FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
November 08, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 September 30, 2010,

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 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1440803
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 SOUTH MAIN STREET (P.O. BOX 6010), CHAMBERSBURG, PA 17201-0819
(Address of principal executive offices)

717/264-6116
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 (§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 ¨ 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 Act) Yes ¨ No x

There were 3,900,881 outstanding shares of the Registrant's common stock as of October 29, 2010.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets
(Amounts in thousands, except share and per share data)
(unaudited)

	September 30 2010	December 31 2009
Assets		
Cash and due from banks	$ 16,117	$ 14,336
Interest-bearing deposits in other banks	5,281	18,912
Total cash and cash equivalents	21,398	33,248
Investment securities available for sale	125,172	143,288
Restricted stock	6,482	6,482
Loans	757,803	739,563
Allowance for loan losses	(9,598)	(8,937)
Net Loans	748,205	730,626
Premises and equipment, net	16,771	15,741
Bank owned life insurance	19,422	18,919
Goodwill	9,016	9,159
Other intangible assets	2,118	2,461
Other assets	19,004	19,449
Total assets	$ 967,588	$ 979,373
Liabilities		
Deposits		
Demand (non-interest bearing)	$ 87,114	$ 77,675
Savings and interest-bearing checking	436,024	388,222
Time	203,661	272,468
Total Deposits	726,799	738,365
Securities sold under agreements to repurchase	54,573	55,855
Long-term debt	91,343	94,688
Other liabilities	12,633	11,699
Total liabilities	885,348	900,607
Shareholders' equity		
Common stock $1 par value per share, 15,000,000 shares authorized with 4,298,904 shares issued, and 3,900,750 shares and 3,863,066 shares outstanding at September 30, 2010 and December 31, 2009, respectively	4,299	4,299
Capital stock without par value, 5,000,000 shares authorized with no shares issued or outstanding	-	-
Additional paid-in capital	32,799	32,832
Retained earnings	57,363	54,566
Accumulated other comprehensive loss	(5,101)	(5,138)
Treasury stock, 398,154 shares and 435,838 shares at cost at September 30, 2010 and December 31, 2009, respectively	(7,120)	(7,793)

Total shareholders' equity	82,240	78,766
Total liabilities and shareholders' equity	$ 967,588	$ 979,373

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

Consolidated Statements of Income
(Amounts in thousands, except per share data)
(unaudited)

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2010	2009	2010	2009
Interest income				
Loans, including fees	$ 9,838	$ 9,559	$ 29,080	$ 28,214
Interest and dividends on investments:				
Taxable interest	739	954	2,368	3,059
Tax exempt interest	385	419	1,253	1,357
Dividend income	12	38	39	134
Federal funds sold	-	5	-	11
Deposits and obligations of other banks	10	9	26	10
Total interest income	10,984	10,984	32,766	32,785
Interest expense				
Deposits	2,048	2,659	6,611	7,677
Securities sold under agreements to repurchase	38	40	116	130
Short-term borrowings	-	2	-	13
Long-term debt	980	1,040	2,930	3,145
Total interest expense	3,066	3,741	9,657	10,965
Net interest income	7,918	7,243	23,109	21,820
Provision for loan losses	625	1,644	1,875	2,663
Net interest income after provision for loan losses	7,293	5,599	21,234	19,157
Noninterest income				
Investment and trust services fees	884	866	2,908	2,622
Loan service charges	288	189	757	844
Mortgage banking activities	(55)	19	25	109
Deposit service charges and fees	622	678	1,793	1,911
Other service charges and fees	353	322	1,029	963
Increase in cash surrender value of life insurance	172	158	503	482
Other	18	17	90	341
OTTI losses on securities	(318)	-	(1,007)	(422)
Loss recognized in other comprehensive loss (before taxes)	-	-	(434)	-
Net OTTI losses recognized in earnings	(318)	-	(573)	(422)
Securities (losses) gains, net	(56)	(267)	212	(212)
Total noninterest income	1,908	1,982	6,744	6,638
Noninterest Expense				
Salaries and employee benefits	3,384	3,121	10,147	9,400
Net occupancy expense	478	495	1,498	1,451
Furniture and equipment expense	196	216	578	646
Advertising	378	334	1,033	1,068

Legal and professional fees	418	614	1,163	1,158
Data processing	370	383	1,249	1,219
Pennsylvania bank shares tax	151	143	459	431
Intangible amortization	114	117	343	351
FDIC insurance	302	234	882	1,148
Other	844	808	2,468	2,709
Total noninterest expense	6,635	6,465	19,820	19,581
Income before federal income taxes	2,566	1,116	8,158	6,214
Federal income tax expense	763	33	2,221	1,392
Net income	$ 1,803	$ 1,083	$ 5,937	$ 4,822
Per share				
Basic earnings per share	$ 0.46	$ 0.28	$ 1.53	$ 1.26
Diluted earnings per share	$ 0.46	$ 0.28	$ 1.53	$ 1.26
Cash dividends declared per share	$ 0.27	$ 0.27	$ 0.81	$ 0.81

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

Consolidated Statements of Changes in Shareholders' Equity
For the Nine Months Ended September 30, 2010 and 2009
(unaudited)

(Dollars in thousands, except share and per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2008	$ 4,299	$ 32,883	$ 52,126	$ (7,757)	$ (8,492)	$ 73,059
Comprehensive income:						
Net income	-	-	4,822	-	-	4,822
Unrealized gain on securities, net of reclassification adjustments and taxes	-	-	-	1,742	-	1,742
Unrealized gain on hedging activities, net of reclassification adjustments and taxes	-	-	-	654	-	654
Total Comprehensive income						7,218
Cash dividends declared, $.81 per share	-	-	(3,104)	-	-	(3,104)
Acquisition of 5,640 shares of treasury stock	-	-	-	-	(142)	(142)
Treasury shares issued to dividend reinvestment plan: 23,496 shares	-	(65)	-	-	639	574
Common stock issued under stock option plans: 98 shares	-	-	-	-	2	2
Stock option compensation	-	29	-	-	-	29
Balance at September 30, 2009	$ 4,299	$ 32,847	$ 53,844	$ (5,361)	$ (7,993)	$ 77,636
Balance at December 31, 2009	$ 4,299	$ 32,832	$ 54,566	$ (5,138)	$ (7,793)	$ 78,766
Comprehensive income:						
Net income	-	-	5,937	-	-	5,937
Unrealized gain on securities, net of reclassification adjustments and taxes	-	-	-	776	-	776
Unrealized loss on hedging activities, net of reclassification adjustments and taxes	-	-	-	(613)	-	(613)
Pension adjustment, net of tax				(126)		(126)
Total Comprehensive income						5,974
Cash dividends declared, $.81 per share	-	-	(3,140)	-	-	(3,140)
Treasury shares issued under stock option plans: 1,434 shares	-	(2)	-	-	25	23
Treasury shares issued to dividend reinvestment plan: 36,250 shares	-	(31)	-	-	648	617

