NORWOOD FINANCIAL CORP
Form 10-Q
May 09, 2011

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from ________ to ________

Commission file number 0-28366

Norwood Financial Corp.
(Exact name of Registrant as specified in its charter)

Pennsylvania	23-2828306
(State or other jurisdiction of Incorporation or organization)	(I.R.S. employer identification no.)
717 Main Street, Honesdale, Pennsylvania	18431
(Address of principal executive offices)	(Zip Code)

(570) 253-1455
(Registrant's telephone number, including area code)

NA
(Former name, former address and former fiscal year, if changed since last report))

Indicate by check (x) 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o
(Do not check if a 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[X] No

Class	Outstanding as of May 3, 2011
Common stock, par value $0.10 per share	2,761,444

NORWOOD FINANCIAL CORP.
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2011

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NORWOOD FINANCIAL CORP.
Consolidated Balance Sheets (unaudited)
(dollars in thousands, except share and per share data)

	March 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$5,670	$5,782
Interest bearing deposits with banks	13,864	7,843
Federal funds sold	0	3,000
Cash and cash equivalents	19,534	16,625
Securities available for sale	143,104	145,815
Securities held to maturity, fair value 2011: $177, 2010: $179	170	170
Loans receivable (net of unearned income)	350,128	356,855
Less: Allowance for loan losses	5,780	5,616
Net loans receivable	344,348	351,239
Investment in Federal Home Loan Bank Stock, at cost	3,193	3,361
Bank premises and equipment, net	4,798	4,904
Bank owned life insurance	8,333	8,249
Accrued interest receivable	2,191	2,166
Foreclosed real estate owned	948	748
Other assets	4,307	3,728
TOTAL ASSETS	$530,926	$537,005
LIABILITIES		
Deposits:		
Non-interest bearing demand	$62,736	$62,238
Interest-bearing	334,384	331,627
Total deposits	397,120	393,865
Short-term borrowings	25,465	33,309
Other borrowings	35,000	38,000
Accrued interest payable	1,342	1,536
Other liabilities	3,424	2,597
TOTAL LIABILITIES	462,351	469,307
STOCKHOLDERS' EQUITY		
Common stock, $.10 par value per share, authorized 10,000,000; shares issued 2,840,872	284	284
Surplus	9,867	9,826
Retained earnings	59,507	58,648
Treasury stock at cost: 2011: 78,960 shares, 2010: 72,068	(2,388)	(2,197)
Accumulated other comprehensive income	1,305	1,137
TOTAL STOCKHOLDERS' EQUITY	68,575	67,698

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$530,926	$537,005

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Income (unaudited)
(dollars in thousands, except per share data)

	Three Months Ended March 31, 2011	2010
INTEREST INCOME		
Loans receivable, including fees	$4,928	$5,410
Securities	1,090	1,221
Other	8	11
Total interest income	6,026	6,642
INTEREST EXPENSE		
Deposits	885	1,199
Short-term borrowings	24	34
Other borrowings	336	412
Total interest expense	1,245	1,645
NET INTEREST INCOME	4,781	4,997
PROVISION FOR LOAN LOSSES	220	330
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,561	4,667
OTHER INCOME		
Service charges and fees	549	523
Income from fiduciary activities	113	86
Net realized gains on sales of securities	212	155
Gains on sale of loans and servicing rights	143	75
Other	191	163
Total other income	1,208	1,002
OTHER EXPENSES		
Salaries and employee benefits	1,701	1,615
Occupancy, furniture & equipment, net	398	394
Data processing related	215	196
Taxes, other than income	129	147
Professional fees	134	139
Merger related expenses	267	-
Federal Deposit Insurance Corporation Insurance assessment	120	118
Foreclosed real estate owned	19	16
Other	551	535
Total other expenses	3,534	3,160
INCOME BEFORE INCOME TAXES	2,235	2,509
INCOME TAX EXPENSE	575	712
NET INCOME	$1,660	$1,797
BASIC EARNINGS PER SHARE	$0.60	$0.65

DILUTED EARNINGS PER SHARE	$0.60	$0.65

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Changes in Stockholders' Equity (unaudited)
Three Months ended March 31, 2011
(dollars in thousands, except share and per share data)

