calculates the discounted present value of anticipated cash flows of financial instruments, assuming an immediate increase or decrease in interest rates. Management ordinarily runs a variety of scenarios within a range of plus or minus 100-400 basis points of current rates.

The model makes estimates, at each level of interest rate change, regarding cash flows from principal repayments on loans and mortgage-backed securities and call activity on other investment securities. Actual results could vary significantly from these estimates, which could result in significant differences in the calculations of projected changes in net interest income and market value of portfolio equity. Also, the model does not make estimates related to changes in the composition of the deposit portfolio that could occur due to rate competition, and the table does not necessarily reflect changes that management would make to realign the portfolio as a result of changes in interest rates.

The Corporation's Board of Directors has established policy guidelines for acceptable levels of interest rate risk, based on an immediate increase or decrease in interest rates. The policy limits acceptable fluctuations in net interest income from the baseline (flat rates) one-year scenario and variances in the market value of portfolio equity from the baseline values based on current rates.

Table XIV, which follows this discussion, is based on the results of calculations performed using the simulation model as of December 31, 2016 and December 31, 2015. The table shows that as of the respective dates, the changes in net interest income and changes in market value were within the policy limits in all scenarios.

TABLE XIV - THE EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES

December 31, 2016 Data

(In Thousands)

Period Ending December 31, 2017

Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+400	$53,712	$22,315	$ 31,397	-20.5 %	25.0 %
+300	51,128	17,545	33,583	-15.0 %	20.0 %
+200	48,500	12,809	35,691	-9.6 %	15.0 %
+100	45,845	8,102	37,743	-4.4 %	10.0 %
0	43,132	3,643	39,489	0.0 %	0.0 %
-100	40,581	2,978	37,603	-4.8 %	10.0 %
-200	38,881	2,949	35,932	-9.0 %	15.0 %
-300	38,269	2,936	35,333	-10.5 %	20.0 %
-400	38,104	2,936	35,168	-10.9 %	25.0 %

Market Value of Portfolio Equity at December 31, 2016

Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+400	$168,600	-24.6 %	50.0 %
+300	180,500	-19.3 %	45.0 %
+200	194,471	-13.1 %	35.0 %
+100	208,830	-6.7 %	25.0 %
0	223,744	0.0 %	0.0 %
-100	227,806	1.8 %	25.0 %
-200	229,602	2.6 %	35.0 %
-300	252,118	12.7 %	45.0 %
-400	290,792	30.0 %	50.0 %

December 31, 2015 Data

(In Thousands)

Period Ending December 31, 2016

Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change		NII Risk Limit	
+400	$52,181	$21,985	$ 30,196	-20.8	%	25.0	%
+300	49,687	17,282	32,405	-15.0	%	20.0	%
+200	47,136	12,659	34,477	-9.6	%	15.0	%
+100	44,546	8,109	36,437	-4.4	%	10.0	%
0	41,835	3,715	38,120	0.0	%	0.0	%
-100	39,116	3,171	35,945	-5.7	%	10.0	%
-200	37,417	3,168	34,249	-10.2	%	15.0	%
-300	36,838	3,168	33,670	-11.7	%	20.0	%
-400	36,689	3,168	33,521	-12.1	%	25.0	%

Market Value of Portfolio Equity at December 31, 2015

Basis Point Change in Rates	Present Value Equity	Present Value % Change		Present Value Risk Limit	
+400	$167,741	-24.4	%	50.0	%
+300	179,772	-18.9	%	45.0	%
+200	193,823	-12.6	%	35.0	%
+100	207,803	-6.3	%	25.0	%
0	221,750	0.0	%	0.0	%
-100	223,517	0.8	%	25.0	%
-200	225,185	1.5	%	35.0	%
-300	250,353	12.9	%	45.0	%
-400	286,210	29.1	%	50.0	%

