DIMECO INC
Form 10-K
March 18, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number **0-49639**

DIMECO, INC.

(Exact name of Registrant as specified in its Charter)

Pennsylvania	**23-2250152**
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
820 Church Street, Honesdale, Pennsylvania	**18431**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, including area code: **(570) 253-1970**

Securities Registered Pursuant to Section 12(b) of the Act: **None**

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, $.50 par value
(Title of Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately $47 million as of June 30, 2009 based on the last sale ($36.30 per share) reported on the OTC Bulletin Board as of that date. Solely for purposes of this calculation, the term affiliate refers to all directors and executive officers of the registrant and all stockholders beneficially owning more than 5% of the registrant s common stock.

As of February 26, 2010, there were issued and outstanding 1,578,528 shares of the registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Registrant s Annual Report to Stockholders for the fiscal year ended December 31, 2009. (Part II)
2. Portions of the Registrant s definitive Proxy Statement for the 2010 Annual Meeting of Shareholders. (Part III)

Table of Contents

DIMECO, INC.

ANNUAL REPORT ON FORM 10-K

for the fiscal year ended December 31, 2009

INDEX

Table of Contents

PART I

Forward-Looking Statements

Dimeco, Inc. (the Company or Registrant) may, from time to time, make written or oral forward-looking statements, including statements contained in the Company s filings with the Securities and Exchange Commission (including this annual report on Form 10-K and the exhibits thereto), in its reports to shareholders and in other communications by the Company, which are made in good faith by the Company pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company s plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (some of which are beyond the Company s control). The following factors, among others, could cause the Company s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors products and services; the willingness of users to substitute competitors products and services for the Company s products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes, acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing these risks.

The Company cautions that this list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Item 1. Business

General

The Company, a Pennsylvania corporation, is a bank holding company headquartered in Honesdale, Pennsylvania. At December 31, 2009, the Company had total consolidated assets, deposits and stockholders equity of approximately $531 million, $443 million and $47 million, respectively. The Company s principal business is to serve as a holding company for its wholly-owned subsidiary, The Dime Bank (the Bank).

The Bank is a Pennsylvania-chartered commercial bank, originally organized in 1905. The Bank provides a comprehensive range of lending, depository and financial services to individuals and small to medium-sized businesses. The Bank s deposit services range from traditional time, demand, and savings deposit accounts to sophisticated cash management products, including electronic banking and commercial sweep accounts. The Bank s lending services include secured and unsecured commercial, real estate and consumer loans. The Bank also operates a trust department and an investment department which had $88 million in client assets under management at December 31, 2009. The Bank conducts business from six branch offices, located in Honesdale, Hawley, Damascus, Greentown and Dingmans Ferry, Pennsylvania, as well as maintaining two off-site ATM machines each located in Honesdale and Hawley, Pennsylvania and an Operations Center in Honesdale, Pennsylvania. The Bank s Lake Region office in Hawley, Pennsylvania also serves as the office for the Bank s trust and investments departments. The Bank maintains a website at www.thedimebank.com. Information on our website should not be treated as part of this Annual Report on Form 10-K.

The Bank has a 100% owned subsidiary, TDB Insurance Services, LLC in order to offer title insurance services in conjunction with the Bank s lending function.

Table of Contents

Competition

The Bank is one of many financial institutions serving its principal market area, which includes Wayne and Pike Counties, Pennsylvania and Sullivan County, New York. Such market areas are approximately 90 miles west of New York City. Pike County, Pennsylvania is one of the fastest growing counties in Pennsylvania. The competition for deposit products comes primarily from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Company s market area. Based on data compiled by the FDIC as of June 30, 2009 (the latest date for which such information is available), the Bank had the largest share of FDIC-insured deposits in Wayne County with approximately 25% and the second largest share of FDIC-insured deposits in Pike County with approximately 17%. This data does not reflect deposits held by credit unions with which the Bank also competes. Deposit competition also includes a number of insurance products sold by local agents and investment products, such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage brokers.

Lending Activities

General. The principal lending activity of the Bank is the origination of commercial real estate loans, residential mortgage loans, commercial and industrial loans, installment loans, and, to a lesser extent, construction and development loans, home equity loans, and agricultural loans. Generally, loans are originated in the Company s primary market area of Pike and Wayne Counties, Pennsylvania and Sullivan County, New York. The majority of the Bank s borrowers are located in these counties and would be expected to be affected by economic and other conditions in this area. In addition, at December 31, 2009, the Company had $110 million of loans granted to summer camps and recreational facilities in the northeastern United States. This amount of loans constituted approximately 27% of the loan portfolio. The Company does not believe that there are any other concentrations of loans or borrowers exceeding 10% of total loans.

Table of Contents

Analysis of Loan Portfolio. Set forth below is selected data relating to the composition of the Bank s loan portfolio by type of loan on the dates indicated. Prior period information has been reclassified to agree with current year presentation.

	At December 31,									
	2009		2008		2007		2006		2005	
(Dollars in thousands)	**$**	**%**	**$**	**%**	**$**	**%**	**$**	**%**	**$**	**%**
Loans secured by real estate:										
Construction and development	$ 16,286	4.0%	$ 13,403	3.5%	$ 8,385	2.4%	$ 3,733	1.2%	$ 3,771	1.3%
Mortgage loans secured by farmland	1,684	0.4%	1,804	0.5%	1,869	0.5%	1,775	0.6%	1,879	0.7%
Commercial loans secured by non-farm, non-residential properties	243,014	59.3%	217,378	57.2%	198,323	57.5%	170,910	56.0%	157,076	55.4%
Secured by 1-4 family residential properties:										
Home equity lines of credit	8,657	2.1%	6,342	1.7%	4,718	1.4%	4,218	1.4%	2,535	0.9%
Mortgage loans	76,193	18.6%	75,715	19.9%	69,242	20.1%	64,188	21.0%	54,682	19.2%
Commercial and industrial loans	42,502	10.4%	42,396	11.1%	39,337	11.4%	38,502	12.0%	41,289	19.2%
Installment loans	12,869	3.1%	14,750	3.9%	15,656	4.5%	16,258	5.3%	17,895	6.3%
Other loans:										
Agriculture	1,426	0.3%	694	0.2%	879	0.3%	1,132	0.4%	858	0.3%
Other	7,381	1.8%	7,725	2.0%	6,349	1.9%	4,575	1.5%	3,577	1.3%
Total loans	$ 410,012	100.0%	$ 380,207	100.0%	$ 344,758	100.0%	$ 305,291	100.0%	$ 283,562	100.0%
Loans held for sale	$				$		$		$ 211	

5

Table of Contents

Loan Maturities. The following table sets forth the maturities for selected categories of the Bank s loan portfolio at December 31, 2009. The table does not include prepayments or scheduled principal repayments. All loans are shown as maturing based on contractual maturities. Demand loans and loans having no stated maturity are shown as due within one year.

