CONTANGO OIL & GAS CO
Form 10-Q
May 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2016

OR

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

For the transition period from to

Commission file number 001-16317

CONTANGO OIL & GAS COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE	95-4079863
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

717 TEXAS AVENUE, SUITE 2900

HOUSTON, TEXAS	77002
(Address of principal executive offices)	(Zip Code)

(713) 236-7400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The total number of shares of common stock, par value $0.04 per share, outstanding as of May 6, 2016 was 19,586,187.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE MONTHS ENDED MARCH 31, 2016

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All references in this Quarterly Report on Form 10-Q to the "Company", "Contango", "we", "us" or "our" are to Contango Oil Gas Company and its subsidiaries.

Item 1. Consolidated Financial Statements

CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except shares)

	March 31, 2016	December 31, 2015
	(unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	$ —	$ —
Accounts receivable, net	13,200	20,504
Prepaid expenses	856	1,228
Current derivative asset	2,696	—
Inventory	540	540
Total current assets	17,292	22,272
PROPERTY, PLANT AND EQUIPMENT:		
Natural gas and oil properties, successful efforts method of accounting:		
Proved properties	1,194,095	1,187,707
Unproved properties	12,452	16,439
Other property and equipment	1,081	1,081
Accumulated depreciation, depletion and amortization	(842,854)	(826,022)
Total property, plant and equipment, net	364,774	379,205
OTHER NON-CURRENT ASSETS:		
Investments in affiliates	14,262	14,222
Other	906	1,057
Total other non-current assets	15,168	15,279
TOTAL ASSETS	$ 397,234	$ 416,756
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 30,065	$ 36,358
Current asset retirement obligations	4,444	4,603
Total current liabilities	34,509	40,961
NON-CURRENT LIABILITIES:		

Long-term debt	112,182	115,446
Asset retirement obligations	22,830	22,506
Total non-current liabilities	135,012	137,952
Total liabilities	169,521	178,913
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
SHAREHOLDERS' EQUITY:		
Common stock, $0.04 par value, 50 million shares authorized, 24,677,584 shares issued and 19,393,001 shares outstanding at March 31, 2016, 24,636,936 shares issued and 19,381,146 shares outstanding at December 31, 2015	975	974
Additional paid-in capital	241,025	239,524
Treasury shares at cost (5,284,583 shares at March 31, 2016 and 5,255,790 shares at December 31, 2015)	(127,988)	(127,760)
Retained earnings	113,701	125,105
Total shareholders' equity	227,713	237,843
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 397,234	$ 416,756

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

CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
REVENUES:		
Oil and condensate sales	$ 5,247	$ 10,694
Natural gas sales	9,935	16,823
Natural gas liquids sales	2,400	3,130
Total revenues	17,582	30,647
EXPENSES:		
Operating expenses	7,604	9,911
Exploration expenses	320	4,483
Depreciation, depletion and amortization	16,545	35,115
Impairment and abandonment of oil and gas properties	1,851	2,281
General and administrative expenses	5,902	7,828
Total expenses	32,222	59,618
OTHER INCOME (EXPENSE):		
Gain from investment in affiliates (net of income taxes)	40	558
Interest expense	(878)	(695)
Gain on derivatives, net	4,204	—
Other expense	(40)	(5)
Total other income (expense)	3,326	(142)
NET LOSS BEFORE INCOME TAXES	(11,314)	(29,113)
Income tax benefit (provision)	(90)	10,549
NET LOSS	$ (11,404)	$ (18,564)
NET LOSS PER SHARE:		
Basic	$ (0.60)	$ (0.98)
Diluted	$ (0.60)	$ (0.98)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	19,079	18,939
Diluted	19,079	18,939

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Three Months Ended March 31,	
	2016	2015
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (11,404)	$ (18,564)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, depletion and amortization	16,545	35,115
Impairment of natural gas and oil properties	1,872	2,305
Exploration expenses	(58)	3,216
Deferred income taxes	—	(10,455)
Gain from investment in affiliates	(40)	(858)
Stock-based compensation	1,699	1,140
Unrealized gain on derivative instruments	(2,696)	—
Changes in operating assets and liabilities:		
Decrease in accounts receivable and other receivables	6,971	3,465
Decrease (increase) in prepaid expenses	372	(2,577)
Decrease in accounts payable and advances from joint owners	(5,458)	(16,791)
Increase (decrease) in other accrued liabilities	175	(2,030)
Decrease in income taxes receivable, net	368	200
Other	(18)	(1)
Net cash provided by (used in) operating activities	$ 8,328	$ (5,835)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Natural gas and oil exploration and development expenditures	$ (4,836)	$ (35,262)
Net cash used in investing activities	$ (4,836)	$ (35,262)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facility	$ 45,167	$ 122,039
Repayments under credit facility	(48,431)	(80,935)
Purchase of treasury stock	(228)	(7)
Net cash provided by (used in) financing activities	$ (3,492)	$ 41,097
NET CHANGE IN CASH AND CASH EQUIVALENTS	$ —	$ —
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	—	—

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ —	$ —

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

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in thousands, except number of shares)

	Common Stock		Additional Paid-in	Treasury	Retained	Total Shareholders'
	Shares	Amount	Capital	Stock	Earnings	Equity
	(unaudited)					
Balance at December 31, 2015	19,381,146	$ 974	$ 239,524	$ (127,760)	$ 125,105	$ 237,843
Treasury shares at cost	(28,793)	—	—	(228)	—	(228)
Restricted shares activity	40,648	1	(1)	—	—	—
Stock-based compensation	—	—	1,502	—	—	1,502
Net loss	—	—	—	—	(11,404)	(11,404)
Balance at March 31, 2016	19,393,001	$ 975	$ 241,025	$ (127,988)	$ 113,701	$ 227,713

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

CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization and Business

Contango Oil & Gas Company (collectively with its subsidiaries, "Contango" or the "Company") is a Houston, Texas based, independent oil and natural gas company. The Company's business is to maximize production and cash flow in order to explore, develop, exploit, produce and acquire crude oil and natural gas properties in the onshore Texas Gulf Coast and Rocky Mountain regions of the United States.

The following table lists the Company's primary producing areas as of March 31, 2016:

Location	Formation
Gulf of Mexico	Offshore Louisiana - water depths less than 300 feet
Madison and Grimes counties, Texas	Woodbine (Upper Lewisville)
Zavala and Dimmit counties, Texas	Buda / Austin Chalk
Weston County, Wyoming	Muddy Sandstone
Texas Gulf Coast	Conventional formations
Sublette County, Wyoming	Jonah Field (1)

(1) Through a 37% equity investment in Exaro Energy III LLC ("Exaro"). Production associated with this investment is not included in the Company's reported production results for the three months ended March 31, 2016.

Additionally, the Company has (i) operated properties producing from various conventional formations in various counties along the Texas Gulf Coast; (ii) operated producing properties in the Denver Julesburg Basin ("DJ Basin") in Weld and Adams counties in Colorado, which the Company believes may also be prospective in the Niobrara Shale oil play; and (iii) operated producing properties in the Haynesville Shale, Mid Bossier and James Lime formations in East Texas.

Due to the current challenging commodity price environment, the Company intends to focus its 2016 capital program on: (i) the preservation of its healthy financial position, including limiting its overall capital expenditure budget to a minimal amount; (ii) focusing drilling expenditures, if any, on strategic projects; (iii) identification of opportunities for cost efficiencies in all areas of its operations; and (iv) continuing to identify new resource potential opportunities, internally and, where appropriate, through acquisition. The Company will continuously monitor the commodity price environment, stability and forecast, and, if warranted, make adjustments to its drilling strategy as the year progresses.

The following table lists the primary area to which the Company has allocated drilling capital for 2016:

Location	Formation
Weston County, Wyoming	Muddy Sandstone

In addition, we have allocated some geological and geophysical and leasehold capital to Madison and Grimes counties, Texas and Weston County, Wyoming.

2. Summary of Significant Accounting Policies

The accounting policies followed by the Company are set forth in the notes to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Form 10-K") filed with the Securities and Exchange Commission ("SEC"). Please refer to the notes to the financial statements included in the 2015 Form 10-K for additional details of the Company's financial condition, results of operations and cash flows. No material items included in those notes have changed except as a result of normal transactions in the interim or as disclosed within this report.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information, pursuant to the rules and regulations of the SEC, including instructions to Quarterly Reports on Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, all adjustments considered necessary for a fair statement of the unaudited consolidated financial statements have been included. All such adjustments are of a normal recurring nature. The consolidated financial statements

should be read in conjunction with the 2015 Form 10-K. The consolidated results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The Company's consolidated financial statements include the accounts of Contango Oil & Gas Company and its subsidiaries, after elimination of all material intercompany balances and transactions. All wholly-owned subsidiaries are consolidated. Republic Exploration LLC ("REX"), a partially-owned oil and gas exploration and development affiliate which is not controlled by the Company, was proportionately consolidated prior to its dissolution as of December 31, 2015. The investment in Exaro by our wholly-owned subsidiary, Contaro Company ("Contaro") is accounted for using the equity method of accounting, and therefore, the Company does not include its share of individual operating results, reserves or production in those reported for the Company's consolidated results.

Impairment of Long-Lived Assets

Pursuant to GAAP, when circumstances indicate that proved properties may be impaired, the Company compares expected undiscounted future cash flows on a field by field basis to the unamortized capitalized cost of the asset. If the estimated future undiscounted cash flows based on the Company's estimate of future reserves, natural gas and oil prices, operating costs and production levels from oil and natural gas reserves, are lower than the unamortized capitalized cost, then the capitalized cost is reduced to fair value. The factors used to determine fair value include, but are not limited to, estimates of proved and probable reserves, future commodity prices, the timing of future production and capital expenditures and a discount rate commensurate with the risk reflective of the lives remaining for the respective oil and gas properties. Additionally, the Company may use appropriate market data to determine fair value. The Company recognized approximately $0.7 million for impairment of proved properties for the quarter ended March 31, 2016. Substantially all of the non-cash impairment charge in the quarter ended March 31, 2016 is directly related to the decline in commodity prices and the resulting impact on estimated future net cash flows from associated reserves. The Company recognized a $2.0 million impairment of small marginal proved properties for the quarter ended March 31, 2015.

Unproved properties are reviewed quarterly to determine if there has been impairment of the carrying value, with any such impairment charged to expense in the period. The Company recognized impairment expense of approximately $1.1 million for the quarter ended March 31, 2016, related to partial impairment of certain unproved properties due primarily to the sustained low commodity price environment and expiring leases; substantially all of which is related to unproved lease cost amortization of the Elm Hill project in Fayette and Gonzales counties Texas. The Company recognized impairment expense of approximately $0.2 million for the quarter ended March 31, 2015, related to partial impairment of certain unproved properties due to expiring leases.

Net Loss Per Common Share

Basic net loss per common share is computed by dividing the net loss attributable to common stock by the weighted average number of common shares outstanding for the period. Diluted net loss per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potential dilutive securities, including unexercised stock options and unvested restricted stock, have not been considered when their effect would be antidilutive. For the quarter ended March 31, 2016, 116,461 stock options and 284,528 restricted shares were excluded from dilutive shares due to the loss for the period. For the quarter ended March 31, 2015, 129,852 stock options and 456,528 restricted shares were excluded from dilutive shares due to the loss for the period.

Subsidiary Guarantees

Contango Oil & Gas Company, as the parent company (the “Parent Company”), has filed a registration statement on Form S-3 with the SEC to register, among other securities, debt securities that the Parent Company may issue from time to time. Any such debt securities would likely be guaranteed on a full and unconditional basis by each of the Company’s current subsidiaries and any future subsidiaries specified in any future prospectus supplement (each a “Subsidiary Guarantor”). Each of the Subsidiary Guarantors is wholly-owned by the Parent Company, either directly or indirectly. The Parent Company has no assets or operations independent of the Subsidiary Guarantors, and there are no significant restrictions upon the ability of the Subsidiary Guarantors to distribute funds to the Parent Company. The Parent Company has one wholly-owned subsidiary that is inactive and not a Subsidiary Guarantor. Finally, the Parent Company’s wholly-owned subsidiaries do not have restricted assets that exceed 25% of net assets as of the most recent fiscal year end that may not be transferred to the Parent Company in the form of loans, advances or cash dividends by such subsidiary without the consent of a third party.

Recent Accounting Pronouncements

In March 2016, the FASB issued Accounting Standards Update No. 2016-09: Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016-09 is part of an initiative to reduce complexity in accounting standards. The areas of simplification in ASU 2016-09 involve several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years; early application is

permitted. The Company will continue to assess the impact this may have on its financial position, results of operations, and cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02: Leases (Topic 842) (ASU 2016-02). The main objective of ASU 2016-02 is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and Topic 842 is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. ASU 2016-02 requires lessees to recognize assets and liabilities arising from leases on the balance sheet. ASU 2016-02 further defines a lease as a contract that conveys the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration. Control over the use of the identified asset means that the customer has both (1) the right to obtain substantially all of the economic benefit from the use of the asset and (2) the right to direct the use of the asset. ASU 2016-02 requires disclosures by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. For public entities, ASU 2016-02 is effective for financial statements issued for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; early application is permitted. The Company will continue to assess the impact this may have on its financial position, results of operations, and cash flows.

In January 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update No. 2016-01: Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01). The main objective of ASU 2016-01 is enhancing the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments in ASU 2016-01 make targeted improvements to GAAP by: (i) requiring equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) be measured at fair value with changes in fair value recognized in net income; (ii) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) exempting all non-public business entities from disclosing fair value information for financial instruments measured at amortized cost; (iv) eliminating requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet: (v) requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (vi) requiring separate presentation in other comprehensive income the portion of the total change in fair value of a liability resulting from a change in the instrument- specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vii) requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset; and (viii) clarifying that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. For public entities, ASU 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years; early application is permitted. The provisions of this accounting update are not expected to have a material impact on the Company’s financial position or results of operations.

Further, management is closely monitoring the joint standard-setting efforts of the FASB and the International Accounting Standards Board. There are a large number of pending accounting standards that are being targeted for completion in 2016 and beyond. Because these pending standards have not yet been finalized, management is not able to determine the potential future impact that these standards will have, if any, on the Company's financial position, results of operations, or cash flows.

3. Fair Value Measurements

Pursuant to Accounting Standards Codification 820, Fair Value Measurements and Disclosures (ASC 820), the Company's determination of fair value incorporates not only the credit standing of the counterparties involved in transactions with the Company resulting in receivables on the Company's consolidated balance sheets, but also the impact of the Company's nonperformance risk on its own liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy assigns the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 measurements are inputs that are observable for assets or liabilities, either directly or indirectly, other than quoted prices included within Level 1. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs.

