

RURBAN FINANCIAL CORP
Form 10-K
March 20, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008
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 0-13507

RURBAN FINANCIAL CORP.
(Exact name of Registrant as specified in its charter)

Ohio
(State or other jurisdiction of
incorporation or organization)

34-1395608
(I.R.S. Employer
Identification No.)

401 Clinton Street, Defiance, Ohio
(Address of principal executive offices)

43512
(Zip Code)

Registrant's telephone number, including area code:

(419) 783-8950

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Shares, Without Par Value

Name of each exchange on which registered
The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act:

Not Applicable

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

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

Indicate by check mark 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 Accelerate Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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

The aggregate market value of the common shares of the registrant held by non-affiliates computed by reference to the price at which the common shares were last sold as of the last business day of the registrant's most recently completed second fiscal quarter was \$43,311,868.

The number of common shares of the registrant outstanding at March 11, 2009 was 4,873,351.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on April 16, 2009 are incorporated by reference into Part III of this Annual Report on Form 10-K.

RURBAN FINANCIAL CORP.

2008 ANNUAL REPORT ON FORM 10-K

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PART I

Item 1. Business.

General

Rurban Financial Corp., an Ohio corporation (the “Company”), is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). The Company was organized in 1983. The executive offices of the Company are located at 401 Clinton Street, Defiance, Ohio 43512.

Through its direct and indirect subsidiaries, The State Bank and Trust Company (“State Bank”), RFCBC, Inc. (“RFCBC”), RDSI Banking Systems (“RDSI”), Rurban Mortgage Company (“RMC”), Rurban Statutory Trust I (“RST I”), and Rurban Statutory Trust II (“RST II”), the Company is engaged in a variety of activities, including commercial banking, data and item processing, and trust and financial services, as explained in more detail below. State Bank owns all of the outstanding stock of Rurban Mortgage Company (“RMC”).

General Description of Holding Company Group

State Bank

State Bank is an Ohio state-chartered bank. State Bank presently operates five branch offices in Defiance County, Ohio (four in the city of Defiance and one in Ney), two branch offices in adjacent Paulding County, Ohio (one each in Paulding and Oakwood), three branch offices in Fulton County, Ohio (one each in Delta, Lyons and Wauseon), two branch offices in Allen County, Ohio (two in the city of Lima), three branch offices in Wood County, Ohio (one each in Luckey, Walbridge and Perrysburg), five branch offices in Williams County, Ohio (two in the city of Montpelier and one each in Bryan, Pioneer, and West Unity) and one office in Lucas County, Ohio (Sylvania), a Commercial and Mortgage Loan Production Office in Franklin County, and one branch office in Allen County, Indiana. At December 31, 2008, State Bank had 197 full-time equivalent employees.

State Bank offers a full range of commercial banking services, including checking accounts, passbook savings, money market accounts and time certificates of deposit; automatic teller machines; commercial, consumer, agricultural and residential mortgage loans (including “Home Value Equity” line of credit loans); personal and corporate trust services; commercial leasing; bank credit card services; safe deposit box rentals; Internet and telephone banking and other personalized banking services.

Reliance Financial Services (“RFS”) is the trust and financial services division of State Bank. RFS offers various trust and financial services, including asset management services for individuals and corporate employee benefit plans, as well as brokerage services through Raymond James Financial, Inc.

RMC

RMC is an Ohio corporation and wholly-owned subsidiary of State Bank. RMC is a mortgage company; however, it ceased originating mortgage loans in the second quarter of 2000 and is presently inactive.

At December 31, 2008, RMC had no employees.

RFCBC

RFCBC is an Ohio corporation and wholly-owned subsidiary of the Company that was incorporated in August 2004. RFCBC operates as a loan subsidiary in servicing and working out problem loans. At December 31, 2008, RFCBC had no employees.

RDSI

RDSI has been in operation since 1964 and became an Ohio corporation in June 1976. RDSI has one operating location in Defiance, Ohio. In September 2006, RDSI acquired Diverse Computer Marketers, Inc. ("DCM") which was merged into RDSI effective December 31, 2007 and now operates as a division of RDSI doing business as "DCM". DCM has one operating location in Lansing, Michigan.

RDSI delivers software systems to the banking industry which provide a broad range of data processing and item processing services in an outsourced environment utilizing Information Technology Inc. (ITI) software.