(In thousands)	Due within 1 year	Due after 1 through 5 years	Due after 5 years	Total
Commercial & agricultural real estate	$ 22,380	$ 8,480	$ 213,838	$ 244,698
Commercial & industrial, and agricultural	18,899	11,549	13,480	43,928
Construction and development	6,597	3,651	6,038	16,286
Total	$ 47,876	$ 23,680	$ 233,356	$ 304,912

The following table sets forth the dollar amount as of December 31, 2009 of selected categories of the Company s loans due more than one year after December 31, 2009, which are based upon fixed interest rates or floating or adjustable interest rates.

(In thousands)	Fixed Rates	Variable Rates	Total
Commercial & agricultural real estate	$ 7,377	$ 214,941	$ 222,318
Commercial & industrial, and agricultural	12,688	12,341	25,029
Construction and development	1,969	7,720	9,689
Total	$ 22,034	$ 235,002	$ 257,036

Construction and Development Loans. The Bank s construction lending has primarily involved lending for commercial construction projects and for single-family residences. All loans for the construction of speculative sale homes have a loan to value ratio of not more than 80%. For both commercial and single-family projects loan proceeds are disbursed during the construction phase according to a draw schedule based on the stage of completion. Construction projects are inspected by contracted inspectors or bank personnel. Construction loans are underwritten on the basis of the estimated value of the property as completed. For commercial projects, the Bank typically provides the permanent financing after the construction period, as a commercial mortgage.

The Bank also originates loans for the development of raw land. Development loans have a term of up to three years. Development loans granted to developers may have an interest only period during development. Development loans have a loan-to-value ratio not exceeding 75%. The Bank may expand its lending on raw land, as market conditions allow, to qualified borrowers experienced in the development and sale of raw land.

Loans involving construction and development financing have a higher level of risk than loans for the purchase of existing homes since collateral values, land values, development costs and construction costs can only be estimated at the time the loan is approved. The Bank has sought to minimize its risk in construction and development lending by offering such financing primarily to builders and developers to whom the Bank has loaned funds in the past and to persons who have previous experience in such projects. The Bank also limits construction and development lending to its market area, with which management is familiar.

Commercial Real Estate and Farmland Loans. The commercial real estate loan portfolio consists of loans secured primarily by children s recreational summer camps, retail stores, restaurants, resorts, investment real estate, stone quarries and manufacturing facilities. The Bank also makes loans secured by farmland. Loans secured by commercial property or farmland may be originated in amounts up to 80% of the lower of the appraised value or purchase price, for a maximum term of 20 years. The Bank has a concentration of commercial real estate loans that

Table of Contents

are secured by summer camps and recreational facilities for children in the northeastern United States; these loans are generally adjustable-rate loans, with terms of up to 20 years, with the rate tied to the prime interest rate. At December 31, 2009, $110 million of the loan portfolio consisted of loans to these summer camps and recreational facilities for children. These loans increased over 13% when compared to the year ended December 31, 2008, due to the Bank establishing new camp relationships, while continuing to serve the needs of existing camp customers.

Loans secured by commercial properties generally involve a greater degree of risk than residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income-producing properties and the greater difficulty of evaluating and monitoring these types of loans. Any significant adverse change in economic conditions could have an adverse impact on the borrowers ability to repay loans. A large portion of the Bank s commercial real estate loan portfolio consists of loans secured by summer camps and recreational facilities located in the northeastern United States. Such loans are dependent upon seasonal business and factors beyond the Bank s control, such as the general economic condition of the northeastern United States and the impact on discretionary consumer spending. Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related business or commercial project. If the cash flow from the project is reduced, the borrower s ability to repay the loan may be impaired. This cash flow shortage may result in the failure to make loan payments. In such cases, the Bank may be compelled to modify the terms of the loan. In addition, the nature of these loans makes them generally less predictable and more difficult to evaluate and monitor. As a result, repayment of these loans may be subject to a greater extent than residential loans to adverse conditions in the real estate market or economy.

Residential Real Estate Loans. The residential real estate portfolio consists of owner-occupied 1-4 family residential mortgage loans. The Bank generally originates 1-4 family residential mortgage loans in amounts of up to 80% of the appraised value of the mortgaged property without requiring mortgage insurance. The Bank will originate residential mortgage loans in amounts up to 95% of the appraised value of a mortgaged property, however, mortgage insurance is required for any loan amount in excess of 80% of appraised value. In addition, the Bank participates in special residential loan programs through various state and federal agencies which provide first-time home buyers the ability to finance up to 100% of the property value; these loans are guaranteed by those various federal and state agencies. The Bank offers residential fixed-rate loans and adjustable-rate loans with a 15 to 30 year amortization period. Interest rates for adjustable-rate loans for residences adjust every 1 to 3 years based upon rates on U.S. Treasury bills and notes. Interest rate adjustments on such loans are generally limited to two percentage points during any adjustment period and six percentage points over the life of the loan. These loans are originated for retention in the portfolio. The Bank does not use introductory teaser rates on adjustable-rate mortgages nor have they originated interest-only mortgages.

Fixed-rate loans are generally underwritten in accordance with Freddie Mac guidelines. Currently, loans underwritten in accordance with Freddie Mac guidelines are generally sold in the secondary market. However, the number of saleable loans could vary materially as a result of market conditions. Fixed-rate loans which are held in portfolio are underwritten in accordance with Freddie Mac credit guidelines but occasionally may not conform in relation to loan amount or property guidelines. Since we are located in a rural area, many homes are on properties with more acreage then permitted by Freddie Mac underwriting guidelines. At December 31, 2009, $37 million of the Bank s residential real estate loan portfolio consisted of long-term, fixed-rate first mortgage loans.

Substantially all of the 1-4 family mortgages include due on sale clauses, which are provisions giving the Bank the right to declare a loan immediately payable if the borrower sells or otherwise transfers an interest in the property to a third party.

Property appraisals on real estate securing 1-4 family residential loans are made by appraisers approved by the Loan Committee. Appraisals are performed in accordance with applicable regulations and policies. The Bank obtains title insurance policies on most first mortgage real estate loans originated.

Home equity term loans are written for terms of 1 to 15 years with fixed rates of interest. The Bank also offers revolving home equity lines of credit with variable interest rates tied to the New York prime rate. These lines allow for a 10-year draw period followed by a 10-year repayment period. Both types of home equity loans are typically based upon the lower of 80% of the collateral value or $150,000.

Table of Contents

Commercial and Industrial Loans. Commercial and industrial loans consist of equipment, accounts receivable, inventory, lines of credit, and other business purpose loans. Such loans are generally originated in amounts up to 75% of the appraised value of the business asset and are secured by either the underlying collateral and/or by the personal guarantees of the borrower. Commercial and industrial loans are generally originated at rates above the prime interest rate and periodically adjust with changes to prime. These loans generally mature in 5 to 10 years.