	Common Stock			Retained	Treasury Stock		Accumulated Other Comprehensive	
	Shares	Amount	Surplus	Earnings	Shares	Amount	Income	Total
Balance December 31, 2010	2,840,872	$ 284	$ 9,826	$ 58,648	72,068	$ (2,197)	$ 1,137	$ 67,698
Comprehensive Income:								
Net Income				1,660				1,660
Change in unrealized gains on securities available for sale, net of reclassification adjustments and tax effects							168	168
Total comprehensive income								$ 1,828
Cash dividends declared $.29 per share				(801)				(801)
Acquisition of treasury stock					6,892	(191)		(191)
Compensation expense related to stock options			41					41
Balance, March 31, 2011	2,840,872	$ 284	$ 9,867	$ 59,507	78,960	$ (2,388)	$ 1,305	$ 68,575

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Cash Flows (Unaudited)
(dollars in thousands)

	Three Months Ended March 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$1,660	$1,797
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	220	330
Depreciation	110	117
Amortization of intangible assets	13	13
Deferred income taxes	(84)	28
Net amortization of securities premiums and discounts	179	59
Net realized gain on sales of securities	(212)	(155)
Net increase in investment in life insurance	(84)	(95)
Net gain on sale of mortgage loans and servicing rights	(143)	(75)
Mortgage loans originated for sale	(4,692)	(4,300)
Proceeds from sale of mortgage loans originated for sale	4,835	4,375
Compensation expense related to stock options	41	39
Decrease (increase) in accrued interest receivable and other assets	(615)	199
Increase in accrued interest payable and other liabilities	635	33
Net cash provided by operating activities	1,863	2,365
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Proceeds from sales	6,187	8,837
Proceeds from maturities and principal reductions on mortgage-backed securities	7,113	15,055
Purchases	(10,302)	(18,748)
Securities held to maturity, proceeds from maturities	-	540
Redemption of FHLB stock	168	-
Net decrease in loans	6,467	5,396
Purchase of bank premises and equipment	(4)	(54)
Net cash provided by investing activities	9,629	11,026
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	3,255	183
Net decrease in short-term borrowings	(7,844)	(4,022)
Repayments of other borrowings	(3,000)	-
Stock options exercised	-	10
Tax benefit of stock options exercised	-	5
Acquisition of treasury stock	(191)	(529)
Cash dividends paid	(803)	(776)
Net cash used in financing activities	(8,583)	(5,129)
Increase in cash and cash equivalents	2,909	8,262
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	16,625	17,355
CASH AND CASH EQUIVALENTS, END OF PERIOD	$19,534	$25,617

See accompanying notes to the unaudited consolidated financial statements.

Notes to the Unaudited Consolidated Financial Statements

1. Basis of Presentation

The unaudited consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp., Norwood Investment Corp., Norwood Settlement Services, LLC and WTRO Properties. All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the financial position and results of operations of the Company. The operating results for the three month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 or any other future interim period.

These statements should be read in conjunction with the consolidated financial statements and related notes which are incorporated by reference in the Company's Annual Report on Form 10-K for the year-ended December 31, 2010.

2. Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

The following table sets forth the weighted average shares outstanding used in the computations of basic and diluted earnings per share:

(in thousands)

	Three Months Ended March 31,	
	2011	2010
Basic EPS weighted average shares outstanding	2,767	2,768
Dilutive effect of stock options	3	7
Diluted EPS weighted average shares outstanding	2,770	2,775

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Stock options which had no intrinsic value, because their effect would be anti-dilutive and therefore would not be included in the diluted EPS calculation were 163,150 and 137,150 as of March 31, 2011 and 2010, respectively based upon the closing price of Norwood stock of $27.25 and $27.00 per share on March 31, 2011 and 2010.

3. Stock-Based Compensation

The Company's shareholders approved the Norwood Financial Corp 2006 Stock Option Plan at the annual meeting on April 25, 2006 and the Company awarded 47,700 options in 2006, 22,000 options in 2007, 24,000 options in 2008, 27,000 options in 2009 and 28,000 options in 2010, all of which have a twelve month vesting period. As of March 31, 2011, there was $123,000 of total unrecognized compensation cost related to non-vested options granted in 2010 under the plan, which will be fully amortized by December 31, 2011.

A summary of stock options from all plans, adjusted for stock dividends declared, is shown below.