The following table sets forth, by level within the fair value hierarchy, the Company’s financial assets and liabilities that were accounted for at fair value as of March 31, 2016. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the

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significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have been no transfers between Level 1, Level 2 or Level 3.

Fair value information for financial assets and liabilities was as follows as of March 31, 2016 (in thousands):

	Total	Fair Value Measurements Using		
	Carrying Value	Level 1	Level 2	Level 3
Derivatives				
Commodity price contracts - assets	$ 2,696	$ —	$ 2,696	$ —
Commodity price contracts - liabilities	$ —	$ —	$ —	$ —

Derivatives listed above are recorded in “Current derivative asset” on the Company’s consolidated balance sheet and include swaps that are carried at fair value. The Company records the net change in the fair value of these positions in "Gain (loss) on derivatives, net" in the Company's consolidated statements of operations. The Company is able to value the assets and liabilities based on observable market data for similar instruments, which resulted in the Company reporting its derivatives as Level 2. This observable data includes the forward curves for commodity prices based on quoted markets prices and implied volatility factors related to changes in the forward curves. As of December 31, 2015, there were no outstanding commodity price contracts. See Note 4 - "Derivative Instruments" for additional discussion of derivatives.

As of March 31, 2016, the Company's derivative contracts were with major financial institutions with investment grade credit ratings which are believed to have minimal credit risk. As such, the Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts discussed above; however, the Company does not anticipate such nonperformance.

Estimates of the fair value of financial instruments are made in accordance with the requirements of ASC 825, Financial Instruments. The estimated fair value amounts are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to their short-term nature. The estimated fair value of the Company's credit facility with the Royal Bank of Canada and other lenders (the “RBC Credit Facility”) approximates carrying value because the facility interest rate approximates current market rates and is reset at least every three months. See Note 8 - "Long-Term Debt" for further information.

Impairments

Contango tests proved oil and natural gas properties for impairment when events and circumstances indicate a decline in the recoverability of the carrying value of such properties, such as a downward revision of the reserve estimates or lower commodity prices. The Company estimates the undiscounted future cash flows expected in connection with the oil and gas properties on a field by field basis and compares such future cash flows to the unamortized capitalized costs of the properties. If the estimated future undiscounted cash flows are lower than the unamortized capitalized cost, the capitalized cost is reduced to its fair value. The factors used to determine fair value include, but are not limited to, estimates of proved and probable reserves, future commodity prices, the timing of future production and capital expenditures and a discount rate commensurate with the risk reflective of the lives remaining for the respective

oil and gas properties. Additionally, the Company may use appropriate market data to determine fair value. Because these significant fair value inputs are typically not observable, impairments of long-lived assets are classified as a Level 3 fair value measure.

Asset Retirement Obligations

The initial measurement of asset retirement obligations at fair value is calculated using discounted cash flow techniques and based on internal estimates of future retirement costs associated with oil and gas properties. The factors used to determine fair value include, but are not limited to, estimated future plugging and abandonment costs and expected lives of the related reserves.

4. Derivative Instruments

The Company is exposed to certain risks relating to its ongoing business operations, such as commodity price risk. Derivative contracts are typically utilized to hedge the Company's exposure to price fluctuations and reduce the variability in the Company's cash flows associated with anticipated sales of future oil and natural gas production. The Company typically hedges a substantial, but varying, portion of anticipated oil and natural gas production for future periods. The Company believes that these derivative arrangements, although not free of risk, allow it to achieve a more predictable cash flow and to reduce exposure to commodity price fluctuations. However, derivative arrangements limit the benefit of increases in the prices of crude oil, natural gas and natural gas liquids sales. Moreover, because its derivative arrangements apply only to a portion of its production, the Company’s strategy provides only partial protection against declines in commodity prices. Such arrangements may expose the

Company to risk of financial loss in certain circumstances. The Company continuously reevaluates its hedging programs in light of changes in production, market conditions and commodity price forecasts.

As of March 31, 2016, the Company's natural gas derivative positions consisted of "swaps". Swaps are designed so that the Company receives or makes payments based on a differential between fixed and variable prices for crude oil and natural gas.

It is the Company's policy to enter into derivative contracts only with counterparties that are creditworthy institutions deemed by management as competent and competitive market makers. The Company does not post collateral, nor is exposed to potential margin calls, under any of these contracts as they are secured under the RBC Credit Facility. See Note 8 - "Long-Term Debt" for further information regarding the RBC Credit Facility.

The Company has elected not to designate any of its derivative contracts for hedge accounting. Accordingly, derivatives are carried at fair value on the consolidated balance sheets as assets or liabilities, with the changes in the fair value included in the consolidated statements of operations for the period in which the change occurs. The Company records the net change in the mark-to-market valuation of these derivative contracts, as well as all payments and receipts on settled derivative contracts, in "Gain (loss) on derivatives, net" on the consolidated statements of operations.

The following swaps were in place at March 31, 2016 (fair value in thousands):

Commodity	Period	Derivative	Volume/Month	Price/Unit (1)	Fair Value
Natural Gas	Apr 2016 - Jul 2016	Swap	1,300,000 MMBtu	$2.53	2,665
Natural Gas	Aug 2016 - Oct 2016	Swap	250,000 MMBtu	$2.53	212
Natural Gas	Nov 2016 - Dec 2016	Swap	1,300,000 MMBtu	$2.53	(181)
		Total net fair value of derivative instruments			$ 2,696

(1) Commodity price derivatives based on Henry Hub NYMEX natural gas prices.

The following summarizes the fair value of commodity derivatives outstanding on a gross and net basis as of March 31, 2016 (in thousands):

	Gross	Netting (1)	Total
Assets	$ 2,961	$ (265)	$ 2,696
Liabilities	$ (265)	$ 265	$ —

(1) Represents counterparty netting under agreements governing such derivatives.
As of December 31, 2015, the Company did not have any outstanding derivative positions.

The following table summarizes the effect of derivative contracts on the consolidated statements of operations for the quarter ended March 31, 2016 (in thousands):

		20,526	20,601	0	213	213
Home equity lines of credit	0	38,585	38,585	0	339	339
1-4 Family residential construction	0	23,633	23,633	0	312	312
Total residential mortgage	727	380,188	380,915	4	3,511	3,515
Commercial:						
Commercial loans secured by real estate	6,227	129,533	135,760	98	1,633	1,731
Commercial and industrial	327	71,684	72,011	75	853	928
Political subdivisions	0	40,186	40,186	0	0	0
Commercial construction and land	25	6,827	6,852	0	107	107
Loans secured by farmland	1,463	6,058	7,521	52	58	110
Multi-family (5 or more) residential	987	8,194	9,181	233	78	311
Agricultural loans	19	4,569	4,588	0	43	43
Other commercial loans	0	12,691	12,691	0	121	121
Total commercial	9,048	279,742	288,790	458	2,893	3,351
Consumer	0	10,160	10,160	0	123	123
Unallocated						427
Total	$9,775	$670,090	$679,865	$462	$6,527	$7,416

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December 31, 2014 (In Thousands)	Loans:			Allowance for Loan Losses:		
	Individually Evaluated	Collectively Evaluated	Totals	Individually Evaluated	Collectively Evaluated	Totals
Residential mortgage:						
Residential mortgage loans - first liens	$1,665	$290,217	$291,882	$358	$2,583	$2,941
Residential mortgage loans - junior liens	17	21,149	21,166	0	176	176
Home equity lines of credit	0	36,629	36,629	0	322	322
1-4 Family residential construction	0	16,739	16,739	0	214	214
Total residential mortgage	1,682	364,734	366,416	358	3,295	3,653
Commercial:						
Commercial loans secured by real estate	6,537	139,341	145,878	16	1,742	1,758
Commercial and industrial	663	49,494	50,157	82	606	688
Political subdivisions	0	17,534	17,534	0	0	0
Commercial construction	1,939	4,999	6,938	211	72	283
Loans secured by farmland	1,470	6,446	7,916	102	63	165
Multi-family (5 or more) residential	0	8,917	8,917	0	87	87
Agricultural loans	25	3,196	3,221	0	31	31
Other commercial loans	0	13,334	13,334	0	131	131
Total commercial	10,634	243,261	253,895	411	2,732	3,143
Consumer	0	10,234	10,234	0	145	145
Unallocated						395
Total	$12,316	$618,229	$630,545	$769	$6,172	$7,336

Summary information related to impaired loans at September 30, 2015 and December 31, 2014 is as follows:

(In Thousands)	September 30, 2015			December 31, 2014		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Unpaid Principal Balance	Recorded Investment	Related Allowance
With no related allowance recorded:						
Residential mortgage loans - first liens	$609	$609	$0	$950	$950	$0
Residential mortgage loans - junior liens	75	75	0	17	17	0
Commercial loans secured by real estate	7,519	5,908	0	8,062	6,521	0
Commercial and industrial	252	252	0	513	513	0
Commercial construction and land	25	25	0	124	124	0
Loans secured by farmland	924	924	0	925	925	0
Agricultural loans	19	19	0	25	25	0
Total with no related allowance recorded	9,423	7,812	0	10,616	9,075	0

With a related allowance recorded:						
Residential mortgage loans - first liens	43	43	4	715	715	358
Commercial loans secured by real estate	319	319	98	16	16	16
Commercial and industrial	75	75	75	150	150	82
Commercial construction and land	0	0	0	1,815	1,815	211
Loans secured by farmland	539	539	52	545	545	102
Multi-family (5 or more) residential	987	987	233	0	0	0
Total with a related allowance recorded	1,963	1,963	462	3,241	3,241	769
Total	$11,386	$9,775	$462	$13,857	$12,316	$769

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

	Average Investment in Impaired Loans				Interest Income Recognized on Impaired Loans on a Cash Basis			
(In Thousands)	3 Months Ended		9 Months Ended		3 Months Ended		9 Months Ended	
	Sept. 30,		Sept. 30,		Sept. 30,		Sept. 30,	
	2015	2014	2015	2014	2015	2014	2015	2014
Residential mortgage:								
Residential mortgage loans - first lien	$1,990	$4,427	$2,534	$4,460	$9	$19	$67	$65
Residential mortgage loans - junior lien	67	198	62	206	1	0	3	2
Total residential mortgage	2,057	4,625	2,596	4,666	10	19	70	67
Commercial:								
Commercial loans secured by real estate	6,327	7,131	6,382	7,360	90	78	293	345
Commercial and industrial	421	874	467	930	4	10	16	29
Commercial construction and land	42	407	50	463	0	0	0	4
Loans secured by farmland	1,466	1,530	1,467	1,405	26	23	78	56
Multi-family (5 or more) residential	741	0	741	0	0	0	0	0
Agricultural loans	21	42	22	44	1	0	3	2
Total commercial	9,018	9,984	9,129	10,202	121	111	390	436
Consumer	0	2	0	2	0	0	0	0
Total	$11,075	$14,611	$11,725	$14,870	$131	$130	$460	$503

Loans are placed on nonaccrual status for all classes of loans when, in the opinion of management, collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on loans for which the risk of further loss is greater than remote are applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans, including impaired loans, is recognized only to the extent of interest payments received. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments. Also, the amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

The breakdown by portfolio segment and class of nonaccrual loans and loans past due ninety days or more and still accruing is as follows:

(In Thousands)	September 30, 2015		December 31, 2014	
	Past Due 90+ Days and Accruing	Nonaccrual	Past Due 90+ Days and Accruing	Nonaccrual
Residential mortgage:				
Residential mortgage loans - first liens	$2,021	$3,074	$1,989	$3,440
Residential mortgage loans - junior liens	100	8	82	50
Home equity lines of credit	48	19	49	22
Total residential mortgage	2,169	3,101	2,120	3,512
Commercial:				
Commercial loans secured by real estate	628	5,712	653	5,804
Commercial and industrial	0	327	5	379
Commercial construction and land	0	25	35	1,915
Loans secured by farmland	0	1,438	0	951
Multi-family (5 or more) residential	0	987	0	0
Agricultural loans	0	19	0	25
Total commercial	628	8,508	693	9,074
Consumer	36	23	30	24
Totals	$2,833	$11,632	$2,843	$12,610

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The amounts shown in the table immediately above include loans classified as troubled debt restructurings (described in more detail below), if such loans are past due ninety days or more or nonaccrual.

The table below presents a summary of the contractual aging of loans as of September 30, 2015 and December 31, 2014:

(In Thousands)	As of September 30, 2015				As of December 31, 2014			
	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total
Residential mortgage:								
Residential mortgage loans - first liens	$290,371	$4,241	$3,484	$298,096	$282,766	$5,443	$3,673	$291,882
Residential mortgage loans - junior liens	20,290	211	100	20,601	20,853	190	123	21,166
Home equity lines of credit	38,243	294	48	38,585	36,300	258	71	36,629
1-4 Family residential construction	23,633	0	0	23,633	16,739	0	0	16,739
Total residential mortgage	372,537	4,746	3,632	380,915	356,658	5,891	3,867	366,416
Commercial:								
Commercial loans secured by real estate	134,453	18	1,289	135,760	143,713	883	1,282	145,878
Commercial and industrial	71,948	42	21	72,011	49,994	43	120	50,157
Political subdivisions	40,186	0	0	40,186	17,534	0	0	17,534
Commercial construction and land	6,827	0	25	6,852	4,897	91	1,950	6,938
Loans secured by farmland	6,688	0	833	7,521	6,811	254	851	7,916
Multi-family (5 or more) residential	8,019	175	987	9,181	8,720	197	0	8,917
Agricultural loans	4,447	122	19	4,588	3,105	91	25	3,221
Other commercial loans	12,691	0	0	12,691	13,334	0	0	13,334
Total commercial	285,259	357	3,174	288,790	248,108	1,559	4,228	253,895
Consumer	10,060	64	36	10,160	10,164	40	30	10,234
Totals	$667,856	$5,167	$6,842	$679,865	$614,930	$7,490	$8,125	$630,545

Nonaccrual loans are included in the contractual aging in the immediately preceding table. A summary of the contractual aging of nonaccrual loans at September 30, 2015 and December 31, 2014 is as follows:

(In Thousands)	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Total
September 30, 2015 Nonaccrual Totals	$7,236	$387	$4,009	$11,632
December 31, 2014 Nonaccrual Totals	$6,959	$369	$5,282	$12,610

Loans whose terms are modified are classified as Troubled Debt Restructurings (TDRs) if the Corporation grants such borrowers concessions, and it is deemed that those borrowers are experiencing financial difficulty. Loans classified as TDRs are designated as impaired. The outstanding balance of loans subject to TDRs, as well as contractual aging information at September 30, 2015 and December 31, 2014 is as follows:

(In Thousands)	Current & Past Due Less than 30 Days	Past Due 30-89 Days	Past Due 90+ Days	Nonaccrual	Total
September 30, 2015 Totals	$962	$81	$0	$5,182	$6,225
December 31, 2014 Totals	$1,725	$82	$0	$5,388	$7,195

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There were no TDRs that occurred during the three-month periods ended September 30, 2015 and 2014. TDRs that occurred during the nine-month periods ended September 30, 2015 and 2014 were as follows:

Nine Months Ended September 30, 2015 (Balances in Thousands)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential mortgage:			
Residential mortgage loans - first liens	1	$56	$56
Residential mortgage loans - junior liens	1	32	32
Consumer	1	30	30

Nine Months Ended September 30, 2014	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential mortgage:			
Residential mortgage loans - first liens	3	$150	$150
Commercial:			
Commercial loans secured by real estate	5	6,679	5,193
Commercial and industrial	1	80	80

The TDRs in the nine-month period ended September 30, 2015 included an extended maturity date and a reduction in interest rate on a residential mortgage – first lien, a lowered interest rate and reduced payment amount on a residential mortgage – junior lien loan and a lowered interest rate and reduced payment amount on the consumer loan. There was no allowance for loan losses on these loans at September 30, 2015, and no change in the allowance for loan losses resulting from these TDRs.