Balance at September 30, 2010	$	4,299	$	32,799	$	57,363	$	(5,101)	$	(7,120)	$	82,240

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

Consolidated Statements of Cash Flows
(unaudited)

(Amounts in thousands)	For the Nine Months Ended September 30 2010	2009
Cash flows from operating activities		
Net income	$ 5,937	$ 4,822
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,000	1,074
Net amortization of loans and investment securities	262	92
Stock option compensation expense	-	29
Amortization and net change in mortgage servicing rights valuation	187	123
Amortization of intangibles	343	351
Provision for loan losses	1,875	2,663
Net realized (gains) losses on sales of securities	(212)	212
OTTI losses on securities	573	422
Loans originated for sale	(1,299)	(487)
Proceeds from sale of loans	952	495
Gain on sales of loans	(32)	(8)
(Gain) loss on sale or disposal of premises and equipment	(4)	120
Net gain on sale or disposal of other real estate/other repossessed assets	-	(10)
Increase in cash surrender value of life insurance	(503)	(482)
Gain from surrender of life insurance policy	-	(278)
Contribution to pension plan	(525)	(172)
Decrease in interest receivable and other assets	266	563
Decrease in interest payable and other liabilities	(207)	(370)
Other, net	253	66
Net cash provided by operating activities	8,866	9,225
Cash flows from investing activities		
Proceeds from sales of investment securities available for sale	7,608	9,114
Proceeds from maturities and paydowns of investment securities available for sale	22,765	21,513
Purchase of investment securities available for sale	(11,560)	(37,295)
Net increase in loans	(19,398)	(59,066)
Proceeds from sale of other real estate/other repossessed assets	517	43
Proceeds from surrender of life insurance policy	-	878
Capital expenditures	(1,955)	(1,219)
Net cash used in investing activities	(2,023)	(66,032)
Cash flows from financing activities		
Net increase in demand deposits, interesting-bearing checking and savings accounts	57,241	20,809
Net (decrease) increase in time deposits	(68,807)	61,701
Net decrease in short-term borrowings	(1,282)	(9,935)
Long-term debt payments	(3,345)	(3,394)
Long-term debt advances	-	260
Dividends paid	(3,140)	(3,104)

Common stock issued to dividend reinvestment plan		617		574
Common stock issued under stock option plans		23		2
Purchase of treasury shares		-		(142)
Net cash (used in) provided by financing activities		(18,693)		66,771
(Decrease) increase in cash and cash equivalents		(11,850)		9,964
Cash and cash equivalents as of January 1		33,248		16,713
Cash and cash equivalents as of September 30	$	21,398	$	26,677
Supplemental Disclosures of Cash Flow Information				
Cash paid during the year for:				
Interest on deposits and other borrowed funds	$	9,889	$	10,835
Income taxes	$	3,412	$	1,944
Noncash Activities				
Loans transferred to Other Real Estate	$	79	$	504

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

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FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES
UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly-owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank), Franklin Financial Properties Corp., and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly-owned subsidiary, Franklin Realty Services Corporation. Franklin Realty Services Corporation is an inactive real-estate brokerage company. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of non-bank entities are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of September 30, 2010, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation's 2009 Annual Report on Form 10-K. The consolidated results of operations for the period ended September 30, 2010 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2009 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include Cash and due from banks, Interest-bearing deposits in other banks and Federal funds sold. Generally, Federal funds are purchased and sold for one-day periods.

Earnings per share is computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
(In thousands, except per share data)	2010	2009	2010	2009
Weighted average shares outstanding (basic)	3,893	3,841	3,880	3,835
Impact of common stock equivalents	1	-	1	-
Weighted average shares outstanding (diluted)	3,894	3,841	3,881	3,835
Anti-dilutive options excluded from the calculation	72	104	75	108
Net income	$ 1,803	$ 1,083	$ 5,937	$ 4,822
Basic earnings per share	$ 0.46	$ 0.28	$ 1.53	$ 1.26
Diluted earnings per share	$ 0.46	$ 0.28	$ 1.53	$ 1.26

Note 2 – Recent Accounting Pronouncements

Receivables and the Allowances for Credit Losses. In July 2010, the FASB issued Accounting Standards Update No. (ASU) 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowances for Credit Losses. This Update requires expanded disclosures to help financial statement users understand the nature of credit risks inherent in a creditor's portfolio of financing receivables; how that risk is analyzed and assessed in arriving at the allowance for credit losses; and the changes, and reasons for those changes, in both the receivables and the allowance for credit losses. The disclosures should be prepared on a disaggregated basis and provide a roll-forward schedule of the allowance for credit losses and detailed information on financing receivables including, among other things, recorded balances, nonaccrual status, impairments, credit quality indicators, details for troubled debt restructurings and an aging of past due financing receivables. Disclosures required as of the end of a reporting period are effective for interim and annual reporting periods ending after December 15, 2010. Disclosures required for activity occurring during a reporting period are effective for interim and annual reporting periods beginning after December 15, 2010. This Update is not expected to have a material impact on the Corporation's financial position or consolidated financial statements.

Fair Value Measurements and Disclosures. The FASB has issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Corporation early adopted ASU 2010-06 effective with the quarter end June 30, 2010.