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2011	189,639	$ 28.52	6.6 Yrs.	$ 146
Granted	-	-	-	-
Exercised	-	-	-	-
Outstanding at March 31, 2011	189,639	$ 28.52	6.3Yrs.	$ 126
Exercisable at March 31, 2011	162,639	$ 28.65	4.9Yrs.	$ 126

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The stock price was $27.25 as of March 31, 2011 and $27.77 as of December 31, 2010. During the three months ended March 31, 2011, no stock options were exercised.

4. Cash Flow Information

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks all of which mature within 90 days and federal funds sold.

Cash payments for interest for the periods ended March 31, 2011 and 2010 were $1,440,000 and $2,121,000, respectively. Cash payments for income taxes for the periods ending March 31, 2011 and 2010 were $3,000 and $3,000, respectively. Non-cash investing activity for 2011 and 2010 included repossession of other assets and foreclosed mortgage loans transferred to real estate owned of $204,000 and $70,000, respectively.

5. Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income and related tax effects are as follows.

(in thousands)	Three Months Ended March 31, 2011	2010
Unrealized holding gains on available for sale securities	$466	$279
Reclassification adjustment for gains Realized in income	(212)	(155)
Net unrealized gains	254	124
Income tax expense	86	43
Other comprehensive income	$168	$81

6. Off-Balance Sheet Financial Instruments and Guarantees

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of the Bank's financial instrument commitments is as follows:

(in thousands)	March 31, 2011	2010
Commitments to grant loans	$23,466	$16,473
Unfunded commitments under lines of credit	29,809	37,020
Standby letters of credit	3,636	3,438
	$56,911	$56,931

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer and generally consists of real estate.

The Bank does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of March 31, 2011 for guarantees under standby letters of credit issued is not material.

7. Securities

The amortized cost and fair value of securities were as follows:

	March 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available for Sale:				
U.S. Government agencies	$32,278	$281	$(369)	$32,190
States and political subdivisions	45,423	751	(159)	46,015
Corporate obligations	3,016	221	-	3,237
Mortgage-backed securities- government sponsored entities	60,189	1,276	(301)	61,164
	140,906	2,529	(829)	142,606
Equity securities-financial services	215	284	(1)	498
	$141,121	$2,813	$(830)	$143,104
Held to Maturity:				
States and political subdivisions	$170	$7	-	$177

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available for Sale:				
U.S. Government agencies	$30,194	$392	$(318)	$30,268
States and political subdivisions	49,880	510	(624)	49,766
Corporate obligations	4,018	231	-	4,249
Mortgage-backed securities-government sponsored entities	59,770	1,398	(240)	60,928
	143,862	2,531	(1,182)	145,211
Equity securities-financial services	224	381	(1)	604
	$144,086	$2,912	$(1,183)	$145,815
Held to Maturity:				
States and political subdivisions	$170	$9	$-	$179

The following tables show the Company's investments' gross unrealized losses and fair value aggregated by length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	March 31, 2011					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies	$12,730	$(369)	$-	$-	$12,730	$(369)
States and political subdivisions	10,051	(159)	-	-	10,051	(159)
Mortgage-backed securities-government sponsored agencies	21,874	(301)	-	-	21,874	(301)
Equity securities-financial services	-	-	16	(1)	16	(1)
	$44,655	$(829)	$16	$(1)	$44,671	$(830)

	December 31, 2010					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies	$8,696	$(318)	$-	$-	$8,696	$(318)
States and political subdivisions	21,829	(624)	-	-	21,829	(624)
Mortgage-backed securities-government sponsored agencies	20,113	(240)	-	-	20,113	(240)
Equity securities-financial services	15	(1)	-	-	15	(1)
	$50,653	$(1,183)	$-	$-	$50,653	$(1,183)

At March 31, 2011, the Company has 42 securities in an unrealized loss position in the less than twelve months category and one security in the twelve months or more category. In Management's opinion the unrealized losses less than twelve months principally reflect changes in interest rates subsequent to the acquisition of specific securities. The Company holds a small amount of equity securities in other financial institutions. The value of these equity securities has been impacted by the overall weakness in the financial sector, one of which has been in a loss position for greater than one year. Management believes that the other unrealized loss represents temporary impairment of the security as the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis.