The TDRs related to residential mortgage loans in the nine-month period ended September 30, 2014 included a reduction in payment amount on one contract, an interest only period allowed on one contract and a reduction in interest rate and payment on one contract. The TDRs related to the commercial loans in the nine-month period ended September 30, 2014 relate to six contracts associated with one relationship. The Corporation entered into a forbearance agreement with this commercial borrower which includes a reduction in monthly payment amounts over a fifteen-month period. At the end of the fifteen-month period, the monthly payment amounts would revert to the original amounts, unless the forbearance agreement is extended or the payment requirements are otherwise modified. In July 2015, the forbearance agreement was extended for twelve months. The Corporation recorded a charge-off of

$1,486,000 in the second quarter 2014 as a result of these modifications, as the payment amounts based on the forbearance agreement are not sufficient to fully amortize the contractual amount of principal outstanding on the loans. The amount of charge-off was determined based on the excess of the contractual principal due over the present value of the payment amounts provided for in the forbearance agreement, assuming the revised payment amounts would continue until maturity, at the contractual interest rates. After the effect of the charge-off, the total recorded investment in loans to this borrower amounted to $5,273,000, with no related allowance for loan losses on these loans at September 30, 2014, while the allowance on the loans amounted to $1,552,000 at December 31, 2013. There were no changes in the allowance for loan losses related to TDRs that occurred in the third quarter 2014.

In the three-month period ended September 30, 2015, defaults on loans for which modifications considered to be TDRs were entered into within the previous 12 months were as follows:

	Number of Contracts	Recorded Investment
Three Months Ended September 30, 2015		
(Balances in Thousands)		
Residential mortgage:		
Residential mortgage loans - first liens	1	$32

In the third quarter 2015, the event of default in the table listed above resulted from a borrower's failure to make regular payments after reduced payment amount period of six months ended on a first lien residential mortgage. There was no allowance for loan losses recorded on this loan at September 30, 2015. In the third quarter 2014, there were no defaults on loans for which modifications considered to be TDRs were entered into within the previous 12 months.

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In the nine-month periods ended September 30, 2015 and 2014, defaults on loans for which modifications considered to be TDRs were entered into within the previous 12 months were as follows:

	Number of Contracts	Recorded Investment
Nine Months Ended September 30, 2015		
(Balances in Thousands)		
Residential mortgage,		
Residential mortgage loans - first liens	2	$65
Commercial,		
Commercial construction and land	1	25

	Number of Contracts	Recorded Investment
Nine Months Ended September 30, 2014		
(Balances in Thousands)		
Residential mortgage:		
Residential mortgage loans - first liens	2	$223
Residential mortgage loans - junior liens	1	62
Commercial:		
Commercial loans secured by real estate	1	429
Loans secured by farmland	4	490
Agricultural	1	13

In the nine-month period ended September 30, 2015, the events of default in the table listed above resulted from the borrowers' failure to make timely payments under the following circumstances: (1) for one customer relationship included in the Residential first lien mortgage class, payment was missed after reduced payment amount for a period of six months; (2) for a second customer relationship included in the Residential first lien mortgage class, payment was missed after reduction to interest only payment requirements for a period of a year; and (3) for the Commercial construction and land loan, monthly payments were missed after extending the term of maturity. There were no allowances for loan losses recorded on these loans at September 30, 2015.

In the nine-month period ended September 30, 2014, the events of default in the table listed above included a borrower's failure to make reduced payments provided for at a reduced interest rate on a first lien residential mortgage. The other events of default listed above in the nine-month period ended September 30, 2014 resulted from the borrowers' failure to make interest only monthly payments. There were no allowances for loan losses recorded on these

loans at September 30, 2014.

At September 30, 2015, the carrying amount of foreclosed residential real estate properties held as a result of obtaining physical possession (included in Foreclosed assets held for sale in the unaudited consolidated balance sheet) was $654,000.

At September 30, 2015, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process was $1,485,000.

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8. BORROWED FUNDS

SHORT-TERM BORROWINGS

Short-term borrowings include the following:

(In Thousands)	Sept. 30, 2015	Dec. 31 2014
FHLB-Pittsburgh borrowings	$4,500	$0
Customer repurchase agreements	5,744	5,537
Total short-term borrowings	$10,244	$5,537

The FHLB-Pittsburgh loan facilities are collateralized by qualifying loans secured by real estate with a book value totaling $444,285,000 at September 30, 2015 and $446,780,000 at December 31, 2014. Also, the FHLB-Pittsburgh loan facilities require the Corporation to invest in established amounts of FHLB-Pittsburgh stock. The carrying values of the Corporation's holdings of FHLB-Pittsburgh stock (included in Other Assets) were $2,337,000 at September 30, 2015 and $1,454,000 at December 31, 2014.

The short-term borrowing from the FHLB-Pittsburgh is an overnight borrowing and has an interest rate of 0.34%.

The Corporation engages in repurchase agreements with certain commercial customers. These agreements provide that the Corporation sells specified investment securities to the customers on an overnight basis and repurchases them on the following business day. The weighted average rate paid by the Corporation on customer repurchase agreements was 0.10% at September 30, 2015 and December 31, 2014. The carrying value of the underlying securities was $5,800,000 at September 30, 2015 and $5,590,000 at December 31, 2014.

LONG-TERM BORROWINGS

Long-term borrowings are as follows:

(In Thousands)	Sept. 30,	Dec. 31

	2015	2014
FHLB-Pittsburgh borrowings	$11,842	$12,060
Repurchase agreements	51,000	61,000
Total long-term borrowings	$62,842	$73,060

Long-term borrowings from FHLB - Pittsburgh are as follows:

(In Thousands)	Sept. 30, 2015	Dec. 31 2014
Loan maturing in 2016 with a rate of 6.86%	$70	$107
Loan maturing in 2017 with a rate of 6.83%	12	16
Loan maturing in 2017 with a rate of 3.81%	10,000	10,000
Loan maturing in 2020 with a rate of 4.79%	863	987
Loan maturing in 2025 with a rate of 4.91%	897	950
Total long-term FHLB-Pittsburgh borrowings	$11,842	$12,060

Repurchase agreements included in long-term borrowings are as follows:

(In Thousands)	Sept. 30, 2015	Dec. 31 2014
Agreement maturing in 2017 with a rate of 3.595%	$27,000	$27,000
Agreement maturing in 2017 with a rate of 4.265%	24,000	34,000
Total long-term repurchase agreements	$51,000	$61,000

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The Corporation incurred a loss of $910,000 in the second quarter of 2015 on prepayment of $10,000,000 of the agreement with an interest rate of 4.265%.

“Repurchase Dates,” as defined in the Master Repurchase Agreement between the Corporation and the broker-dealer, occur quarterly on or about the 20th of each March, June, September and December until the “Final Repurchase Date” (as defined) on December 20, 2017. The Corporation pays interest, and each of the borrowings is putable by the issuer, on each Repurchase Date. The Final Repurchase Date is the effective maturity date of the borrowings.

Securities sold under repurchase agreements were delivered to the broker-dealer who is the counter-party to the transactions. The broker-dealer may have sold, loaned or otherwise disposed of such securities to other parties in the normal course of their operations, and has agreed to resell to the Corporation substantially identical securities at the maturities of the agreements. The Master Repurchase Agreement provides that the Agreement constitutes a “netting contract,” as defined; however, the Corporation and the broker-dealer have no other obligations to one another and accordingly, no netting has occurred.

The carrying value of the underlying securities was $62,453,000 at September 30, 2015 and $70,982,000 at December 31, 2014, detailed in the following table:

(In Thousands)	September 30, 2015	December 31, 2014
Mortgage-backed securities	$19,181	$24,114
Collateralized mortgage obligations, Issued by U.S. Government agencies	43,272	46,868
Total	$62,453	$70,982

Two of the more significant risks associated with the repurchase agreements are as follows:

- The borrowings are putable at quarterly intervals by the issuer. Accordingly, if interest rates were to rise to a sufficient level, the issuer would be expected to require the Corporation to pay off the borrowings. In this circumstance, the Corporation would be required to obtain new borrowings at a higher interest rate than the existing repurchase agreements or utilize cash from other sources to pay off the borrowings. If sales of available-for-sale securities were used to generate cash to pay off the borrowings, the value of such securities would be expected to have fallen, which could result in the Corporation recognizing a loss.

- As principal pay-downs of mortgage backed securities and CMOs occur, the Corporation must have available, unencumbered assets or purchase a sufficient amount of assets with credit quality suitable to the broker-dealer to replace the amounts being paid off. Since pre-payments of mortgages typically increase as interest rates fall, the Corporation may be required to purchase additional assets at times when market rates are lower than the rates paid on the borrowings.

The Corporation manages these risks by maintaining sufficient available assets of acceptable credit quality, as well as maintaining other borrowing facilities, to meet ongoing collateral maintenance requirements or pay off the borrowings if required. In particular, the Corporation had unused borrowing capacity available from the FHLB-Pittsburgh of $305,431,000 at September 30, 2015.

9. DEFINED BENEFIT PLANS

The Corporation sponsors a defined benefit health care plan that provides postretirement medical benefits and life insurance to employees who meet certain age and length of service requirements. Full-time employees no longer accrue service time toward the Corporation-subsidized portion of the medical benefits. This plan contains a cost-sharing feature, which causes participants to pay for all future increases in costs related to benefit coverage. Accordingly, actuarial assumptions related to health care cost trend rates do not significantly affect the liability balance at September 30, 2015 and December 31, 2014, and are not expected to significantly affect the Corporation's future expenses. The Corporation uses a December 31 measurement date for the postretirement plan.

In an acquisition in 2007, the Corporation assumed the Citizens Trust Company Retirement Plan, a defined benefit pension plan. This plan covers certain employees who were employed by Citizens Trust Company on December 31, 2002, when the plan was amended to discontinue admittance of any future participant and to freeze benefit accruals. Information related to the Citizens Trust Company Retirement Plan has been included in the tables that follow. The Corporation uses a December 31 measurement date for this plan.

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The components of net periodic benefit costs from these defined benefit plans are as follows:

(In Thousands)	Pension Nine Months Ended Sept. 30,		Postretirement Nine Months Ended Sept. 30,	
	2015	2014	2015	2014
Service cost	$0	$0	$29	$26
Interest cost	27	55	42	43
Expected return on plan assets	(34)	(66)	0	0
Amortization of prior service cost	0	0	(22)	(23)
Recognized net actuarial loss	11	11	0	0
Net periodic benefit cost	$4	$0	$49	$46

(In Thousands)	Pension Three Months Ended Sept. 30,		Postretirement Three Months Ended Sept. 30,	
	2015	2014	2015	2014
Service cost	$0	$0	$10	$9
Interest cost	9	18	14	14
Expected return on plan assets	(11)	(22)	0	0
Amortization of prior service cost	0	0	(7)	(7)
Recognized net actuarial loss	4	3	0	0
Net periodic benefit cost	$2	($1)	$17	$16

In the first nine months of 2015, the Corporation funded postretirement contributions totaling $47,000, with estimated annual postretirement contributions of $65,000 expected in 2015 for the full year. Based upon the related actuarial reports, no defined benefit pension contributions are required in 2015, though the Corporation may make discretionary contributions.

10. STOCK-BASED COMPENSATION PLANS

The Corporation has a Stock Incentive Plan for a selected group of officers. Also, the Corporation has an Independent Directors Stock Incentive Plan. In the first quarter 2015, the Corporation issued restricted stock under each of the Plans. In the first quarter 2014, the Corporation issued stock options and restricted stock under each of the Plans.

In the first quarter 2015, the Corporation awarded a total of 34,800 shares of restricted stock under the Stock Incentive and Independent Directors Stock Incentive Plans. In the first quarter 2014, a total of 16,711 shares of restricted stock were awarded under the Plans. Restricted stock awards in the first quarter 2015 included the following: (1) a total of 20,298 shares to employees, vesting over a four-year term, with vesting contingent upon the Corporation meeting an annual return on average equity ("ROAE") performance ratio, as defined; (2) a total of 2,198 shares to employees, vesting over a four-year term, with vesting dependent on satisfactory performance; (3) an award to the Chief Executive Officer of 5,174 shares, vesting over a three-year term, with vesting dependent on satisfactory performance; and (4) a total of 7,130 shares under the Independent Directors Incentive Plan, vesting over a term of one year.

Compensation cost related to restricted stock is recognized based on the market price of the stock at the grant date over the vesting period. Management has estimated restricted stock expense in the first nine months of 2015 based on an assumption that the ROAE target for 2015 will be met.

In January 2014, the Corporation granted options to purchase a total of 39,027 shares of common stock. The exercise price for the 2014 awards is $20.45 per share, based on the market price as of the date of grant. Stock option expense is recognized over the vesting period of each option.

