

PUBLIC DISCLOSURE

October 23, 2006

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**FIRST STATE BANK
RSSD No. 284408**

**3 MAIN STREET
CANISTEO, NY 14823**

FEDERAL RESERVE BANK OF NEW YORK

**33 LIBERTY STREET
NEW YORK, N.Y. 10045**

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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INSTITUTION'S CRA RATING: First State Bank is rated “**SATISFACTORY.**”

The satisfactory performance of First State Bank (“FSB”) with regard to the Community Reinvestment Act (“CRA”) is based on the following performance criteria:

- The bank’s loan-to-deposit ratio was reasonable.
- A majority of loans were originated in the bank’s assessment area.
- The distribution of loans to borrowers of different income levels, including low- and moderate-income (“LMI”) individuals, and to businesses of different sizes showed excellent distribution.
- The geographic distribution of loans in the assessment area was reasonable.

DESCRIPTION OF INSTITUTION

FSB, established in 1898, is a small retail community bank located in Canisteo, New York in Steuben County with total assets of \$44 million as of June 30, 2006. FSB has two branches. The main branch is located in Canisteo, and the other branch is approximately four miles away in Hornell, New York.

FSB extends the following types of credit: residential mortgage loans for one- to four dwelling units, residential mortgages for units of five or more dwellings, housing rehabilitation loans, home improvement loans, small business loans, home equity loans, consumer loans, and commercial loans.

In August 2005, FSB was purchased by Citizens and Northern Corporation of Wellsboro, Pennsylvania.

There are no financial or legal impediments preventing FSB from servicing the credit needs of the consumers and small businesses in its assessment area. FSB received a satisfactory rating at the prior CRA examination, dated October 21, 2002, conducted by the Federal Reserve Bank of New York.

DESCRIPTION OF THE BANK’S ASSESSMENT AREA

The assessment area is located in Non-Metropolitan Statistical Area (“MSA”) Steuben County, New York, consisting of 9 census tracts and does not arbitrarily exclude any LMI geography. One of the census tracts is defined as moderate-income while the remaining eight are middle-income. All eight middle-income census tracts according to the new FFIEC procedures are considered distressed Non-MSA middle-income census tracts due to population losses. There are no low-income census tracts in the assessment area.

A map illustrating FSB’s assessment area is on page BB11.

SCOPE OF EXAMINATION

FSB was examined using the FFIEC small bank examination procedures. The examination covered the period July 1, 2002 to June 30, 2006. For the performance criteria related to lending in the assessment area, borrower income distribution and geographic distribution, a sample of 285 loans originated between January 1, 2004, and June 30, 2006, were analyzed. The sample includes 164 consumer loans, 69 HMDA-related loans and 52 small business loans. Loans for analysis were selected using the Board of Governors' sampling procedures and data was verified as part of the onsite exam.

Examiners also conducted interviews with two community development organizations in order to gain an understanding of local credit needs. One community contact focused on economic development while the other promoted affordable housing and home ownership counseling.

PERFORMANCE CONTEXT

The following demographic and economic information was obtained from publicly available sources that include U.S. Department of Commerce's Bureau of Census, 2000, the U.S. Department of Labor, and the U.S. Department of Housing and Urban Development ("HUD").

Demographic Characteristics

The assessment area contains 9 census tracts, which include one moderate-income tract, and eight middle-income tracts. According to the 2000 Census, the population in the assessment area is small and totals 30,981 or 31% of Steuben County's population of 98,726. 9% of the population resides in the moderate-income census tract.

Income Characteristics

The 2006 HUD-adjusted median family income for Steuben County, NY is \$49,200, compared to \$61,500 for New York State.

Housing Characteristics

The assessment area contains 14,242 housing units, of which 61% are owner-occupied, 22% are rental, and 17% are vacant. Of the total owner-occupied units, 8% were located in LMI census tracts. Demographic information from the 2000 census estimated that the median age of the housing stock throughout the MSA to be 55 years.

Median Home Sales Prices		
Area	2005	3 rd Qtr. 2006
Steuben County.	\$79,750	\$88,250

Source: New York Association of Realtors

As shown in the table at left, the median sales price of existing single-family homes in Steuben County totaled \$79,750 as of December 2005 and increased to \$88,250 in the third quarter of 2006.

