FIRST KEYSTONE CORP
Form 10-Q
August 09, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10Q

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from ________ to ________

Commission File Number: 2-88927

FIRST KEYSTONE CORPORATION
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	23-2249083 (I.R.S. Employer Identification No.)
111 West Front Street, Berwick, PA (Address of principal executive offices)	18603 (Zip Code)

Registrant’s telephone number, including area code: (570) 752-3671

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

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

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

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practical date:

Common Stock, $2 Par Value, 5,445,042 shares as of August 5, 2011.

PART I. - FINANCIAL INFORMATION

ITEM. 1 Financial Statements

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)

	June 2011 (Unaudited)	December 2010
ASSETS		
Cash and due from banks	$7,477	$4,346
Interest-bearing deposits in other banks	2,137	4,559
Federal funds sold	0	3,000
Total cash and cash equivalents	$9,614	$11,905
Investment securities available-for-sale	312,923	303,902
Investment securities held-to-maturity estimated fair value of $6,299 in 2011 and $6,191 in 2010	6,249	6,266
Restricted securities at cost - available-for-sale	5,746	6,363
Loans, net of unearned income	413,550	409,651
Allowance for loan losses	(5,760)	(5,701)
Net loans	$407,790	$403,950
Premises and equipment, net	12,103	11,842
Accrued interest receivable	4,428	4,589
Cash surrender value of bank owned life insurance	18,771	18,388
Investment in limited partnerships	1,542	1,600
Goodwill	19,133	19,133
Core deposit intangible	1,096	1,240
Prepaid FDIC insurance	1,599	2,005
Foreclosed assets held for resale	1,094	1,149
Deferred income taxes	1,214	2,742
Other assets	1,734	1,527
TOTAL ASSETS	$805,036	$796,601
LIABILITIES		
Deposits:		
Non-interest bearing	$68,517	$69,080
Interest bearing	554,583	557,815
TOTAL DEPOSITS	623,100	626,895
Short-term borrowings	23,130	20,977
Long-term borrowings	71,370	66,400
Accrued interest and other expenses	2,941	2,976
Other liabilities	148	293
TOTAL LIABILITIES	$720,689	$717,541
STOCKHOLDERS' EQUITY		
Common stock, par value $2.00 per share	11,375	11,375
Surplus	30,160	30,175

Retained earnings	47,672	45,246
Accumulated other comprehensive income (loss)	1,215	(1,633)
Less treasury stock, at cost, 242,725 shares in 2011 and 243,540 shares in 2010	(6,075)	(6,103)
TOTAL STOCKHOLDERS' EQUITY	$84,347	$79,060
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$805,036	$796,601

See Accompanying Notes to Consolidated Financial Statements

1

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED JUNE 30, 2011 AND 2010
(Unaudited)

(Amounts in thousands except per share data)

	2011	2010
INTEREST INCOME		
Interest and fees on loans	$5,879	$6,086
Interest and dividend income on investment securities	3,450	3,433
Deposits in banks	1	9
Total interest income	$9,330	$9,528
INTEREST EXPENSE		
Deposits	$1,767	$2,319
Short-term borrowings	43	57
Long-term borrowings	653	948
Total interest expense	$2,463	$3,324
Net interest income	$6,867	$6,204
Provision for loan losses	300	400
Net interest income after provision for loan losses	$6,567	$5,804
NON-INTEREST INCOME		
Trust department	$147	$175
Service charges and fees	331	401
Bank owned life insurance income	193	192
ATM fees and debit card income	230	208
Gain on sale of loans	54	97
Investment securities gains (losses) - net	0	245
Other	104	77
Total non-interest income	$1,059	$1,395
NON-INTEREST EXPENSE		
Salaries and employee benefits	$2,350	$2,228
Occupancy, net	326	350
Furniture and equipment	108	151
Computer expenses	243	213
Professional services	173	166
State shares tax	138	177
FDIC Insurance	192	219
ATM and debit card fees	92	87
Other	850	687
Total non-interest expenses	$4,472	$4,278
Income before income taxes	$3,154	$2,921
Income tax expense	611	608
Net Income	$2,543	$2,313

PER SHARE DATA		
Net Income Per Share:		
Basic	$ .47	$ .43
Diluted	.47	.43
Cash dividends per share	.24	.23

See Accompanying Notes to Consolidated Financial Statements

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010
(Unaudited)

(Amounts in thousands except per share data)

	2011	2010
INTEREST INCOME		
Interest and fees on loans	$11,724	$12,085
Interest and dividend income on investment securities	6,950	6,864
Deposits in banks	3	12
Total interest income	$18,677	$18,961
INTEREST EXPENSE		
Deposits	$3,606	$4,783
Short-term borrowings	93	108
Long-term borrowings	1,280	1,902
Total interest expense	$4,979	$6,793
Net interest income	$13,698	$12,168
Provision for loan losses	600	600
Net interest income after provision for loan losses	$13,098	$11,568
NON-INTEREST INCOME		
Trust department	$287	$347
Service charges and fees	647	768
Bank owned life insurance income	383	380
ATM fees and debit card income	440	393
Gain on sale of loans	94	196
Investment securities gains (losses) - net	(75)	209
Other	246	198
Total non-interest income	$2,022	$2,491
NON-INTEREST EXPENSE		
Salaries and employee benefits	$4,633	$4,438
Occupancy, net	680	692
Furniture and equipment	208	255
Computer expenses	477	438
Professional services	326	350
State shares tax	321	354
FDIC Insurance	437	421
ATM and debit card fees	181	175
Other	1,513	1,276
Total non-interest expenses	$8,776	$8,399
Income before income taxes	$6,344	$5,660
Income tax expense	1,305	1,160
Net Income	$5,039	$4,500