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The Corporation records stock option expense based on estimated fair value calculated using an option valuation model. In calculating the 2014 fair value, the Corporation utilized the Black-Scholes-Merton option-pricing model. The calculated fair value of each option granted, and significant assumptions used in the calculations, were as follows:

	2014
Fair value of each option granted	$5.50
Volatility	39%
Expected option lives	8 Years
Risk-free interest rate	2.85%
Dividend yield	4.33%

In calculating the estimated fair value of stock option awards, management based its estimates of volatility and dividend yield on the Corporation's experience over the immediately prior period of time consistent with the estimated lives of the options. The risk-free interest rate was based on the published yield of zero-coupon U.S. Treasury strips with an applicable maturity as of the grant dates. The expected option lives were based on management's estimates of the average term for all options issued under both plans. In 2014, management assumed a 34% forfeiture rate for options granted under the Stock Incentive Plan, and a 3% forfeiture rate for the Directors Stock Incentive Plan. These estimated forfeiture rates were determined based on the Corporation's historical experience.

Total stock-based compensation expense is as follows:

(In Thousands)	3 Months Ended		9 Months Ended	
	Sept. 30, 2015	Sept. 30, 2014	Sept. 30, 2015	Sept. 30, 2014
Stock options	$0	$0	$0	$154
Restricted stock	152	79	459	309
Total	$152	$79	$459	$463

11. INCOME TAXES

The net deferred tax asset at September 30, 2015 and December 31, 2014 represents the following temporary difference components:

(In Thousands)	Sept. 30, 2015	Dec. 31, 2014
Deferred tax assets:		
Net realized losses on securities	$136	$144
Allowance for loan losses	2,596	2,568
Credit for alternative minimum tax paid	0	537
Other deferred tax assets	2,380	2,595
Total deferred tax assets	5,112	5,844
Deferred tax liabilities:		
Unrealized holding gains on securities	3,293	2,844
Defined benefit plans - ASC 835	5	43
Bank premises and equipment	921	1,134
Core deposit intangibles	12	18
Other deferred tax liabilities	119	137
Total deferred tax liabilities	4,350	4,176
Deferred tax asset, net	$762	$1,668

The provision for income tax for the three-month and nine-month periods ended September 30, 2015 and 2014 is based on the Corporation’s estimate of the effective tax rate expected to be applicable for the full year. The effective tax rates for the Corporation are as follows:

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(In thousands)	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2015	2014	2015	2014
Income before income tax provision	$5,629	$5,678	$16,482	$16,928
Income tax provision	1,395	1,411	4,076	4,210
Effective tax rate	24.78%	24.85%	24.73%	24.87%

The effective tax rate for each period presented differs from the statutory rate of 35% principally because of the effects of tax-exempt interest income.

The Corporation has investments in three limited partnerships that manage affordable housing projects that have qualified for the federal low-income housing tax credit. The Corporation's expected return from these investments is based on the receipt of tax credits and tax benefits from deductions of operating losses. The Corporation uses the effective yield method to account for these investments, with the benefits recognized as a reduction of the provision for income taxes. For two of the three limited partnership investments, the tax credits have been received in full in prior years, and the Corporation has fully realized the benefits of the credits and amortized its initial investments in the partnerships. The most recent affordable housing project was completed in 2013, and the Corporation received tax credits in 2013 and 2014 and expects to continue to receive tax credits annually through 2022. The carrying amount of the Corporation's investment is $839,000 at September 30, 2015 and $906,000 at December 31, 2014 (included in Other Assets in the consolidated balance sheets). For the year ending December 31, 2015, the estimated amount of tax credits and other tax benefits to be received is $158,000 and the estimated amount to be recognized as a reduction of the provision for income taxes is $80,000. For the year ended December 31, 2014, tax credits and other tax benefits totaled $159,000 and the amount recognized as a reduction of the provision for income taxes for 2014 was $83,000. The reduction in the provision for income taxes resulting from this investment totaled $22,000 in the third quarter 2015 and $62,000 for the nine months ended September 30, 2015, and $21,000 in the third quarter 2014 and $62,000 for the nine months ended September 30, 2014.

The Corporation has no unrecognized tax benefits, nor pending examination issues related to tax positions taken in preparation of its income tax returns. With limited exceptions, the Corporation is no longer subject to examination by the Internal Revenue Service for years prior to 2011.

12. CONTINGENCIES

In the normal course of business, the Corporation may be subject to pending and threatened lawsuits in which claims for monetary damages could be asserted. In management's opinion, the Corporation's financial position and results of operations would not be materially affected by the outcome of such pending legal proceedings.

13. RECENT ACCOUNTING PRONOUNCEMENTS

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

In January 2014, the FASB issued ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. This Update provides guidance on accounting for investments in flow-through limited liability entities that qualify for the federal low-income housing tax credit. Prior to ASU 2014-01, under U.S. GAAP, a reporting entity that invests in a qualified affordable housing project could elect to account for that investment using the effective yield method if certain conditions are met, or alternatively, the investment would be accounted for under either the equity method or the cost method. Generally, investors in qualified affordable housing project investments expect to receive all of their return through the receipt of tax credits and tax deductions from operating losses, and use of the effective yield method results in recognition of the return as a reduction of income tax expense over the period of the investment. The amendments in this Update modify the conditions that a reporting entity must meet to be eligible to use a method other than the equity or cost methods to account for investments in qualified affordable housing projects. Additionally, the amendments introduce new recurring disclosure requirements about investments in qualified affordable housing projects. The amendments in this Update became effective for the Corporation for annual and interim periods beginning in the first quarter 2015, and are to be applied retrospectively. Information concerning the Corporation's investments in qualified affordable housing projects is provided in Note 11 to these unaudited consolidated financial statements.

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In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The objective of the amendments in this Update is to reduce diversity among reporting entities by clarifying when an in substance foreclosure occurs. The amendments in this Update clarify that an in substance foreclosure occurs, and a creditor is considered to have received physical possession of residential real property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to the requirements of the applicable jurisdiction. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. Under the modified retrospective transition method, an entity would record a cumulative-effect adjustment to residential consumer mortgage loans and foreclosed residential real estate properties existing as of the beginning of the annual period for which the amendments are effective. For prospective transition, an entity would apply the amendments to all instances of an entity receiving physical possession of residential real estate property collateralizing consumer mortgage loans that occur after the date of adoption. Early adoption is permitted. The amendments in this Update became effective for the Corporation for annual and interim periods beginning in the first quarter 2015. The Corporation has applied the amendments to its accounting and reporting practices prospectively in the first quarter 2015. Disclosures required by the Update are provided in Note 7 to these unaudited consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which provides a principles-based framework for revenue recognition that supersedes virtually all previously issued revenue recognition guidance under U.S. GAAP. Additionally, the ASU requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The core principle of the five-step revenue recognition framework is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015 the FASB issued ASU 2015-14, which deferred the effective date of the revenue recognition standard by a year, making it applicable for the Corporation in the first quarter 2018 and for the annual period ending December 31, 2018. The amendments should be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the amendments recognized at the date of initial application. The Corporation is in the process of evaluating the potential impact of adopting the amendments, including determining which transition method to apply.

In June 2014, the FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. In addition to various other amendments that will affect accounting and disclosures for transactions in which the Corporation has not engaged to date, this Update requires expanded disclosures for repurchase agreements that are accounted for as secured borrowings, including: (1) a disaggregation of the gross obligation by the class of collateral pledged, (2) the remaining contractual tenor of the agreements and (3) a discussion of the potential risks

associated with the agreements and the related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed. The expanded disclosure requirements associated with repurchase agreements are effective for the Corporation for annual and interim periods beginning in the second quarter 2015. Information concerning the Corporation's repurchase agreements is provided in Note 8 to these consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, Receivables – Troubled Debt Restructuring by Creditors, which requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under the claim and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. The amendments in this Update became effective for the Corporation for annual and interim periods beginning in the first quarter 2015, and the impact of the amendment was not significant to the Corporation

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

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

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

EARNINGS OVERVIEW

Third quarter 2015 net income was $0.35 per basic and diluted share, as compared to $0.36 in the second quarter 2015 and $0.34 in the third quarter 2014. For the nine months ended September 30, 2015, net income per basic share was $1.02, and net income per diluted share was $1.01, as compared to $1.02 per basic and diluted share for the first nine months of 2014. The return on average assets for the first nine months of 2015 was 1.32%, and the return on average equity was 8.78%.

Some of the more significant fluctuations in revenues and expenses between the three-month and nine-month periods ended September 30, 2015 and the corresponding periods in 2014 were as follows:

- Net interest income was $10,008,000 in the third quarter 2015, flat as compared to $10,010,000 in the second quarter 2015 and down $277,000 (2.7%) from the third quarter 2014 amount. For the first nine months of 2015, net interest income of $29,968,000 was down $708,000 (2.3%) from the first nine months of 2014. The net interest margin was 3.66% in the third quarter 2015 as compared to 3.69% in the second quarter 2015 and 3.75% in the third quarter 2014, and the net interest margin of 3.69% for the first nine months of 2015 was down from 3.82% in the first nine months of 2014. The decrease in margin in 2015 has resulted from reductions in yields on earning assets, mainly loans and available-for-sale securities, accompanied by a smaller decrease in average rates paid on deposits and borrowed funds.

- The provision for loan losses was $302,000 in the third quarter 2015, up from $221,000 in the second quarter 2015 and $218,000 in the third quarter 2014. For the first nine months of 2015, the provision for loan losses totaled $526,000, up from $353,000 for the first nine months of 2014. The higher provision for loan losses in the third quarter and first nine months of 2015 reflects an increase in loans outstanding, which resulted in an increase in the collectively determined portion of the allowance for loan losses.

- Noninterest revenue was $3,961,000 in the third quarter 2015, flat as compared to $3,962,000 in the second quarter 2015 and up 1.9% from the third quarter 2014 amount. Noninterest revenue totaled $11,410,000 for the first nine months of 2015, down $208,000 (1.8%) from the corresponding period in 2014. Fluctuations in noninterest revenue in the third quarter 2015 as compared to the second quarter included an increase in gains from sales of residential mortgage loans of $60,000, a comparative increase of $46,000 as the fair value of servicing rights increased $13,000 in the third quarter 2015 while the fair value had decreased $33,000 in the prior quarter, and a net reduction in revenue from Trust and brokerage services of $109,000, reflecting the effects of timing as well as a reduction in fair value of assets under management in the most recent quarter due mainly to overall declines in values of U.S. equities. The most significant changes in components of noninterest revenue for the first nine months of 2015 as compared to the corresponding period in 2014 included the following: (1) decrease of $183,000 (4.8%) in service charges on deposit accounts, primarily as a result of lower overdraft fees; (2) reduction of $172,000 as the fair value of servicing rights declined $137,000 in the first nine months of 2015 as compared to an increase in fair value of $35,000 in the first nine months of 2014; (3) net increase in revenues from Trust and brokerage services of $111,000 (2.8%); and (4) an increase in other operating income of $79,000, including an increase of $39,000 in dividends from Federal Home Loan Bank of Pittsburgh stock and an increase of $30,000 in revenue from merchant services.

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- Realized gains from securities totaled $79,000 in the third quarter 2015. In comparison, second quarter 2015 results included gains from sales of securities totaling $932,000 and a loss from prepayment of borrowings totaling $910,000. In the third quarter 2014, realized gains from securities totaled $760,000. There were no losses from prepayment of borrowings in the third quarter 2015 or 2014. For the nine months ended September 30, 2015, realized gains from available-for-sale securities totaled $1,085,000 as compared to $894,000 in the first nine months of 2014, and the loss from prepayment of borrowings was $910,000 in the first nine months of 2015 with no such loss in 2014.

- Noninterest expenses, excluding loss on prepayment of borrowings, totaled $8,117,000 in the third quarter 2015, up from $7,964,000 in the second quarter 2015 and lower than the total of $9,036,000 in the third quarter 2014. For the first nine months of 2015, noninterest expenses, excluding loss on prepayment of borrowings, totaled $24,545,000, down $1,362,000 (5.3%) from the first nine months of 2014. Salaries and wages expense increased $141,000, and pensions and other employee benefits expense increased $81,000, in the third quarter 2015 as compared to the second quarter 2015 amounts. The increase in the most recent quarter in salaries and wages reflected a few recent personnel additions, including lending and operations staff. The increase in the most recent quarter in employee benefits expense included an increase in health insurance expense resulting from higher claims on the Corporation's partially self-insured plan. The reduction in noninterest expenses in the third quarter 2015 as compared to the third quarter 2014 included a decrease in salaries and wages of $604,000 resulting from severance expenses in 2014, and a reduction in other operating expense of $225,000, including a reduction in net collection expenses of $79,000 and the effects of a $69,000 sales tax refund that reduced expenses in 2015. The reduction in noninterest expenses for the first nine months of 2015 as compared to the corresponding period in 2014 included the following: (1) a reduction in salaries and wages expenses of $725,000, mainly due to severance expenses in 2014; (2) a reduction in employee benefit-related expenses of $227,000 due to lower employee health insurance expense as a result of lower claims; (3) a reduction in Pennsylvania shares tax expense of $137,000, mainly as a result of an increase in tax credits associated with charitable contributions; and (4) a reduction in other expenses of $310,000, including reductions in expenses from loan collection of $157,000, other real estate properties of $86,000 and attorneys' fees of $86,000.

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

TABLE I - QUARTERLY FINANCIAL DATA

(In Thousands) (Unaudited)	For the Three Months Ended:						
	Sept. 30, 2015	June 30, 2015	Mar. 31, 2015	Dec. 31, 2014	Sept. 30, 2014	June 30, 2014	Mar. 31, 2014
Interest income	$11,134	$11,186	$11,163	$11,468	$11,572	$11,563	$11,406
Interest expense	1,126	1,176	1,213	1,257	1,287	1,290	1,288
Net interest income	10,008	10,010	9,950	10,211	10,285	10,273	10,118
Provision (credit) for loan losses	302	221	3	123	218	446	(311)

Net interest income after provision (credit) for loan losses	9,706	9,789	9,947	10,088	10,067	9,827	10,429
Other income	3,961	3,962	3,487	3,802	3,887	3,980	3,751
Net gains on available-for-sale securities	79	932	74	210	760	103	31
Loss on prepayment of borrowings	0	910	0	0	0	0	0
Other expenses	8,117	7,964	8,464	8,250	9,036	8,347	8,524
Income before income tax provision	5,629	5,809	5,044	5,850	5,678	5,563	5,687
Income tax provision	1,395	1,452	1,229	1,482	1,411	1,400	1,399
Net income	$4,234	$4,357	$3,815	$4,368	$4,267	$4,163	$4,288
Net income per share – basic	$0.35	$0.36	$0.31	$0.35	$0.34	$0.33	$0.35
Net income per share – diluted	$0.35	$0.36	$0.31	$0.35	$0.34	$0.33	$0.34

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CRITICAL ACCOUNTING POLICIES

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

A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. Management believes the allowance for loan losses is adequate and reasonable. Analytical information related to the Corporation's aggregate loans and the related allowance for loan losses is summarized by loan segment and classes of loans in Note 7 to the unaudited consolidated financial statements. Additional discussion of the Corporation's allowance for loan losses is provided in a separate section later in Management's Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions, and could, therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

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

As described in Note 6 to the unaudited consolidated financial statements, management evaluates securities for other-than-temporary impairment (OTTI). In making that evaluation, consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) whether the Corporation intends to sell the security or more likely than not will be required to sell the security before its anticipated recovery. Management's assessments of the likelihood and potential for recovery in value of securities are subjective and based on sensitive assumptions.