Housing therefore is affordable in comparison to other parts of New York State. Community contacts however pointed out that down payment and closing cost assistance is still needed and that while housing is generally affordable it is not affordable for some individuals, particularly of low-income. The contacts also pointed out that considering the age of the housing stock there is a need for home improvement and home rehabilitation loans since repair costs also limit the ability of low-income individuals to purchase and maintain a home.

Labor, Employment and Economic Characteristics

Despite Steuben County’s rural character, manufacturing is the most important industry in the county with 25% of the workforce. Retail trade is second with 10% of the workforce. Steuben County’s major employer is Corning Inc., the glass products and fiber optics manufacturer. Other major employers include Dresser-Rand a manufacturer of gas compressors and Alstom a global leader in power generation and rail infrastructure. During the examination period, average annual unemployment rates decreased slightly from 6.4% in 2004 to 5.8% in 2005. Trends in 2006 indicate further improvement as average unemployment reached 5.3%.

Exhibit 1 provides additional assessment area demographics.

Exhibit 1 Assessment Area Demographics								
Income Categories	Tract Distribution		Families by Tract Income		Families < Poverty Level as % of Families by Tract		Families by Family Income	
	#	%	#	%	#	%	#	%
Low-income	0	0.0	0	0.0	0	0.0	1,751	21.6
Moderate-income	1	11.1	676	8.3	146	21.6	1,607	19.8
Middle-income	8	88.9	7,448	91.7	813	10.9	1,934	23.8
Upper-income	0	0.0	0	0.0	0	0.0	2,832	34.9
Unknown-income	0	0.0	0	0.0	0	0.0	0	0.0
Total Assessment Area	9	100.0	8,124	100.0	959	11.8	8,124	100.0
	Housing Units by Tract	Housing Types by Tract						
		Owner-occupied			Rental		Vacant	
		#	%	%	#	%	#	%
Low-income	0	0	0.0	0.0	0	0.0	0	0.0
Moderate-income	1,202	557	6.4	46.3	492	40.9	153	12.7
Middle-income	13,040	8,179	93.6	62.7	2,641	20.3	2,220	17.0
Upper-income	0	0	0.0	0.0	0	0.0	0	0.0
Unknown-income	0	0	0.0	0.0	0	0.0	0	0.0
Total Assessment Area	14,242	8,736	100.0	61.3	3,133	22.0	2,373	16.7
	Total Businesses by Tract	Businesses by Tract & Revenue Size						
		Less Than or = \$1 Million		Over \$1 Million		Revenue Not Reported		
	#	%	#	%	#	%	#	%
Low-income	0	0.0	0	0.0	0	0.0	0	0.0
Moderate-income	115	14.0	101	14.2	9	16.7	5	8.8
Middle-income	707	86.0	610	85.8	45	83.3	52	91.2
Upper-income	0	0.0	0	0.0	0	0.0	0	0.0
Unknown-income	0	0.0	0	0.0	0	0.0	0	0.0
Total Assessment Area	822	100.0	711	100.0	54	100.0	57	100.0
	Percentage of Total Businesses:			86.5	6.6	6.6	6.9	6.9

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

FSB's overall satisfactory rating is based on an assessment of the bank's core performance criteria discussed below:

Loan-to-deposit Ratio

Bank's loan-to-deposit ratio was reasonable given the bank's size, financial condition, and the credit needs of its assessment area. The bank's average loan-to-deposit ratio for the sixteen quarters ending June 30, 2006, was 71%, based on information contained in its *Consolidated Report of Condition and Income*. This ratio was the same as the national peer average of 71% for similarly sized banks and above a local peer bank average ratio of 63% for seven similarly sized banks located in Western New York during the same time period.

Lending in Assessment Area

FSB originated a majority of its loans, 83%, in its assessment area. Specifically, 90% of its HMDA-related loans, 87% of its consumer loans, and 62% of its commercial loans were made within the assessment area.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

Overall FSB's record of lending to borrowers of different income levels, including LMI individuals, and businesses of different sizes was excellent given the demographics of the bank's assessment area. An analysis of the lending distribution in each loan category follows:

HMDA-related Loans

FSB's HMDA-related lending to borrowers of different income levels was excellent. Exhibit 2 indicates 26% of FSB's HMDA-related loans were to low-income borrowers, while 22% of all families in the assessment area are low-income. 26% of HMDA-related lending was also to moderate-income borrowers while 20% of all families in the assessment area are moderate-income.