Unlike residential mortgage loans, which generally are made on the basis of the borrower s ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. As a result, the availability of funds for the repayment of commercial business loans is substantially dependent on the success of the business itself and the general economic environment.

Installment Loans. The installment loan portfolio includes various types of secured and unsecured consumer loans including automobile, education, and recreational vehicle loans. The Bank originates loans directly and indirectly through local automobile and recreational vehicle dealerships. These loans generally have terms of 1 to 5 years, generally at fixed rates of interest. The interest rates range between 2% for loans that are secured by deposits to 15% for loans that are unsecured, with an average interest rate of approximately 9%. The installment loan portfolio includes approximately $7 million of new and used automobile and recreational vehicle loans. These loans are originated in amounts up to 90% of the purchase price of the vehicle.

Consumer installment lending may entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets, such as automobiles or recreational vehicles, which depreciate rapidly. Repossessed collateral for a defaulted consumer loan may not be sufficient for repayment of the outstanding loan, and the remaining deficiency may not be collectible. Indirect lending exposes us to additional risk in that we must rely on the dealer to provide accurate information to us and accurate disclosure to the borrowers.

Loans Held For Sale. The Bank holds as available for sale certain residential mortgage loans. These loans conform to Freddie Mac guidelines and are readily saleable in the secondary market. The Bank services such loans and is generally not liable for these loans, since they are sold on a non-recourse basis. At December 31, 2009, we had no loans classified as held for sale.

Loan Solicitation and Processing. Loans are derived from a number of sources. Installment loans are primarily solicited through advertising and existing customers and referrals from automobile dealers. Residential mortgage loans are generally derived from advertising, walk-in customers and referrals by realtors, depositors, and borrowers. Commercial real estate loans and commercial and industrial loans are generally obtained through existing relationships with borrowers.

The Bank has established various lending limits for its officers and also maintains a Loan Committee. The Loan Committee is comprised of the President, Senior Lending Officer and other Bank officers. The Loan Committee has the authority to approve all loans up to $500,000. Requests in excess of this limit must be submitted to the Board of Directors Loan Committee or the entire Board for approval. Additionally, the President and Senior Lending Officer each has the authority to approve secured loans up to $200,000, and unsecured loans up to $100,000. Loan officers generally have the authority to approve secured loans between $30,000 and $150,000 and unsecured loans between $15,000 and $50,000. Notwithstanding individual lending authority, certain loan policy exceptions must be submitted to the Loan Committee for approval.

Hazard insurance coverage is required on all properties securing loans made by the Bank. Flood insurance is also required, when applicable.

Residential and commercial loan applicants are notified of the credit decision by letter. If the loan is approved, the loan commitment specifies the terms and conditions of the proposed loan including the amount, interest rate, amortization term, a brief description of the required collateral, and the required insurance coverage.

Table of Contents

The borrower must provide proof of fire, flood (if applicable) and casualty insurance on the property serving as collateral, and these applicable insurances must be maintained during the full term of the loan.

Loan Commitments. The Bank generally grants commitments to fund fixed-rate and adjustable-rate, single-family mortgage loans for periods of 30 days at a specified term and interest rate. The total amount of its commitments to extend credit as of December 31, 2009, was $2 million.

Nonperforming Assets

The following table identifies nonperforming loans including nonaccrual loans and past due loans which were accruing but contractually past due 90 days or more and restructured loans. Restructured loans are those which terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of the deteriorating position of the borrower and constitute troubled debt restructurings under ASC Topic 310, *Receivables*. At December 31, 2009, the Bank had $7,418,000 of impaired loans within the definition of ASC Topic 310.

	At December 31,				
(in thousands)	**2009**	**2008**	**2007**	**2006**	**2005**
Loans accounted for on a non-accrual basis:					
Real estate-construction loans	$	$	$	$	$
Real estate-mortgage loans	5,966	341	443	366	487
Commercial and industrial loans	1,524	23	116		
Installment loans to individuals	32	25	13	45	39
Other loans				15	
`Total	$ 7,522	$ 389	$ 572	$ 426	$ 526
Accruing loans which are contractually past due 90 days or more:					
Real estate-construction loans	$ 6	$ 6	$	$	$
Real estate-mortgage loans	1,988	5,823	509	184	209
Commercial and industrial loans	67	11	50	99	11
Installment loans to individuals	61	20	1	7	59
Other loans	30	4			
Total	$ 2,152	$ 5,864	$ 560	$ 290	$ 279
Restructured loans	46	48	83		
Total nonperforming loans	9,720	6,301	1,215	716	805
Other real estate owned	389	1,955			
Repossessed assets	6	164	4	7	
Total non-performing assets	$ 10,115	$ 8,420	$ 1,219	$ 723	$ 805

Interest income of $463,000 would have been recognized on nonaccrual loans during 2009 if they had been performing in accordance with their original terms. We recognized no income on such loans during 2009. No interest was foregone on restructured loans in 2009.

The primary reason for the increase in nonperforming loans during the year ended December 31, 2009 was the non-accrual classification of $5,667,000 in commercial real estate loans which accounted for 75% of the total non-accrual loans. Included in those loans were $4,608,000 categorized as 90 days past due and accruing at December 31, 2008. These loans are well secured by real estate, with loan to value ratios below our required standards. Management does not believe that we have any one loan that would require a material charge to the allowance for loan losses. In addition, we placed performing loans with the aggregate balance of $1,751,000 as non-accrual due to weakened cash flow concern of the borrower.

Table of Contents

Other Real Estate Owned. Real estate acquired by foreclosure is classified within other assets on the consolidated balance sheet at the lower of the recorded investment in the property or its fair value minus estimated costs of sale. Prior to foreclosure, the value of the underlying collateral is written down by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income and losses on their disposition, are included as other expense.

Classified Assets. Management, in compliance with regulatory guidelines, has instituted an internal loan review program, whereby weaker credits are classified as special mention, substandard, doubtful or loss. When a loan is classified as substandard or doubtful, management is required to establish a valuation reserve for loan losses in an amount that is deemed prudent. When management classifies a loan as a loss asset, a reserve equal to 100% of the loan balance is required to be established or the loan is to be charged-off. The allowance for loan losses is composed of an allowance for both inherent risk associated with lending activities and particular problem assets.

An asset is considered substandard if it is inadequately protected by the paying capacity and net worth of the obligor or the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, highly questionable and improbable, on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a loss reserve is not warranted. Assets which do not currently expose the insured institution to a sufficient degree of risk to warrant classification in one of the aforementioned categories but possess credit deficiencies or potential weaknesses are required to be designated special mention by management.

Management s evaluation of the classification of assets and the adequacy of the allowance for loan losses is reviewed by the Board on a regular basis and by the regulatory agencies as part of their examination process.

