CODORUS VALLEY BANCORP INC
Form 10-Q
May 05, 2016
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2016

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from____________to______________

Commission file number: 0-15536

CODORUS VALLEY BANCORP, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania **23-2428543**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

105 Leader Heights Road, P.O. Box 2887, York, Pennsylvania 17405
(Address of principal executive offices) (Zip code)

717-747-1519
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year,

if changed since the last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. On April 29, 2016, 7,962,658 shares of common stock, par value $2.50, were outstanding.

Codorus Valley Bancorp, Inc.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Codorus Valley Bancorp, Inc.

Consolidated Balance Sheets

	(Unaudited) March 31,	December 31,
(dollars in thousands, except per share data)	**2016**	**2015**
Assets		
Interest bearing deposits with banks	$ 1,919	$ 44,496
Cash and due from banks	10,518	12,989
Total cash and cash equivalents	12,437	57,485
Securities, available-for-sale	199,916	213,470
Restricted investment in bank stocks, at cost	5,371	5,028
Loans held for sale	1,499	564
Loans (net of deferred fees of $2,910 - 2016 and $2,701 - 2015)	1,150,147	1,123,211
Less-allowance for loan losses	(13,090)	(12,704)
Net loans	1,137,057	1,110,507
Premises and equipment, net	24,796	24,606
Goodwill	2,301	2,301
Other assets	43,645	42,373
Total assets	$ 1,427,022	$ 1,456,334
Liabilities		
Deposits		
Noninterest bearing	$ 168,510	$ 162,982
Interest bearing	952,323	931,167
Total deposits	1,120,833	1,094,149
Short-term borrowings	26,586	74,510
Long-term debt	120,310	120,310
Other liabilities	9,276	8,224
Total liabilities	1,277,005	1,297,193
Shareholders' equity		
Preferred stock, par value $2.50 per share; $1,000 liquidation preference, 1,000,000 shares authorized; Series B shares issued and outstanding: 0 at March 31, 2016 and 12,000 at December 31, 2015	0	12,000

Common stock, par value $2.50 per share; 15,000,000 shares authorized; shares issued: 7,963,528 at March 31, 2016 and 7,957,145 at December 31, 2015; and shares outstanding: 7,962,658 at March 31, 2016 and 7,957,145 at December 31, 2015	19,909	19,893
Additional paid-in capital	97,566	97,338
Retained earnings	30,305	28,539
Accumulated other comprehensive income	2,239	1,371
Treasury stock, at cost; 870 shares at March 31, 2016	(2)	0
Total shareholders' equity	150,017	159,141
Total liabilities and shareholders' equity	$ 1,427,022	$ 1,456,334

See accompanying notes.

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Codorus Valley Bancorp, Inc.

Consolidated Statements of Income

Unaudited

(dollars in thousands, except per share data)	Three months ended March 31, 2016	2015
Interest income		
Loans, including fees	$13,811	$12,307
Investment securities:		
Taxable	702	780
Tax-exempt	425	422
Dividends	68	158
Other	8	19
Total interest income	15,014	13,686
Interest expense		
Deposits	1,510	1,640
Federal funds purchased and other short-term borrowings	54	41
Long-term debt	485	327
Total interest expense	2,049	2,008
Net interest income	12,965	11,678
Provision for loan losses	800	1,000
Net interest income after provision for loan losses	12,165	10,678
Noninterest income		
Trust and investment services fees	617	601
Income from mutual fund, annuity and insurance sales	259	156
Service charges on deposit accounts	837	757
Income from bank owned life insurance	174	171
Other income	189	150
Gain on sales of loans held for sale	115	151
Gain on sales of securities	194	371
Total noninterest income	2,385	2,357
Noninterest expense		
Personnel	5,997	5,260
Occupancy of premises, net	897	800
Furniture and equipment	725	678
Postage, stationery and supplies	173	163
Professional and legal	163	174
Marketing	469	219

FDIC insurance	166	175
Debit card processing	297	202
Charitable donations	741	724
Telephone	162	161
External data processing	333	282
Merger related	0	425
Foreclosed real estate including losses on sales	40	117
Other	295	209
Total noninterest expense	10,458	9,589
Income before income taxes	4,092	3,446
Provision for income taxes	1,275	1,012
Net income	2,817	2,434
Preferred stock dividends	16	30
Net income available to common shareholders	$2,801	$2,404
Net income per common share, basic	$0.35	$0.39
Net income per common share, diluted	$0.35	$0.39

See accompanying notes.