Transfers and Servicing. In October 2009, the FASB issued ASU 2009-16, Transfers and Servicing (Topic 860) - Accounting for Transfers of Financial Assets. This Update amends the Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140. The amendments in this Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. This Update was effective January 1, 2010 for the Corporation and there was no material affect on its operating results, financial position or consolidated financial statements.

Note 3 – Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on available-for-sale securities and derivatives and the change in plan assets and benefit obligations on the Bank’s pension plan, net of tax, that are recognized as separate components of shareholders’ equity.

The components of comprehensive income and related tax effects are as follows:

(Amounts in thousands)	For the Three Months Ended September 30 2010	For the Three Months Ended September 30 2009	For the Nine Months Ended September 30 2010	For the Nine Months Ended September 30 2009
Net Income	$ 1,803	$ 1,083	$ 5,937	$ 4,822
Securities:				
Unrealized gains arising during the period	71	2,201	815	2,005
Reclassification adjustment for losses included in net income	374	267	361	634
Net unrealized gains	445	2,468	1,176	2,639
Tax effect	(151)	(839)	(400)	$ (897)
Net of tax amount	294	1,629	776	1,742
Derivatives:				
Unrealized (losses) gains arising during the period	(449)	(424)	(1,464)	461
Reclassification adjustment for losses included in net income	181	179	536	530
Net unrealized (losses) gains	(268)	(245)	(928)	991
Tax effect	91	84	315	(337)
Net of tax amount	(177)	(161)	(613)	654
Pension:				
Change in plan assets and benefit obligations	-	-	(191)	-
Reclassification adjustment for losses included in net income	-	-	-	-
Net unrealized losses	-	-	(191)	-
Tax effect	-	-	65	-
Net of tax amount	-	-	(126)	-
Total other comprehensive income	117	1,468	37	2,396
Total Comprehensive Income	$ 1,920	$ 2,551	$ 5,974	$ 7,218

The components of accumulated other comprehensive loss included in shareholders' equity are as follows:

(Amounts in thousands)	September 30 2010	December 31 2009
Net unrealized losses on securities	$ (653)	$ (1,829)
Tax effect	222	622
Net of tax amount	(431)	(1,207)
Net unrealized losses on derivatives	(2,192)	(1,263)
Tax effect	745	429
Net of tax amount	(1,447)	(834)
Accumulated pension adjustment	(4,883)	(4,692)
Tax effect	1,660	1,595

Net of tax amount		(3,223)		(3,097)
Total accumulated other comprehensive loss	$	(5,101)	$	(5,138)

Note 4 – Guarantees

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit 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. The Bank had $28.7 million and $26.7 million of standby letters of credit as of September 30, 2010 and December 31, 2009, respectively. 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 amount of the liability as of September 30, 2010 and December 31, 2009 for guarantees under standby letters of credit issued was not material.

Note 5 - Investments

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2010 and December 31, 2009 are:

(Amounts in thousands) September 30, 2010	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Equity securities	$ 4,532	$ 2	$ (1,725)	$ 2,809
U.S. Treasury securities and obligations of U.S. Government agencies	20,134	421	(42)	20,513
Obligations of state and political subdivisions	40,869	1,901	(13)	42,757
Corporate debt securities	8,515	58	(1,713)	6,860
Mortgage-backed securities				
Agency	46,905	1,236	(123)	48,018
Non-Agency	4,794	-	(630)	4,164
Asset-backed securities	75	-	(24)	51
	$ 125,824	$ 3,618	$ (4,270)	$ 125,172

(Amounts in thousands) December 31, 2009	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Equity securities	$ 5,400	$ 37	$ (1,462)	$ 3,975
U.S. Treasury securities and obligations of U.S. Government agencies	28,258	618	(161)	28,715
Obligations of state and political subdivisions	42,611	1,332	(62)	43,881
Corporate debt securities	9,603	-	(2,343)	7,260
Mortgage-backed securities				
Agency	53,214	1,576	(47)	54,743
Non-Agency	5,947	-	(1,279)	4,668
Asset-backed securities	84	-	(38)	46
	$ 145,117	$ 3,563	$ (5,392)	$ 143,288

The book value of securities pledged as collateral to secure various funding sources was $115.2 million at September 30, 2010 and $134.6 million at December 31, 2009.

The amortized cost and estimated fair value of debt securities as of September 30, 2010, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities.

(Amounts in thousands)	Amortized cost	Estimated fair value
Due in one year or less	$ 2,447	$ 2,491
Due after one year through five years	14,510	14,926
Due after five years through ten years	25,864	27,218
Due after ten years	26,772	25,546
	69,593	70,181
Mortgage-backed securities	51,699	52,182
	$ 121,292	$ 122,363

The following table reflects temporary impairment in the investment portfolio (excluding restricted stock), aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of September 30, 2010 and December 31, 2009:

	September 30, 2010								
	Less than 12 months			12 months or more			Total		
(Amounts in thousands)	Fair Value	Unrealized Losses	Number	Fair Value	Unrealized Losses	Number	Fair Value	Unrealized Losses	Number
Equity securities	$ 1,033	$ (1,040)	2	$ 1,485	$ (685)	20	$ 2,518	$ (1,725)	22
U.S. Treasury securities and obligations of U.S. Government agencies	27	-	1	6,948	(42)	17	6,975	(42)	18
Obligations of state and political subdivisions	1,328	(9)	3	302	(4)	1	1,630	(13)	4
Corporate debt securities	-	-	-	6,172	(1,713)	9	6,172	(1,713)	9
Mortgage-backed securities									
Agency	10,016	(122)	11	584	(1)	1	10,600	(123)	12
Non-Agency	-	-	-	4,164	(630)	7	4,164	(630)	7
Asset-backed securities	-	-	-	53	(24)	3	53	(24)	3
Total temporarily impaired securities	$ 12,404	$ (1,171)	17	$ 19,708	$ (3,099)	58	$ 32,112	$ (4,270)	75

	December 31, 2009								
	Less than 12 months			12 months or more			Total		
(Amounts in thousands)	Fair Value	Unrealized Losses	Number	Fair Value	Unrealized Losses	Number	Fair Value	Unrealized Losses	Number
Equity securities	$ 2,343	$ (395)	7	$ 1,494	$ (1,067)	21	$ 3,837	$ (1,462)	28
U.S. Treasury securities and obligations of U.S. Government agencies	63	-	3	13,411	(161)	27	13,474	(161)	30
	1,843	(41)	6	285	(21)	1	2,128	(62)	7