The amortized cost and fair value of debt securities as of March 31, 2011 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
		(In Thousands)		
Due after one year through five years	$30,859	$31,346	$170	$177
Due after five years through ten years	23,089	23,213	-	-
Due after ten years	26,769	26,883	-	-
Mortgage-backed securities-government sponsored agencies	60,189	61,164	-	-
	$140,906	$142,606	$170	$177

Gross realized gains and gross realized losses on sales of securities available for sale were as follows (in thousands):

	Three Months Ended March 31, 2011	2010
Gross realized gains	$212	$155
Gross realized losses	-	-
Net realized gain	$212	$155
Proceeds from sales of securities	$6,187	$8,837

8. Loans Receivable and Allowance for Loan Losses

Loans receivable totaled $350.1 million at March 31, 2011 compared to $356.9 million as of December 31, 2010. Residential real estate loans decreased $6.2 million principally due to the sale of $4.7 million of residential mortgages. The loans were sold for interest rate risk management to shorten the average life of the mortgage loan portfolio. Commercial loans including commercial real estate loans increased $900,000 during the period while all other commercial and retail loans decreased $1.4 million due primarily to a reduction in home equity loans as borrowers took advantage of a continued low interest rate environment to convert balances to permanent financing.

Set forth below is selected data relating to the composition of the loan portfolio at the dates indicated:

Types of loans
(dollars in thousands)

	March 31, 2011			December 31, 2010		
Real Estate-Residential	$118,382	33.8	%	$124,562	34.9	%
Commercial	186,195	53.1		184,094	51.5	
Construction	11,894	3.4		12,638	3.5	
Commercial, financial and agricultural	21,194	6.0		22,386	6.3	
Consumer loans to individuals	12,963	3.7		13,668	3.8	
Total loans	350,628	100.0	%	357,348	100.0	%
Deferred fees (net)	(500)			(493)		
	350,128			356,855		
Allowance for loan losses	(5,780)			(5,616)		
Net loans receivable	$344,348			$351,239		

The Company maintains a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probably that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

A loan is considered to be a troubled debt restructuring ("TDR") loan when the Company grants a concession to the borrower because of the borrower's financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates that are less than the current market rate for new obligations with similar risk. TDR loans that are in compliance with their modified terms and that yield a market rate may be removed from the TDR status after a period of performance.

The following table shows the amount of loans in each category that were individually and collectively evaluated for impairment at the dates indicated:

	Real Estate Loans					
	Residential	Commercial	Construction	Commercial Loans	Consumer Loans	Total
March 31, 2011			(In thousands)			
Total Loans	$118,382	$186,195	$11,894	$21,194	$12,963	$350,628
Individually evaluated for impairment	$—	$16,498	$—	$511	$—	$17,009
Collectively evaluated for impairment	$118,382	$169,697	$11,894	$20,683	$12,963	$336,619

	Real Estate Loans					
	Residential	Commercial	Construction	Commercial Loans	Consumer Loans	Total
December 31, 2010			(In thousands)			
Total Loans	$124,562	$184,094	$12,638	$22,386	$13,668	$357,348
Individually evaluated for impairment	$—	$14,239	$—	$513	$—	$14,752
Collectively evaluated for impairment	$124,562	$169,855	$12,638	$21,873	$13,668	$342,596

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired.

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2011					
With no related allowance recorded:			(In thousands)		
Real Estate Loans					
Residential	$—	$—	$—	$—	$—
Construction	—	—	—	—	—
Commercial	4,875	4,875	—	3,714	15
Commercial Loans	511	511	—	512	—
Consumer Loans	—	—	—	—	—
Total	5,386	5,386	—	4,226	15
With an allowance recorded:					
Real Estate Loans					
Residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	11,623	11,531	2,153	11,654	103
Commercial Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Total	11,623	11,531	2,153	11,654	103
Total:					
Real Estate loans					
Residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	16,498	16,406	2,153	15,368	118
Commercial Loans	511	511	—	512	—
Consumer Loans	—	—	—	—	—
Total Impaired Loans	$17,009	$16,917	$2,153	$15,880	$118