NET INTEREST INCOME

The Corporation's primary source of operating income is net interest income, which is equal to the difference between the amounts of interest income and interest expense. Tables II, III and IV include information regarding the Corporation's net interest income for the three-month and nine-month periods ended September 30, 2015 and September 30, 2014. In each of these tables, the amounts of interest income earned on tax-exempt securities and loans have been adjusted to a fully taxable-equivalent basis. Accordingly, the net interest income amounts reflected in these tables exceed the amounts presented in the consolidated financial statements. The discussion that follows is based on amounts in the related Tables.

Nine-Month Periods Ended September 30, 2015 and 2014

For the nine-month periods, fully taxable equivalent net interest income was $32,172,000 in 2015, $774,000 (2.3%) lower than in 2014. As shown in Table IV, interest rate changes had the effect of decreasing net interest income $1,537,000 and changes in volume had the effect of increasing net interest income $763,000 in 2015 compared to 2014. The most significant components of the rate-related change in net interest income in 2015 were a decrease in interest income of $1,302,000 attributable to lower rates earned on loans receivable and a decrease in interest income of $363,000 attributable to lower rates earned on available-for-sale securities, partially offset by a decrease in interest expense of $118,000 due mainly to lower rates paid on interest-bearing deposits. The most significant components of the volume-related change in net interest income in 2015 were an increase in interest income of $727,000 attributable to an increase in the balance of loans receivable, a decrease in interest expense of $144,000 attributable to a reduction in the balance of borrowed funds and a decrease in interest expense of $88,000 attributable to a reduction in the balance of interest-bearing deposits (primarily certificates of deposit), partially offset by a decrease in interest income of $161,000 on available-for-sale securities. As presented in Table III, the "Interest Rate Spread" (excess of average rate of return on earning assets over average cost of funds on interest-bearing liabilities) was 3.54% in 2015, as compared to 3.66% in 2014.

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INTEREST INCOME AND EARNING ASSETS

Interest income totaled $35,687,000 in 2015, a decrease of 3.1% from 2014. Interest and fees on loans receivable decreased $575,000, or 2.2%. The Corporation's annualized average rate of return on loans receivable declined to 5.20% in 2015 from 5.48% in 2014 as rates on new loans have decreased. The average balance of gross loans receivable increased $18,828,000, or 3.0%, to $646,638,000 in 2015 from $627,810,000 in 2014. The largest increase was in tax-exempt municipal loans, for which the average balance was up $13,265,000 in the first nine months of 2015 as compared to the first nine months of 2014. The average balance of taxable commercial loans was higher in 2015 as compared to 2014, including an increase in the average balances of participation loans of $7,877,000. Participation loans represent portions of larger transactions for which other institutions are the "lead banks".

As indicated in Table III, average available-for-sale securities (at amortized cost) totaled $494,921,000 in 2015, an increase of $3,560,000 (0.7%) from 2014. The net increase in the Corporation's available-for-sale securities portfolio was primarily made up of collateralized mortgage obligations issued or guaranteed by U.S. Government agencies. The Corporation's yield on securities was lower in 2015 than in 2014, primarily because of lower market interest rates. The average rate of return on available-for-sale securities was 2.82% in 2015 and 2.98% in 2014.

INTEREST EXPENSE AND INTEREST-BEARING LIABILITIES

Interest expense fell $350,000, or 9.1%, to $3,515,000 in 2015 from $3,865,000 in 2014. Table III shows that the overall cost of funds on interest-bearing liabilities fell to 0.56% in 2015 from 0.61% in 2014.

Total average deposits (interest-bearing and noninterest-bearing) increased 1.2%, to $974,873,000 in 2015 from $963,212,000 in 2014. Increases in the average balances of demand deposits, interest checking and savings accounts were partially offset by decreases in average balances of certificates of deposit, Individual Retirement Accounts, and money market accounts. Consistent with continuing low short-term market interest rates, the average rates incurred on certificates of deposit have decreased in 2015 as compared to 2014.

Total average borrowed funds decreased $2,178,000 to $77,749,000 in 2015 from $79,927,000 in 2014. The average rate on borrowed funds dropped to 3.55% in 2015 from 3.71% in 2014, reflecting a $4,899,000 reduction in the average balance of higher-rate, long-term borrowings resulting from the pre-payment of a portion of a long-term

repurchase agreement borrowing with a book value of $10 million and an interest rate of 4.265% in the second quarter 2015. (The pre-payment of long-term borrowings is described in the Earnings Overview section.)

Three-Month Periods Ended September 30, 2015 and 2014

For the three-month periods, fully taxable equivalent net interest income was $10,755,000 in 2015, which was $276,000 (2.5%) lower than in 2014. As shown in Table IV, interest rate changes had the effect of decreasing net interest income $734,000 and net changes in volume had the effect of increasing net interest income $458,000 in 2015 compared to 2014. As presented in Table III, the "Interest Rate Spread" was 3.51% in 2015, as compared to 3.59% in 2014.

Interest income totaled $11,881,000 in 2015, a decrease of $437,000 (3.5%) from 2014. Interest and fees from loans receivable remained flat in 2015 as compared to 2014 at $8,568,000, while income from available-for-sale securities decreased $422,000 (11.4%). As indicated in Table III, for the three-month periods, the average balance of gross loans receivable increased 7.6% to $673,735,000 in 2015 from $626,336,000 in 2014. The average rate of return on loans was 5.05% in 2015, down from 5.43% in 2014. Total average available-for-sale securities (at amortized cost) in 2015 decreased to $473,216,000 from $505,782,000 in 2014. The average rate of return on available-for-sale securities was 2.75% for 2015, down from 2.91% in 2014.

For the three-month periods, interest expense fell $161,000, or 12.5%, to $1,126,000 in 2015 from $1,287,000 in 2014. Total average deposits (interest-bearing and noninterest-bearing) amounted to $977,317,000 in the third quarter 2015, a decrease of $2,213,000 (0.2%) from the second quarter 2014 total. Total average borrowed funds decreased to $75,848,000 in the third quarter 2015 from $78,487,000 in the third quarter 2014, while the average rate on borrowed funds fell to 3.34% in the third quarter 2015 from 3.76% in the third quarter 2014. The net change in average borrowed funds included a decrease of $10,286,000 in long-term borrowings, partially offset by an increase of $7,647,000 in short-term borrowings. The increase in average short-term borrowings reflected an increase in average overnight borrowings, while the decrease in average long-term borrowings included the effect of pre-payment of a portion of a long-term repurchase agreement borrowing with a book value of $10 million and an interest rate of 4.265% in the second quarter 2015. (The pre-payment of long-term borrowings is described in the Earnings Overview section.) In total, the average interest rate on interest-bearing liabilities was 0.53% in the third quarter 2015 as compared to 0.60% in the third quarter 2014.

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TABLE II - ANALYSIS OF INTEREST INCOME AND EXPENSE

(In Thousands)	Three Months Ended September 30, 2015	2014	Increase/ (Decrease)	Nine Months Ended September 30, 2015	2014	Increase/ (Decrease)
INTEREST INCOME						
Available-for-sale securities:						
Taxable	$1,837	$2,076	($239)	$5,899	$5,994	($95)
Tax-exempt	1,449	1,632	(183)	4,546	4,975	(429)
Total available-for-sale securities	3,286	3,708	(422)	10,445	10,969	(524)
Interest-bearing due from banks	22	33	(11)	73	95	(22)
Loans held for sale	5	5	0	10	13	(3)
Loans receivable:						
Taxable	7,851	8,040	(189)	23,313	24,123	(810)
Tax-exempt	717	532	185	1,846	1,611	235
Total loans receivable	8,568	8,572	(4)	25,159	25,734	(575)
Total Interest Income	11,881	12,318	(437)	35,687	36,811	(1,124)
INTEREST EXPENSE						
Interest-bearing deposits:						
Interest checking	53	55	(2)	162	161	1
Money market	77	73	4	222	214	8
Savings	32	31	1	96	90	6
Certificates of deposit	211	264	(53)	631	833	(202)
Individual Retirement Accounts	113	120	(7)	340	352	(12)
Other time deposits	1	0	1	1	0	1
Total interest-bearing deposits	487	543	(56)	1,452	1,650	(198)
Borrowed funds:						
Short-term	9	1	8	15	7	8
Long-term	630	743	(113)	2,048	2,208	(160)
Total borrowed funds	639	744	(105)	2,063	2,215	(152)
Total Interest Expense	1,126	1,287	(161)	3,515	3,865	(350)
Net Interest Income	$10,755	$11,031	($276)	$32,172	$32,946	($774)

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

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TABLE III - ANALYSIS OF AVERAGE DAILY BALANCES AND RATES

(Dollars in Thousands)

	3 Months Ended 9/30/2015 Average Balance	Rate of Return/ Cost of Funds %	3 Months Ended 9/30/2014 Average Balance	Rate of Return/ Cost of Funds %	9 Months Ended 9/30/2015 Average Balance	Rate of Return/ Cost of Funds %	9 Months Ended 9/30/2014 Average Balance	Rate of Return/ Cost of Funds %
EARNING ASSETS								
Available-for-sale securities, at amortized cost:								
Taxable	$361,481	2.02%	$381,833	2.16%	$379,666	2.08%	$366,853	2.18%
Tax-exempt	111,735	5.14%	123,949	5.22%	115,255	5.27%	124,508	5.34%
Total available-for-sale securities	473,216	2.75%	505,782	2.91%	494,921	2.82%	491,361	2.98%
Interest-bearing due from banks	19,774	0.44%	35,133	0.37%	22,886	0.43%	32,798	0.39%
Loans held for sale	245	8.10%	263	7.54%	160	8.36%	222	7.83%
Loans receivable:								
Taxable	610,516	5.10%	587,799	5.43%	595,170	5.24%	589,607	5.47%
Tax-exempt	63,219	4.50%	38,537	5.48%	51,468	4.80%	38,203	5.64%
Total loans receivable	673,735	5.05%	626,336	5.43%	646,638	5.20%	627,810	5.48%
Total Earning Assets	1,166,970	4.04%	1,167,514	4.19%	1,164,605	4.10%	1,152,191	4.27%
Cash	16,961		17,361		16,723		17,052	
Unrealized gain/loss on securities	7,015		7,810		9,287		5,719	
Allowance for loan losses	(7,376)		(7,332)		(7,331)		(8,166)	
Bank premises and equipment	15,808		16,581		16,050		16,915	
Intangible Asset - Core Deposit Intangible	38		64		44		74	
Intangible Asset - Goodwill	11,942		11,942		11,942		11,942	
Other assets	38,294		40,201		37,836		41,156	
Total Assets	$1,249,652		$1,254,141		$1,249,156		$1,236,883	
INTEREST-BEARING LIABILITIES								
Interest-bearing deposits:								
Interest checking	$197,189	0.11%	$186,034	0.12%	$196,109	0.11%	$181,580	0.12%
Money market	202,106	0.15%	202,536	0.14%	197,852	0.15%	198,987	0.14%

Savings	128,939	0.10%	123,447	0.10%	128,561	0.10%	121,257	0.10%
Certificates of deposit	125,886	0.66%	137,136	0.76%	123,523	0.68%	136,748	0.81%
Individual Retirement Accounts	109,661	0.41%	120,079	0.40%	111,729	0.41%	121,143	0.39%
Other time deposits	1,514	0.26%	1,525	0.00%	1,150	0.12%	1,161	0.00%
Total interest-bearing deposits	765,295	0.25%	770,757	0.28%	758,924	0.26%	760,876	0.29%
Borrowed funds:								
Short-term	12,972	0.28%	5,325	0.07%	9,417	0.21%	6,696	0.14%
Long-term	62,876	3.98%	73,162	4.03%	68,332	4.01%	73,231	4.03%
Total borrowed funds	75,848	3.34%	78,487	3.76%	77,749	3.55%	79,927	3.71%
Total Interest-bearing Liabilities	841,143	0.53%	849,244	0.60%	836,673	0.56%	840,803	0.61%
Demand deposits	212,022		208,773		215,949		202,336	
Other liabilities	8,803		10,975		8,229		9,045	
Total Liabilities	1,061,968		1,068,992		1,060,851		1,052,184	
Stockholders' equity, excluding other comprehensive income/loss	183,116		180,042		182,252		180,912	
Other comprehensive income/loss	4,568		5,107		6,053		3,787	
Total Stockholders' Equity	187,684		185,149		188,305		184,699	
Total Liabilities and Stockholders' Equity	$1,249,652		$1,254,141		$1,249,156		$1,236,883	
Interest Rate Spread		3.51%		3.59%		3.54%		3.66%
Net Interest Income/Earning Assets		3.66%		3.75%		3.69%		3.82%
Total Deposits (Interest-bearing and Demand)	$977,317		$979,530		$974,873		$963,212	