Obligations of state and political subdivisions									
Corporate debt securities	622	(1)	5	6,537	(2,342)	10	7,159	(2,343)	15
Mortgage-backed securities									
Agency	10,812	(47)	9	-	-	-	10,812	(47)	9
Non-Agency	-	-	-	4,668	(1,279)	7	4,668	(1,279)	7
Asset-backed securities	-	-	-	46	(38)	3	46	(38)	3
Total temporarily impaired securities	$ 15,683	$ (484)	30	$ 26,441	$ (4,908)	69	$ 42,124	$ (5,392)	99

The following table provides additional detail about trust preferred securities as of September 30, 2010:

Trust Preferred Securities
September 30, 2010

(Dollars in thousands)

Deal Name	Single Issuer or Pooled	Class	Amortized Cost	Estimated Fair Value	Gross Unrealized Gain (Loss)	Lowest Credit Rating Assigned	Number of Banks currently Performing	Deferrals and Defaults as % of Original Collateral	Expected Deferral/ Defaults as a Percentage of Remaining Performing Collateral
Huntington Cap Trust	Single	Preferred Stock	$ 927	$ 592	$ (335)	Ba1	1	None	None
Huntington Cap Trust II	Single	Preferred Stock	871	561	(310)	B	1	None	None
BankAmerica Cap III	Single	Preferred Stock	955	691	(264)	BB	1	None	None
Wachovia Cap Trust II	Single	Preferred Stock	272	231	(41)	Baa2	1	None	None
Corestates Captl Tr II	Single	Preferred Stock	922	669	(253)	Baa1	1	None	None
Chase Cap VI JPM	Single	Preferred Stock	955	756	(199)	BBB	1	None	None
Fleet Cap Tr V	Single	Preferred Stock	970	718	(252)	Baa3	1	None	None
			$ 5,872	$ 4,218	$ (1,654)				

The following table provides additional detail about private label mortgage-backed securities as of September 30, 2010:

Private Label Mortgage Backed Securities
September 30, 2010

(Dollars in thousands)

Decscription	Orgination Date	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Collateral Type	Lowest Credit Rating Assigned	Credit Support %	OTTI Charges
RALI 2003-QS15 A1	8/1/2003	$ 640	$ 623	$ (17)	ALT A	Aa2	11.37	$ -
RALI 2004-QS4 A7	3/1/2004	620	610	(10)	ALT A	AAA	12.83	-
MALT 2004-6 7A1	6/1/2004	760	648	(112)	ALT A	BBB	10.54	-
RALI 2005-QS2 A1	2/1/2005	703	641	(62)	ALT A	B	7.53	-
RALI 2006-QS4 A2	4/1/2006	1,004	744	(260)	ALT A	D	-	142
GSR 2006-5F 2A1	5/1/2006	494	445	(49)	Prime	CCC	4.29	-
RALI 2006-QS8 A1	7/28/2006	573	453	(120)	ALT A	D	-	113
		$ 4,794	$ 4,164	$ (630)				$ 255

For more information concerning investments, refer to the Investment Securities discussion in the Financial Condition section.

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Note 6 – Pensions

The components of pension expense for the periods presented are as follows:

	Three months ended September 30		Nine months ended September 30	
(Amounts in thousands)	2010	2009	2010	2009
Components of net periodic (benefit) cost:				
Service cost	$ 91	$ 85	$ 274	$ 255
Interest cost	185	181	557	545
Expected return on plan assets	(209)	(190)	(628)	(570)
Amortization of prior service cost	-	(31)	-	(93)
Recognized net actuarial loss	43	82	128	246
Net periodic cost	$ 110	$ 127	$ 331	$ 383

The Bank expects its pension expense to decrease slightly in 2010 compared to 2009. The Bank expects to contribute $626 thousand to its pension plan in 2010. This amount will meet the minimum funding requirements.

Note 7 – Mortgage Servicing Rights

Activity pertaining to mortgage servicing rights and the related valuation allowance follows:

	Nine Months Ended September 30	
(Amounts in thousands)	2010	2009
Cost of mortgage servicing rights:		
Beginning balance	$ 1,190	$ 1,551
Originations	10	6
Amortization	(198)	(292)
Ending balance	$ 1,002	$ 1,265
Valuation allowance:		
Beginning balance	$ (476)	$ (689)
Valuation charges	(49)	-
Valuation reversals	60	170
Ending balance	$ (465)	$ (519)
Mortgage servicing rights cost	$ 1,002	$ 1,265
Valuation allowance	(465)	(519)
Carrying value	$ 537	$ 746
Fair value	$ 537	$ 746

Note 8 – Fair Value Measurements

Management uses its best judgment in estimating the fair value of the Corporation's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective quarter-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each quarter-end.

FASB ASC Topic 825, Financial Instruments, requires disclosure of the fair value of financial assets and liabilities, including those financial assets and liabilities that are not measured and reported at fair value on a recurring and non-recurring basis.

The estimated fair value of the Corporation's financial instruments are as follows:

	September 30, 2010		December 31, 2009	
(Amounts in thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 21,398	$ 21,398	$ 33,248	$ 33,248
Investment securities available for sale	125,172	125,172	143,288	143,288
Restricted stock	6,482	6,482	6,482	6,482
Net loans	748,205	762,540	730,626	742,929
Accrued interest receivable	3,848	3,848	3,904	3,904
Mortgage servicing rights	537	537	714	714
Financial liabilities:				
Deposits	$ 726,799	$ 729,493	$ 738,365	$ 742,953
Securities sold under agreements to repurchase	54,573	54,573	55,855	55,855
Long-term debt	91,343	96,367	94,688	99,013
Accrued interest payable	1,056	1,056	1,288	1,288
Interest rate swaps	2,193	2,193	1,263	1,263

The preceding information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation's financial instruments at September 30, 2010 and December 31, 2009:

Cash and Cash Equivalents: For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment securities available for sale: The fair value of investment securities is determined in accordance with the methods described under FASB ASC Topic 820 as discussed below.