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Data)	December 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks:		
Noninterest-bearing	$ 17,551	$ 14,710
Interest-bearing	14,558	21,351
Total cash and due from banks	32,109	36,061
Available-for-sale securities, at fair value	395,077	420,290
Loans held for sale	142	280
Loans receivable	751,835	704,880
Allowance for loan losses	(8,473)	(7,889)
Loans, net	743,362	696,991
Bank-owned life insurance	19,704	20,764
Accrued interest receivable	3,963	3,768
Bank premises and equipment, net	15,397	15,406
Foreclosed assets held for sale	2,180	1,260
Deferred tax asset, net	5,117	3,115
Intangible assets - Goodwill and core deposit intangibles	11,959	11,972
Other assets	13,282	13,510
TOTAL ASSETS	$ 1,242,292	$ 1,223,417
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 224,175	$ 211,041
Interest-bearing	759,668	724,574
Total deposits	983,843	935,615
Short-term borrowings	26,175	53,496
Long-term borrowings	38,454	38,767
Accrued interest and other liabilities	7,812	8,052
TOTAL LIABILITIES	1,056,284	1,035,930
STOCKHOLDERS' EQUITY		
Preferred stock, $1,000 par value; authorized 30,000 shares; $1,000 liquidation preference per share; no shares issued	0	0
Common stock, par value $1.00 per share; authorized 20,000,000 shares; issued 12,655,171; outstanding 12,113,228 at December 31, 2016 and 12,180,623 December 31, 2015	12,655	12,655
Paid-in capital	71,730	71,654
Retained earnings	112,790	109,454
Treasury stock, at cost; 541,943 shares at December 31, 2016 and 474,548 shares at December 31, 2015	(10,269)	(8,804)

Accumulated other comprehensive (loss) income	(898)	2,528
TOTAL STOCKHOLDERS' EQUITY	186,008	187,487
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 1,242,292	$ 1,223,417

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

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Consolidated Statements of Income

(In Thousands Except Per Share Data)

	Years Ended December 31,		
	2016	2015	2014
INTEREST INCOME			
Interest and fees on loans:			
Taxable	$32,827	$31,311	$32,127
Tax-exempt	1,783	1,668	1,403
Interest on mortgages held for sale	27	16	16
Interest on balances with depository institutions	116	93	125
Income from available-for-sale securities:			
Taxable	5,846	7,303	7,721
Tax-exempt	3,429	3,844	4,310
Dividends	70	284	307
Total interest and dividend income	44,098	44,519	46,009
INTEREST EXPENSE			
Interest on deposits	2,085	1,924	2,163
Interest on short-term borrowings	155	32	9
Interest on long-term borrowings	1,453	2,646	2,950
Total interest expense	3,693	4,602	5,122
Net interest income	40,405	39,917	40,887
Provision for loan losses	1,221	845	476
Net interest income after provision for loan losses	39,184	39,072	40,411
OTHER INCOME			
Service charges on deposit accounts	4,695	4,864	5,025
Service charges and fees	439	494	538
Trust and financial management revenue	4,760	4,626	4,490
Brokerage revenue	756	839	901
Insurance commissions, fees and premiums	102	109	118
Interchange revenue from debit card transactions	1,943	1,935	1,959
Net gains from sale of loans	1,029	735	768
Decrease in fair value of servicing rights	(282)	(162)	(27)
Increase in cash surrender value of life insurance	382	386	376
Other operating income	1,687	1,652	1,272
Sub-total	15,511	15,478	15,420
Realized gains on available-for-sale securities, net	1,158	2,861	1,104
Total other income	16,669	18,339	16,524
OTHER EXPENSES			
Salaries and wages	15,411	14,682	15,121
Pensions and other employee benefits	4,717	4,420	4,769
Occupancy expense, net	2,340	2,574	2,628
Furniture and equipment expense	1,730	1,860	1,859
FDIC assessments	488	603	600
Pennsylvania shares tax	1,274	1,248	1,350
Professional fees	1,126	638	699

Automated teller machine and interchange expense	1,137	988	924
Software subscriptions	981	876	784
Loss on prepayment of debt	0	2,573	0
Other operating expense	5,540	5,141	5,423
Total other expenses	34,744	35,603	34,157
Income before income tax provision	21,109	21,808	22,778
Income tax provision	5,347	5,337	5,692
NET INCOME	$15,762	$16,471	$17,086
NET INCOME PER SHARE - BASIC	$1.30	$1.35	$1.38
NET INCOME PER SHARE - DILUTED	$1.30	$1.35	$1.38

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

Consolidated Statements of Comprehensive Income

(In Thousands)