At December 31, 2008, RDSI had 94 full-time equivalent employees.

RST I

RST I is a trust that was organized in August 2000. In September 2000, RST I closed a pooled private offering of 10,000 Capital Securities with a liquidation amount of \$1,000 per security. The proceeds of the offering were loaned to the Company in exchange for junior subordinated debentures with terms similar to the Capital Securities. The sole assets of RST I are the junior subordinated debentures and the back-up obligations, which in the aggregate, constitute a full and unconditional guarantee by the Company of the obligations of RST I under the Capital Securities.

RST II

RST II is a trust that was organized in August 2005. In September 2005, RST II closed a pooled private offering of 10,000 Capital Securities with a liquidation amount of \$1,000 per security. The proceeds of the offering were loaned to the Company in exchange for junior subordinated debentures with terms similar to the Capital Securities. The sole assets of RST II are the junior subordinated debentures and the back-up obligations, which in the aggregate, constitute a full and unconditional guarantee by the Company of the obligations of RST II under the Capital Securities.

Recent Developments

During the fourth quarter of 2008, Rurban acquired NBM Bancorp, Inc. and its subsidiary the National Bank of Montpelier, through the merger of NBM Bancorp, Inc. into the Company. Upon closing of the acquisition, the National Bank of Montpelier was merged into State Bank. The merger has allowed the State Bank to expand its footprint into Williams County, Ohio and now has five full service branches in Williams County. The acquisition is expected to be immediately accretive to earnings.

In addition to the Loan Production Office in Columbus, Ohio, which opened in December, 2007, State Bank added a mortgage origination group to the Columbus region during the fourth quarter of 2008.

On April 12, 2007, Rurban initiated a stock repurchase program, authorizing the repurchase of up to 250,000 shares, or approximately 5%, of the Company's outstanding shares. As of the end of 2008, Rurban had repurchased a total of 145,981 shares at an average cost of \$11.05 per share.

Rurban increased its dividend to shareholders from \$0.26 per share in 2007 to \$0.34 per share in 2008.

5.

Competition

State Bank experiences significant competition in attracting depositors and borrowers. Competition in lending activities comes principally from other commercial banks in the lending areas of State Bank, and, to a lesser extent, from savings associations, insurance companies, governmental agencies, credit unions, securities brokerage firms and pension funds. The primary factors in competing for loans are interest rates charged and overall banking services.

State Bank's competition for deposits comes from other commercial banks, savings associations, money market funds and credit unions as well as from insurance companies and securities brokerage firms. The primary factors in competing for deposits are interest rates paid on deposits, account liquidity and convenience of office location.

RDSI and DCM also operate in a highly competitive field. RDSI and DCM compete primarily on the basis of the value and quality of their data processing and item processing services and service and convenience to their customers.

RFS operates in the highly competitive trust services field and its competition consists primarily of other Ohio bank trust departments.

Supervision and Regulation

The following is a summary of certain statutes and regulations affecting the Company and its subsidiaries. The summary is qualified in its entirety by reference to such statutes and regulations.

Regulation of Bank Holding Companies and Their Subsidiaries in General

The Company is a bank holding company and, as such, is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "Bank Holding Company Act"). The Bank Holding Company Act requires the prior approval of the Federal Reserve Board before a bank holding company may acquire direct or indirect ownership or control of more than 5% of the voting shares of any bank (unless the bank is already majority owned by the bank holding company), acquire all or substantially all of the assets of another bank or bank holding company, or merge or consolidate with any other bank holding company. Subject to certain exceptions, the Bank Holding Company Act also prohibits a bank holding company from acquiring 5% of the voting shares of any company that is not a bank and from engaging in any business other than banking or managing or controlling banks. The primary exception to this prohibition allows a bank holding company to own shares in any company the activities of which the Federal Reserve Board had determined, as of November 19, 1999, to be so closely related to banking as to be a proper incident thereto.

The Company is subject to the reporting requirements of, and examination and regulation by, the Federal Reserve Board. The Federal Reserve Board has extensive enforcement authority over bank holding companies, including, without limitation, the ability to assess civil money penalties, issue cease and desist or removal orders, and require that a bank holding company divest subsidiaries, including its subsidiary banks. In general, the Federal Reserve Board may initiate enforcement actions for violations of laws and regulations and unsafe or unsound practices. A bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with extensions of credit and/or the provision of other property or services to a customer by the bank holding company or its subsidiaries.