The following table sets forth the Bank s classified assets in accordance with its classification system:

	At December 31,				
(In thousands)	**2009**	**2008**	**2007**	**2006**	**2005**
Special mention	$ 12,029	$ 18,281	$ 11,990	$ 8,955	$ 5,685
Substandard	23,308	18,359	7,889	6,964	1,831
Doubtful	1,774	2,032	2,561	965	1,049
Loss					
Total	$ 37,111	$ 38,672	$ 22,440	$ 16,884	$ 8,565

Potential Problem Loans. As of December 31, 2009, there were no loans other than those disclosed as non-performing or classified assets, where known information about possible credit problems of borrowers caused management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Allowance for Loan Losses

For a description of the Company s methodology for determining the allowance for loan losses, see Note 1 of the Notes to Consolidated Financial Statements. For information on charge-off and recovery activity in the Allowance for Loan Losses, see Management s Discussion and Analysis of Financial Condition and Results of Operations Allowance for Loan Losses in the Annual Report to Shareholders for the year ended December 31, 2009 which is filed as Exhibit 13 to this Annual Report on Form 10-K and incorporated herein by reference.

The allowance for loan losses increased 15.5% from December 31, 2008 to December 31, 2009 with several factors contributing to the change. The allowance for loan losses is made up of various components including: historical loss ratios for rated loans (loans subject to individual evaluations), historical loss ratios for homogeneous loans, and external environmental factors such as trends in volume, trends in delinquencies, classified loans and charge-offs, local and national economic factors, changes in management and loan policies, loan concentrations, etc. Contributing to increases in our allowance for loan losses were an increase in the historical charge-off loans and deteriorating external economic factors. During 2009 management took a very conservative approach to evaluating loans subject to individual reviews in light of current economic conditions within the banking industry. Impaired loans, which are identified independently of the above categories, increased by $7 million from less than $1 million while $2 million of such loans continued to perform without delinquencies. While management has been diligent in its underwriting of loans and generally requires real estate collateral on these risk rated loans, we believe it was appropriate to review these loans on a conservative basis. The increase in the allowance for loan losses relating to impaired loans amounted to $1.3 million. External economic factors also contributed to an increase of the allowance for loan losses amounting to $.5 million. Offsetting these increasing components were declines relating to lower balances in higher rated loans. The portion of the calculation that deals with historical loss includes analysis of all losses incurred over the past three years, tracking the rating of each in order to determine the percentage of loans in each loan review rating that have resulted in a loss to the Company, weighting the most recent years heavier than the oldest year in the calculation.

The allowance for loan losses is based on significant estimates and management evaluates the allowance for loan losses based on an appropriate range as opposed to an absolute amount. Management believes the allowance for loan losses is in an acceptable range at December 31, 2009 and will continue to actively monitor current events and trends in their analysis.

Table of Contents

The following table presents a breakdown by loan category of the allowance for loan losses:

	At December 31,									
	2009		2008		2007		2006		2005	
(Dollars in thousands)	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
Commercial and industrial, and agricultural	$ 626	12.5%	$ 1,263	13.4%	$ 1,916	13.5%	$ 798	14.5%	$ 604	16.1%
Construction and Development		4.0%		3.5%		2.4%		1.2%		1.3%
Mortgage	5,456	80.4%	3,980	79.2%	3,270	79.6%	3,433	79.0%	3,079	76.1%
Installment	171	3.1%	173	3.9%	206	4.5%	238	5.4%	290	6.5%
Total	$ 6,253	100.0%	$ 5,416	100.0%	$ 5,392	100.0%	$ 4,469	100.0%	$ 3,973	100.0%

12

Investment Activities

The Bank is required by federal banking regulators to maintain an adequate level of liquid assets which may be invested in specified short-term securities and certain other investments. The level of liquid assets varies depending upon several factors, including: (i) the yields on investment alternatives, (ii) management s judgment as to the attractiveness of the yields then available in relation to other opportunities, (iii) expectation of future yield levels, and (iv) management s projections as to the short-term demand for funds to be used in loan origination and other activities. Investment securities are classified at the time of purchase, based upon management s intentions and abilities, as securities held to maturity or securities available for sale. Management has for several years maintained all current investment purchases in the available for sale category in order to have the ability to liquidate the investment with no accounting ramifications. It is not our intent to sell these securities, we do expect to hold them until maturity, but have classified them as available for sale in order to have the ability to sell them if the need arises without accounting reclassification. Debt securities classified as held to maturity would be those which management purchased with the intent and ability to hold to maturity and would be stated at cost and adjusted for amortization of premium and accretion of discount, computed using the interest method and recognized as adjustments of interest income. Equity securities which consist of investments in stock of various financial services companies are classified as available for sale when purchased.

Current regulatory and accounting guidelines regarding investment securities (including mortgage-backed securities) require the Bank to categorize securities as held to maturity, available for sale or trading. As of December 31, 2009, the Bank had no securities classified as held to maturity and had securities in the amount of $74 million classified as available for sale with no securities classified as trading. Securities classified as available for sale are reported for financial reporting purposes at the fair market value with net changes in the market value from period to period included as a separate component of stockholders equity, net of income taxes. At December 31, 2009, the Bank securities available for sale had an amortized cost of $73 million and market value of $74 million. Changes in market value in the Bank s available for sale portfolio reflect normal market conditions and vary, either positively or negatively, based primarily on changes in general levels of market interest rates relative to the yields of the portfolio. Changes in the market value of securities available for sale do not affect the Company s income. In addition, changes in the market value of securities available for sale do not affect the Bank s regulatory capital requirements or its loan-to-one borrower limit.

At December 31, 2009, the Company s investment portfolio policy allowed investments in instruments such as: (i) U.S. Treasury obligations; (ii) U.S. federal agency or federally sponsored agency obligations; (iii) obligations of state and political subdivisions; (iv) mortgage-backed securities; (v) banker s acceptances; (vi) certificates of deposit; (vii) equity securities and (viii) investment grade corporate bonds and commercial paper. The Board of Directors may authorize additional investments. The Company does not have any investments in subprime mortgage-backed securities or collateralized debt obligations.

Management evaluates securities in the investment portfolio for other than temporary impairment in accordance with ASC Topic 320, *Investments, Debt and Equity Securities.* Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security s ability to recover any decline in its market value, and management s intent and ability to hold the security for a period of time sufficient to allow for a recovery in market value. Among the factors that are considered in determining management s intent and ability is a review of the Company s capital adequacy, interest rate risk position, and liquidity. The assessment of a security s ability to recover any decline in market value, the ability of the issuer to meet contractual obligations, and management s intent and ability requires considerable judgment. A decline in value that is considered to be other than temporary is recorded as a loss within noninterest income in the Consolidated Statement of Income.

Table of Contents

Investment Portfolio. The following table sets forth the carrying value of the investment securities portfolio at the dates indicated.