	Years Ended December 31,		
	2016	2015	2014
Net income	$15,762	$16,471	$17,086
Unrealized (losses) gains on available-for-sale securities:			
Unrealized holding (losses) gains on available-for-sale securities	(4,138)	(1,429)	10,774
Reclassification adjustment for gains realized in income	(1,158)	(2,861)	(1,104)
Other comprehensive (loss) gain on available-for-sale securities	(5,296)	(4,290)	9,670
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in accumulated other comprehensive gain (loss)	46	(135)	(79)
Amortization of net transition obligation, prior service cost, net actuarial (gain) loss, and loss on settlement included in net periodic benefit cost	(22)	67	184
Other comprehensive gain (loss) on unfunded retirement obligations	24	(68)	105
Other comprehensive (loss) income before income tax	(5,272)	(4,358)	9,775
Income tax related to other comprehensive loss (income)	1,846	1,526	(3,422)
Net other comprehensive (loss) income	(3,426)	(2,832)	6,353
Comprehensive income	$12,336	$13,639	$23,439

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

Consolidated Statements of Changes in Stockholders' Equity

(In Thousands Except Share and Per Share Data)

	Common Shares	Treasury Shares	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2014	12,596,540	206,477	$12,596	$70,105	$101,216	$ (993)	$(3,452)	$179,472
Net income					17,086			17,086
Other comprehensive income, net						6,353		6,353
Cash dividends declared on common stock, $1.04 per share					(12,889)			(12,889)
Shares issued for dividend reinvestment Plan	59,498	(18,473)	60	1,069			368	1,497
Treasury stock purchased		208,300					(4,002)	(4,002)
Shares issued from treasury related to exercise of stock options	(867)	(11,860)	(1)	(64)			188	123
Restricted stock granted		(16,711)		(279)			279	0
Forfeiture of restricted stock		7,458		125			(125)	0
Stock-based compensation expense				565				565
Tax benefit from compensation plans				20	137			157
Balance, December 31, 2014	12,655,171	375,191	12,655	71,541	105,550	5,360	(6,744)	188,362
Net income					16,471			16,471
Other comprehensive loss, net						(2,832)		(2,832)
Cash dividends declared on common stock, $1.04 per share					(12,710)			(12,710)
Shares issued for dividend reinvestment Plan		(73,810)		86			1,379	1,465
		226,900					(4,415)	(4,415)

Treasury stock purchased								
Shares issued from treasury related to exercise of stock options		(22,435)		(27)			408	381
Restricted stock granted		(34,800)		(627)			627	0
Forfeiture of restricted stock		3,502		59			(59)	0
Stock-based compensation expense				606				606
Tax benefit from compensation plans				16	143			159
Balance, December 31, 2015	12,655,171	474,548	12,655	71,654	109,454	2,528	(8,804)	187,487
Net income					15,762			15,762
Other comprehensive loss, net						(3,426)		(3,426)
Cash dividends declared on common stock, $1.04 per share					(12,578)			(12,578)
Shares issued for dividend reinvestment Plan		(68,571)		170			1,296	1,466
Treasury stock purchased		187,300					(3,723)	(3,723)
Shares issued from treasury related to exercise of stock options		(19,113)		(98)			361	263
Restricted stock granted		(35,427)		(658)			658	0
Forfeiture of restricted stock		3,431		61			(61)	0
Stock-based compensation expense				578				578
Other stock-based expense		(225)					4	4
Tax benefit from compensation plans				23	152			175
Balance, December 31, 2016	12,655,171	541,943	$12,655	$71,730	$112,790	$(898)	$(10,269)	$186,008