PER SHARE DATA		
Net Income Per Share:		
Basic	$ .93	$ .83
Diluted	.93	.83
Cash dividends per share	.48	.46

See Accompanying Notes to Consolidated Financial Statements

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

(Amounts in thousands, except per share data)

	Common Stock	Surplus	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive (Loss)	Treasury Stock	Total
Balance at December 31, 2009	$ 11,375	$ 30,269		$ 41,346	$ (2,583)	$ (6,240)	$ 74,167
Comprehensive Income:							
Net Income			$ 4,500	4,500			4,500
Change in net unrealized gain (loss) on investment securities available-for-sale, net of reclassification adjustment and tax effects			5,621		5,621		5,621
Total comprehensive income			$ 10,121				
Issuance of 482 shares of treasury stock upon exercise of employee stock options		(11)				16	5
Cash dividends - $.46 per share				(2,503)			(2,503)
Balance at June 30, 2010	$ 11,375	$ 30,258		$ 43,343	$ 3,038	$ (6,224)	$ 81,790
Balance at December 31, 2010	$ 11,375	$ 30,175		$ 45,246	$ (1,633)	$ (6,103)	$ 79,060
Comprehensive Income:							
Net Income			$ 5,039	5,039			5,039
Change in unrealized gain (loss) on investment securities available-sale, net of reclassification adjustment and tax effects			2,848		2,848		2,848
Total Comprehensive income			$ 7,887				
Issuance of 815 shares of treasury stock upon exercise of employee stock options		(15)				28	13
				(2,613)			(2,613)

Cash dividends - $.48 per share							
Balance at June 30, 2011	$ 11,375	$ 30,160		$ 47,672	$ 1,215	$ (6,075)	$ 84,347

See accompanying notes to consolidated financial statements.

4

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010
(Unaudited)

(Amounts in thousands)

	2011	2010
OPERATING ACTIVITIES		
Net income	$5,039	$4,500
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision or loan losses	600	600
Provision for depreciation and amortization	459	487
Premium amortization on investment securities	509	310
Core deposit amortization	144	141
Discount accretion on investment securities	(580)	(708)
Gain on sale of mortgage loans	(94)	(196)
Proceeds from sale of mortgage loans for resale	9,774	6,428
Originations of mortgage loans for resale	(8,333)	(6,103)
Loss (gain) on sale and valuation adjustments on foreclosed assets held for sale	138	(20)
Loss (gain) on sales of investment securities	75	(209)
Deferred income tax provision (benefit)	65	(55)
Increase in interest receivable and other assets	(46)	(40)
Decrease in prepaid FDIC insurance	406	369
Increase in cash surrender value of bank owned life insurance	(383)	(380)
Increase/(Decrease) in interest payable, accrued expenses and other liabilities	(180)	200
NET CASH PROVIDED BY PROVIDED BY OPERATING ACTIVITIES	$7,593	$5,324
INVESTING ACTIVITIES		
Purchases of investment securities	$(66,390)	$(26,880)
Proceeds from sales of investment securities available for sale	44,129	18,081
Proceeds from maturities and redemptions of investment securities available for sale	17,520	12,235
Proceeds from the redemption of restricted securities	617	0
Proceeds from maturities and redemption of investment securities held to maturity	44	2,729
Net (decrease) in loans	(6,067)	(11,025)
Purchase of premises and equipment	(705)	(684)
Proceeds from sale of foreclosed assets	240	200
Purchase of investment in real estate venture	0	(1,084)
NET CASH (USED IN) INVESTING ACTIVITIES	$(10,612)	$(6,428)
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	$(3,795)	$29,498
Net increase (decrease) in short-term borrowings	2,153	3,991
Proceeds from long-term borrowings	5,000	7,000
Repayment of long-term borrowings	(30)	(5,527)
Proceeds from issuance of treasury stock under stock option plan	13	5
Cash dividends	(2,613)	(2,503)
NET CASH PROVIDED BY FINANCING ACTIVITIES	$728	$32,464
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$(2,291)	$31,360
CASH AND CASH EQUIVALENTS, BEGINNING	11,905	11,426

CASH AND CASH EQUIVALENTS, ENDING	$9,614	$42,786
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during period for		
Interest	$5,081	$6,065
Income Taxes	1,062	689
Loans transferred to foreclosed assets held for resale	323	0

See Accompanying Notes to Consolidated Financial Statements

5

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(Unaudited)

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of First Keystone Corporation and Subsidiary (the "Corporation") are in accordance with accounting principles generally accepted in the United States of America and conform to common practices within the banking industry. The more significant policies follow:

Principles of Consolidation

The consolidated financial statements include the accounts of First Keystone Corporation and its wholly-owned Subsidiary, First Keystone Community Bank (the "Bank"). All significant inter-company balances and transactions have been eliminated in consolidation.