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to its subsidiary bank and to commit resources to support its subsidiary bank. Pursuant to this policy, the Federal Reserve Board may require a bank holding company to contribute additional capital to an undercapitalized subsidiary bank.

6.

State Bank is a member of the Federal Reserve System, so its primary federal regulator is the Federal Reserve Board. The Federal Reserve Board issues regulations governing the operations of State Bank and examines State Bank. The Federal Reserve Board may initiate enforcement action against insured depository institutions and affiliated persons for violations of laws and regulations and for engaging in unsafe or unsound practices. The deposits of State Bank are insured by the Federal Deposit Insurance Corporation (“FDIC”) and are subject to the applicable provisions of the Federal Deposit Insurance Act.

As a state-chartered bank incorporated under Ohio law, State Bank is also subject to regulation, supervision and examination by the Ohio Division of Financial Institutions (the “Division”). The Division may initiate supervisory measures or formal enforcement actions against Ohio state-chartered banks and, if the grounds provided by law exist, the Division may place an Ohio bank in conservatorship or receivership. Whenever the Division considers it necessary or appropriate, the Division may also examine the affairs of any holding company or any affiliate or subsidiary of an Ohio bank.

Various requirements and restrictions under the laws of the United States and the State of Ohio affect the operations of State Bank, including requirements to maintain reserves against deposits, restrictions on the nature and amount of loans which may be made and the interest that may be charged thereon, restrictions relating to investments and other activities, limitations on credit exposure to correspondent banks, limitations on activities based on capital and surplus, limitations on payment of dividends, and limitations on branching. Various consumer laws and regulations also affect the operations of State Bank.

The Federal Home Loan Banks (“FHLBs”) provide credit to their members in the form of advances. As a member of the FHLB of Cincinnati, State Bank must maintain certain minimum investments in the capital stock of the FHLB of Cincinnati. State Bank was in compliance with these requirements at December 31, 2008.

Dividends

The ability of the Company to obtain funds for the payment of dividends and for other cash requirements is largely dependent on the amount of dividends that may be declared by its subsidiaries. State Bank may not pay dividends to the Company if, after paying such dividends, it would fail to meet the required minimum levels under the risk-based capital guidelines and the minimum leverage ratio requirements. State Bank must obtain the approval of the Federal Reserve Board and the Division if a dividend in any year would cause the total dividends for that year to exceed the sum of the current year’s net profits and the retained net profits for the preceding two years, less required transfers to surplus. Payment of dividends by State Bank may be restricted at any time at the discretion of the regulatory authorities, if they deem such dividends to constitute an unsafe and/or unsound banking practice. These provisions could have the effect of limiting the Company’s ability to pay dividends on its outstanding common shares. Moreover, the Federal Reserve Board expects the Company to serve as a source of strength to its subsidiary banks, which may require it to retain capital for further investment in the subsidiary, rather than for dividends to shareholders of the Company.

Transactions with Affiliates, Directors, Executive Officers and Shareholders

Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Board Regulation W restrict transactions by banks and their subsidiaries with their affiliates. Any company or entity that controls, is controlled by or is under common control with a bank is generally considered to be an affiliate of the bank.

In general, Sections 23A and 23B and Regulation W:

- limit the extent to which a bank or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of the bank’s capital stock and surplus (i.e., tangible capital);
- limit the extent to which a bank or its subsidiaries may engage in “covered transactions” with all affiliates to 20% of the bank’s capital stock and surplus; and
- require that all covered transactions be on terms substantially the same, or at least as favorable to the bank or subsidiary, as those provided to non-affiliates.

The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and similar types of transactions.

A bank’s authority to extend credit to executive officers, directors and greater than 10% shareholders, as well as entities such persons control, is subject to Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder by the Federal Reserve Board. Among other things, these loans must be made on terms substantially the same as those offered to unaffiliated individuals (or be made under a benefit or compensation program and on terms widely available to employees) and must not involve a greater than normal risk of repayment. In addition, the amount of loans a bank may make to these persons is based, in part, on the bank’s capital position, and specified approval procedures must be followed in making loans which exceed specified amounts.