Restricted stock: The carrying value of restricted stock approximates its fair value based on redemption provisions for the restricted stock.

Net loans: The fair value of fixed-rate loans is estimated for each major type of loan (e.g. real estate, commercial, industrial and agricultural and consumer) by discounting the future cash flows associated with such loans using rates currently offered for loans with similar terms to borrowers of comparable credit quality. The model considers scheduled principal maturities, repricing characteristics, prepayment assumptions and interest cash flows. The discount rates used are estimated based upon consideration of a number of factors including the treasury yield curve, expense and service charge factors. For variable rate loans that reprice frequently and have no significant change in credit quality, carrying values approximate the fair value.

Accrued interest receivable: The carrying amount is a reasonable estimate of fair value.

Mortgage servicing rights: The fair value of mortgage servicing rights, upon initial recognition, is estimated using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates assumptions, such as loan default rates, costs to service, and prepayment speeds. Mortgage servicing rights are carried at the lower of cost or fair value after initial recognition.

Deposits, Securities sold under agreements to repurchase and Long-term debt: The fair value of demand deposits, savings accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-rate certificates of deposit and long-term debt is estimated by discounting the future cash flows using rates approximating those currently offered for certificates of deposit and borrowings with similar remaining maturities. For securities sold under agreements to repurchase, the carrying value approximates a reasonable estimate of the fair value.

Accrued interest payable: The carrying amount is a reasonable estimate of fair value.

Interest rate swaps: The fair value of the interest rate swaps is determined in accordance with the methods described under FASB ASC Topic 820 as discussed below.

Off balance sheet financial instruments: Outstanding commitments to extend credit and commitments under standby letters of credit include fixed and variable rate commercial and consumer commitments. The fair value of the commitments is estimated using the fees currently charged to enter into similar agreements.

FASB ASC Topic 820, Fair Value Measurements and Disclosures 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 under FASB ASC Topic 820 are as follows:

Level 1: Valuation is based on unadjusted, quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Corporation's assumptions regarding what market participants would assume when pricing a financial instrument.

For financial assets and liabilities measured at fair value on a recurring basis, there were no transfers of financial assets or liabilities between Level 1 and Level 2 during the period ending September 30, 2010.

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollars in Thousands)	Fair Value at September 30, 2010			
Asset Description	Level 1	Level 2	Level 3	Total
Equity securities	$ 2,809	$ -	$ -	$ 2,809
U.S. Treasury securities and obligations of U.S. Government agencies	-	20,513	-	20,513
Obligations of state and political subdivisions	-	42,757	-	42,757
Corporate debt securities	-	6,860	-	6,860
Mortgage-backed securities				
Agency	-	48,018	-	48,018
Non-Agency	-	4,164	-	4,164
Asset-backed securities	-	51	-	51
Total assets	$ 2,809	$ 122,363	$ -	$ 125,172
Liability Description				
Interest rate swaps	$ -	$ 2,193	$ -	$ 2,193
Total liabilities	$ -	$ 2,193	$ -	$ 2,193

(Dollars in Thousands)	Fair Value at December 31, 2009			
Asset Description	Level 1	Level 2	Level 3	Total
Equity securities	$ 3,975	$ -	$ -	$ 3,975
U.S. Treasury securities and obligations of U.S. Government agencies	-	28,715	-	28,715
Obligations of state and political subdivisions	-	43,881	-	43,881
Corporate debt securities	-	7,260	-	7,260
Mortgage-backed securities				
Agency	-	54,743	-	54,743
Non-Agency	-	4,668	-	4,668
Asset-backed securities	-	46	-	46
Total assets	$ 3,975	$ 139,313	$ -	$ 143,288
Liability Description				
Interest rate swaps	$ -	$ 1,263	$ -	$ 1,263
Total liabilities	$ -	$ 1,263	$ -	$ 1,263

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. The Corporation used the following methods and significant assumptions to estimate the fair value for assets and liabilities measured on a recurring basis.

Investment securities: Level 1 securities represent equity securities that are valued using quoted market prices from nationally recognized markets. Level 2 securities represent debt securities that are valued using a mathematical model based upon the specific characteristics of a security in relationship to quoted prices for similar securities.

Interest rate swaps: The interest rate swaps are valued using a discounted cash flow model that uses verifiable market environment inputs to calculate the fair value. This method is not dependent on the input of any significant judgments or assumptions by Management.

For financial assets and liabilities measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollars in Thousands)

	Fair Value at September 30, 2010			
Asset Description	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ -	$ 18,473	$ 18,473
Other real estate owned	-	-	308	308
Mortgage servicing rights	-	-	537	537
Total assets	$ -	$ -	$ 19,318	$ 19,318

(Dollars in Thousands)

	Fair Value at December 31, 2009			
Asset Description	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ -	$ 7,943	$ 7,943
Other real estate owned	-	-	643	643
Mortgage servicing rights	-	-	714	714
Total assets	$ -	$ -	$ 9,300	$ 9,300

The Corporation used the following methods and significant assumptions to estimate the fair value of assets and liabilities measured on a nonrecurring basis:

Impaired loans: Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria.

Other real estate: The fair value of other real estate, upon initial recognition, is estimated using Level 2 inputs within the fair value hierarchy based on observable market data and Level 3 inputs based on customized discounting criteria. In connection with the measurement and initial recognition of the foregoing assets, the Corporation recognizes charge-offs through the allowance for loan losses.

Mortgage servicing rights: The fair value of mortgage servicing rights, upon initial recognition, is estimated using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates Level 3 assumptions such as cost to service, discount rate, prepayment speeds, default rates and losses. Mortgage servicing rights are carried at the lower of cost or fair value after initial recognition.