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

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

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

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TABLE IV - ANALYSIS OF VOLUME AND RATE CHANGES

(In Thousands)	3 Months Ended 9/30/15 vs. 9/30/14			9 Months Ended 9/30/15 vs. 9/30/14		
	Change in Volume	Change in Rate	Total Change	Change in Volume	Change in Rate	Total Change
EARNING ASSETS						
Available-for-sale securities:						
Taxable	($110)	($129)	($239)	$205	($300)	($95)
Tax-exempt	(161)	(22)	(183)	(366)	(63)	(429)
Total available-for-sale securities	(271)	(151)	(422)	(161)	(363)	(524)
Interest-bearing due from banks	(16)	5	(11)	(31)	9	(22)
Loans held for sale	0	0	0	(4)	1	(3)
Loans receivable:						
Taxable	312	(501)	(189)	226	(1,036)	(810)
Tax-exempt	305	(120)	185	501	(266)	235
Total loans receivable	617	(621)	(4)	727	(1,302)	(575)
Total Interest Income	330	(767)	(437)	531	(1,655)	(1,124)
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	3	(5)	(2)	12	(11)	1
Money market	0	4	4	(1)	9	8
Savings	1	0	1	5	1	6
Certificates of deposit	(21)	(32)	(53)	(76)	(126)	(202)
Individual Retirement Accounts	(10)	3	(7)	(28)	16	(12)
Other time deposits	0	1	1	0	1	1
Total interest-bearing deposits	(27)	(29)	(56)	(88)	(110)	(198)
Borrowed funds:						
Short-term	3	5	8	3	5	8
Long-term	(104)	(9)	(113)	(147)	(13)	(160)
Total borrowed funds	(101)	(4)	(105)	(144)	(8)	(152)
Total Interest Expense	(128)	(33)	(161)	(232)	(118)	(350)
Net Interest Income	$458	($734)	($276)	$763	($1,537)	($774)

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

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

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TABLE V - COMPARISON OF NONINTEREST INCOME

(In Thousands)

	9 Months Ended September 30,		$	%
	2015	2014	Change	Change
Service charges on deposit accounts	$3,629	$3,812	($183)	(4.8)
Service charges and fees	373	405	(32)	(7.9)
Trust and financial management revenue	3,478	3,325	153	4.6
Brokerage revenue	640	682	(42)	(6.2)
Insurance commissions, fees and premiums	87	103	(16)	(15.5)
Interchange revenue from debit card transactions	1,456	1,474	(18)	(1.2)
Net gains from sales of loans	573	557	16	2.9
(Decrease) increase in fair value of servicing rights	(137)	35	(172)	(491.4)
Increase in cash surrender value of life insurance	294	278	16	5.8
Net (loss) gain from premises and equipment	(1)	8	(9)	(112.5)
Other operating income	1,018	939	79	8.4
Total other operating income before realized gains on available-for-sale securities, net	$11,410	$11,618	($208)	(1.8)

Table V excludes realized gains on available-for-sale securities, which are discussed in the “Earnings Overview” section of Management’s Discussion and Analysis. Total noninterest income shown in Table V decreased $208,000 or 1.8%, in the nine months of 2015 as compared to the same period in 2014. The most significant variances include the following:

- Service charges on deposit accounts decreased $183,000 or 4.8%, primarily due to lower overdraft fees.

- Fair value of mortgage servicing rights declined $137,000 in the nine months ended September 30, 2015 compared to a $35,000 increase in fair value during the same period in 2014. The decrease in fair value in 2015 resulted mainly from faster prepayment assumptions driven by market assumptions of lower interest rates.

- Brokerage revenue decreased $42,000, or 6.2%, as a result of lower annuity sales

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Trust and financial management revenue increased $153,000, or 4.6%, including an increase in revenue from retirement services of $74,000 and growth in the average value of assets under management resulting from market appreciation as well as new business.

Other noninterest revenue increases included a $39,000 increase in dividends on Federal Home Loan Bank of Pittsburgh stock as well as a $30,000 increase in revenue from merchant services.

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TABLE VI - COMPARISON OF NONINTEREST INCOME

(In Thousands)

	3 Months Ended September 30,		$	%
	2015	2014	Change	Change
Service charges on deposit accounts	$1,302	$1,275	$27	2.1
Service charges and fees	137	144	(7)	(4.9)
Trust and financial management revenue	1,123	1,140	(17)	(1.5)
Brokerage revenue	215	213	2	0.9
Insurance commissions, fees and premiums	24	44	(20)	(45.5)
Interchange revenue from debit card transactions	482	504	(22)	(4.4)
Net gains from sales of loans	243	141	102	72.3
Increase (decrease) in fair value of servicing rights	13	(17)	30	(176.5)
Increase in cash surrender value of life insurance	95	99	(4)	(4.0)
Net loss from premises and equipment	(1)	9	(10)	(111.1)
Other operating income	328	335	(7)	(2.1)
Total other operating income before realized gains on available-for-sale securities, net	$3,961	$3,887	$74	1.9

Table VI excludes realized gains on available-for-sale securities, which are discussed in the “Earnings Overview” section of Management’s Discussion and Analysis. Total noninterest income shown in Table VI increased $74,000 or 1.9%, in the three months ended September 30, 2015 as compared to the three months ended September 30, 2014. The most significant variances include the following:

- Net gains from sales of loans increased $102,000, or 72.3%, reflecting an increase of $3,017,000 in volume of loans sold, based on origination cost, in the third quarter 2015 as compared to the third quarter 2014.

- Fair value of mortgage servicing rights increased $13,000 in the three months ended September 30, 2015 compared to a $17,000 decrease in fair value during the same period in 2014. The increase in fair value in 2015 resulted mainly from slightly slower prepayment assumptions driven by market assumptions of higher interest rates.

TABLE VII- COMPARISON OF NONINTEREST EXPENSE

(In Thousands)

	9 Months Ended September 30,		$	%
	2015	2014	Change	Change
Salaries and wages	$10,834	$11,559	($725)	(6.3)
Pensions and other employee benefits	3,336	3,563	(227)	(6.4)
Occupancy expense, net	1,985	2,002	(17)	(0.8)
Furniture and equipment expense	1,398	1,399	(1)	(0.1)
FDIC Assessments	454	444	10	2.3
Pennsylvania shares tax	877	1,014	(137)	(13.5)
Professional fees	363	427	(64)	(15.0)
Automated teller machine and interchange expense	735	668	67	10.0
Software subscriptions	617	575	42	7.3
Loss on prepayment of debt	910	0	910	100.0
Other operating expense	3,946	4,256	(310)	(7.3)
Total Other Expense	$25,455	$25,907	($452)	(1.7)

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As shown in Table VII, total noninterest expense decreased $452,000 or 1.7% in the nine months ended September 30, 2015 as compared to the nine months ended September 30, 2014. The 2015 expenses included the loss on prepayment of debt of $910,000 in 2015 compared to no loss in 2014. Excluding the loss on prepayment of debt in 2015, total noninterest expense decreased $1,362,000, or 5.3%. Other significant variances include the following:

- Salaries and wages decreased $725,000, or 6.3%, primarily due to severance pay in 2014.
- Pensions and other employee benefits decreased $227,000, or 6.4%. Health care expense decreased $328,000, as the amount of claims incurred during the nine months ended September 30, 2015 was lower than in the same period in 2014. The Corporation is self-insured for health insurance, up to a cap for catastrophic levels of losses, which are insured by a third party. This decrease was partially offset by an increase in retirement expenses.
- Other operating expense decreased $310,000, including a reduction in net collection expenses of $157,000, an $86,000 decrease in attorney fees as a result of nonrecurring legal matters in 2014 and an $86,000 reduction in net expenses and gains or losses from foreclosed assets (real estate).
- Pennsylvania shares tax expense decreased $137,000, mainly as a result of an increase in tax credits associated with charitable contributions.
- Professional fees decreased $64,000, or 15.0%, in the nine months ended September 30, 2015 as compared to the same period in 2014. This decrease was primarily in recruiting expenses.
- Automated teller machine and interchange expenses increased $67,000, or 10.0%, reflecting rate increases for ATM and interchange processing services.

TABLE VIII- COMPARISON OF NONINTEREST EXPENSE

(In Thousands)

3 Months Ended September 30, 2015	2014	$ Change	% Change

Salaries and wages	$3,744	$4,348	($604)	(13.9)
Pensions and other employee benefits	1,016	1,091	(75)	(6.9)
Occupancy expense, net	623	646	(23)	(3.6)
Furniture and equipment expense	477	461	16	3.5
FDIC Assessments	155	151	4	2.6
Pennsylvania shares tax	311	336	(25)	(7.4)
Professional fees	128	135	(7)	(5.2)
Automated teller machine and interchange expense	234	239	(5)	(2.1)
Software subscriptions	209	184	25	13.6
Other operating expense	1,220	1,445	(225)	(15.6)
Total Other Expense	$8,117	$9,036	($919)	(10.2)

As shown in Table VIII, total noninterest expense decreased $919,000 or 10.2% in the three months ended September 30, 2015 as compared to the same period of 2014. .Significant variances include the following:\

- Salaries and wages decreased $604,000, or 6.3%, primarily due to severance pay in 2014.

- Pensions and other employee benefits decreased $75,000, or 6.9%. Health care expense decreased $143,000, as the amount of claims incurred during the three months ended September 30, 2015 was lower than in the same period in 2014. The Corporation is self-insured for health insurance, up to a cap for catastrophic levels of losses, which are insured by a third party. This was partially offset by increased retirement expenses.

- Other operating expense decreased $225,000, Within this category, net collection expense decreased $79,000, attorney fees decreased $69,000 as a result of nonrecurring legal matters in 2014 and a sales tax refund in the amount of $69,000 was received in 2015 and credited against other expenses.

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FINANCIAL CONDITION

Gross loans outstanding (excluding mortgage loans held for sale) were $679,865,000 at September 30, 2015, up 7.8% from $630,545,000 at December 31, 2014. The outstanding balance of tax-exempt municipal loans totaled $40,186,000 at September 30, 2015, an increase of $22,652,000 from December 31, 2014, and total participation loans outstanding amounted to $20,796,000 at September 30, 2015, an increase of $15,850,000 from December 31, 2014. The increase in municipal loans in 2015 includes loans to two school districts in the Corporation’s market area with outstanding balances totaling $15,947,000 at September 30, 2015. Participation loans represent portions of larger commercial transactions for which other institutions are the “lead banks”. Although not the lead bank, the Corporation conducts detailed underwriting and monitoring of participation loan opportunities. Participation loans are included in the “Commercial and industrial” and “Commercial loans secured by real estate” classes in the loan tables presented in this Form 10-Q. At September 30, 2015, the balance of participation loans outstanding includes $9,503,000 to a business based in the Corporation’s market area and $7,043,000 from participations in loans originated through the Corporation’s membership in a network that originates loans throughout the U.S. The Corporation’s participation loans originated through the network consist of loans to businesses that are larger than the Corporation’s typical commercial customer base. The loans originated through the network are considered “leveraged loans,” meaning the businesses typically have minimal tangible book equity and the extent of collateral available is limited, though the businesses have demonstrated strong cash flow performance in their recent histories.

The balance of available-for-sale securities fell $55,094,000 to $461,713,000 at September 30, 2015 from $516,807,000 at December 31, 2014. As discussed in the Earnings Overview section, the reduction included sales of securities for which the proceeds were used to pre-pay long-term debt with a book value of $10 million prior to the pay-down. The reduction also included use of proceeds from calls and maturities of securities to fund the increase in loans receivable in the second and third quarters. The average balance of available-for-sale securities, at amortized cost, was $494,921,000 for the first nine months of 2015, or $3.6 million (0.7%) higher than the average balance for the first nine months of 2014, as the reduction in available-for-sale securities outstanding occurred in the second and third quarters.

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

Management does not expect capital expenditures to have a material, detrimental effect on the Corporation’s financial condition in 2015.

Since 2009, the Corporation has originated and sold residential mortgage loans to the secondary market through the MPF Xtra program administered by the Federal Home Loan Banks of Pittsburgh and Chicago. Residential mortgages originated and sold through the MPF Xtra program consist primarily of conforming, prime loans sold to the Federal National Mortgage Association (Fannie Mae), a government agency. In 2014, the Corporation began to originate and sell residential mortgage loans to the secondary market through the MPF Original program, which is also administered by the Federal Home Loan Banks of Pittsburgh and Chicago. Residential mortgages originated and sold through the MPF Original program consist primarily of conforming, prime loans sold to the Federal Home Loan Bank of Pittsburgh. For loans sold under the Original program, the Corporation provides a credit enhancement whereby the Corporation would assume credit losses in excess of a defined First Loss Account ("FLA") balance, up to specified amounts. The FLA is funded by the Federal Home Loan Bank of Pittsburgh based on a percentage of the outstanding balance of loans sold. The Corporation does not provide a credit enhancement for loans sold through the Xtra program.

For loan sales originated under the MPF Xtra and Original programs, the Corporation provides customary representations and warranties to investors that specify, among other things, that the loans have been underwritten to the standards established by the investor. The Corporation may be required to repurchase a loan and reimburse a portion of fees received, or reimburse the investor for a credit loss incurred on a loan, if it is determined that the representations and warranties have not been met. Such repurchases or reimbursements generally result from an underwriting or documentation deficiency. At September 30, 2015, the total outstanding balance of loans the Corporation has repurchased as a result of identified instances of noncompliance amounted to $1,985,000, and the corresponding total outstanding balance repurchased at December 31, 2014 was $1,802,000.

At September 30, 2015, outstanding balances of loans sold and serviced through the two programs totaled $152,275,000, including loans sold through the MPF Xtra program of $130,274,000 and loans sold through the Original program of $22,001,000. At December 31, 2014, outstanding balances of loans sold and serviced through the two programs totaled $152,505,000, including loans sold through the MPF Xtra program of $144,743,000 and loans sold through the Original program of $7,762,000. Based on the fairly limited volume of required repurchases to date, and of sales through the Original program with credit enhancement, no allowance had been established for representation and warranty exposures, or for credit losses on loan sales through the Original program as of September 30, 2015 and December 31, 2014.

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PROVISION AND ALLOWANCE FOR LOAN LOSSES

The Corporation maintains an allowance for loan losses that represents management's estimate of the losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction of the investment in loans. Note 7 to the unaudited consolidated financial statements provides an overview of the process management uses for evaluating and determining the allowance for loan losses.

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

recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for loan losses was $7,416,000 at September 30, 2015, up slightly from $7,336,000 at December 31, 2014. As shown in Table X, the specific allowance on impaired loans totaled $462,000 at September 30, 2015, which was $307,000 lower than the total specific allowance at December 31, 2014. Table X also shows the collectively determined component of the allowance for residential loans was $217,000 higher at September 30, 2015 than at December 31, 2014, reflecting a slightly higher allocation because average net charge-offs were higher for the previous three-year period and there was an increase in loans outstanding at September 30, 2015 as compared to December 31, 2014.