(In thousands)	At December 31, 2009	2008	2007
Available-for-Sale:			
U.S. Government agency securities	$ 22,120	$ 10,552	$ 8,006
Mortgage-backed securities	4,305	3,743	4,092
Obligations of state and political subdivisions	27,088	22,392	13,782
Corporate securities	6,636	8,034	3,651
Commercial paper	13,045	20,463	36,845
Equity securities	434	416	363
Total	$ 73,628	$ 65,600	$ 66,739

Table of Contents

Investment Portfolio Maturities. The following table sets forth certain information regarding the carrying values, weighted average yields and maturities of the Registrant s investment and mortgage-backed securities portfolio at December 31, 2009. The following table does not take into consideration the effects of scheduled repayments of mortgage-backed securities or the effects of possible prepayments. Securities held in the available for sale category are carried at their market value.

	At December 31, 2009										
	One Year or Less		One to Five Years		Five to Ten Years		More Than Ten Years		Total Investment Securities		
(Dollars in thousands)	Carrying Value	Average Yield(1)	Carrying Value	Average Yield(1)	Carrying Value	Average Yield(1)	Carrying Value	Average Yield(1)	Carrying Value	Average Yield(1)	Market Value
Available for Sale:											
U.S. Government agencies	$ 3,959	1.87%	$ 8,215	2.75%	$ 4,222	4.57%	$ 5,724	4.83%	$ 22,120	3.48%	$ 22,120
Mortgage-backed securities	779	5.15%	1,193	4.81%	612	4.60%	1,721	4.61%	4,305	4.76%	4,305
Obligations of state and political subdivisions	407	3.79%	3,838	3.86%	4,198	4.24%	18,645	3.92%	27,088	3.96%	27,088
Corporate securities	1,025	6.38%	3,264	6.93%	1,117	7.78%	1,230	.50%	6,636	5.70%	6,636
Commercial paper	13,045	.56%		%		%		%	13,045	.56%	13,045
Equity securities		%		%		%	434	1.72%	434	1.72%	434
Total	$ 19,215	1.38%	$ 16,510	3.94%	$ 10,149	4.74%	$ 27,754	3.95%	$ 73,628	3.38%	$ 73,628

(1) Weighted average yields have been computed on a taxable equivalent basis assuming a federal income tax rate of 34%.

Table of Contents

Sources of Funds

General. Deposits are the major source of the Bank s funds for lending and other investment purposes. Borrowings may be used on a short-term basis to compensate for reductions in the availability of funds from other sources. They also may be used on a longer-term basis for interest rate risk management and general business purposes. In addition to deposits and borrowings, the Bank derives funds from loan principal repayments, short-term borrowings in the form of securities sold under agreement to repurchase and proceeds from the sale and maturity of investment securities. Loan payments are a relatively stable source of funds, while deposit inflows are significantly influenced by general interest rates and money market conditions.

Deposits. The Bank offers a variety of deposit accounts, although a majority of deposits are in fixed-term, market-rate certificate of deposit accounts. Deposit account terms vary, primarily as to the required minimum balance amount, the amount of time that the funds must remain on deposit and the applicable interest rate. In 2004, the Bank joined the Promontory Interfinancial Network, gaining the ability to offer customers certificates of deposit with FDIC insurance coverage up to $50 million through its Certificate of Deposit Account Registry Service (CDARS). Our customers funds are reciprocated in the network with funds from other banks, with no bank having total customer deposits at the current maximum FDIC coverage limit of $250,000. The Bank is the only point of contact for the customer. For this service, CDARS charges a fee of between 2.25 and 30 basis points depending on the size/term of the deposit. Any deposits placed through this network are classified as brokered certificates of deposit. The Bank had $6 million of deposits in the program at December 31, 2009.

Jumbo Certificates of Deposit. The following table shows the amount (in thousands) of the Bank s certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2009:

Maturity Period	**Certificates of Deposit**
Three months or less	$ 48,012
Four through six months	29,236
Seven through twelve months	42,189
Over twelve months	16,184
Total	$ 135,621

Borrowings. The Bank may obtain advances from the Federal Home Loan Bank (FHLB) of Pittsburgh to supplement its supply of lendable funds. Advances from the FHLB of Pittsburgh are typically secured by a pledge of the Bank s stock in the FHLB of Pittsburgh and a portion of the Bank s first mortgage loans and certain other assets. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The Bank, if the need arises, may also access the Federal Reserve Bank discount window to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The Bank has offered securities sold with agreements to repurchase to larger commercial customers and had balances of $11 million at December 31, 2009. These arrangements are not deposits within the definition of the FDIC and therefore do not qualify for FDIC insurance. To collateralize these liabilities, the Bank has pledged securities with amortized cost and market value of $15 million at December 31, 2009.

Table of Contents

The following table sets forth information concerning short-term borrowings, which consist primarily of securities sold under agreements to repurchase during the periods indicated.

(Dollars in thousands)	At or For the Years Ended December 31, 2009	2008	2007
Average outstanding	$ 15,488	$ 15,626	$ 13,537
Maximum amount outstanding at any month-end during the year	21,003	19,454	19,165
Weighted average interest rate during the year	0.79%	1.51%	2.58%
Total short-term borrowings at year end	$ 10,974	$ 16,671	$ 8,210
Weighted average interest rate at year end	0.65%	0.83%	2.22%

Trust and Financial Services Activities

The Bank operates a Trust Department and an Investment Department. These departments provide estate planning, investment management and financial planning to customers. At December 31, 2009, the Bank had $88 million of assets under management, of which $285 thousand is non-discretionary with no investment authority.

Personnel

As of December 31, 2009, the Company had 113 full-time employees and 19 part-time employees. The employees are not represented by a collective bargaining unit. The Company believes its relationship with its employees to be satisfactory.

SUPERVISION AND REGULATION

Set forth below is a brief description of certain laws which relate to the regulation and supervision of the Company and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

Regulation of the Company

General. As a bank holding company under the Bank Holding Company Act of 1956, as amended, the Company is subject to regulation, supervision and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve) and by the Pennsylvania Department of Banking. The Company is required to file annually a report of its operations with the Federal Reserve and the Pennsylvania Department of Banking. This regulation and oversight is generally intended to ensure that the Company limits its activities to those allowed by law and that it operates in a safe and sound manner without endangering the financial health of the Bank.

Under the Bank Holding Company Act, the Company must obtain the prior approval of the Federal Reserve before it may acquire control of another bank or bank holding company, merge or consolidate with another bank holding company, acquire all or substantially all of the assets of another bank or bank holding company, or acquire direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the Company would directly or indirectly own or control more than 5% of such shares.

Federal statutes impose restrictions on the ability of a bank holding company and its nonbank subsidiaries to obtain extensions of credit from its subsidiary bank, on the subsidiary bank s investments in the stock or securities of the holding company, and on the subsidiary bank s taking of the holding company s stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services by the subsidiary bank.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve policy that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve regulations, or both.