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Codorus Valley Bancorp, Inc.

Consolidated Statements of Comprehensive Income

Unaudited

(dollars in thousands)	Three months ended March 31, 2016	2015
Net income	$2,817	$2,434
Other comprehensive income (loss):		
Securities available for sale:		
Net unrealized holding gains arising during the period (net of tax expense of $513 and $276, respectively)	996	536
Reclassification adjustment for gains included in net income (net of tax expense of $66 and $126, respectively) (a) (b)	(128)	(245)
Net unrealized gains	868	291
Comprehensive income	$3,685	$2,725

(a) Amounts are included in net gain on sales of securities on the Consolidated Statements of Income within noninterest income.

(b) Income tax amounts are included in provision for income taxes on the Consolidated Statements of Income.

See accompanying notes.

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Codorus Valley Bancorp, Inc.

Consolidated Statements of Cash Flows

Unaudited

(dollars in thousands)	**Three months ended March 31, 2016**	**2015**
Cash flows from operating activities		
Net income	$2,817	$2,434
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation/amortization	574	557
Net amortization of premiums on securities	220	251
Amortization of deferred loan origination fees and costs	(236)	(197)
Provision for loan losses	800	1,000
Provision for losses on foreclosed real estate	0	59
Increase in bank owned life insurance	(174)	(171)
Originations of loans held for sale	(8,805)	(7,885)
Proceeds from sales of loans held for sale	7,985	7,100
Gain on sales of loans held for sale	(115)	(151)
Net gain on disposal of premises and equipment	2	0
Gain on sales of securities, available-for-sale	(194)	(371)
Net loss on sales of foreclosed real estate	1	9
Stock-based compensation	123	71
Decrease (increase) in interest receivable	72	(27)
Decrease in other assets	228	510
Increase in interest payable	42	10
Increase (decrease) in other liabilities	1,044	(168)
Net cash provided by operating activities	4,384	3,031
Cash flows from investing activities		
Purchases of securities, available-for-sale	(12,156)	(19,082)
Maturities, repayments and calls of securities, available-for-sale	14,096	8,148
Sales of securities, available-for-sale	12,903	7,170
Purchase of restricted investment in bank stock	(343)	0
Net proceeds from acquisition	0	21,091
Proceeds from acquired receivables of sold investment settlements	0	15,256
Net increase in loans made to customers	(27,114)	(24,004)
Purchases of premises and equipment	(762)	(1,004)
Investment in bank owned life insurance	(1,987)	0
Proceeds from sale of premises and equipment	0	18
Proceeds from sales of foreclosed real estate	133	95
Net cash (used in) provided by investing activities	(15,230)	7,688
Cash flows from financing activities		

Net increase in demand and savings deposits	24,905	16,571
Net increase (decrease) in time deposits	1,779	(17,958)
Net decrease in short-term borrowings	(47,924)	(13,023)
Repayment of long-term debt	0	(23)
Cash dividends paid to preferred shareholder	(46)	(30)
Cash dividends paid to common shareholders	(1,035)	(729)
Redemption of preferred stock	(12,000)	0
Issuance of common stock	119	201
Net cash used in financing activities	(34,202)	(14,991)
Net decrease in cash and cash equivalents	(45,048)	(4,272)
Cash and cash equivalents at beginning of year	57,485	31,094
Cash and cash equivalents at end of period	$12,437	$26,822

See accompanying notes.

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Codorus Valley Bancorp, Inc.