Nature of Operations

The Corporation, headquartered in Berwick, Pennsylvania, provides a full range of banking, trust and related services through its wholly-owned Bank subsidiary and is subject to competition from other financial institutions in connection with these services. The Bank serves a customer base which includes individuals, businesses, public and institutional customers primarily located in the Northeast Region of Pennsylvania. The Bank has 16 full service offices and 18 ATMs located in Columbia, Luzerne, Montour and Monroe Counties. The Corporation and its subsidiary must also adhere to certain federal banking laws and regulations and are subject to periodic examinations made by various federal agencies.

Segment Reporting

The Corporation's banking subsidiary acts as an independent community financial services provider, and offers traditional banking and related financial services to individual, business and government customers. Through its branch and automated teller machine network, the Bank offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and mortgage loans; and the providing of other financial services. The Bank also performs personal, corporate, pension and fiduciary services through its Trust Department.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial, retail, trust and mortgage banking operations of the Corporation. Currently, management measures the performance and allocates the resources of First Keystone Corporation as a single segment.

Use of Estimates

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the reported amounts of income and expenses during the reporting periods. Actual results could significantly differ from those estimates.

Material estimates that are particularly susceptible to significant changes include the assessment for impairment of certain investment securities, the allowance for loan losses, deferred tax assets and liabilities, impairment of other intangible assets and foreclosed real estate. Assumptions and factors used in the estimates are evaluated on an annual basis or whenever events or changes in circumstance indicate that the previous assumptions and factors have changed. The result of the analysis could result in adjustments to the estimates.

Investment Securities

The Corporation classifies its investment securities as either “Held-to-Maturity” or “Available-for-Sale” at the time of purchase. Debt securities are classified as Held-to-Maturity when the Corporation has the ability and positive intent to hold the securities to maturity. Investment securities Held-to-Maturity are carried at cost adjusted for amortization of premium and accretion of discount to maturity.

Debt securities not classified as Held-to-Maturity and equity securities are included in the Available-for-Sale category and are carried at fair value. The amount of any unrealized gain or loss, net of the effect of deferred income taxes, is reported as other comprehensive income (loss) in the Consolidated Statement of Changes in Stockholders’ Equity. Management’s decision to sell Available-for-Sale securities is based on changes in economic conditions controlling the sources and applications of funds, terms, availability of and yield of alternative investments, interest rate risk and the need for liquidity.

The cost of debt securities classified as Held-to-Maturity or Available-for-Sale is adjusted for amortization of premiums and accretion of discounts to expected maturity. Such amortization and accretion, as well as interest and dividends is included in interest income from investments. Realized gains and losses are included in net investment securities gains and losses. The cost of investment securities sold, redeemed or matured is based on the specific identification method.

Restricted Securities

Restricted equity securities consist of stock in Federal Home Loan Bank of Pittsburgh (“FHLB-Pittsburgh”), Atlantic Central Bankers Bank (“ACBB”) and Federal Reserve Bank and do not have a readily determinable fair value because their ownership is restricted, and they can be sold back only to the FHLB-Pittsburgh, ACBB, the Federal Reserve Bank or to another member institution. Therefore, these securities are classified as restricted equity investment securities, carried at cost, and evaluated for impairment. At June 30, 2011, the Corporation held $5,711,000 in stock of FHLB-Pittsburgh and $35,000 in stock of ACBB. At December 31, 2010, the Corporation held $6,328,000 in stock of the FHLB-Pittsburgh, and $35,000 in stock of ACBB.

The Corporation evaluated its holding of restricted stock for impairment and deemed the stock to not be impaired due to the expected recoverability of cost, which equals the value reflected within the Corporation’s consolidated financial statements. The decision was based on several items ranging from the estimated true economic losses embedded within FHLB’s mortgage portfolio to the FHLB’s liquidity position and credit rating. The Corporation utilizes the impairment framework outlined in GAAP to evaluate stock for impairment. The following factors were evaluated to determine the ultimate recoverability of the cost of the Corporation’s restricted stock holdings; (i) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted; (ii) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (iii) the impact of legislative and regulatory changes on the institutions and, accordingly, on the customer base of the FHLB; (iv) the liquidity position of the FHLB; and (v) whether a decline is temporary or whether it affects the ultimate recoverability of the FHLB stock based on (a) the materiality of the carrying amount to the member institution and (b) whether an assessment of the institution’s operational needs for the foreseeable future allow management to dispose of the stock. Based on the analysis of these factors, the Corporation determined that its holdings of restricted stock were not impaired at June 30, 2011 and December 31, 2010.

Loans

Loans are stated at their outstanding unpaid principal balances, net of deferred fees or costs, unearned income and the allowance for loan losses. Interest on installment loans is recognized as income over the term of each loan, generally, by the actuarial or accrual methods. Interest on all other loans is primarily recognized based upon the principal amount outstanding on an actual day basis. Loan origination fees and certain direct loan origination costs have been deferred with the net amount amortized using the interest method over the contractual life of the related loans as an interest yield adjustment.