The provision (credit) for loan losses by segment in the three-month and nine-month periods ended September 30, 2015 and 2014 is as follows:

(In Thousands)	3 Months Ended		9 Months Ended	
	Sept. 30, 2015	Sept. 30, 2014	Sept. 30, 2015	Sept. 30, 2014
Residential mortgage	($17)	$62	$52	$111
Commercial	282	161	443	295
Consumer	6	(5)	(1)	(50)
Unallocated	31	0	32	(3)

Total	$302	$218	$526	$353

In the third quarter 2015, the total provision for loan losses was $302,000 compared to the third quarter 2014 total of $218,000. The provision for loan losses on commercial loans in the third quarter 2015 included a $131,000 increased allowance on one impaired loan.

The provision for loan losses in the first nine months of 2015 of $526,000 exceeded the total for the first nine months of 2014 by $173,000. The overall increase in the provision included an increase in the collectively determined portion of the allowance of $355,000 at September 30, 2015 from the December 31, 2014 total, as compared to a $156,000 increase in the collectively determined portion of the allowance in the first nine months of 2014. The increase in the collectively determined portion of the allowance in the first nine months of 2015 included the effect of an increase in commercial and residential mortgage loans outstanding. In the nine months ended September 30, 2015, the provision related to commercial loans included the effects of establishing an allowance of $233,000 on one multi-family residential loan with an outstanding balance of $987,000 at September 30, 2015. The lower provision for the residential mortgage segment in the first nine months of 2015 as compared to the corresponding period in 2014 reflected 2015 charge-offs that were $203,000 lower than the corresponding allowances established on those loans at December 31, 2014. The $50,000 credit for loan losses for the consumer segment in the first nine months of 2014 included a reduction in net charge-offs experience that resulted in a reduction in the collectively determined portion of the allowance.

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Table XI presents information related to past due and impaired loans, and loans that have been modified under terms that are considered troubled debt restructurings (TDRs). Table XI shows total impaired loans of $9,775,000 at September 30, 2015, down $2,541,000 from the corresponding amount at December 31, 2014 of $12,316,000. Table XI shows that total impaired loans at December 31, 2013 was significantly higher than the corresponding amounts from 2010-2012, and that the amount of impaired loans (as well as nonperforming loans as reflected in the table) decreased in 2014 and the first nine months of 2015. The increase in impaired and nonaccrual loans outstanding in 2013, and the subsequent decrease in 2014 and 2015, included the effects of changes in the outstanding balance of large loans to two commercial entities. For one of the credits for which there was a loan balance of $1,815,000 and an allowance of $211,000 at December 31, 2014 and $72,000 at December 31, 2013, the Corporation acquired the commercial property that had collateralized the loan through foreclosure and sold the property, resulting in no remaining loan balance and a charge-off of $115,000 in 2015. For the other large commercial relationship, as described in the following paragraph, during the second quarter 2014, the Corporation recorded a charge-off of $1,486,000 related to a restructuring, which has reduced the outstanding balance of loans to this commercial entity to $5,054,000 at September 30, 2015.

As shown in Table XI, loans classified as TDRs totaled $6,225,000 at September 30, 2015 down from $7,195,000 at December 31, 2014. The reduction in outstanding TDRs in 2015 includes the effect of pay-offs received on loans secured by farmland. The balance of TDRs at December 31, 2014 had increased from $4,175,000 at December 31, 2013, mainly due to a restructuring agreement with one commercial borrower. The Corporation entered into a forbearance agreement with this commercial borrower which includes a reduction in monthly payment amounts over a fifteen-month period. At the end of the fifteen-month period, the monthly payment amounts would revert to the original amounts, unless the forbearance agreement is extended or the payment requirements are otherwise modified. In July 2015, the forbearance agreement was extended for twelve months. The Corporation recorded a charge-off of $1,486,000 in the second quarter 2014 as a result of these modifications, as the payment amounts based on the forbearance agreement are not sufficient to fully amortize the contractual amount of principal outstanding on the loans. The amount of the charge-off was determined based on the excess of the contractual principal due over the present value of the payment amounts provided for in the forbearance agreement, assuming the revised payment amounts would continue until maturity, at the contractual interest rates.

Table XI reflects a lower amount of total loans past due 30-89 days and still accruing interest at September 30, 2015 of $4,780,000 as compared to the December 31, 2014 total of $7,121,000, mainly due to a lower amount of past due residential mortgage loans. Each period presented in Table XI includes a few large commercial relationships that have required significant monitoring and workout efforts. As a result, a limited number of relationships may significantly impact the total amount of allowance required on impaired loans, and may significantly impact the amount of total charge-offs reported in any one period.

Management believes it has been conservative in its decisions concerning identification of impaired loans, estimates of loss, and nonaccrual status; however, the actual losses realized from these relationships could vary materially from the allowances calculated as of September 30, 2015. Management continues to closely monitor its commercial loan relationships for possible credit losses, and will adjust its estimates of loss and decisions concerning nonaccrual status, if appropriate.

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

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TABLE IX - ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

(In Thousands)

	9 Months Ended						
	Sept. 30,	Sept. 30,	Years Ended December 31,				
	2015	2014	2014	2013	2012	2011	2010
Balance, beginning of year	$7,336	$8,663	$8,663	$6,857	$7,705	$9,107	$8,265
Charge-offs:							
Residential mortgage	(191)	(96)	(327)	(95)	(552)	(100)	(340)
Commercial	(240)	(1,715)	(1,715)	(459)	(498)	(1,189)	(91)
Consumer	(65)	(70)	(97)	(117)	(171)	(157)	(188)
Total charge-offs	(496)	(1,881)	(2,139)	(671)	(1,221)	(1,446)	(619)
Recoveries:							
Residential mortgage	1	13	25	24	18	3	55
Commercial	5	264	264	348	8	255	113
Consumer	44	37	47	58	59	71	102
Total recoveries	50	314	336	430	85	329	270
Net charge-offs	(446)	(1,567)	(1,803)	(241)	(1,136)	(1,117)	(349)
Provision (credit) for loan losses	526	353	476	2,047	288	(285)	1,191
Balance, end of period	$7,416	$7,449	$7,336	$8,663	$6,857	$7,705	$9,107
Net charge-offs as a % of average loans	0.07%	0.25%	0.29%	0.04%	0.16%	0.16%	0.05%

TABLE X - COMPONENTS OF THE ALLOWANCE FOR LOAN LOSSES

(In Thousands)

	Sept. 30,	As of December 31,				
	2015	2014	2013	2012	2011	2010
ASC 310 - Impaired loans	$462	$769	$2,333	$623	$1,126	$2,288
ASC 450 - Collective segments:						
Commercial	2,893	2,732	2,583	2,594	2,811	3,047
Residential mortgage	3,511	3,295	3,156	3,011	3,130	3,227
Consumer	123	145	193	188	204	232
Unallocated	427	395	398	441	434	313
Total Allowance	$7,416	$7,336	$8,663	$6,857	$7,705	$9,107

The above allocation is based on estimates and subjective judgments and is not necessarily indicative of the specific amounts or loan categories in which losses may occur.

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TABLE XI - PAST DUE AND IMPAIRED LOANS, NONPERFORMING ASSETS

AND TROUBLED DEBT RESTRUCTURINGS (TDRs)

(In Thousands)	As of Sept. 30,	As of December 31,				
	2015	2014	2013	2012	2011	2010
Impaired loans with a valuation allowance	$1,963	$3,241	$9,889	$2,710	$3,433	$5,457
Impaired loans without a valuation allowance	7,812	9,075	6,432	4,719	4,431	3,191
Total impaired loans	$9,775	$12,316	$16,321	$7,429	$7,864	$8,648
Total loans past due 30-89 days and still accruing	$4,780	$7,121	$8,305	$7,756	$7,898	$7,125
Nonperforming assets:						
Total nonaccrual loans	$11,632	$12,610	$14,934	$7,353	$7,197	$10,809
Total loans past due 90 days or more and still accruing	2,833	2,843	3,131	2,311	1,267	727
Total nonperforming loans	14,465	15,453	18,065	9,664	8,464	11,536
Foreclosed assets held for sale (real estate)	1,363	1,189	892	879	1,235	537
Total nonperforming assets	$15,828	$16,642	$18,957	$10,543	$9,699	$12,073
Loans subject to troubled debt restructurings (TDRs):						
Performing	$1,043	$1,807	$3,267	$906	$1,064	$645
Nonperforming	5,182	5,388	908	1,155	2,413	0
Total TDRs	$6,225	$7,195	$4,175	$2,061	$3,477	$645
Total nonperforming loans as a % of loans	2.13%	2.45%	2.80%	1.41%	1.19%	1.58%
Total nonperforming assets as a % of assets	1.28%	1.34%	1.53%	0.82%	0.73%	0.92%
Allowance for loan losses as a % of total loans	1.09%	1.16%	1.34%	1.00%	1.09%	1.25%
Allowance for loan losses as a % of nonperforming loans	51.27%	47.47%	47.95%	70.95%	91.03%	78.94%

TABLE XII - SUMMARY OF LOANS BY TYPE

Summary of Loans by Type

(In Thousands)	Sept. 30,	As of December 31,				
	2015	2014	2013	2012	2011	2010
Residential mortgage:						
Residential mortgage loans - first liens	$298,096	$291,882	$299,831	$311,627	$331,015	$333,012

Residential mortgage loans - junior liens	20,601	21,166	23,040	26,748	28,851	31,590
Home equity lines of credit	38,585	36,629	34,530	33,017	30,037	26,853
1-4 Family residential construction	23,633	16,739	13,909	12,842	9,959	14,379
Total residential mortgage	380,915	366,416	371,310	384,234	399,862	405,834
Commercial:						
Commercial loans secured by real estate	135,760	145,878	147,215	158,413	156,388	167,094
Commercial and industrial	72,011	50,157	42,387	48,442	57,191	59,005
Political subdivisions	40,186	17,534	16,291	31,789	37,620	36,480
Commercial construction and land	6,852	6,938	17,003	28,200	23,518	24,004
Loans secured by farmland	7,521	7,916	10,468	11,403	10,949	11,353
Multi-family (5 or more) residential	9,181	8,917	10,985	6,745	6,583	7,781
Agricultural loans	4,588	3,221	3,251	3,053	2,987	3,472
Other commercial loans	12,691	13,334	14,631	362	552	392
Total commercial	288,790	253,895	262,231	288,407	295,788	309,581
Consumer	10,160	10,234	10,762	11,269	12,665	14,996
Total	679,865	630,545	644,303	683,910	708,315	730,411
Less: allowance for loan losses	(7,416)	(7,336)	(8,663)	(6,857)	(7,705)	(9,107)
Loans, net	$672,449	$623,209	$635,640	$677,053	$700,610	$721,304

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LIQUIDITY

Liquidity is the ability to quickly raise cash at a reasonable cost. An adequate liquidity position permits the Corporation to pay creditors, compensate for unforeseen deposit fluctuations and fund unexpected loan demand. At September 30, 2015, the Corporation maintained overnight interest-bearing deposits with the Federal Reserve Bank of Philadelphia and other correspondent banks totaling $13,012,000.

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

The Corporation has a line of credit with the Federal Reserve Bank of Philadelphia's Discount Window. Management intends to use this line of credit as a contingency funding source. As collateral for the line, the Corporation has pledged available-for-sale securities with a carrying value of $21,065,000 at September 30, 2015.

The Corporation's outstanding, available, and total credit facilities at September 30, 2015 and December 31, 2014 are as follows:

	Outstanding		Available		Total Credit	
(In Thousands)	Sept. 30, 2015	Dec. 31, 2014	Sept. 30, 2015	Dec. 31, 2014	Sept. 30, 2015	Dec. 31, 2014
Federal Home Loan Bank of Pittsburgh	$16,342	$12,060	$305,431	$311,007	$321,773	$323,067
Federal Reserve Bank Discount Window	0	0	19,560	25,367	19,560	25,367
Other correspondent banks	0	0	45,000	45,000	45,000	45,000
Total credit facilities	$16,342	$12,060	$369,991	$381,374	$386,333	$393,434

At September 30, 2015, the Corporation's outstanding credit facilities with the Federal Home Loan Bank of Pittsburgh consisted of long-term borrowings with a total amount of $11,842,000 and an overnight borrowing of $4,500,000. At December 31, 2014, the Corporation's outstanding credit facilities with the Federal Home Loan Bank of Pittsburgh consisted of long-term borrowings with a total amount of $12,060,000. Additional information regarding borrowed funds is included in Note 8 of the unaudited consolidated financial statements.

Additionally, the Corporation uses repurchase agreements placed with brokers to borrow funds secured by investment assets and "RepoSweep" arrangements to borrow funds from commercial banking customers on an overnight basis. If required to raise cash in an emergency situation, the Corporation could sell available-for-sale securities to meet its obligations. At September 30, 2015, the carrying value of available-for-sale securities in excess of amounts required to meet pledging or repurchase agreement obligations was $232,375,000.

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

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STOCKHOLDERS' EQUITY AND CAPITAL ADEQUACY

The Corporation and C&N Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Details concerning capital ratios at September 30, 2015 and December 31, 2014 are presented below. Management believes, as of September 30, 2015 and December 31, 2014, that the Corporation and C&N Bank meet all capital adequacy requirements to which they are subject.

(Dollars in Thousands)	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2015:						
Total capital to risk-weighted assets:						
Consolidated	$180,534	24.54%	$58,842	³8%	$73,553	³10%
C&N Bank	160,578	22.05%	58,249	³8%	72,812	³10%
Tier 1 capital to risk-weighted assets:						
Consolidated	172,027	23.39%	29,421	³6%	58,842	³8%
C&N Bank	153,132	21.03%	29,125	³6%	58,249	³8%
Common equity tier 1 capital to risk-weighted assets:						
Consolidated	172,027	23.39%	29,421	³4.5%	47,809	³6.5%
C&N Bank	153,132	21.03%	29,125	³4.5%	47,328	³6.5%
Tier 1 capital to average assets:						
Consolidated	172,027	13.95%	49,340	³4%	61,675	³5%
C&N Bank	153,132	12.54%	48,857	³4%	61,072	³5%
December 31, 2014:						
Total capital to risk-weighted assets:						
Consolidated	$179,588	27.60%	$52,051	³8%	n/a	n/a
C&N Bank	156,420	24.33%	51,442	³8%	$64,303	³10%
Tier 1 capital to risk-weighted assets:						
Consolidated	170,880	26.26%	26,026	³4%	n/a	n/a
C&N Bank	149,055	23.18%	25,721	³4%	38,582	³6%
Tier 1 capital to average assets:						
Consolidated	170,880	13.89%	49,224	³4%	n/a	n/a
C&N Bank	149,055	12.22%	48,798	³4%	60,998	³5%

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

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. As described in more detail in the section below titled “New Capital Rule," the Corporation and C&N Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities.