Regulatory Capital

The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies and for state member banks, such as State Bank. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk weighted assets by assigning assets and off-balance-sheet items to broad risk categories. The minimum ratio of total capital to risk weighted assets (including certain off-balance-sheet items, such as standby letters of credit) is 8%. Of that 8%, 4% is to be comprised of common shareholders’ equity (including retained earnings but excluding treasury stock), non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less goodwill and certain other intangible assets (“Tier 1 capital”). The remainder of total risk-based capital (“Tier 2 capital”) may consist, among other things, of certain amounts of mandatory convertible debt securities, subordinated debt, preferred stock not qualifying as Tier 1 capital, an allowance for loan and lease losses and net unrealized gains, after applicable taxes, on available-for-sale equity securities with readily determinable fair values, all subject to limitations established by the guidelines. The Federal Reserve Board also imposes a minimum leverage ratio (Tier 1 capital to total assets) of 3% for bank holding companies and state member banks that meet certain specified conditions, including no operational, financial or supervisory deficiencies, and including having the highest regulatory rating. The minimum leverage ratio is 1%-2% higher for other bank holding companies and state member banks based on their particular circumstances and risk profiles and those experiencing or anticipating significant growth. Failure to meet applicable capital guidelines could subject a banking institution to a variety of enforcement remedies available to federal and state regulatory authorities, including the termination of deposit insurance by the FDIC.

The federal banking regulators have established regulations governing prompt corrective action to resolve capital deficient banks. The regulations establish five capital level categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under these regulations, institutions which become undercapitalized can become subject to mandatory regulatory scrutiny and limitations, which increase as capital decreases. Such institutions may also be required to file capital plans with their primary federal regulator,

and their holding companies may be required to guarantee the capital shortfall up to 5% of the assets of the capital deficient institution at the time it becomes undercapitalized.

8.

The Company's management believes that the Company and State Bank, at year end 2008, satisfied all requirements to be deemed "well capitalized".

Federal Deposit Insurance Corporation ("FDIC")

The FDIC is an independent federal agency which insures the deposits of federally-insured banks and savings associations up to certain prescribed limits and safeguards the safety and soundness of financial institutions. State Bank's deposits are subject to the deposit insurance assessments of the FDIC. Under the FDIC's deposit insurance assessment system, the assessment rate for any insured institution may vary according to regulatory capital levels of the institution and other factors such as supervisory evaluations.

The FDIC is authorized to prohibit any insured institution from engaging in any activity that poses a serious threat to the insurance fund and may initiate enforcement actions against a bank, after first giving the institution's primary regulatory authority an opportunity to take such action. The FDIC may also terminate the deposit insurance of any institution that has engaged in or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, order or condition imposed by the FDIC.

Monetary Policy and Economic Conditions

The commercial banking business is affected not only by general economic conditions, but also by the policies of various governmental regulatory authorities, including the Federal Reserve Board. The Federal Reserve Board regulates money and credit conditions and interest rates in order to influence general economic conditions primarily through open market operations in U.S. Government securities, changes in the discount rate on bank borrowings and changes in reserve requirements against bank deposits. These policies and regulations significantly affect the overall growth and distribution of bank loans, investments and deposits, and the interest rates charged on loans as well as the interest rates paid on deposits and accounts.

Holding Company Activities

In November 1999, the Gramm-Leach-Bliley Act was enacted, permitting bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized under the Federal Deposit Insurance Corporation Act of 1991 prompt corrective action provisions, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act by filing a declaration that the bank holding company wishes to become a financial holding company. No regulatory approval is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

The Gramm-Leach-Bliley Act defines "financial in nature" to include: (i) securities underwriting, dealing and market making; (ii) sponsoring mutual funds and investment companies; (iii) insurance underwriting and agency; (iv) merchant banking activities; and (v) activities that the Federal Reserve Board has determined to be closely related to banking.

The Company has not elected to become a financial holding company. The Company intends to continue to analyze the proposed advantages and disadvantages of becoming a financial holding company on a periodic basis.

SEC Regulation

The Company is subject to the jurisdiction of the Securities and Exchange Commission (the “SEC”) and certain state securities authorities relating to the offering and sale of its securities. The Company is subject to the registration, reporting and other regulatory requirements of the Securities Act of 1933, as amended, and the Exchange Act and the rules adopted by the SEC under those acts. The Company’s common shares are listed on The NASDAQ Global Market under the symbol “RBNF”, and the Company is subject to the rules and regulations of The NASDAQ Stock Market, Inc. (“NASDAQ”) applicable to listed companies.