The following table presents a reconciliation of impaired loans, foreclosed real estate and mortgage servicing rights measured at fair value on a nonrecurring basis, using significant unobservable inputs (Level 3) for the nine months ended September 30, 2010:

(Dollars in Thousands)	Impaired Loans	Foreclosed Real Estate	Mortgage Servicing Rights
Balance - January 1, 2010	$ 7,943	$ 643	$ 714
Charged off	(846)	-	-
Settled or otherwise removed	(983)	(414)	-
Additions	13,827	79	10
Payments / amortization	(599)	-	(198)
(Increase) decrease in valuation allowance	(869)	-	11
Balance - September 30, 2010	$ 18,473	$ 308	$ 537

Note 9 – Financial Derivatives

The Board of Directors has given Management authorization to enter into derivative activity including interest rate swaps, caps and floors, forward-rate agreements, options and futures contracts in order to hedge interest rate risk. The Bank is exposed to credit risk equal to the positive fair value of a derivative instrument, if any, as a positive fair value indicates that the counterparty to the agreement is financially liable to the Bank. To limit this risk, counterparties must have an investment grade long-term debt rating and individual counterparty credit exposure is limited by Board approved parameters. Management anticipates continuing to use derivatives, as permitted by its Board-approved policy, to manage interest rate risk. During 2008, the Bank entered into two interest rate swap transactions in order to hedge the Corporation's exposure to changes in cash flows attributable to the effect of interest rate changes on variable rate liabilities.

Information regarding the interest rate swaps as of September 30, 2010 follows:

(Dollars in thousands) Notional Amount	Maturity Date	Interest Rate Fixed	Interest Rate Variable	Amount Expected to be Expensed into Earnings within the next 12 Months
$ 10,000	5/30/2013	3.60%	0.16%	$ 344
$ 10,000	5/30/2015	3.87%	0.16%	$ 371

The variable rate is indexed to the 91-day Treasury Bill auction (discount) rate and resets weekly.

Derivatives with a positive fair value are reflected as other assets in the consolidated balance sheet while those with a negative fair value are reflected as other liabilities. As short-term interest rates decrease, the net expense of the swap increases. As short-term rates increase, the net expense of the swap decreases.

Fair Value of Derivative Instruments in the Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009 are as follows:

Fair Value of Derivative Instruments

(Dollars in thousands) Date	Type	Balance Sheet Location	Fair Value
September 30, 2010	Interest rate contracts		$ 2,193

		Other liabilities		
December 31, 2009	Interest rate contracts	Other liabilities	$	1,263

The Effect of Derivative Instruments on the Statement of Income for the Nine Months Ended September 30, 2010 and 2009 follows:

Derivatives in ASC Topic 815 Cash Flow Hedging Relationships

(Dollars in thousands, net of tax)

Date / Type	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)
September 30, 2010					
Interest rate contracts	$ (613)	Interest Expense	$ (536)	Other income (expense)	$ -
September 30, 2009					
Interest rate contracts	$ 654	Interest Expense	$ (530)	Other income (expense)	$ -

Note 10 – Reclassifications

Certain prior period amounts may have been reclassified to conform to the current year presentation. Such reclassifications did not affect reported net income.

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Item 2

Management's Discussion and Analysis of Results of Operations and Financial Condition
For the Three and Nine Month Periods Ended September 30, 2010 and 2009

Forward Looking Statements

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements refer to a future period or periods, reflecting management's current views as to likely future developments, and use words such as "may," "will," "expect," "believe," "estimate," "anticipate," or similar terms. Because forward-looking statements involve certain ris uncertainties and other factors over which the Corporation has no direct control, actual results could differ materially from those contemplated in such statements. These factors include (but are not limited to) the following: general economic conditions, changes in interest rates, changes in the Corporation's cost of funds, changes in government monetary policy, changes in government regulation and taxation of financial institutions, changes in the rate of inflation, changes in technology, the intensification of competition within the Corporation's market area, and other similar factors.

Critical Accounting Policies

Management has identified critical accounting policies for the Corporation to include Allowance for Loan Losses, Mortgage Servicing Rights, Financial Derivatives, Temporary Investment Impairment and Stock-based Compensation. There were no changes to the critical accounting policies disclosed in the 2009 Annual Report on Form 10-K in regards to application or related judgements and estimates used. Please refer to Item 7 of the Corporation's 2009 Annual Report on Form 10-K for a more detailed disclosure of the critical accounting policies.

Results of Operations

Year-to-Date Summary
The Corporation reported net income for the first nine months ended September 30, 2010 of $5.9 million. This is a 23.1% increase versus net income of $4.8 million for the same period in 2009. Total revenue (interest income and noninterest income) increased $87 thousand year-over-year. Interest income remained flat, while noninterest income increased due to an increase in investment and trust services fees. Noninterest expense increased due to increased salary and benefit expense. The provision for loan losses was $1.9 million for the period, $788 thousand less than in 2009. Diluted earnings per share increased to $1.53 in 2010 from $1.26 in 2009. Net loans grew to $748.2 million, while total deposits decreased to $726.8 million. Total assets were $967.6 million at September 30, 2010, a decrease of $11.8 million from year-end 2009.

Other key performance ratios as of, or for the nine months ended September 30, 2010 and 2009 (on an annualized basis) are listed below:

	2010	2009
Return on average equity (ROE)	9.56%	8.34%
Return on average assets (ROA)	.79%	.66%
Return on average tangible average equity(1)	11.80%	10.79%
Return on average tangible average assets(1)	.85%	.73%
Net interest margin	3.47%	3.44%
Efficiency ratio	64.16%	65.50%

(1) The Corporation supplements its traditional GAAP measurements with Non-GAAP measurements. The Non-GAAP measurements include Return on Average Tangible Assets and Return on Average Tangible Equity. As a result of merger transactions, intangible assets (primarily goodwill and core deposit intangibles) were created. The Non-GAAP disclosures are intended to eliminate the effects of the intangible assets and allow for better comparisons to periods when such assets did not exist. The following table shows the adjustments made between the GAAP and NON-GAAP measurements:

GAAP Measurement	Calculation
Return on Average Assets	Net Income / Average Assets
Return on Average Equity	Net Income / Average Equity
Non- GAAP Measurement	Calculation
Return on Average Tangible Assets	Net Income plus Intangible Amortization / Average Assets less Average Intangible Assets
Return on Average Tangible Equity	Net Income plus Intangible Amortization / Average Equity less Average Intangible Assets
Efficiency Ratio	Noninterest Expense / Tax Equivalent Net Interest Income plus Noninterest Income (excluding Security Gains/Losses and Other Than Temporary Impairment)