Mortgage loans held for resale are carried at the lower of cost or market on an aggregate basis determined by independent pricing from appropriate federal or state agency investors. These loans are sold without recourse to the Corporation.

Past-Due Loans — Generally, a loan is considered to be past-due when scheduled loan payments are in arrears 15 days or more. Delinquent notices are generated automatically when a loan is 15 days past-due. Collection efforts continue on loans past-due beyond 60 days that have not been satisfied, when it is believed that some chance exists for improvement in the status of the loan. Past-due loans are continually evaluated with the determination for charge-off being made when no reasonable chance remains that the status of the loan can be improved.

Non-Accrual Loans — Generally, a loan is classified as non-accrual and the accrual of interest on such a loan is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan currently is performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Certain non-accrual loans may continue to perform, that is, payments are still being received. Generally, the payments are applied to principal. These loans remain under constant scrutiny and if performance continues, interest income may be recorded on a cash basis based on management's judgement as to collectibility of principal.

Impaired Loans — A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Under current accounting standards, the allowance for loan losses related to impaired loans is based on discounted cash flows using the loan=s effective interest rate or the fair value of the collateral for certain collateral dependent loans. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above.

Allowance for Loan Losses — The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level estimated by management to be adequate to absorb potential loan losses. Management's periodic evaluation of the adequacy of the allowance for loan losses is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

In addition, the Corporation is subject to periodic examination by its federal and state examiners, and may be required by such regulators to recognize additions to the allowance for loan losses based on their assessment of credit information available to them at the time of their examinations.

In addition, an allowance is provided for possible credit losses on off-balance sheet credit exposures. The allowance is estimated by management and is classified in other liabilities.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. At the present time, select loans are not aggregated for collective impairment evaluation, as such; all loans are subject to individual impairment evaluation should the facts and circumstances pertinent to a particular loan suggest that such evaluation is necessary. Factors considered by management in determining impairment include payment status and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from collateral. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a trouble debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers all other loans not identified as impaired and is based on historical losses adjusted for current factors. The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding two years. In calculating the historical component of our allowance, we aggregate loans into one of four portfolio segments: Commercial, Commercial Real Estate, Consumer and Residential. Risk factors impacting loans in each of the portfolio segments include broad deterioration of property values, reduced consumer and business spending as a result of continued high unemployment and reduced credit availability and lack of confidence in a sustainable recovery. Actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: the concentration of watch and substandard loans as a percentage of total loans, levels of loan concentration within the portfolio segment or division of a portfolio segment and broad economic conditions.

Premises and Equipment

Premises, improvements, and equipment are stated at cost less accumulated depreciation computed principally utilizing the straight-line method over the estimated useful lives of the assets. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying value may not be recovered. Maintenance and minor repairs are charged to operations as incurred. The cost and accumulated depreciation of the premises and equipment retired or sold are eliminated from the property accounts at the time of retirement or sale, and the resulting gain or loss is reflected in current operations.

Mortgage Servicing Rights

The Corporation originates and sells real estate loans to investors in the secondary mortgage market. After the sale, the Corporation may retain the right to service these loans. When originated mortgage loans are sold and servicing is retained, a servicing asset is capitalized based on relative fair value at the date of sale. Servicing assets are amortized as an offset to other fees in proportion to, and over the period of, estimated net servicing income. The unamortized cost is included in other assets in the accompanying consolidated balance sheet. The servicing rights are periodically evaluated for impairment based on their relative fair value.

Foreclosed Assets Held for Resale

Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value on the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and if fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. The real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenues derived from and costs to maintain the assets and subsequent gains and losses on sales are included in other non-interest income and expense.

Bank Owned Life Insurance

The Corporation invests in Bank Owned Life Insurance (BOLI) with split dollar life provisions. Purchase of BOLI provides life insurance coverage on certain employees with the Corporation being owner and beneficiary of the policies.

Investments in Real Estate Ventures

The Bank is a limited partner in real estate ventures that own and operate affordable residential low-income housing apartment buildings for elderly residents. The investments are accounted for under the effective yield method. Under the effective yield method, the Bank recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that the tax credits are allocated to the Bank. Under this method, the tax credits allocated, net of any amortization of the investment in the limited partnerships, are recognized in the consolidated statements of income as a component of income tax expense. The amount of tax credits allocated to the Bank were $187,000 in 2011 and 2010, and the amortization of the investments in the limited partnerships were $58,000 and $80,000 for the six months ended June 30, 2011 and 2010, respectively. The carrying value of the investments as of June 30, 2011 and December 31, 2010 were $1,542,000 and $1,600,000, respectively. During 2010, the Bank purchased an interest in a low income housing partnership in the amount of $1,084,000.

Income Taxes

The provision for income taxes is based on the results of operations, adjusted primarily for tax-exempt income. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. Deferred tax assets and liabilities are determined based on the differences between the consolidated financial statement and income tax bases of assets and liabilities measured by using the enacted tax rates and laws expected to be in effect when the timing differences are expected to reverse. Deferred tax expense or benefit is based on the difference between deferred tax asset or liability from period to period.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, the projected future taxable income and tax planning strategies in making this assessment. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Corporation and the Bank are subject to U.S. federal income tax and Commonwealth of Pennsylvania tax. The Corporation is no longer subject to examination by Federal or State taxing authorities for the years before 2007. At June 30, 2011 and 2010 the Corporation did not have any unrecognized tax benefits. The Corporation does not expect the amount of any unrecognized tax benefits to significantly increase in the next twelve months. The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other noninterest expense. At June 30, 2011 and December 31, 2010, the Corporation does not have any amounts accrued for interest and/or penalties.