Sarbanes-Oxley Act of 2002 and Related Rules Affecting Corporate Governance

As mandated by the Sarbanes-Oxley Act of 2002, the SEC has adopted rules and regulations governing, among other issues, corporate governance, auditing and accounting and executive compensation, and enhanced the timely disclosure of corporate information. The SEC has also approved corporate governance rules promulgated by NASDAQ. The Board of Directors of the Company has taken a series of actions to comply with the new NASDAQ and SEC rules and to further strengthen its corporate governance practices. The Company has adopted and implemented a Code of Conduct and Ethics and a copy of that policy can be found on the Company’s website at www.rurbanfinancial.net by first clicking “Corporate Governance” and then “Code of Conduct”. The Company has also adopted charters of the Audit Committee, the Compensation Committee and the Executive Governance and Nominating Committee, which charters are available on the Company’s website at www.rurbanfinancial.net by first clicking “Corporate Governance” and then “Supplementary Info”.

Patriot Act

The Uniting and Strengthening of America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “Patriot Act”) gives the United States Government greater powers over financial institutions to combat money laundering and terrorist access to the financial system in our country. The Patriot Act requires regulated financial institutions to establish programs for obtaining identifying information from customers seeking to open new accounts and establish enhanced due diligence policies, procedures and controls designed to detect and report suspicious activity.

Effect of Environmental Regulation

Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had a material effect upon the capital expenditures, earnings or competitive position of the Company and its subsidiaries. The Company believes that the nature of the operations of its subsidiaries has little, if any, environmental impact. The Company, therefore, anticipates no material capital expenditures for environmental control facilities for its current fiscal year or for the foreseeable future. The Company’s subsidiaries may be required to make capital expenditures for environmental control facilities related to properties which they may acquire through foreclosure proceedings in the future; however, the amount of such capital expenditures, if any, is not currently determinable.

Available Information

The Company will provide, without charge, to each shareholder, upon written request to Rurban Financial Corp., P.O. Box 467, Defiance, Ohio 43512, Attention: Valda Colbart, Investor Relations Department, a copy of the Company’s Annual Report on Form 10-K, including the Financial Statements and Schedules thereto required to be filed with the SEC, for the Company’s most recent fiscal year.

10.

Statistical Financial Information Regarding the Company

The following schedules and tables analyze certain elements of the consolidated balance sheets and statements of income of the Company and its subsidiaries, as required under Exchange Act Industry Guide 3 promulgated by the SEC, and should be read in conjunction with the narrative analysis presented in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements of the Company and its subsidiaries included at pages F-1 through F-53 of this Annual Report on Form 10-K.

11.

I. DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL

The following are the condensed average balance sheets for the years ending December 31 and the interest earned or paid on such amounts and the average interest rate thereon:

(\$in thousands)	2008			2007			2006		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets:									
Securities									
Taxable	\$ 84,301	\$ 4,293	5.09%	\$ 84,389	\$ 4,284	5.08%	\$ 119,394	\$ 5,212	4.37%
Non-taxable (1)	17,193	1,040	6.05%	16,405	978	5.96%	14,497	848	5.85%
Federal funds sold	4,985	134	2.68%	5,072	225	4.44%	2,259	177	7.84%
Loans, net (2)(3)	401,770	27,601	6.87%	381,449	27,893	7.31%	354,400	25,055	7.07%
Total earning assets	508,250	33,067	6.51%	487,315	33,380	6.85%	490,550	31,292	6.38%
Cash and due from banks	9,570			11,605			11,827		
Allowance for loan losses	(4,182)			(3,843)			(4,495)		
Premises and equipment	21,145			19,788			19,387		
Other assets	40,708			41,707			36,825		
Total assets	\$ 575,491			\$ 556,572			\$ 554,094		
Liabilities									
Deposits									
Savings and interest-bearing									
demand deposits	\$ 158,765	\$ 1,748	1.10%	\$ 138,314	\$ 2,714	1.96%	\$ 127,179	\$ 1,656	1.30%
Time deposits	213,891	\$ 8,319	3.89%	231,605	10,882	4.70%	228,193	9,366	4.10%
Short-term									
borrowings	44,891	1,874	4.18%	36,588	1,653	4.52%	21,965	946	4.30%
Advances from									
FHLB	33,377	1,508	4.52%	19,329	1,037	5.36%	41,353	2,106	5.09%
Junior subordinated									
debentures	20,620	1,692	8.20%	20,620	1,809	8.77%	20,620	1,787	8.67%
Other borrowed									
funds	-	-	N/A	1,641	127	7.74%	939	75	7.98%
Total									
interest-bearing liabilities	471,544	15,141	3.21%	448,097	18,222	4.07%	440,249	15,936	3.62%
Demand deposits	35,386			42,848			47,176		
Other liabilities	8,597			7,682			12,168		
Total liabilities	515,527			498,627			499,593		
Shareholders'									
equity	59,964			57,945			54,501		