Consumer Loans

Performance overall in consumer lending to low- and moderate-income borrowers was also excellent. Exhibit 2 indicates 41% of consumer loans were to low-income borrowers while 22% of all families in the assessment area are low-income. 28% of consumer loans were to moderate-income borrowers while 20% of all families in the assessment area are moderate-income.

Exhibit 2			
Distribution of Loans in Assessment Area			
By Income Level of Borrower*			
January 1, 2004 – June 30, 2006			
	HMDA-RELATED	CONSUMER	TOTAL
LOW-INCOME:			
Less than 50% of Median Income			
Number	16	56	72
Percentage	26.2%	40.9%	36.4%
Amount (\$)	\$701,000	\$270,000	\$971,000
Percentage	30.2%	32.7%	30.9%
MODERATE-INCOME:			
At least 50% & less than 80% of Median Income			
Number	16	38	54
Percentage	26.2%	27.7%	27.3%
Amount (\$)	\$495,000	\$206,000	\$701,000
Percentage	21.4%	25.0%	22.3%
MIDDLE-INCOME:			
At least 80% & less than 120% of Median Income			
Number	15	32	47
Percentage	24.6%	23.3%	23.7%
Amount (\$)	\$516,000	\$285,000	\$801,000
Percentage	22.3%	34.5%	25.5%
UPPER-INCOME:			
120% or more of Median Income			
Number	14	11	25
Percentage	23.0%	8.0%	12.6%
Amount (\$)	\$604,000	\$64,000	\$668,000
Percentage	26.1%	7.8%	21.3%

*Does not include 5 consumer loans and 1 HMDA-related loan which did not report income.

Small Business Loans

Lending to businesses with gross annual revenues (“GAR”) of \$1 million or less was excellent. 94% of FSB’s small business loans went to businesses with GAR of \$1 million or less compared to 87% of all business establishments in FSB’s assessment area having GAR of \$1 million or less.

In addition, 26 loans or 81% were in amounts of \$100,000 or less. The average loan size was \$54,500, an amount reflecting the credit needs of smaller businesses.

Exhibit 3
Distribution of Loans in Assessment Area
By Size of Business
January 1, 2004 – June 30, 2006

Small Business Lending Summary					
Number of loans to businesses	Number of loans to <u>small</u> businesses*	% of loans to <u>small</u> businesses	\$ amount of loans to businesses	\$ amount of loans to <u>small</u> businesses*	% of \$ amount of loans to <u>small</u> businesses*
32	30	94%	\$2,175,000	\$1,635,000	75%

Geographic Distribution of Loans

Overall, FSB's geographic distribution of loans was considered reasonable given the demographics of the assessment area. The distribution of lending for each loan category is analyzed as follows:

HMDA-related Loans

The geographic distribution of HMDA-related lending was reasonable. Of the 62 HMDA-related loans included in the analysis and within the bank's assessment area, 4.8% (3 loans) were located in the one moderate-income census tract compared to 6.4% of the owner-occupied housing units located in the moderate-income census tract.

Consumer Loans

The geographic distribution of consumer loans was reasonable. Of the 142 consumer loans in the bank's assessment area included in the analysis, 4.2% (6 loans) were located in the moderate-income census tract compared to 10.3% of all households residing in the moderate-income census tract.

Small Business Loans

The geographic distribution of small business loans was reasonable. While FSB did not make any small business loans in the moderate-income census tract, opportunities to do so are limited. Of the 822 business establishments in FSB's assessment area only 115 or 14% are located in the moderate-income census tract.

* Businesses with gross annual revenues of \$1 million or less.

Response to Complaints

FSB received no complaints relating to the bank's CRA performance, and no complaints have been filed with the Federal Reserve Bank of New York since the previous examination.

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

No evidence of discriminatory or other illegal credit practices, including the Equal Credit Opportunity Act and the Fair Housing Act, was identified as being inconsistent with helping to meet community credit needs.