Goodwill, Other Intangible Assets, and Premium Discount

Goodwill resulted from the acquisition of the Pocono Community Bank in November 2007 and of certain fixed and operating assets acquired and deposit liabilities assumed of the branch of another financial institution in Danville, Pennsylvania, in January 2004. Such goodwill represents the excess cost of the acquired assets relative to the assets fair value at the dates of acquisition. The amount was comprised of the finalization of severance agreements and contract terminations related to the acquisition. In accordance with current accounting standards, goodwill is not amortized. Management performs an annual evaluation for impairment. Any impairment of goodwill results in a charge to income. The Corporation periodically assesses whether events or changes in circumstances indicate that the carrying amounts of goodwill and other intangible assets may be impaired. Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The Corporation has tested the goodwill included in its consolidated balance sheet at December 31, 2010, and has determined there was no impairment as of that date or as of June 30, 2011. No assurance can be given that future impairment tests will not result in a charge to earnings.

Intangible assets are comprised of core deposit intangibles and premium discount (negative premium) on certificates of deposit acquired. The core deposit intangible is being amortized over the average life of the deposits acquired as determined by an independent third party. Premium discount (negative premium) on acquired certificates of deposit resulted from the valuation of certificate of deposit accounts by an independent third party. The book value of certificates of deposit acquired was greater than their fair value at the date of acquisition which resulted in a negative premium due to higher cost of the certificates of deposit compared to the cost of similar term financing. The Corporation has tested the core deposit intangible included in its consolidated balance sheet at December 31, 2010 and has determined there was no impairment as of that date or as of June 30, 2011. No assurance can be given that future impairment tests will not result in a charge to earnings.

Stock Based Compensation

The Corporation sponsored a stock option plan which expired on April 21, 2008. Compensation cost is recognized for stock options to employees based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation expense is recognized over the requisite service period. There were 20,245 outstanding options that may be exercised as of June 30, 2011.

Per Share Data

FASB ASC 260-10 Earnings Per Share ((SFAS) No. 128, “Earnings Per Share”), requires dual presentation of basic and fully diluted earnings per share. Basic earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding at the end of each period. Diluted earnings per share is calculated by increasing the denominator for the assumed conversion of all potentially dilutive securities. The Corporation’s dilutive securities are limited to stock options. The most recent options issued were in December 2007.

Cash Flow Information

For purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand and due from other banks and interest bearing deposits in other banks and federal funds sold. The Corporation considers cash classified as interest bearing deposits with other banks as a cash equivalent since they are represented by cash accounts essentially on a demand basis. Federal funds are also included as a cash equivalent because they are generally purchased and sold for one-day periods.

Treasury Stock

The purchase of the Corporation=s common stock is recorded at cost. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on a last-in-first-out basis.

Trust Assets and Income

Property held by the Corporation in a fiduciary or agency capacity for its customers is not included in the accompanying consolidated financial statements since such items are not assets of the Corporation. Trust Department income is generally recognized on a cash basis and is not materially different than if it were reported on an accrual basis.

Accumulated Other Comprehensive Income

The Corporation is required to present accumulated other comprehensive income in a full set of general-purpose financial statements for all periods presented. Accumulated other comprehensive income is comprised of net unrealized holding gains on the available for sale investment securities portfolio. The Corporation has elected to report the effects of other comprehensive income as part of the Consolidated Statement of Changes in Stockholders= Equity.

Recent Accounting Pronouncements

FASB ASU 2010-20 - AReceivable (Topic 310), Disclosures about the Credit Quality of Financial Receivables and the Allowance for Credit Losses@ — ASU 2010-20 requires new and enhanced disclosures about the credit quality of an entity=s financing receivables and its allowance for credit losses. The new and amended disclosure requirements focus on such areas as nonaccrual and past-due financing receivables, allowance for credit losses related to financing receivable, impaired loans, credit quality information and modifications. The ASU requires an entity to disaggregate new and existing disclosures based on how it develops its allowance for credit losses and how it manages credit exposures. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. See Note 3.

FASB ASU 2010-09 - Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure requirements. This accounting standard update modifies the requirement to disclose the date that subsequent events are considered through for SEC filers. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. This change alleviates potential conflicts between Subtopic 855-10 and the SEC=s requirements.

FASB ASC 860 - In June 2009, the FASB issued new guidance impacting FASB ASC 860, Transfers and servicing (Statement No. 166 — Accounting for Transfers of Financial Assets — and amendment of FASB Statement No. 140). The new guidance removes the concept of a qualifying special-purpose entity and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset. The new guidance became effective for the Corporation on January 1, 2010. The implementation of this new guidance did not have a material impact on the Corporation=s consolidated financial statements.