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Years Ended December 31,		
	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$15,762	$16,471	$17,086
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,221	845	476
Realized gains on available-for-sale securities, net	(1,158)	(2,861)	(1,104)
Loss on prepayment of debt	0	2,573	0
Realized loss (gain) on foreclosed assets	49	(84)	(136)
(Gain) loss on disposition of premises and equipment	(3)	1	(8)
Depreciation expense	1,589	1,888	1,940
Accretion and amortization on securities, net	1,462	1,562	1,375
Accretion and amortization on loans and deposits, net	(15)	(21)	(27)
Decrease in fair value of servicing rights	282	162	27
Increase in cash surrender value of life insurance	(382)	(386)	(376)
Gain on life insurance benefits	0	(212)	0
Stock-based compensation and other expense	582	606	565
Amortization of core deposit intangibles	13	22	35
Deferred income taxes	(156)	79	1,254
Gains on sales of loans, net	(1,029)	(735)	(768)
Origination of loans for sale	(29,296)	(21,823)	(21,680)
Proceeds from sales of loans	30,215	22,101	22,317
(Increase) decrease in accrued interest receivable and other assets	(410)	(1,697)	1,395
(Decrease) increase in accrued interest payable and other liabilities	(216)	1,195	(90)
Net Cash Provided by Operating Activities	18,510	19,686	22,281
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturities of certificates of deposit	1,540	1,780	2,560
Purchase of certificates of deposit	(2,280)	(100)	(960)
Proceeds from sales of available-for-sale securities	37,032	44,504	56,269
Proceeds from calls and maturities of available-for-sale securities	74,477	89,159	78,101
Purchase of available-for-sale securities	(91,896)	(40,363)	(158,894)
Redemption of Federal Home Loan Bank of Pittsburgh stock	5,277	5,029	2,804
Purchase of Federal Home Loan Bank of Pittsburgh stock	(5,046)	(8,102)	(602)
Net (increase) decrease in loans	(49,085)	(77,129)	10,317
Proceeds from bank owned life insurance	1,442	1,953	0
Purchase of premises and equipment	(1,580)	(1,039)	(801)
Proceeds from disposition of premises and equipment	3	0	43
Return of principal on limited liability entity investments	178	181	173
Proceeds from sale of foreclosed assets	539	2,536	1,504
Net Cash (Used in) Provided by Investing Activities	(29,399)	18,409	(9,486)
CASH FLOWS FROM FINANCING ACTIVITIES:			

Net increase (decrease) in deposits	48,228	(32,374)	13,473
Net (decrease) increase in short-term borrowings	(27,321)	47,959	(17,848)
Repayments of long-term borrowings	(313)	(36,866)	(278)
Purchase of treasury stock	(3,723)	(4,415)	(4,002)
Sale of treasury stock	263	381	123
Tax benefit from compensation plans	175	159	157
Common dividends paid	(11,112)	(11,245)	(11,392)
Net Cash Provided by (Used in) Financing Activities	6,197	(36,401)	(19,767)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(4,692)	1,694	(6,972)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	33,313	31,619	38,591
CASH AND CASH EQUIVALENTS, END OF YEAR	$28,621	$33,313	$31,619
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Accrued purchase of available-for-sale securities	$0	$0	$226
Assets acquired through foreclosure of real estate loans	$1,508	$2,523	$1,665
Interest paid	$3,698	$4,636	$5,138
Income taxes paid	$5,129	$4,827	$4,432

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF CONSOLIDATION - The consolidated financial statements include the accounts of Citizens & Northern Corporation and its subsidiaries, Citizens & Northern Bank ("C&N Bank"), Bucktail Life Insurance Company and Citizens & Northern Investment Corporation (collectively, "Corporation"), as well as C&N Bank's wholly-owned subsidiary, C&N Financial Services Corporation. All material intercompany balances and transactions have been eliminated in consolidation.

NATURE OF OPERATIONS - The Corporation is primarily engaged in providing a full range of banking and mortgage services to individual and corporate customers in North Central Pennsylvania and Southern New York State. Lending products include mortgage loans, commercial loans and consumer loans, as well as specialized instruments such as commercial letters-of-credit. Deposit products include various types of checking accounts, passbook and statement savings, money market accounts, interest checking accounts, Individual Retirement Accounts and certificates of deposit. The Corporation also offers non-insured "RepoSweep" accounts.

The Corporation provides Trust and Financial Management services, including administration of trusts and estates, retirement plans, and other employee benefit plans, and investment management services. The Corporation offers a variety of personal and commercial insurance products through C&N Financial Services Corporation. C&N Financial Services Corporation also offers mutual funds, annuities, educational savings accounts and other investment products through registered agents. Management has determined that the Corporation has one reportable segment, "Community Banking." All of the Corporation's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Corporation supports the others.

The Corporation is subject to competition from other financial institutions. It is also subject to regulation by certain federal and state agencies and undergoes periodic examination by those regulatory authorities. As a consequence, the Corporation's business is particularly susceptible to being affected by future federal and state legislation and regulations.

USE OF ESTIMATES - The financial information is presented in accordance with generally accepted accounting principles and general practice for financial institutions in the United States of America ("U.S. GAAP"). In preparing financial statements, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements. In addition, these estimates and assumptions affect revenues and expenses in the financial statements and as such, actual results could differ from those estimates.

Material estimates that are particularly susceptible to change include: (1) the allowance for loan losses, (2) fair values of debt securities based on estimates from independent valuation services or from brokers, (3) assessment of impaired securities to determine whether or not the securities are other-than-temporarily impaired, (4) valuation of deferred tax assets and (5) valuation of obligations from defined benefit plans.