Consolidated Statements of Changes in Shareholders' Equity

Unaudited

(dollars in thousands, except per share data)	**Preferred Stock**	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income**	**Treasury Stock**	**Total**
Balance, January 1, 2016	$ 12,000	$ 19,893	$ 97,338	$ 28,539	$ 1,371	$ 0	$ 159,141
Net income				2,817			2,817
Other comprehensive income, net of tax					868		868
Common stock cash dividends ($0.13 per share)				(1,035)			(1,035)
Preferred stock cash dividends				(16)			(16)
Redemption of preferred stock	(12,000)						(12,000)
Stock-based compensation including related tax benefit			123				123
Forfeiture of restricted stock			4			(4)	0
Issuance and reissuance of common stock including related tax benefit:							
5,378 shares under the dividend reinvestment and stock purchase plan		13	94				107
704 shares under the stock option plan			10			2	12
1,005 shares of stock-based compensation awards		3	(3)				0
Balance, March 31, 2016	$ 0	$ 19,909	$ 97,566	$ 30,305	$ 2,239	$ (2)	$ 150,017
Balance, January 1, 2015	$ 12,000	$ 14,577	$ 62,713	$ 26,483	$ 2,667	$ 0	$ 118,440
Net income				2,434			2,434
Other comprehensive income, net of tax					291		291
Common stock cash dividends ($0.119 per share, adjusted)				(729)			(729)
Preferred stock cash dividends				(30)			(30)
Stock-based compensation including related tax benefit			71				71
Forfeiture of restricted stock			6			(6)	0
Issuance and reissuance of common stock including related tax benefit:							
5,133 shares under the dividend reinvestment and stock purchase plan		13	87				100

8,568 shares under the stock option plan		21	80					101
Balance, March 31, 2015	$ 12,000	$ 14,611	$ 62,957	$ 28,158	$ 2,958	$ (6	)	$ 120,678

See accompanying notes.

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Note 1—Summary of Significant Accounting Policies

Nature of Operations and Basis of Presentation

The accompanying consolidated balance sheet at December 31, 2015 has been derived from audited financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, the instructions to Form 10-Q, and FASB Accounting Standards Codification (ASC) 270. Accordingly, the interim financial statements do not include all of the financial information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the interim consolidated financial statements include all adjustments necessary to present fairly the financial condition and results of operations for the reported periods, and all such adjustments are of a normal and recurring nature.

Codorus Valley Bancorp, Inc. ("Corporation" or "Codorus Valley") is a one-bank holding company headquartered in York, Pennsylvania that provides a full range of banking services through its subsidiary, PeoplesBank, A Codorus Valley Company ("PeoplesBank" or "Bank"). PeoplesBank operates two wholly-owned subsidiaries, Codorus Valley Financial Advisors, Inc., which sells nondeposit investment products, and SYC Settlement Services, Inc., which provides real estate settlement services. In addition, PeoplesBank may periodically create nonbank subsidiaries for the purpose of temporarily holding foreclosed properties pending the liquidation of these properties. PeoplesBank operates under a state charter and is subject to regulation by the Pennsylvania Department of Banking and Securities, and the Federal Deposit Insurance Corporation. The Corporation is subject to regulation by the Federal Reserve Board and the Pennsylvania Department of Banking and Securities.

The consolidated financial statements include the accounts of Codorus Valley and its wholly-owned bank subsidiary, PeoplesBank, and two wholly-owned nonbank subsidiaries, SYC Realty Company, Inc. and CVLY Corp. SYC Realty is primarily used to hold foreclosed properties obtained by PeoplesBank and was inactive during the period ended March 31, 2016. CVLY Corp. was formed to facilitate the acquisition of Madison Bancorp, Inc. ("Madison") and may be used, as needed, for the financial and legal management of future acquisition transactions. The accounts of CVB Statutory Trust No. 1 and No. 2 are not included in the consolidated financial statements as discussed in Note 8—Short-Term Borrowings and Long-Term Debt. All significant intercompany account balances and transactions have been eliminated in consolidation. The accounting and reporting policies of Codorus Valley and subsidiaries conform to accounting principles generally accepted in the United States of America and have been followed on a consistent basis.

These consolidated statements should be read in conjunction with the notes to the audited consolidated financial statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2015.

The results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results to be expected for the full year.

In accordance with FASB ASC 855, the Corporation evaluated the events and transactions that occurred after the balance sheet date of March 31, 2016 and through the date these consolidated financial statements were issued, for items of potential recognition or disclosure.

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Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances less amounts charged off, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Generally, loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) over the contractual life of the loan. The loans receivable portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following industry classes: builder & developer, commercial real estate investor, residential real estate investor, hotel/motel, wholesale & retail, agriculture, manufacturing and all other. Consumer loans consist of the following classes: residential mortgage, home equity and all other.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A past due loan may remain on accrual status if it is in the process of collection and well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to the Corporation’s judgment as to the collectability of principal. Generally, nonaccrual loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Acquired Loans

Acquired loans are initially recorded at their acquisition date fair values. The carryover of allowance for loan losses is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. Fair values for acquired loans are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values and discount rate.