Non-Banking Activities. The business activities of the Company, as a bank holding company, are restricted by the Bank Holding Company Act. Under the Bank Holding Company Act and the Federal Reserve s bank holding company regulations, the Company may only engage in, or acquire or control voting securities or assets of a company engaged in (i) banking or managing or controlling banks and other subsidiaries authorized under the Bank Holding Company Act; or (ii) any non-banking activity the Federal Reserve has determined to be so closely related to banking or managing or controlling banks to be a proper incident thereto. These include any incidental activities necessary to carry on those activities, as well as a lengthy list of activities that the Federal Reserve has determined to be so closely related to the business of banking as to be a proper incident thereto.

Financial Activities. Provisions of the Gramm-Leach-Bliley Act, which became effective in March 2001, permit greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a financial holding company. A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including: (i) securities underwriting, dealing and market making; (ii) sponsoring mutual funds and investment companies; (iii) insurance underwriting and agency; and (iv) merchant banking activities. The Gramm-Leach-Bliley Act also permits the Federal Reserve and the Treasury Department to authorize additional activities for financial holding companies if they are financial in nature or incidental to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a satisfactory CRA rating. A financial holding company must provide notice to the Federal Reserve within 30 days after commencing activities previously determined by statute or by the Federal Reserve and Department of the Treasury to be permissible. The Company has not submitted notice to the Federal Reserve to become a financial holding company.

Regulatory Capital Requirements. The Federal Reserve has adopted capital adequacy guidelines under which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve s capital adequacy guidelines are similar to those imposed on the Bank by the Federal Deposit Insurance Corporation (FDIC). See Regulation of the Bank Regulatory Capital Requirements.

Restrictions on Dividends. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve s view that a bank holding company should pay cash dividends only to the extent that the holding company s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company s capital needs, asset quality and overall financial condition. The Federal Reserve also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the federal prompt corrective action regulations, the Federal Reserve may prohibit a bank holding company from paying any dividends if the holding company s bank subsidiary is classified as undercapitalized. The Federal Reserve requires advance notice of any dividend that exceeds earnings for the period for which the dividend is being paid.

Table of Contents

Regulation of the Bank

General. As a Pennsylvania chartered commercial bank with deposits insured by the FDIC which is not a Federal Reserve System member, the Bank is subject to extensive regulation and examination by the Pennsylvania Department of Banking and by the FDIC, which insures its deposits to the maximum extent permitted by law. The federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting stockholders. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Pennsylvania Department of Banking, the FDIC or the United States Congress, could have a material impact on the Bank and its operations.

Federal law provides the federal banking regulators, including the FDIC and the Federal Reserve, with substantial enforcement powers. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders, and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Pennsylvania Banking Law. The Pennsylvania Banking Code contains detailed provisions governing the organization, location of offices, rights and responsibilities of trustees, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Code delegates extensive rule-making power and administrative discretion to the Pennsylvania Department of Banking so that the supervision and regulation of state chartered commercial banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

The Code also provides state-chartered commercial banks with all of the powers enjoyed by national banks and federal savings associations, subject to regulation by the Pennsylvania Department of Banking. The Federal Deposit Insurance Corporation Act, however, prohibits a state-chartered bank from making new investments, loans, or becoming involved in activities as principal and equity investments which are not permitted for national banks unless (i) the FDIC determines the activity or investment does not pose a significant risk of loss to the relevant insurance fund and (ii) the bank meets all applicable capital requirements. Accordingly, the additional operating authority provided to the Bank by the code is significantly restricted by the Federal Deposit Insurance Act.

The Pennsylvania Banking Code states, in part, that dividends may be declared and paid only out of accumulated net earnings and may not be declared or paid unless surplus (retained earnings) is at least equal to contributed capital. The Bank has not declared or paid any dividends that have caused its retained earnings to be reduced below the amount required. Finally, dividends may not be declared or paid if the Bank is in default in payment of any assessment due the FDIC.

Federal Deposit Insurance. The Bank s deposits are insured to applicable limits by the FDIC. The maximum deposit insurance amount has been increased from $100,000 to $250,000 until December 31, 2013. On October 13, 2008, the FDIC established a Temporary Liquidity Guarantee Program under which the FDIC fully guarantees all non-interest-bearing transaction accounts until December 31, 2009 (the Transaction Account Guarantee Program) and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008 and June 30, 2009, with the FDIC s guarantee expiring by June 30, 2012 (the Debt Guarantee Program). Senior unsecured debt would include federal funds purchased and certificates of deposit standing to the credit of the bank. After November 12, 2008, institutions that did not opt out of the Programs by December 5, 2008 were assessed at the rate of ten basis points for transaction account balances in excess of $250,000 and at a rate between 50 and 100 basis points of the amount of debt issued. In May, 2009, the Debt Guarantee Program issue end date and the guarantee expiration date were both extended, to October 31, 2009 and December 31, 2012, respectively. Participating holding companies that have not issued FDIC-guaranteed debt prior to April 1, 2009 must apply to remain in the Debt Guarantee Program. Participating institutions will be subject to surcharges for debt issued after that date. Effective October 1, 2009, the Transaction Account Guarantee Program was extended until June 30, 2010, with an increased assessment after December 31, 2009. The Company and the Bank opted out of the Debt Guarantee Program. The Bank did not opt out of the original Transaction Account Guarantee Program but did opt out of its extension.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution s ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and, until 2009, were assessed for deposit insurance at an annual rate of between five and seven basis points with the assessment rate for an individual institution determined according to a formula based on a weighted average of the institution s individual CAMELS component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV were assessed at annual rates of 10, 28 and 43 basis points, respectively. Insured depository institutions that were in existence on December 31, 1996 and paid assessments prior to that date (or their successors) were entitled to a one-time credit against future assessments based on their past contributions to the predecessor to the Deposit Insurance Fund. The Bank used its special assessment credit to offset the cost of its deposit insurance premium until the fourth quarter of calendar 2007 when the credit was exhausted.