INVESTMENT SECURITIES - Investment securities are accounted for as follows:

Available-for-sale securities - includes debt securities not classified as held-to-maturity or trading, and unrestricted equity securities. Such securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported separately through accumulated other comprehensive income (loss), net of tax. Amortization of premiums and accretion of discounts on available-for-sale securities are recorded using the level yield method over the remaining contractual life of the securities, adjusted for actual prepayments. Realized gains and losses on sales of available-for-sale securities are computed on the basis of specific identification of the adjusted cost of each security. Securities within the available-for-sale portfolio may be used as part of the Corporation's asset and liability management strategy and may be sold in response to changes in interest rate risk, prepayment risk or other factors.

Other-than-temporary impairment - Declines in the fair value of available-for-sale securities that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment (OTTI) losses, management considers (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, (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value, and (4) whether the Corporation intends to sell the security or if it is more likely than not that the Corporation will be required to sell the security before the recovery of its amortized cost basis. The credit-related impairment is recognized in earnings and is the difference between a security's amortized cost basis and the present value of expected future cash flows discounted at the security's effective interest rate. For debt securities classified as held-to-maturity, if any, the amount of noncredit-related impairment is recognized in other comprehensive income and accreted over the remaining life of the debt security as an increase in the carrying value of the security.

Restricted equity securities - Restricted equity securities consist primarily of Federal Home Loan Bank of Pittsburgh stock, and are carried at cost and evaluated for impairment. Holdings of restricted equity securities are included in Other Assets in the consolidated balance sheets, and dividends received on restricted securities are included in Other Income in the consolidated statements of income.

LOANS HELD FOR SALE - Mortgage loans held for sale are reported at the lower of cost or market, determined in the aggregate.

LOANS RECEIVABLE - Loans receivable which management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan fees. Interest income is accrued on the unpaid principal balance. Loan origination and commitment fees, as well as certain direct origination costs, are deferred and amortized as a yield adjustment over the lives of the related loans using the interest method.

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 loans secured by farmland.

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.

ALLOWANCE FOR LOAN LOSSES - The allowance for loan losses represents management’s estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the collection of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than when they are 120 days past due on a contractual basis, or earlier in the event of bankruptcy or if there is an amount deemed uncollectible.

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 addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination. In the process of evaluating the loan portfolio, management also considers the Corporation's exposure to losses from unfunded loan commitments. As of December 31, 2016 and 2015, management determined that no allowance for credit losses related to unfunded loan commitments was required.

The allowance consists primarily of two major components – (1) a specific component based on a detailed assessment of certain larger loan relationships, mainly commercial purpose, determined 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.

The specific component relates to loans that are classified as impaired based on a detailed assessment of certain larger loan relationships evaluated by a management committee referred to as the Watch List Committee. Specific loan relationships are identified for evaluation based on the related credit risk rating. For individual loans classified as impaired, an allowance is established when the collateral value less estimated selling costs, present value of discounted cash flows or observable market price of the impaired loan is lower than the carrying value of that loan.

The general component covers pools of loans by loan class 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 for each loan segment are evaluated for loss exposure based upon average historical net charge-off rates (currently thirty-six months), adjusted for qualitative factors. Qualitative risk factors (described in the following paragraph) are evaluated for the impact on each of the three distinct 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. Any adjustments to the factors are supported by a narrative documentation of changes in conditions accompanying the allowance for loan losses calculation.

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 57% at December 31, 2016) are 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.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. 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.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging data or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Loans whose terms are modified are classified as troubled debt restructurings if the Corporation grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve reductions in required payments, an extension of a loan's stated maturity date or a temporary reduction in interest rate. Loans classified as troubled debt restructurings are designated as impaired. Non-accrual troubled debt restructurings may be restored to accrual status if the ultimately collectability of principal and interest payments under the modified terms is not in doubt, and there has been a period (generally, for at least six consecutive months) of satisfactory payment performance by the borrower either immediately before or after the restructuring.

BANK PREMISES AND EQUIPMENT - Bank premises and equipment are stated at cost less accumulated depreciation. Repair and maintenance expenditures which extend the useful lives of assets are capitalized, and other repair and maintenance expenditures are expensed as incurred. Depreciation expense is computed using the straight-line method.