FASB ASC 820-10 - In January 2010, the FASB issued an updated (ASC No. 2010-06, Improving Disclosures about Fair Value Measurements) impacting FASB ASC 210-10, Fair Value Measurements and Disclosures. The amendments in this update require new disclosures about significant transfers in and out of Level 1 and Level 2 fair value measurements. The amendments also require a reporting entity to provide information about activity for purchases, sales issuances and settlements in Level 3 fair value measurements and clarify disclosures about the level of disaggregation and disclosures about inputs and valuation techniques. This update became effective for the Corporation on January 1, 2010. The implementation of this new guidance did not have a material impact on the Corporation's consolidated financial statements.

Advertising Costs

It is the Corporation's policy to expense advertising costs in the period in which they are incurred. Advertising expense for the six months ended June 30, 2011 and 2010, was approximately $111,000 and $121,000, respectively.

Reclassifications

Certain amounts in the consolidated financial statements of prior periods have been reclassified to conform with presentation used in the 2011 consolidated financial statements. Such reclassifications have no effect on the Corporation's consolidated financial condition or net income.

NOTE 2 — INVESTMENT SECURITIES

The amortized cost, related estimated fair value, and unrealized gains and losses for investment securities classified as "Available-For-Sale" or "Held-to-Maturity" were as follows at June 30, 2011 and December 31, 2010:

(Amounts in thousands)	Available-for-Sale Securities			
June 30, 2011:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government Corporations and Agencies:				
Mortgage-backed	$66,731	$1,908	$0	$68,639
Other	10,096	52	(11)	10,137
Obligations of state and political subdivisions	176,399	3,949	(4,783)	175,565
Corporate securities	56,125	888	(223)	56,790
Marketable equity securities	1,725	258	(191)	1,792
Restricted equity securities	5,746	0	0	5,746
Total	$316,822	$7,055	$(5,208)	$318,669

(Amounts in thousands)	Held-to-Maturity Securities			
June 30, 2011:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government Corporations and Agencies:				
Mortgage-backed	$133	$3	$0	$136
Other	5,019	42	0	5,061
Obligations of state and political subdivisions	1,097	5	0	1,102
Total	$6,249	$50	$0	$6,299

12

(Amounts in thousands) December 31, 2010:	Available-for-Sale Securities Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government Corporations and Agencies:				
Mortgage-backed	$43,673	$1,250	$(146)	$44,777
Other	7,079	47	(30)	7,096
Obligations of state and political subdivisions	182,181	2,617	(7,546)	177,252
Corporate securities	71,708	1,497	(253)	72,952
Marketable equity securities	1,725	256	(156)	1,825
Restricted equity securities	6,363	0	0	6,363
Total	$312,729	$5,667	$(8,131)	$310,265

(Amounts in thousands) December 31, 2010:	Held-to-Maturity Securities Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government Corporations and Agencies:				
Mortgage-backed	$142	$3	$0	$145
Other	5,027	19	(81)	4,965
Obligations of state and political subdivisions	1,097	0	(16)	1,081
Total	$6,266	$22	$(97)	$6,191

Securities Available-for-Sale with an aggregate fair value of $174,000,000 at June 30, 2011 and $186,735,000 at December 31, 2010; and securities Held-to-Maturity with an aggregate book value of $5,782,000 at June 30, 2011 and $5,799,000 at December 31, 2010, were pledged to secure public funds, trust funds, securities sold under agreements to repurchase, FHLB advances and other balances of $109,031,000 at June 30, 2011 and $109,283,000 at December 31, 2010.

The amortized cost, estimated fair value and weighted average yield of debt securities, by contractual maturity, are shown below at June 30, 2011 and December 31, 2010. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Amounts in thousands)

June 30, 2011

	U.S. Government Agency & Corporation Obligations1	Obligations of State & Political Subdivisions2	Marketable Equity Securities3	Restricted Equity Securities3	Corporate Securities
Available-For-Sale:					
Within 1 Year:					
Amortized cost	$ 1,024	$ —	$—	$—	$11,935
Estimated fair value	1,031	—	—	—	12,112
Weighted average yield	1.05 %	—	—	—	3.28 %
1 - 5 Years:					
Amortized cost	4,068	2,469	—	—	42,635
Estimated fair value	4,107	2,534	—	—	43,136
Weighted average yield	1.37 %	4.11 %	—	—	2.96 %
5 - 10 Years:					
Amortized cost	11,447	11,282	—	—	1,555
Estimated fair value	11,898	11,996	—	—	1,543
Weighted average yield	3.66 %	5.35 %	—	—	3.13 %
After 10					
Amortized cost	60,288	162,648	1,725	5,746	—
Estimated fair value	61,739	161,035	1,792	5,746	—
Weighted average yield	3.98 %	6.23 %	3.15 %	.01 %	—
Total:					
Amortized cost	$ 76,827	$ 176,399	$1,725	$5,746	$56,125
Estimated fair value	78,775	175,565	1,792	5,746	56,791
Weighted average yield	3.76 %	6.14 %	3.15 %	.01 %	3.03 %

1Mortgage-backed securities are allocated for maturity reporting at their original maturity date.
2Average yields on tax-exempt obligations of state and political subdivisions have been computed on a tax-equivalent basis using a 34% tax rate.
3Marketable equity securities and restricted equity securities are not considered to have defined maturities and are included in the after ten year category.