The Corporation’s total stockholders’ equity is affected by fluctuations in the fair values of available-for-sale securities. The difference between amortized cost and fair value of available-for-sale securities, net of deferred income tax, is included in Accumulated Other Comprehensive Income within stockholders’ equity. The balance in Accumulated Other Comprehensive Income related to unrealized gains on available-for-sale securities, net of deferred income tax, amounted to $6,116,000 at September 30, 2015 and $5,281,000 at December 31, 2014. Changes in accumulated other comprehensive income are excluded from earnings and directly increase or decrease stockholders’ equity. If available-for-sale securities are deemed to be other-than-temporarily impaired, unrealized losses are recorded as a charge against earnings, and amortized cost for the affected securities is reduced. Note 6 to the unaudited consolidated financial statements provides additional information concerning management’s evaluation of available-for-sale securities for other-than-temporary impairment at September 30, 2015.

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Stockholders' equity is also affected by the underfunded or overfunded status of defined benefit pension and postretirement plans. The balance in Accumulated Other Comprehensive Income related to defined benefit plans, net of deferred income tax, was $6,000 at September 30, 2015 and $79,000 at December 31, 2014.

NEW CAPITAL RULE

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

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A summarized comparison of the prior capital requirements with requirements under the current (new) rule is as follows:

	Prior General Risk-Based Capital Rule	**Current (New) Capital Rule**
Minimum regulatory capital ratios:		
Common equity tier 1 capital/ risk-weighted assets (RWA)	N/A	4.5%
Tier 1 capital / RWA	4%	6%
Total capital / RWA	8%	8%
Tier 1 capital / Average assets (Leverage ratio)	4%	4%
Capital buffers:		
Capital conservation buffer	N/A	2.5% of RWA; composed of common equity tier 1 capital
Prompt correction action levels - Common equity tier 1 capital ratio:		
Well capitalized	N/A	³6.5%
Adequately capitalized	N/A	³4.5%
Undercapitalized	N/A	<4.5%
Significantly undercapitalized	N/A	<3%
Prompt correction action levels - Tier 1 capital ratio:		
Well capitalized	³6%	³8%
Adequately capitalized	³4%	³6%
Undercapitalized	<4%	<6%
Significantly undercapitalized	<3%	<4%
Prompt correction action levels - Total capital ratio:		
Well capitalized	³10%	³10%
Adequately capitalized	³8%	³8%
Undercapitalized	<8%	<8%
Significantly undercapitalized	<6%	<6%
Prompt correction action levels - Leverage ratio:		
Well capitalized	³5%	³5%

Adequately capitalized	³4%	³4%
Undercapitalized	<4%	<4%
Significantly undercapitalized	<3%	<3%
Prompt correction action levels - Critically undercapitalized:		
Tangible equity to total assets	≤2%	≤2%

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

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

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

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

COMPREHENSIVE INCOME

Comprehensive Income is the total of (1) net income, and (2) all other changes in equity from non-stockholder sources, which are referred to as Other Comprehensive Income. Changes in the components of Accumulated Other Comprehensive Income (Loss) are included in Other Comprehensive Income, and for the Corporation, consist of changes in unrealized gains or losses on available-for-sale securities and changes in underfunded or overfunded defined benefit plans.

Fluctuations in interest rates significantly affect fair values of available-for-sale securities, and accordingly have an effect on Other Comprehensive Income (Loss) in each period. Comprehensive Income totaled $6,270,000 for the three months ended September 30, 2015 as compared to $2,888,000 in the third quarter 2014. For the three months ended September 30, 2015, Comprehensive Income included: (1) Net Income of $4,234,000, which was $33,000 lower than in the third quarter 2014; (2) Other Comprehensive Income from an increase in net unrealized gains on available-for-sale securities of $2,039,000 as compared to Other Comprehensive Loss of $1,376,000 from a decrease in net unrealized gains on available-for-sale securities in the third quarter 2014; and (3) Other Comprehensive Loss from defined benefit plans of $3,000, which was the same as the Other Comprehensive Loss from defined benefit plans in the third quarter 2014. For the nine months ended September 30, 2015, Comprehensive Income totaled $13,168,000 as compared to $17,748,000 for the nine months ended September 30, 2014. In the nine months ended September 30, 2015, Comprehensive Income included: (1) Net Income of $12,406,000, which was $312,000 lower than in the first nine months of 2014; (2) Other Comprehensive Income from an increase in net unrealized gains on available-for-sale securities of $835,000 as compared to Other Comprehensive Income of $4,944,000 in the first nine months of 2014; and (3) Other Comprehensive Loss from defined benefit plans of $73,000 as compared to Other Comprehensive Income of $86,000 in the first nine months of 2014.

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INCOME TAXES

The effective income tax rate was approximately 25% of pre-tax income for the three-month and nine-month periods ended September 30, 2015 and 2014. The provision for income tax for interim periods is based on the Corporation's estimate of the effective tax rate expected to be applicable for the full year. The Corporation's effective tax rates differ from the statutory rate of 35% principally because of the effects of tax-exempt interest income.

The Corporation recognizes deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax basis of assets and liabilities. At September 30, 2015, the net deferred tax asset was $762,000, down from $1,668,000 at December 31, 2014. The most significant changes in temporary difference components were a $537,000 reduction in the deferred tax asset related to the credit for alternative minimum tax paid and an increase of $449,000 in the deferred tax liability associated with unrealized gains on available-for-sale securities.

The Corporation regularly reviews deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. Management believes the recorded net deferred tax asset at September 30, 2015 is fully realizable; however, if management determines the Corporation will be unable to realize all or part of the net deferred tax asset, the Corporation would adjust the deferred tax asset, which would negatively impact earnings.

Additional information related to income taxes is presented in Note 11 to the unaudited, consolidated financial statements.

INFLATION

The Corporation is significantly affected by the Federal Reserve Board's efforts to control inflation through changes in short-term interest rates. Beginning in September 2007, in response to concerns about weakness in the U.S. economy, the Federal Reserve lowered the fed funds target rate numerous times; in December 2008, it established a target range of 0% to 0.25%, which it has maintained through September 30, 2015. Also, the Federal Reserve has injected massive amounts of liquidity into the nation's monetary system through a variety of programs. The Federal Reserve has purchased large amounts of securities in an effort to keep interest rates low and stimulate economic growth. Beginning

in late 2013, the Federal Reserve began reducing the amount of securities purchased under its asset purchase program and then ended the program in October 2014, though still reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and continuing to roll over maturing Treasury securities at auction. The Federal Reserve is expected to continue its highly accommodative monetary policy in the form of low short-term interest rates for the foreseeable future, though some observers believe the fed funds target rate may be raised above its current level in the fourth quarter 2015.

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

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

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

The Corporation's two major categories of market risk are interest rate risk and equity securities risk, which are discussed in the following sections.

INTEREST RATE RISK

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

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

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

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

Table XIII, which follows this discussion, is based on the results of calculations performed using the simulation model as of July 31, 2015 and October 31, 2014. The table shows that as of the respective dates, the changes in net interest income and changes in market value were within the policy limits in all scenarios.

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TABLE XIII - THE EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES

July 31, 2015 Data

(In Thousands)		Period Ending July 31, 2016			
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+400	$51,729	$22,818	$28,911	-23.7%	25.0%
+300	49,494	17,902	31,592	-16.6%	20.0%
+200	47,145	13,210	33,935	-10.4%	15.0%
+100	44,710	8,822	35,888	-5.3%	10.0%
0	42,321	4,433	37,888	0.0%	0.0%
-100	39,682	4,199	35,483	-6.3%	10.0%
-200	37,878	4,196	33,682	-11.1%	15.0%
-300	37,116	4,196	32,920	-13.1%	20.0%
-400	36,995	4,196	32,799	-13.4%	25.0%

	Market Value of Portfolio Equity at July 31, 2015		
Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+400	$154,835	-29.5%	50.0%
+300	168,857	-23.1%	45.0%
+200	184,934	-15.8%	35.0%
+100	201,457	-8.3%	25.0%
0	219,669	0.0%	0.0%
-100	223,178	1.6%	25.0%
-200	227,743	3.7%	35.0%
-300	254,616	15.9%	45.0%
-400	291,228	32.6%	50.0%

October 31, 2014 Data

(In Thousands)		Period Ending October 31, 2015			
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+400	$55,351	$23,123	$32,228	-20.3%	25.0%
+300	52,975	18,223	34,752	-14.1%	20.0%
+200	50,546	13,618	36,928	-8.7%	15.0%
+100	47,977	9,330	38,647	-4.4%	10.0%

0	45,478	5,043	40,435	0.0%	0.0%
-100	42,869	4,794	38,075	-5.8%	10.0%
-200	41,095	4,729	36,366	-10.1%	15.0%
-300	40,123	4,707	35,416	-12.4%	20.0%
-400	39,998	4,707	35,291	-12.7%	25.0%

Market Value of Portfolio Equity at October 31, 2014

Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+400	$176,447	-24.4%	50.0%
+300	189,184	-18.9%	45.0%
+200	203,838	-12.6%	35.0%
+100	218,314	-6.4%	25.0%
0	233,255	0.0%	0.0%
-100	232,818	-0.2%	25.0%
-200	232,294	-0.4%	35.0%
-300	251,791	7.9%	45.0%
-400	288,059	23.5%	50.0%

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EQUITY SECURITIES RISK

The Corporation's equity securities portfolio consists of investments in stocks of banks and bank holding companies. Investments in bank stocks are subject to risk factors that affect the banking industry in general, including credit risk, competition from non-bank entities, interest rate risk and other factors, which could result in a decline in market prices. Also, losses could occur in individual stocks held by the Corporation because of specific circumstances related to each bank.

Equity securities held as of September 30, 2015 and December 31, 2014 are presented in Table XIV. Table XIV presents quantitative data concerning the effects of a decline in fair value of the Corporation's equity securities of 10% or 20%. The data in Table XIV does not reflect the effects of any appreciation in value that may occur, nor does it present the Corporation's maximum exposure to loss on equity securities, which would be 100% of their fair value as of September 30, 2015.

TABLE XIV - EQUITY SECURITIES RISK
(In Thousands)

	Sept 30, 2015	**Dec. 31, 2014**
Cost	$5,365	$5,605
Fair Value	7,789	8,654
Hypothetical 10% Decline In Market Value	(779)	(865)
Hypothetical 20% Decline In Market Value	(1,558)	(1,731)

ITEM 4. CONTROLS AND PROCEDURES

The Corporation's management, under the supervision of and with the participation of the Corporation's Chief Executive Officer and Chief Financial Officer, has carried out an evaluation of the design and effectiveness of the Corporation's disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934 as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Corporation's disclosure controls and procedures are effective to ensure that all material information required to be disclosed in reports the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no significant changes in the Corporation's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or that are reasonably likely to affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings
The Corporation and C&N Bank are involved in various legal proceedings incidental to their business. Management believes the aggregate liability, if any, resulting from such pending and threatened legal proceedings will not have a material, adverse effect on the Corporation's financial condition or results of operations.

Item 1A. Risk Factors
There have been no material changes from the risk factors previously disclosed in Item 1A of the Corporation's Form 10-K filed February 26, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Effective July 17, 2014, the Corporation terminated its existing treasury stock repurchase programs and approved a new treasury stock repurchase program. Under the new program, the Corporation is authorized to repurchase up to 622,500 shares of the Corporation's common stock, or approximately 5% of the Corporation's issued and outstanding shares at July 16, 2014. As permitted by securities laws and other legal requirements and subject to market conditions and other factors, purchases under the new program may be made from time to time in the open market at prevailing prices, or through privately negotiated transactions. As of September 30, 2015, the maximum number of additional shares the Corporation may repurchase under this program is 211,100.

Consistent with previous programs, the Board of Directors' July 17, 2014 authorization provides that: (1) the new treasury stock repurchase program shall be effective when publicly announced and shall continue thereafter until suspended or terminated by the Board of Directors, in its sole discretion; and (2) all shares of common stock repurchased pursuant to the new program shall be held as treasury shares and be available for use and reissuance for purposes as and when determined by the Board of Directors including, without limitation, pursuant to the Corporation's Dividend Reinvestment and Stock Purchase Plan and its equity compensation program. Through September 30, 2015, 411,400 shares had been repurchased for a total cost of $7,946,000.

The following table sets forth a summary of the purchases by the Corporation, on the open market, of its equity securities during the third quarter 2015:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
July 1 - 31, 2015	0	0	384,300	238,200
August 1 - 31, 2015	7,000	$19.50	391,300	231,200
September 1 - 30, 2015	20,100	$19.52	411,400	211,100

Item 3. Defaults Upon Senior Securities
None

Item 4. Mine Safety Disclosures
Not applicable

Item 5. Other Information
None

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Item 6. Exhibits

2. Plan of acquisition, reorganization, arrangement, liquidation or succession	Not applicable
3. (i) Articles of Incorporation	Incorporated by reference to Exhibit 3.1 of the Corporation's Form 8-K filed September 21, 2009
3. (ii) By-laws	Incorporated by reference to Exhibit 3.1 of the Corporation's Form 8-K filed April 19, 2013
4. Instruments defining the rights of Security holders, including indentures	Not applicable
10. Material contracts	Not applicable
11. Statement re: computation of per share earnings	Information concerning the computation of earnings per share is provided in Note 2 to the unaudited consolidated financial statements, which is included in Part I, Item 1 of Form 10-Q
15. Letter re: unaudited interim information	Not applicable
18. Letter re: change in accounting principles	Not applicable
19. Report furnished to security holders	Not applicable
22. Published report regarding matters submitted to vote of security holders	Not applicable
23. Consents of experts and counsel	Not applicable
24. Power of attorney	Not applicable
31. Rule 13a-14(a)/15d-14(a) certifications:	
31.1 Certification of Chief Executive Officer	Filed herewith
31.2 Certification of Chief Financial Officer	Filed herewith
32. Section 1350 certifications	Filed herewith

99. Additional exhibits	Not applicable
100. XBRL-related documents	Not applicable
101. Interactive data file	Filed herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	CITIZENS & NORTHERN CORPORATION
November 5, 2015	By:/s/ J. Bradley Scovill
Date	President and Chief Executive Officer
November 5, 2015	By: /s/ Mark A. Hughes
Date	Treasurer and Chief Financial Officer

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