IMPAIRMENT OF LONG-LIVED ASSETS - The Corporation reviews long-lived assets, such as premises and equipment and intangibles, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. These changes in circumstances may include a significant decrease in the market value of an asset or the manner in which an asset is used. If there is an indication the carrying value of an asset may not be recoverable, future undiscounted cash flows expected to result from use of the asset are estimated. If the sum of the expected cash flows is less than the carrying value of the asset, a loss is recognized for the difference between the carrying value and fair market value of the asset.

FORECLOSED ASSETS HELD FOR SALE - Foreclosed assets held for sale consist of real estate acquired by foreclosure and are initially recorded at fair value, less estimated selling costs.

GOODWILL AND CORE DEPOSIT INTANGIBLE ASSETS - Goodwill represents the excess of the cost of acquisitions over the fair value of the net assets acquired. Goodwill is tested at least annually for impairment, or more often if events or circumstances indicate there may be impairment. Core deposit intangibles are being amortized over periods of time that represent the expected lives using a method of amortization that reflects the pattern of economic benefit. Core deposit intangibles are subject to impairment testing whenever events or changes in circumstances indicate their carrying amounts may not be recoverable.

SERVICING RIGHTS - The estimated fair value of servicing rights related to mortgage loans sold and serviced by the Corporation is recorded as an asset upon the sale of such loans. The valuation of servicing rights is adjusted quarterly, with changes in fair value included in Other Income in the consolidated statements of income. Significant inputs to the valuation include expected net servicing income to be received, the expected life of the underlying loans and the discount rate. The servicing rights asset is included in Other Assets in the consolidated balance sheets.

INCOME TAXES - Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases given the provisions of the enacted tax laws. Deferred tax assets are reduced, if necessary, by the amount of such benefits that are not expected to be realized based upon available evidence. Tax benefits from investments in limited partnerships that have qualified for federal low-income tax credits are recognized as a reduction in the provision for income tax over the term of the investment using the effective yield method. The Corporation includes income tax penalties in the provision for income tax. The Corporation has no accrued interest related to unrecognized tax benefits.

STOCK COMPENSATION PLANS - The Corporation’s stock-based compensation policy applies to all forms of stock-based compensation including stock options and restricted stock units. All stock-based compensation is accounted for under the fair value method as required by U.S. GAAP. The expense associated with stock-based compensation is recognized over the vesting period of each individual arrangement.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option valuation model. The fair value of restricted stock is based on the current market price on the date of grant.

OFF-BALANCE SHEET FINANCIAL INSTRUMENTS - In the ordinary course of business, the Corporation has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

CASH FLOWS - The Corporation utilizes the net reporting of cash receipts and cash payments for certain deposit and lending activities. Cash equivalents include federal funds sold and all cash and amounts due from depository institutions and interest-bearing deposits in other banks with original maturities of three months or less.

TRUST ASSETS AND INCOME - Assets held by the Corporation in a fiduciary or agency capacity for its customers are not included in the financial statements since such items are not assets of the Corporation. Trust income is recorded on a cash basis, which is not materially different from the accrual basis.

2. RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") issues Accounting Standards Updates (ASUs) to the FASB Accounting Standards Codification (ASC). This section provides a summary description of recent ASUs that have significant implications (elected or required) within the consolidated financial statements, or that management expects may have a significant impact on financial statements issued in the near future.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which provides a principles-based framework for revenue recognition that supersedes virtually all previously issued revenue recognition guidance under U.S. GAAP. Additionally, the ASU requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The core principle of the five-step revenue recognition framework is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In April 2016, the FASB issued ASU 2016-10, which provides clarifying information related to identifying performance obligations and licensing. In May 2016, the FASB issued ASU 2016-12 and in December 2016, the FASB issued ASU 2016-20, which provide clarifying guidance in a few narrow areas and adds some practical expedients to the guidance. In August 2015 the FASB issued ASU 2015-14, which deferred the effective date of the revenue recognition standard by a year, making it applicable for the Corporation in the first quarter 2018 and for the annual period ending December 31, 2018. The amendments should be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the amendments recognized at the date of initial application. Initial adoption of this ASU is not expected to have a significant impact on the Corporation, as recognition of interest income and the larger sources of noninterest income in the Corporation's current business model would not be impacted by the ASU. The Corporation is in the process of evaluating whether there will be any impact as a result of adopting the amendments.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities. This makes significant changes in U.S. GAAP related to certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The changes provided for in this Update that are applicable to the Corporation are as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; however, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) for equity investments without readily determinable fair values, require a qualitative assessment to identify impairment, and if a qualitative assessment indicates that impairment exists, requiring an entity to measure the investment at fair value; (3) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (4) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (5) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments (at December 31, 2016 and 2015, the Corporation has no liabilities for which the fair value measurement option has been elected); (6) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (7) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this Update will become effective for the Corporation for annual and interim periods beginning in the first quarter 2018. With limited exceptions, early adoption of the amendments in this Update is not permitted. Amendments are to be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values should be applied prospectively. Initial adoption of this ASU is not expected to have a significant impact on the Corporation's financial position; however, the method for determining the fair value of loans and other financial instruments for disclosure purposes will be affected.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. Specifically, a lessee should recognize on the balance sheet a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee would be permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and liabilities. Topic 842 would not significantly change the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee from current U.S. GAAP; however, the principal change from current GAAP is that lease assets and liabilities arising from operating leases would be recognized on the balance sheet. Topic 842 provides several other changes or clarifications to existing GAAP, and will require qualitative disclosures, along with quantitative disclosures, so that financial statement users can understand more about the nature of an entity's leasing activities. In transition, Topic 842 provides that lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, including optional practical expedients. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees will be required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. Topic 842 will become effective for the Corporation for annual and interim periods beginning in the first quarter 2019. The Corporation is in the early stages of evaluating the potential impact of adopting this amendment.

In March 2016, the FASB issued ASU No. 2016-07, Investments – Equity Method and Joint Ventures. This ASU eliminates the requirement that when an investment qualifies for the equity method as a result of an increase in the level of ownership interest or influence, an investor must adjust the investment, results of operations and retained earnings retroactively as if the equity method had been in effect during all previous periods the investment had been held. The ASU requires the equity method investor to add the cost of acquiring an additional interest in the investee to the basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for the equity method. The ASU further requires that an entity that has an available-for-sale equity security that becomes qualified for the equity method recognize through earnings the unrealized gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments in this Update are effective for the Corporation for annual and interim periods beginning in the first quarter 2017. The amendments should be applied prospectively upon their effective date. Initial adoption of this ASU in 2017 did not have a significant impact on the Corporation.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation. This ASU changes several aspects of accounting for share-based payment transactions, and includes some changes that apply only to nonpublic companies. This Update includes amendments that currently apply, or may apply in the future, to the Corporation related to the following: (1) accounting for the difference between the deduction for tax purposes and the amount of compensation cost recognized for financial reporting purposes; (2) classification of excess tax benefits on the statement of cash flows; (3) accounting for forfeitures; (4) accounting for awards partially settled in cash in excess of the employer's minimum statutory tax withholding requirements; and (5) classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. The amendments in this Update are effective for the Corporation for annual and interim periods beginning in the first quarter 2017, with earlier adoption permitted. The ASU provides separate transition provisions for each of the amendments. Initial adoption of this ASU in 2017 did not have a significant impact on the Corporation.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326). This ASU will result in significant changes in the Corporation's accounting for credit losses related to loans receivable and investment securities. A summary of significant provisions of this ASU is as follows:

- The ASU requires that a financial asset (or a group of financial assets) measured at amortized cost basis be presented, net of a valuation allowance for credit losses, at an amount expected to be collected on the financial asset(s), and that the income statement include the measurement of credit losses for newly recognized financial assets as well as changes in expected losses on previously recognized financial assets. The provisions of this ASU require measurement of expected credit losses based on relevant information including past events, historical experience, current conditions, and reasonable and supportive forecasts that affect the collectability of the asset. The provisions of this ASU differ from current U.S. GAAP in that current U.S. GAAP generally delays recognition of the full amount of credit losses until the loss is probable of occurring.

- The amendments in the Update retain many of the disclosure requirements related to credit quality in current U.S. GAAP, updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. In addition, the Update requires that disclosure of credit quality indicators in relation to the amortized cost of financing receivables, a current requirement, be further disaggregated by year of origination.

- This ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down, and limits the amount of the allowance for credit losses to the amount by which the fair value is below amortized cost. For purchased available-for-sale securities with a more-than-insignificant amount of credit deterioration since origination, the ASU requires an allowance be determined in a manner similar to other available-for-sale debt securities; however, the initial allowance would be added to the purchase price, with only subsequent changes in the allowance recorded in credit loss expense, and interest income recognized at the effective rate excluding the discount embedded in the purchase price related to estimated credit losses at acquisition.