(Amounts in thousands)

June 30, 2011

	U.S. Government Agency & Corporation Obligations1		Obligations of State & Political Subdivisions2		Marketable Equity Securities3	Restricted Equity Securities3	Corporate Securities
Held-To-Maturity:							
Within 1 Year:							
Amortized cost	$ —		$ 630		$—	$—	$—
Estimated fair value	—		630		—	—	—
Weighted average yield	—		4.45	%	—	—	—
1 - 5 Years:							
Amortized cost	3,019		—		—	—	—
Estimated fair value	3,057		—		—	—	—
Weighted average yield	1.26	%	—		—	—	—
5 - 10 Years:							
Amortized cost	2,133		—		—	—	—
Estimated fair value	2,140		—		—	—	—
Weighted average yield	2.36	%	—		—	—	—
After 10 Years:							
Amortized cost	—		467		—	—	—
Estimated fair value	—		472		—	—	—
Weighted average yield	—		7.04	%	—	—	—
Total:							
Amortized cost	$ 5,152		$ 1,097		$—	$—	$—
Estimated fair value	5,197		1,102		—	—	—
Weighted average yield	1.72	%	5.55	%	—	—	—

1Mortgage-backed securities are allocated for maturity reporting at their original maturity date.
2Average yields on tax-exempt obligations of state and political subdivisions have been computed on a tax-equivalent basis using a 34% tax rate.
3Marketable equity securities and restricted equity securities are not considered to have defined maturities and are included in the after ten year category.

(Amounts in thousands)

December 31, 2010

	U.S. Government Agency & Corporation Obligations1	Obligations of State & Political Subdivisions2	Marketable Equity Securities3	Restricted Equity Securities3	Corporate Securities
Available-For-Sale:					
Within 1 Year:					
Amortized cost	$ —	$ —	$—	$—	$10,746
Estimated fair value	—	—	—	—	10,845
Weighted average yield	—	—	—	—	4.32 %
1 - 5 Years:					
Amortized cost	4,056	452	—	—	57,902
Estimated fair value	4,064	467	—	—	59,069
Weighted average yield	1.25 %	5.78 %	—	—	3.22 %
5 - 10 Years:					
Amortized cost	10,682	1,734	—	—	3,060
Estimated fair value	11,149	1,823	—	—	3,040
Weighted average yield	4.08 %	6.05 %	—	—	3.19 %
After 10					
Amortized cost	36,014	179,995	1,725	6,363	—
Estimated fair value	36,660	174,962	1,825	6,363	—
Weighted average yield	4.03 %	6.14 %	2.54 %	.95 %	—
Total:					
Amortized cost	$ 50,752	$ 182,181	$1,725	$6,363	$71,708
Estimated fair value	51,873	177,252	1,825	6,363	72,952
Weighted average yield	3.82 %	6.14 %	2.54 %	.95 %	3.38 %

1Mortgage-backed securities are allocated for maturity reporting at their original maturity date.
2Average yields on tax-exempt obligations of state and political subdivisions have been computed on a tax-equivalent basis using a 34% tax rate.
3Marketable equity securities and restricted equity securities are not considered to have defined maturities and are included in the after ten year category.

(Amounts in thousands)

December 31, 2010

	U.S. Government Agency & Corporation Obligations1	Obligations of State & Political Subdivisions2	Marketable Equity Securities3	Restricted Equity Securities3	Corporate Securities
Held-To-Maturity:					
Within 1 Year:					
Amortized cost	$ —	$ 630	$—	$—	$—
Estimated fair value	—	628	—	—	—
Weighted average yield	—	4.49 %	—	—	—
1 - 5 Years:					
Amortized cost	3,027	—	—	—	—
Estimated fair value	3,030	—	—	—	—
Weighted average yield	3.83 %	—	—	—	—
5 - 10 Years:					
Amortized cost	2,142	—	—	—	—
Estimated fair value	2,080	—	—	—	—
Weighted average yield	2.37 %	—	—	—	—
After 10 Years:					
Amortized cost	—	467	—	—	—
Estimated fair value	—	453	—	—	—
Weighted average yield	—	7.04 %	—	—	—
Total:					
Amortized cost	$ 5,169	$ 1,097	$—	$—	$—
Estimated fair value	5,110	1,081	—	—	—
Weighted average yield	3.22 %	5.58 %	—	—	—

1Mortgage-backed securities are allocated for maturity reporting at their original maturity date.
2Average yields on tax-exempt obligations of state and political subdivisions have been computed on a tax-equivalent basis using a 34% tax rate.
3Marketable equity securities and restricted equity securities are not considered to have defined maturities and are included in the after ten year category.

There were no aggregate investments with a single issuer (excluding the U.S. Government and its agencies) which exceeded ten percent of consolidated shareholders' equity at June 30, 2011. The quality rating of the obligations of state and political subdivisions are generally investment grade, as rated by Moody's, Standard and Poors or Fitch. The typical exceptions are local issues which are not rated, but are secured by the full faith and credit obligations of the communities that issued these securities. The state and political subdivision investments are actively traded in a liquid market.