Total liabilities and shareholders' equity	\$ 575,491	\$ 556,572	\$ 554,094
Net interest income (tax equivalent basis)	\$ 17,926	\$ 15,158	\$ 15,356
Net interest income as a percent of average interest-earning assets	3.53%	3.11%	3.13%

(1) Interest is computed on a tax equivalent basis using a 34% statutory tax rate. The tax equivalent adjustment was \$354,000, \$333,000 and \$288,000 in 2008, 2007 and 2006, respectively.

(2) Nonaccruing loans and loans held for sale are included in the average balances.

(3) Interest is computed on a tax equivalent basis using a 34% statutory tax rate. The tax equivalent adjustment was \$44,000, \$38,000 and \$33,000 in 2008, 2007 and 2006 respectively.

12.

I. DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Continued)

The following tables set forth the effect of volume and rate changes on interest income and expense for the periods indicated. For purposes of these tables, changes in interest due to volume and rate were determined as follows:

Volume Variance - change in volume multiplied by the previous year's rate.

Rate Variance - change in rate multiplied by the previous year's volume.

Rate/Volume Variance - change in volume multiplied by the change in rate. This variance was allocated to volume variance and rate variance in proportion to the relationship of the absolute dollar amount of the change in each.

Interest on non-taxable securities has been adjusted to a fully tax equivalent basis using a statutory tax rate of 34% in 2008, 2007 and 2006.

	Total Variance 2008/2007	Variance Attributable To Volume	Rate
	(dollars in thousands)		
Interest income			
Securities			
Taxable	\$ 11	\$ (4)	\$ 15
Non-taxable	62	48	14
Federal funds sold	(94)	(4)	(90)
Loans, net of unearned income and deferred loan fees	(292)	1,444	(1,736)
	(313)	1,484	(1,797)
Interest expense			
Deposits			
Savings and interest-bearing demand deposits	(966)	357	(1,323)
Time deposits	(2,563)	(788)	(1,775)
Short-term borrowings	221	354	(133)
Advances from FHLB	471	656	(185)
Trust preferred securities	(117)	-	(117)
Other borrowed funds	(127)	(127)	-
	\$ (3,081)	\$ 452	\$ (3,533)
Net interest income	\$ 2,768	\$ 1,032	\$ 1,736

I. DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Continued)

	Total Variance 2007/2006	Variance Attributable To Volume	Rate
	(dollars in thousands)		
Interest income			
Securities			
Taxable	\$ (928)	\$ (1,688)	\$ 760
Non-taxable	130	113	17
Federal funds sold	48	149	(101)
Loans, net of unearned income and deferred loan fees	2,838	1,958	880
	2,088	532	1,556
Interest expense			
Deposits			
Savings and interest-bearing demand deposits	1,058	156	902
Time deposits	1,516	142	1,374
Short-term borrowings	707	659	48
Advances from FHLB	(1,069)	(1,176)	107
Trust preferred securities	22	-	22
Other borrowed funds	52	54	(2)
	\$ 2,286	\$ (165)	\$ 2,451
Net interest income	\$ (198)	\$ 697	\$ (895)

14.

II. INVESTMENT PORTFOLIO

A. The book value of securities available for sale as of December 31 in each of the following years are summarized as follows:

Book Value of Securities

	2008	2007	2006
	(dollars in thousands)		
U.S. Treasury and government agencies	\$ 15,184	\$ 40,189	\$ 58,123
State and political subdivisions	22,801	16,019	15,465
Mortgage-backed securities	64,546	36,380	28,770
Other securities	52	50	81
Marketable equity securities	23	23	23