- This ASU will be effective for the Corporation for interim and annual periods beginning in the first quarter of 2020. Earlier adoption is permitted beginning in the first quarter of 2019. The entity will record the effect of implementing this ASU through a cumulative-effect adjustment through retained earnings as of the beginning of the reporting period in which Topic 326 is effective.

The Corporation is in the early stages of evaluating the potential impact of adopting this amendment.

In June 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230) –Classification of Certain Cash Receipts and Cash Payments. This Update provides clarification regarding eight specific cash flow issues with the objective of reducing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. For the Corporation, the amendments in this Update are effective beginning in the first quarter 2018. The amendments in this Update should be applied using a retroactive transition method to each period presented. The Corporation anticipates there will be no adjustments to the Consolidated Statements of Cash Flows, as previously reported, as a result of the clarifications provided in the Update.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350) to simplify the accounting for goodwill impairment. This guidance, among other things, removes step 2 of the goodwill impairment test thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting unit. Upon adoption of this ASU, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under current guidance. This Update will become effective for the Corporation's annual and interim goodwill impairment tests beginning in the first quarter of 2020.

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 (loss) income. The components of other comprehensive (loss) income, and the related tax effects, are as follows:

(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
2016			
Unrealized losses on available-for-sale securities:			
Unrealized holding losses on available-for-sale securities	$ (4,138)	$ 1,448	$ (2,690)
Reclassification adjustment for (gains) realized in income	(1,158)	406	(752)
Other comprehensive loss on available-for-sale securities	(5,296)	1,854	(3,442)
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	46	(16)	30
Amortization of net transition obligation, prior service cost and net actuarial gain included in net periodic benefit cost	(22)	8	(14)
Other comprehensive income on unfunded retirement obligations	24	(8)	16
Total other comprehensive loss	$ (5,272)	$ 1,846	$ (3,426)

(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
2015			
Unrealized losses on available-for-sale securities:			
Unrealized holding losses on available-for-sale securities	$ (1,429)	$ 500	$ (929)
Reclassification adjustment for (gains) realized in income	(2,861)	1,002	(1,859)
Other comprehensive loss on available-for-sale securities	(4,290)	1,502	(2,788)
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive loss	(135)	47	(88)
Amortization of net transition obligation, prior service cost, net actuarial loss and loss on settlement included in net periodic benefit cost	67	(23)	44
Other comprehensive loss on unfunded retirement obligations	(68)	24	(44)
Total other comprehensive loss	$ (4,358)	$ 1,526	$ (2,832)

(In Thousands)	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
2014			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains on available-for-sale securities	$ 10,774	$ (3,771)	$ 7,003
Reclassification adjustment for (gains) realized in income	(1,104)	386	(718)
Other comprehensive income on available-for-sale securities	9,670	(3,385)	6,285
Unfunded pension and postretirement obligations:			
Changes from plan amendments and actuarial gains and losses included in other comprehensive income	(79)	28	(51)
Amortization of net transition obligation, prior service cost, net actuarial loss and loss on settlement included in net periodic benefit cost	184	(65)	119
Other comprehensive income on unfunded retirement obligations	105	(37)	68
Total other comprehensive income	$ 9,775	$ (3,422)	$ 6,353

Changes in the components of accumulated other comprehensive income (loss), included in stockholders' equity, are as follows:

(In Thousands)	Unrealized Holding Gains (Losses) on Securities	Unfunded Pension and Postretirement Obligations	Accumulated Other Comprehensive Income (Loss)
2016			
Balance, beginning of period	$ 2,493	$ 35	$ 2,528
Other comprehensive loss before reclassifications	(2,690)	30	(2,660)
Amounts reclassified from accumulated other comprehensive (loss) income	(752)	(14)	(766)
Other comprehensive (loss) income	(3,442)	16	(3,426)
Balance, end of period	$ (949)	$ 51	$ (898)
2015			
Balance, beginning of period	$ 5,281	$ 79	$ 5,360
Other comprehensive loss before reclassifications	(929)	(88)	(1,017)
Amounts reclassified from accumulated other comprehensive income	(1,859)	44	(1,815)
Other comprehensive loss	(2,788)	(44)	(2,832)
Balance, end of period	$ 2,493	$ 35	$ 2,528
2014			
Balance, beginning of period	$ (1,004		