Proceeds from sale of investments in Available-for-Sale debt and equity securities during the second quarter of 2011 and 2010 were $0 and $13,115,000, respectively. Gross gains realized on these sales were $0 and $407,000, respectively. Gross losses on these sales were $0 and $162,000, respectively. There were no impairment losses in 2011 and 2010.

There were no proceeds from sale of investments in Held-To-Maturity debt and equity securities during 2011 and 2010. There were no gains or losses realized during these periods.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities classified as available-for-sale or held-to-maturity are generally evaluated for OTTI under FASB ASC 320 (SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities). In determining OTTI under the FASB 320 (SFAS No. 115) model, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions; and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When other-than-temporary impairment occurs, the amount of the other-than-temporary impairment recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment=s amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the other-than-temporary impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total other-than-temporary impairment related to the other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings shall become the new amortized cost basis of the investment.

The fair market value of the equity securities tends to fluctuate with the overall equity markets as well as the trends specific to each institution. The equity securities portfolio is reviewed in a similar manner as that of the debt securities with greater emphasis placed on the length of time the market value has been less than the carrying value and the financial sector outlook. The Corporation also reviews dividend payment activities, levels of non-performing assets and loan loss reserves, and whether or not the issuer is participating in the TARP Capital Purchase Program. The starting point for the equity analysis is the length and severity of market value decline. The Corporation and an independent consultant monitor the entire portfolio monthly with particular attention given to securities in a continuous loss position of at least ten percent for over twelve months. Securities with an unrealized loss that were determined to be other-than-temporary were written down to fair value, with the write-down recorded as a realized loss included in security (losses) gains. The Corporation evaluated the near-term prospects of the issuer in relation the severity and duration of the market value decline as well as the other attributes listed above. Based on that evaluation and the Corporation=s ability and intent to hold these equity securities for a reasonable period of time sufficient for a forecasted recovery of fair value, the Corporation does not consider these equity securities to be other-than-temporary impaired at June 30, 2011.

In accordance with disclosures required by FASB ASC 320-10-50 Investments-Debt and Equity Securities Disclosures (EITF No. 03-1), the summary below shows the gross unrealized losses and fair value of the Bank’s investments, aggregated by investment category, that individual securities have been in a continuous unrealized loss position for less than 12 months or more than 12 months as of June 30, 2011 and December 31, 2010:

June 30, 2011

	Less Than 12 Months		12 Months or More		Total	
(Amounts in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Direct obligations of the U.S. Government	$1,989	$11	$—	$—	$1,989	$11
Federal Agency Backed Securities	—	—	—	—	—	—
Municipal Bonds	34,128	1,153	13,418	3,630	47,546	4,783
Corporate Securities	20,314	223	—	—	20,314	223
Equities	324	34	603	157	927	191
	$56,755	$1,421	$14,021	$3,787	$70,776	$5,208

December 31, 2010

	Less Than 12 Months		12 Months or More		Total	
(Amounts in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Direct obligations of the U.S. Government	$7,925	$111	$—	$—	$7,925	$111
Federal Agency Backed Securities	4,859	146	—	—	4,859	146
Municipal Bonds	90,995	3,239	13,160	4,323	104,155	7,562
Corporate Securities	18,414	253	—	—	18,414	253
Equities	98	27	645	129	743	156
	$122,291	$3,776	$13,805	$4,452	$136,096	$8,228

The Corporation invests in various forms of agency debt including mortgage backed securities and callable debt. The mortgage backed securities are issued by FHLMC (Federal Home Loan Mortgage Corporation) of FNMA (Federal National Mortgage Association). The municipal securities consist of general obligations and revenue bonds. The equity securities consist of stocks in other bank holding companies. The fair market value of the above securities is influenced by market interest rates, prepayment speeds on mortgage securities, bid to offer spreads in the market place and credit premiums for various types of agency debt. These factors change continuously and therefore the market value of these securities may be higher or lower than the Corporation=s carrying value at any measurement date. Management does not believe any of their 92 securities in an unrealized position as of June 30, 2011 represents an other-than-temporary impairment. The Corporation has the ability to hold the remaining securities contained in the above table for a time necessary to recover the cost.

Securities with an unrealized loss that are determined to be other-than-temporary are written down to fair value, with the write-down recorded as a realized loss included in securities gains (losses).

NOTE 3 — LOANS

Major classifications of loans at June 30, 2011 and December 31, 2010 consisted of:

(Amounts in thousands)

	June 30, 2011	December 31, 2010
Commercial, Financial, and Agricultural	$23,860	$ 29,693
Tax-exempt	18,419	12,450
Real estate mortgages - Held-for-sale	3,604	4,950
Real estate mortgages - Consumer	125,004	127,031
Real estate mortgages - Commercial	234,531	227,147
Consumer	8,359	8,781
Gross loans	$413,777	$ 410,052
Add (deduct): Unearned discount	(512)	(675)
Net deferred loan fees and costs	285	274
Loans, net of unearned income	$413,550	$ 409,651

Activity in the allowance for loan losses for the quarter ended June 30, 2011 and the year ended December 31, 2010:

(Amounts in thousands)

June 30,