CRA APPENDIX A

GLOSSARY

Census tract: A small subdivision of metropolitan and other densely populated counties. Census tract boundaries do not cross county lines; however, they may cross the boundaries of metropolitan statistical areas. Census tracts usually have between 2,500 and 8,000 persons, and their physical size varies widely depending upon population density. Census tracts are designed to be homogeneous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons.

Community development: Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or, activities that revitalize or stabilize low- or moderate-income geographies.

Effective September 1, 2005, the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation have adopted the following additional language as part of the revitalize or stabilize definition of community development. Activities that revitalize or stabilize-

- (i) Low-or moderate-income geographies;
- (ii) Designated disaster areas; or
- (iii) Distressed or underserved non-metropolitan middle-income geographies designated by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, based on-
 - a. Rates of poverty, unemployment, and population loss; or
 - b. Population size, density, and dispersion. Activities that revitalize and stabilize geographies designated based on population size, density, and dispersion if they help to meet essential community needs, including needs of low- and moderate-income individuals.

Consumer loan(s): A loan(s) to one or more individuals for household, family, or other personal expenditures. A consumer loan does not include a home mortgage, small business, or small farm loan. This definition includes the following categories: motor vehicle loans, credit card loans, home equity loans, other secured consumer loans, and other unsecured consumer loans.

Family: Includes a householder and one or more other persons living in the same household who are related to the householder by birth, marriage, or adoption. The number of family households always equals the number of families; however, a family household may also include non-relatives living with the family. Families are classified by type as either a married-couple family or other family, which is further classified into "male householder" (a family with a male

householder and no wife present) or “female householder” (a family with a female householder and no husband present).

Geography: A census tract or a block numbering area delineated by the United States Bureau of the Census in the most recent decennial census.

Home Mortgage Disclosure Act (“HMDA”): The statute that requires certain mortgage lenders that do business or have banking offices in a metropolitan statistical area to file annual summary reports of their mortgage lending activity. The reports include such data as the race, gender, and income of applications, the amount of loan requested, and the disposition of the application (e.g., approved, denied, and withdrawn).

Home mortgage loans: Includes home purchase and home improvement loans as defined in the HMDA regulation. This definition also includes multifamily (five or more families) dwelling loans, loans for the purchase of manufactured homes, and refinancings of home improvement and home purchase loans.

Household: Includes all persons occupying a housing unit. Persons not living in households are classified as living in group quarters. In 100 percent tabulations, the count of households always equals the count of occupied housing units.

Low-income: Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography.

Metropolitan area (MA): A metropolitan statistical area (MSA) or a metropolitan division (MD) as defined by the Office of Management and Budget. A MSA is a core area containing at least one urbanized area of 50,000 or more inhabitants, together with adjacent communities having a high degree of economic and social integration with that core. A MD is a division of a MSA based on specific criteria including commuting patterns. Only a MSA that has a population of at least 2.5 million may be divided into MDs.

Middle-income: Individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 percent and less than 120 percent, in the case of a geography.

Moderate-income: Individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 percent and less than 80 percent, in the case of a geography.

Multifamily: Refers to a residential structure that contains five or more units.

Owner-occupied units: Includes units occupied by the owner or co-owner, even if the unit has not been fully paid for or is mortgaged.

Rated area: A rated area is a state or multistate metropolitan area. For an institution with domestic branches in only one state, the institution’s CRA rating would be the state rating. If an

institution maintains domestic branches in more than one state, the institution will receive a rating for each state in which those branches are located. If an institution maintains domestic branches in two or more states within a multistate metropolitan area, the institution will receive a rating for the multistate metropolitan area.

Small loan(s) to business(es): A loan included in “loans to small businesses” as defined in the Consolidated Report of Condition and Income (“Call Report”) and the Thrift Financial Reporting (“TFR”) instructions. These loans have original amounts of \$1 million or less and typically are either secured by nonfarm or nonresidential real estate or are classified as commercial and industrial loans. However, thrift institutions may also exercise the option to report loans secured by nonfarm residential real estate as "small business loans" if the loans are reported on the TFR as nonmortgage, commercial loans.

Upper-income: Individual income that is more than 120 percent of the area median income, or a median family income that is more than 120 percent, in the case of a geography.

First State Bank

Assessment Area

January 1, 2004 - June 30, 2006

Legend

- Moderate Income Tracts
- 2000 Census Tracts
- Counties
- Branch
- Assessment Area