A more detailed discussion of the operating results for the three and nine months ended September 30, 2010 follows:

Comparison of the three months ended September 30, 2010 to the three months ended September 30, 2009:

Net Interest Income

The most important source of the Corporation's earnings is net interest income, which is defined as the difference between income on interest-earning assets and the expense of interest-bearing liabilities supporting those assets. Principal categories of interest-earning assets are loans and securities, while deposits, securities sold under agreements to repurchase (Repos), short-term borrowings and long-term debt are the principal categories of interest-bearing liabilities. Demand deposits enhance net interest income because they are noninterest-bearing deposits. For the purpose of this discussion, balance sheet items refer to the average balance for the year and net interest income is adjusted to a fully taxable-equivalent basis. This tax-equivalent adjustment facilitates performance comparisons between taxable and tax-free assets by increasing the tax-free income by an amount equivalent to the Federal income taxes that would have been paid if this income were taxable at the Corporation's 34% Federal statutory rate.

Interest income for the third quarter of 2010 remained flat at $11.2 million compared to the third quarter of 2009. Average interest-earning assets increased by $617 thousand from the third quarter of 2009 but the yield on these assets decreased by 3 basis points. The average balance on investment securities decreased $20.7 million quarter over quarter due to pay downs, maturities and sales in the portfolio, net of investment purchases. Total average loans increased $43.0 million (6.0%) quarter over quarter. Average commercial loans increased $61.2 million (11.7%), but the increase was partially offset by a decrease in the average balance of mortgage and consumer loans. Average mortgage loans decreased $6.4 million, as the majority of new mortgage originations are sold in the secondary market and the portfolio continues to runoff. Average consumer loans, including home equity loans, decreased $11.8 million, as consumers continue to borrow less during the economic recession and the indirect lending portfolio continues to run-off as the Bank exited this business in early 2010 and no new loans have been booked.

Interest expense was $3.1 million for the third quarter, a decrease of $675 thousand from the third quarter of 2009 total of $3.7 million. Average interest-bearing liabilities decreased to $797.9 million in the third quarter of 2010 from an average balance of $807.4 million during the same period in 2009, a decrease of $9.5 million. The average cost of these liabilities decreased from 1.84% for the third quarter of 2009 to 1.52% for the same period in 2010. Average interest-bearing deposits increased $4.0 million, due to increases in money management accounts ($60.4 million), but these increases were partially offset by decreases in certificates of deposit ($57.4 million). The cost of interest-bearing deposits decreased from 1.65% to 1.26%. Securities sold under agreements to repurchase have decreased $2.6 million on average over the prior year quarter and the average rate has remained constant at .25%. The average balance of long-term debt decreased by $9.9 million due to scheduled amortization and maturities on Federal Home Loan Bank of Pittsburgh (FHLB) advances.

The changes in the balance sheet and interest rates resulted in an increase in tax equivalent net interest income of $603 thousand to $8.1 million for the third quarter of 2010 compared to $7.5 million for the third quarter of 2009. The Bank's net interest margin increased from 3.27% to 3.53% in 2010. The increase in the net interest margin is the result of a decrease in the rate on interest-earning liabilities of 32 basis points, while the yield on interest-bearing assets only decreased 3 basis points.

The following table shows a comparative analysis of average balances, asset yields and funding costs for the three months ended September 30, 2010 and 2009. These components drive changes in net interest income.

	For the Three Months Ended September 30					
	2010			2009		
(Dollars in thousands)	Average balance	Tax Equivalent Interest	Average yield/rate	Average balance	Tax Equivalent Interest	Average yield/rate
Interest-earning assets						
Federal funds sold and interest-bearing balances	$ 15,402	$ 12	0.31%	$ 37,050	$ 14	0.15%
Investment securities	134,327	1,315	3.92%	155,018	1,601	4.13%
Loans	760,576	9,837	5.10%	717,620	9,621	5.29%
Total interest-earning assets	$ 910,305	11,164	4.87%	$ 909,688	11,236	4.90%
Interest-bearing liabilities						
Interest-bearing deposits	$ 643,094	2,048	1.26%	$ 639,118	2,659	1.65%
Securities sold under agreements to repurchase	61,480	38	0.25%	64,112	40	0.25%
Short-term borrowings	-	-	-	954	2	0.83%
Long-term debt	93,278	980	4.17%	103,181	1,040	4.00%
Total interest-bearing liabilities	$ 797,852	3,066	1.52%	$ 807,365	3,741	1.84%
Interest spread			3.34%			3.06%
Tax equivalent Net interest income/Net interest margin		8,098	3.53%		7,495	3.27%
Tax equivalent adjustment		(180)			(252)	
Net interest income		$ 7,918			$ 7,243	

All amounts have been adjusted to a tax-equivalent basis using a tax rate of 34%. Investments include the average unrealized gains or losses. Dividend income is reported as taxable income, but is adjusted for the dividend received deduction. Loan balances include nonaccruing loans, loans held for sale, and are gross of the allowance for loan losses. Loan categories are based on an internal classification/purpose and do not necessarily reflect a specific type of collateral, if any.

Provision for Loan Losses

For the third quarter of 2010, the provision expense was $625 thousand versus $1.6 million for the same period in 2009. For more information concerning loan quality and the allowance for loan losses, refer to the Loan discussion in the Financial Condition section.

Noninterest Income

For the three months ended September 30, 2010, noninterest income decreased slightly to $1.9 million compared to $2.0 million in the third quarter of 2009. Investment and trust service fees increased $18 thousand due to increases in nonrecurring income from estate fees. Loan service charges increased $99 thousand from a higher volume of mortgage production fees from refinancing activity in 2010, compared to 2009. Mortgage banking fees decreased quarter over quarter due to an impairment charge of $48 thousand on mortgage servicing rights in 2010 versus a net impairment reversal of $26 thousand in 2009. Deposit service charges decreased $56 thousand in the third quarter of 2010 due to a decrease in account analysis fees and a decrease in fees from the Bank's overdraft protection program. New regulations effective July 1, 2010 require consumers to opt-in to overdraft protection programs for certain ATM and debit card transactions. Fee income from overdraft programs during the quarter appear consistent with the first two quarters of the year and the reduction in overdraft fees does not appear to be directly related to new regulations on overdraft fees imposed by the Dodd-Frank Act. However, the overall affect of this new regulation on future overdraft fees is uncertain at this time. Other service charges and fees, the increase in cash surrender value of life insurance and other income remained fairly flat in the third quarter of 2010. There was $318 thousand in other than temporary impairment charges on two equity securities recognized in the third quarter of 2010, versus no impairment charges in the same quarter in 2009. The Corporation also had realized losses of $56 thousand during the quarter ended September 30, 2010 versus losses of $267 thousand for the same period in 2009.