Pursuant to the Federal Deposit Insurance Reform Act of 2005 (the Reform Act), the FDIC is authorized to set the reserve ratio for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. Due to recent bank failures, the FDIC determined that the reserve ratio was 1.01% as of June 30, 2008. In accordance with the Reform Act, as amended by the Helping Families Save Their Home Act of 2009, the FDIC has established and implemented a plan to restore the reserve ratio to 1.15% within eight years. For the quarter beginning January 1, 2009, the FDIC raised the base annual assessment rate for institutions in Risk Category I to between 12 and 14 basis points while the base annual assessment rates for institutions in Risk Categories II, III and IV were increased to 17, 35 and 50 basis points, respectively. For the quarter beginning April 1, 2009 the FDIC set the base annual assessment rate for institutions in Risk Category I to between 12 and 16 basis points and the base annual assessment rates for institutions in Risk Categories II, III and IV at 22, 32 and 45 basis points, respectively. An institution s assessment rate could be lowered by as much as five basis points based on the ratio of its long-term unsecured debt to deposits or, for smaller institutions based on the ratio of certain amounts of Tier 1 capital to adjusted assets. The assessment rate may be adjusted for Risk Category I institutions that have a high level of brokered deposits and have experienced higher levels of asset growth (other than through acquisitions) and could be increased by as much as ten basis points for institutions in Risk Categories II, III and IV whose ratio of brokered deposits to deposits exceeds 10%. Reciprocal deposit arrangements like CDARS® were treated as brokered deposits for Risk Category II, III and IV institutions but not for institutions in Risk Category I. An institution s base assessment rate would also be increased if an institution s ratio of secured liabilities (including FHLB advances and repurchase agreements) to deposits exceeds 25%. The maximum adjustment for secured liabilities for institutions in Risk Categories I, II, III and IV would be 8, 11, 16 and 22.5 basis points, respectively, provided that the adjustment may not increase an institution s base assessment rate by more than 50%.

The FDIC imposed a special assessment equal to five basis points of assets less Tier 1 capital as of June 30, 2009, payable on September 30, 2009, and reserved the right to impose additional special assessments. In November, 2009, instead of imposing additional special assessments, the FDIC amended the assessment regulations to require all insured depository institutions to prepay their estimated risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 on December 30, 2009. For purposes of estimating the future assessments, each institution s base assessment rate in effect on September 30, 2009 was used, assuming a 5% annual growth rate in the assessment base and a 3 basis point increase in the assessment rate in 2011 and 2012. The prepaid assessment will be applied against actual quarterly assessments until exhausted. Any funds remaining after June 30, 2013 will be returned to the institution. If the prepayment would impair an institution s liquidity or otherwise create significant hardship, it may apply for an exemption. Requiring this prepaid assessment does not preclude the FDIC from changing assessment rates or from further revising the risk-based assessment system.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation (FICO), an agency of the Federal government established to recapitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment rates, which are determined quarterly, averaged .0104% of insured deposits on an annualized basis in fiscal year 2009. These assessments will continue until the FICO bonds mature in 2017.

Table of Contents

Regulatory Capital Requirements. The FDIC has promulgated capital adequacy requirements for state-chartered banks that, like the Bank, are not members of the Federal Reserve System. At December 31, 2009, the Bank exceeded all regulatory capital requirements and was classified as well capitalized.

The FDIC s capital regulations establish a minimum 3% Tier 1 leverage capital requirement for the most highly rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier 1 leverage ratio for such other banks to 4% to 5% or more. Under the FDIC s regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Tier 1 or core capital is defined as the sum of common stockholders equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain mortgage and non-mortgage servicing assets and purchased credit card relationships.

The FDIC s regulations also require that state-chartered, non-member banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital (which is defined as Tier 1 capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item. The components of Tier 1 capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity securities and a bank s allowance for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier 1 capital.

A bank that has less than the minimum leverage capital requirement is subject to various capital plan and activities restriction requirements. The FDIC s regulations also provide that any insured depository institution with a ratio of Tier 1 capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the Federal Deposit Insurance Act and could be subject to termination of deposit insurance.

The Bank is also subject to minimum capital requirements imposed by the Pennsylvania Department of Banking on Pennsylvania-chartered depository institutions. Under the Pennsylvania Department of Banking s capital regulations, a Pennsylvania bank or savings bank must maintain a minimum leverage ratio of Tier 1 capital (as defined under the FDIC s capital regulations) to total assets of 4%. In addition, the Pennsylvania Department of Banking has the supervisory discretion to require a higher leverage ratio for any institutions based on the institution s substandard performance in any of a number of areas. The Bank was in compliance with both the FDIC and the Pennsylvania Department of Banking capital requirements as of December 31, 2009.

Affiliate Transaction Restrictions. Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Such transactions between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of a bank subsidiary s capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary s capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that all transactions between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank system. It makes loans to

Table of Contents

members (*i.e.*, advances) in accordance with policies and procedures established by the board of trustees of the Federal Home Loan Bank.

As a member, it is required to purchase and maintain stock in the Federal Home Loan Bank of Pittsburgh in an amount equal to 4% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year and 4.75% of its outstanding advances from the Federal Home Loan Bank. At December 31, 2009, the Bank was in compliance with this requirement.

Federal Reserve System. The Federal Reserve requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking and NOW accounts) and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy the liquidity requirements that are imposed by the Department. At December 31, 2009, the Bank met its reserve requirements.

Loans to One Borrower. Under Pennsylvania law, commercial banks have, subject to certain exemptions, lending limits to one borrower in an amount equal to 15% of the institution s capital accounts. Pursuant to the national bank parity provisions of the Pennsylvania Banking Code, the Bank may also lend up to the maximum amounts permissible for national banks, which are allowed to make loans to one borrower of up to 25% of capital and surplus in certain circumstances. An institution s capital account includes the aggregate of all capital, surplus, undivided profits, capital securities and general reserves for loan losses. As of December 31, 2009, the Bank s loans to one borrower limitation was $7.6 million and the Bank was in compliance with such limitation.

Item 1A. Risk Factors

Not applicable.

Item 1B. Unresolved Staff Comments

Not applicable.

Table of Contents

Item 2. Properties

The Company operates from its main office, an operational center, and six branch offices, as described in Item 1. Business. All offices are owned except for two branch offices and the Operations Center. The leases have initial terms of between 5-20 years, with renewal options for additional years. The following table sets forth certain information regarding our offices:

	Year Opened	Owned or Leased	Book Value at 12/31/09 (in thousands)
Main Office			
820 Church Street	1985	Owned	$2,467
Honesdale, PA			
Branch Offices			
309 Main Avenue	1988	Owned	$864
Hawley, PA			
Route 371	1995	Leased (1)	$105
Damascus, PA			
Route 507	1997	Leased (2)	$400
Greentown, PA			
Route 739	2004	Owned	$1,274
Dingmans Ferry, PA			
99 Welwood Avenue (Route 6)	2008	Owned	$5,206
Hawley, PA			
Operations Center			
120 Sunrise Avenue	1998	Leased (3)	$649
Honesdale, PA			

(1) Lease expires 2015 with 15 year renewal option.
(2) Lease expires 2012 with 10 year renewal option.
(3) Lease expires 2013 with a 5 year renewal option.

Item 3. Legal Proceedings

There are various claims and lawsuits in which Registrant is periodically involved, such as claims to enforce liens, condemnation proceedings on properties in which Registrant holds security interests, claims involving the making and servicing of real property loans, and other issues incident to Registrant s business. In the opinion of management, no material loss is expected from any of the pending claims or lawsuits.