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2010					
With no related allowance recorded:		(In thousands)			
Real Estate Loans					
Residential	$—	$—	$—	$—	$—
Construction	—	—	—	—	—
Commercial	5,598	5,598	—	5,088	266
Commercial Loans	513	513	—	115	—
Consumer Loans	—	—	—	—	—
Total	6,111	6,111	—	5,203	266
With an allowance recorded:					
Real Estate Loans					
Residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	8,641	8,548	1,648	4,734	119
Commercial Loans	—	—	—	159	—
Consumer Loans	—	—	—	—	—
Total	8,641	8,548	1,648	4,893	119
Total:					
Real Estate loans					
Residential	—	—	—	—	—
Construction	—	—	—	—	—
Commercial	14,239	14,146	1,648	9,822	385
Commercial Loans	513	513	—	274	—
Consumer Loans	—	—	—	—	—
Total Impaired Loans	$14,752	$14,659	$1,648	$10,096	$385

Management uses a seven point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first three categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as non performance, repossession, or death occurs to raise awareness of a possible credit event. The Bank’s Loan Review Department is responsible for the timely and accurate risk rating of the loans on an ongoing basis. Every credit which must be approved by Loan Committee or the Board of Directors is assigned a risk rating at time of consideration. Loan Review also annually reviews relationships of $500,000 and over to assign or re-affirm risk ratings. Loans in the Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

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The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard, Doubtful and Loss within the internal risk rating system as of March 31, 2011 and December 31, 2010 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
March 31, 2011						
Commercial real estate loans	$167,696	$1,601	$16,898	$—	$—	$186,195
Commercial loans	20,586	75	533	—	—	21,194
Total	$188,282	$1,676	$17,431	$—	$—	$207,389

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
December 31, 2010						
Commercial real estate loans	$165,226	$1,780	$17,088	$—	$—	$184,094
Commercial loans	21,759	75	552	—	—	22,386
Total	$186,985	$1,855	$17,640	$—	$—	$206,480

For residential real estate loans, construction loans and consumer loans, the Company evaluates credit quality based on the performance of the individual credits. The following table presents the recorded investment in the loan classes based on payment activity as of March 31, 2011 and December 31, 2010 (in thousands):

March 31, 2011	Performing	Nonperforming	Total
Residential real estate loans	$117,490	$ 892	$118,382
Construction	11,894	—	11,894
Consumer loans	12,963	—	12,963
Total	$142,347	$ 892	$143,239

December 31, 2010	Performing	Nonperforming	Total
Residential real estate loans	$123,623	$ 939	$124,562
Construction	12,638	—	12,638
Consumer loans	13,668	—	13,668
Total	$149,929	$ 939	$150,868

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of March 31, 2011 and December 31, 2010 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
March 31, 2011							
Real Estate loans							
Residential	$117,227	$263	$—	$—	$892	$ 1,155	$118,382
Construction	11,783	111	—	—	—	111	11,894
Commercial	180,035	176	—	—	5,984	6,160	186,195
Commercial loans	20,683	—	—	—	511	511	21,194
Consumer loans	12,948	7	8	—	—	15	12,963
Total	$342,676	$557	$8	$—	$7,387	$ 7,952	$350,628

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
December 31, 2010							
Real Estate loans							
Residential	$123,177	$407	$—	$39	$939	$ 1,385	$124,562
Construction	12,622	16	—	—	—	16	12,638
Commercial	176,981	3,047	1,478	—	2,588	7,113	184,094
Commercial loans	21,858	15	—	—	513	528	22,386
Consumer loans	13,642	24	2	—	—	26	13,668
Total	$348,280	$3,509	$1,480	$39	$4,040	$ 9,068	$357,348

The following table presents changes in the allowance for loan losses:

	Three months ended March 31,	
	2011	2010
	(dollars in thousands)	
Allowance balance at beginning of period	$5,616	$5,453

Charge-offs:	(75)	(429)
Recoveries:	19	8
Provision expense	220	330
Allowance balance at end of period	$5,780	$5,362

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The following table presents the allowance for loan losses by the classes of the loan portfolio:

(In thousands)	Residential Real Estate	Commercial Real Estate	Construction	Commercial	Consumer	Total
Beginning balance, December 31, 2010	$1,167	$3,976	$110	$171	$192	$5,616
Charge Offs	(37)	(14)	—	(2)	(22)	(75)
Recoveries	2	—	—	5	12	19
Provision Expense	(14)	124	1	139	(30)	220
Ending balance	$1,118	$4,086	$111	$313	$152	$5,780
Ending balance individually evaluated for impairment	$ —	$ 2,153	$ —	$ —	$ —	$ 2,153
Ending balance collectively evaluated for impairment	$ 1,118	$ 1,933	$ 111	$ 313	$ 152	$ 3,627

The Company's primary business activity is with customers located in northeastern Pennsylvania. Accordingly, the Company has extended credit primarily to commercial entities and individuals in this area whose ability to honor their contracts is influenced by the region's economy.