The following table presents a comparison of noninterest income for the three months ended September 30, 2010 and 2009:

	For the Three Months Ended September 30		Change	
(Dollars in thousands)	2010	2009	Amount	%
Noninterest Income				
Investment and trust services fees	$ 884	$ 866	$ 18	2.1
Loan service charges	288	189	99	52.4
Mortgage banking activities	(55)	19	(74)	(389.5)
Deposit service charges and fees	622	678	(56)	(8.3)
Other service charges and fees	353	322	31	9.6
Increase in cash surrender value of life insurance	172	158	14	8.9
Other	18	17	1	5.9
OTTI losses on securities	(318)	-	(318)	-
Less: Loss recognized in other comprehensive income (before taxes)	-	-	-	-
Net OTTI losses recognized in earnings	(318)	-	(318)	-
Securities (losses) gains, net	(56)	(267)	211	(79.0)
Total noninterest income	$ 1,908	$ 1,982	$ (74)	(3.7)

Noninterest Expense

Noninterest expense for the third quarter of 2010 totaled $6.6 million compared to $6.5 million in the third quarter of 2009. The increase in salaries and benefits was primarily due to annual salary adjustments. Net occupancy expense decreased from lower real estate taxes on the Bank's headquarters location, while furniture and equipment expense decreased due to less depreciation on fixed assets. Advertising expense increased $44 thousand due to the marketing of the Bank's new office that opened in Camp Hill during the quarter. Legal and professional fees decreased over the same period in 2009 due to less attorney's fees in 2010 and a special audit project in the third quarter of 2009. The Pennsylvania bank shares tax expense and intangible amortization expense remained flat quarter over quarter. FDIC insurance increased $68 thousand, as the FDIC assessment rate was higher in 2010. Other expenses increased slightly in 2010 compared to 2009.

The following table presents a comparison of noninterest expense for the three months ended September 30, 2010 and 2009:

	For the Three Months Ended September 30		Change	
(Dollars in thousands)	2010	2009	Amount	%
Noninterest Expense				
Salaries and benefits	$ 3,384	$ 3,121	$ 263	8.4
Net occupancy expense	478	495	(17)	(3.4)
Furniture and equipment expense	196	216	(20)	(9.3)
Advertising	378	334	44	13.2
Legal and professional fees	418	614	(196)	(31.9)
Data processing	370	383	(13)	(3.4)
Pennsylvania bank shares tax	151	143	8	5.6
Intangible amortization	114	117	(3)	(2.6)
FDIC insurance	302	234	68	29.1
Other	844	808	36	4.5
Total noninterest expense	$ 6,635	$ 6,465	$ 170	2.6

Income taxes

Federal income tax expense was $763 thousand for the third quarter of 2010 compared to $33 thousand in 2009. The effective tax rate for the third quarter of 2010 was 29.7% and 3.0% for 2009. The low effective tax rate in the third quarter of 2009 was caused by the provision for loan loss expense of $1.6 million compared to $625 thousand in the third quarter of 2010, thereby significantly reducing the pre-tax income for the third quarter of 2009. All taxable income for the Corporation is taxed at a rate of 34%.

Comparison of the nine months ended September 30, 2010 to the nine months ended September 30, 2009:

Net Interest Income

Interest income for the first nine months of 2010 was $33.5 million, $134 thousand less than the same period in 2009. Average interest-earning assets increased by $35.8 million from the first nine of 2009, however; the yield on these assets decreased by 23 basis points. The average balance on investment securities decreased $12.5 million year over year due to pay downs, maturities and sales in the portfolio, net of investment purchases. Total average loans increased $53.3 million (7.6%) year over year. Average commercial loans increased $73.9 million, but the increase was partially offset by a decrease in the average balance of mortgage and consumer loans. Average mortgage loans decreased $6.7 million, as the majority of new mortgage originations are sold in the secondary market and the portfolio continues to runoff. Average consumer loans, including home equity loans, decreased $13.9 million, as consumers continue to borrow less during the economic recession and as the Bank's indirect portfolio continues to run off.

Interest expense was $9.7 million for the first nine months, a decrease of $1.3 million from the first nine months of 2009 total of $11.0 million. Average interest-bearing liabilities increased to $799.5 million from an average balance of $772.8 million during the same period in 2009, an increase of $26.7 million. The average cost of these liabilities decreased from 1.90% to 1.61%. Average interest-bearing deposits increased $47.3 million, due to increases in money management accounts ($54.4 million) while certificates of deposit decreased ($8.3 million). Securities sold under agreements to repurchase have decreased $7.5 million on average over the prior year and the average rate has remained constant at .25%. The average balance of long-term debt decreased by $10.6 million due to scheduled amortization and maturities on FHLB advances.

The changes in the balance sheet and interest rates resulted in an increase in tax equivalent net interest income of $1.2 million to $23.8 million for the first nine months of 2010 compared to $22.6 million for the same period in 2009. The Bank's net interest margin increased from 3.25% in 2009 to 3.31% in 2010. The increase in the net interest margin is due to the yield on interest-earning liabilities decreasing 29 basis points, while the yield on interest-bearing liabilities decreased 23 basis points.

The following table shows a comparative analysis of average balances, asset yields and funding costs for the nine months ended September 30, 2010 and 2009. These components drive changes in net interest income.

	For the Nine Months Ended September 30					
		2010			2009	
		Tax			Tax	
	Average	Equivalent	Average	Average	Equivalent	Average
(Dollars in thousands)						