Item 4. [Reserved]

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) ***Market for Common Equity.*** The Information relating to the market for Registrant s common equity and related stockholder matters appears under Market Prices of Stock/Dividends Paid in the Registrant s Annual Report to Shareholders for the fiscal year ended December 31, 2009 (Annual Report) which is filed as

Exhibit 13 hereto and is incorporated herein by reference. During the period covered by this report, the Company did not sell any equity securities that were not registered under the Securities Act of 1933.

(b) ***Use of Proceeds.*** Not applicable.

(c) ***Issuer Purchases of Equity Securities.*** Not applicable.

Item 6. Selected Financial Data

The information contained in the table captioned Summary of Selected Financial Data in the Annual Report is incorporated herein by reference.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation

The information contained in the section captioned Management s Discussion and Analysis of Financial Condition and Results of Operations in the Annual Report is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

The information contained in the section captioned Quantitative and Qualitative Disclosures About Market Risk in the Annual Report is incorporated herein by reference. The consolidated financial statements and notes thereto presented herein have been prepared in accordance with U.S. generally accepted accounting principles, which generally require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, nearly all of the Registrant s assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on the Registrant s performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Item 8. Financial Statements and Supplementary Data

The Registrant s financial statements listed in Item 15 are incorporated herein by reference from the Annual Report.

Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Table of Contents

Item 9A(T). Controls and Procedures

(a) Disclosure Controls and Procedures. Dimeco, Inc. s management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of December 31, 2009, an evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Registrant s disclosure controls and procedures as of December 31, 2009. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Registrant s disclosure controls and procedures were effective as of that date in ensuring material information required to be disclosed in this Annual Report on 10-K was recorded, processed, summarized, and reported on a timely basis.

(b) Internal Control Over Financial Reporting. Management s Report on Internal Control Over Financial Reporting is furnished herein by reference from the Annual Report. Such report is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section. This annual report does not include an attestation report of the Company s registered pubic accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management s report in this Annual Report. There were no changes in the Registrant s internal control over financial reporting that occurred during the quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Registrant s internal control over financial reporting.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Other information required under this item is incorporated herein by reference to the Proxy Statement for the 2010 Annual Meeting of Shareholders (the Proxy Statement) contained under the sections captioned Section 16(a) Beneficial Ownership Reporting Compliance, Proposal I Election of Directors, and Corporate Governance.

The Registrant has adopted a Code of Ethics that applies to its principal executive officers, principal financial officer, principal accounting officer or controller or persons performing similar functions. A copy of the Registrant s Code of Ethics will be provided to any person without charge upon written request to Secretary, Dimeco, Inc., PO Box 509, Honesdale, PA 18431.

Item 11. Executive Compensation

The information required by this item is incorporated by reference to the Proxy Statement contained under the sections captioned Executive Compensation and Director Compensation.

Item 12. Security Ownership of Certain Beneficial Owners and Management

(a) **Security Ownership of Certain Beneficial Owners**

Information required by this item is incorporated herein by reference to the section captioned Principal Holders of Our Common Stock of the Proxy Statement.

Table of Contents

(b) **Security Ownership of Management**
Information required by this item is incorporated herein by reference to the section captioned Proposal I Election of Directors of the Proxy Statement.

(c) **Changes in Control**
Management of the Registrant knows of no arrangements, including any pledge by any person of securities of the Registrant, the operation of which may at a subsequent date result in a change in control of the Registrant.

(d) **Securities Authorized for Issuance Under Equity Compensation Plans**
Information required by this item is incorporated herein by reference to the section captioned Equity Compensation Plan Information of the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated herein by reference to the section captioned Related Party Transactions and Corporate Governance in the Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information called for by this item is incorporated herein by reference to the section entitled Ratification of Appointment of Independent Auditors in the Proxy Statement.

Table of Contents

Part IV

Item 15. Exhibits, Financial Statement Schedules

(a) The following documents are filed as a part of this report:

(1) The consolidated balance sheet of Dimeco, Inc. as of December 31, 2009 and 2008 and the related consolidated statements of income, changes in stockholders equity and cash flows for each of the three years in the period ended December 31, 2009, together with the related notes and the independent auditors report of S.R. Snodgrass, A.C., independent certified public accountants for the three years ended December 31, 2009.

(2) Schedules omitted as they are not applicable.

(3) The following exhibits are included in this Report or incorporated herein by reference:

3(i)	Articles of Incorporation of Dimeco, Inc., as amended *
3(ii)	Amended Bylaws of Dimeco, Inc.
10.1	2000 Independent Directors Stock Option Plan**
10.2	2000 Stock Incentive Plan***
10.3	Form of Salary Continuation Plan for Executive Officers, as amended and restated****
10.4	Change in Control Severance Agreement with Gary C. Beilman*****
10.5	Change in Control Severance Agreement with Maureen H. Beilman*****
10.6	Change in Control Severance Agreement with Peter Bochnovich*****
13	Annual Report to Shareholders for the fiscal year ended December 31, 2009
14	Code of Ethics for Principal Executive Officers and Senior Financial Officers ******
21	Subsidiaries of the Registrant
23	Consent of S.R. Snodgrass, A.C.
31.1	Rule 13a-14(a)/15d-14(a) Certificate
31.2	Rule 13a-14(a)/15d-14(a) Certificate
32	Section 1350 Certification

Management contract or compensatory plan or arrangement.

*	Incorporated by reference to the identically numbered exhibit to the Registrant s Form 10-K for the fiscal year ended December 31, 2004.
**	Incorporated by reference to Exhibit 99.1 to the Registration Statement on Form S-8 (File No. 333-69416) filed with the Commission on September 14, 2002.
***	Incorporated by reference to Exhibit 99.1 to the Registration Statement on Form S-8 (File No. 333-69420) filed with the Commission on September 14, 2002.
****	Incorporated by reference to identically numbered exhibit to the Registrant s Form 8-K filed July 2, 2007.
*****	Incorporated by reference to identically numbered exhibit to the Registrant s Form 10-K for the fiscal year ended December 31, 2006.
******	Incorporated by reference to the identically numbered exhibit to the Registrant s Form 10-KSB for the fiscal year ended December 31, 2003.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

DIMECO, INC.

Dated: March 18, 2010	By: /s/ Gary C. Beilman Gary C. Beilman President and Chief Executive Officer (Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on March 18, 2010 on behalf of the Registrant and in the capacities indicated.

/s/ William E. Schwarz William E. Schwarz Chairman of the Board and Director	/s/ Gary C. Beilman Gary C. Beilman President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ Maureen H. Beilman Maureen H. Beilman Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	/s/ Robert E. Genirs Robert E. Genirs Director
/s/ Barbara Jean Genzlinger Barbara Jean Genzlinger Director	/s/ John S. Kiesendahl John S. Kiesendahl Vice Chairman of the Board of Directors
/s/ Thomas A. Peifer Thomas A. Peifer Director	/s/ Henry M. Skier Henry M. Skier Director
/s/ John F. Spall John F. Spall	

Director