As of March 31, 2011, the Company considered its concentration of credit risk to be acceptable. The two highest concentrations are in the hospitality lodging industry and summer camps, with loans outstanding of $42.3 million, or 59.0% of capital, to the hospitality lodging industry and $21.7 million, or 31.0% of capital, to summer camps. In 2011, there were no losses in either portfolio. As of March 31, 2011, one motel loan with an outstanding balance of $3,028,000 was on nonaccrual status and considered impaired.

Gross realized gains and gross realized losses on sales of residential mortgage loans were $96,000 and $0, respectively, in the first quarter of 2011 compared to $54,000 and $5,000, respectively, in the same period in 2010. The proceeds from the sales of residential mortgage loans totaled $4.7 million and $4.3 million for the three months ended March 31, 2011 and 2010, respectively.

The allowance for loan losses totaled $5,780,000 as of March 31, 2011 and represented 1.65% of total loans, compared to $5,616,000 at December 31, 2010, and $5,362,000 as of March 31, 2010. The Company had net charge-offs for the three months ended March 31, 2011 of $56,000 compared to $421,000 in the comparable period in 2010. The Company's loan review process assesses the adequacy of the allowance for loan losses on a quarterly basis. The process includes an analysis of the risks inherent in the loan portfolio. It includes an analysis of impaired loans and a historical review of credit losses by loan type. Other factors considered include: concentration of credit in specific industries; economic and industry conditions; trends in delinquencies and loan classifications, large dollar exposures and loan growth. Management considers the allowance adequate at March 31, 2011 based on the Company's criteria. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

As of March 31, 2011, non-performing loans totaled $7.4 million, which is 2.11% of total loans compared to $4,079,000, or 1.14% of total loans at December 31, 2010. The increase was principally due to the transfer of one credit to nonaccrual status due to the borrower's inability to make scheduled payments.

The following table sets forth information regarding non-performing loans and foreclosed real estate at the dates indicated:

(dollars in thousands)		March 31, 2011			December 31, 2010	
Loans accounted for on a non-accrual basis:						
Commercial and all other	$	-		$	513	
Real Estate		6,786			3,527	
Consumer		601			-	
Total		7,387			4,040	
Accruing loans which are contractually past due 90 days or more		-			39	
Total non-performing loans		7,387			4,079	
Foreclosed real estate		948			748	
Total non-performing assets	$	8,335		$	4,827	
Allowance for loans losses	$	5,780		$	5,616	
Coverage of non-performing loans		.78	x		1.38	x
Non-performing loans to total loans		2.11	%		1.14	%
Non-performing loans to total assets		1.39	%		.76	%
Non-performing assets to total assets		1.57	%		.90	%

9. Fair Value Measurements

Generally accepted accounting principles in the United States of America established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1:	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
Level 2:	Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset’s or liability’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at March 31, 2011 and December 31, 2010 are as follows:

	Fair Value Measurement Reporting Date Using			
Description	Total	(Level 1) Quoted Prices in Active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
	(In thousands)			
March 31, 2011				
Available for Sale:				
US Government agencies	$32,190	$-	$32,190	$ -
States and political subdivisions	46,015	-	46,015	-
Corporate obligations	3,237	-	3,237	-
Mortgage-backed securities-government sponsored agencies	61,164	-	61,164	-
Equity securities-financial services	498	498	-	--
Total	$143,104	$498	$142,606	$ -
December 31, 2010				
Available for Sale:				
US Government agencies	$30,268	$-	$30,268	$ -
States and political subdivisions	49,766	-	49,766	-
Corporate obligations	4,249	-	4,249	-
Mortgage-backed securities-government sponsored agencies	60,928	-	60,928	-
Equity securities-financial services	604	604	_____-_	--
Total	$145,815			