For acquired loans that are not deemed impaired at acquisition, credit discounts representing principal losses expected over the life of the loan are a component of the initial fair value and amortized over the life of the asset. Subsequent to the acquisition date, the methods used to estimate the required allowance for loan losses on these loans is similar to originated loans. However, the Corporation records a provision for loan losses only when the required allowance for loan losses exceeds any remaining credit discount. The remaining differences between the acquisition date fair value and the unpaid principal balance at the date of acquisition are recorded in interest income over the life of the loan.

Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Corporation will be unable to collect all contractually required payments are accounted for as impaired loans under ASC 310-30. The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loans. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable discount. The non-accretable discount represents estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows require the Corporation to evaluate the need for an allowance for loan losses on these loans. Subsequent improvements in expected cash flows result in the reversal of a corresponding amount of the non-accretable discount which the Corporation then reclassifies as an accretable discount that is recognized into interest income over the remaining life of the loans using the interest method.

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The following is a summary of acquired impaired loans from the merger, as discussed in Note 2-Merger with Madison Bancorp, Inc.:

(dollars in thousands)	**January 16, 2015**
Contractually required principal and interest at acquisition	$ 1,961
Contractual cash flows not expected to be collected	1,185
Expected cash flows at acquisition	776
Interest component of expected cash flows	160
Basis in acquired loans at acquisition - estimated fair value	$ 616

Allowance for Loan Losses

The allowance for loan losses represents the Corporation's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectable are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. While the Corporation attributes a portion of the allowance to individual loans and groups of loans that it evaluates and determines to be impaired, the allowance is available to cover all charge-offs that arise from the loan portfolio.

The allowance for loan losses is maintained at a level considered by management to be adequate to provide for losses that can be reasonably anticipated. The Corporation performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

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The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired, generally substandard and nonaccrual loans. For loans that are classified as impaired, an allowance is established when the collateral value (or discounted cash flows or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class, including commercial loans not considered impaired, as well as smaller balance homogeneous loans such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these classes of loans, adjusted for qualitative (environmental) risk factors. Historical loss rates are based on a two year rolling average of net charge-offs. Qualitative risk factors that supplement historical losses in the evaluation of loan pools are shown below. Each factor is assigned a value to reflect improving, stable or declining conditions based on the Corporation's best judgment using relevant information available at the time of the evaluation.

- Changes in national and local economies and business conditions
- Changes in the value of collateral for collateral dependent loans
- Changes in the level of concentrations of credit
- Changes in the volume and severity of classified and past due loans
- Changes in the nature and volume of the portfolio
- Changes in collection, charge-off, and recovery procedures
- Changes in underwriting standards and loan terms
- Changes in the quality of the loan review system
- Changes in the experience/ability of lending management and key lending staff
- Regulatory and legal regulations that could affect the level of credit losses
- Other pertinent environmental factors

The unallocated component is maintained to cover uncertainties that could affect the Corporation's estimate of probable losses. For example, increasing credit risks and uncertainties, not yet reflected in current leading indicators, associated with prolonged low economic growth, or recessionary business conditions for certain industries or the broad economy, or the erosion of real estate values, represent risk factors, the occurrence of any or all of which can adversely affect a borrowers' ability to service their loans. The unallocated component of the allowance also reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the loan portfolio, including the unpredictable timing and amounts of charge-offs and related historical loss averages, and specific-credit or broader portfolio future cash flow value and collateral valuation uncertainties which could negatively impact unimpaired portfolio loss factors.

As disclosed in Note 5—Loans, the Corporation engages in commercial and consumer lending. Loans are made within the Corporation's primary market area and surrounding areas, and include the purchase of whole loan or participation interests in loans from other financial institutions or private equity companies. Commercial loans, which pose the greatest risk of loss to the Corporation, whether originated or purchased, are generally secured by real estate. Within the broad commercial loan segment, the builder & developer and commercial real estate investor loan classes generally present a higher level of risk than other commercial loan classifications. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties, unstable real estate prices and the dependency upon successful construction and sale or operation of the real estate project. Within the consumer loan segment, junior (i.e., second) liens present a higher risk to the Corporation because economic and housing market conditions can adversely affect the underlying value of the collateral, which could render the Corporation under-secured or unsecured. In addition, economic and housing market conditions can adversely affect the ability of borrowers to service their debt.

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A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. The Corporation determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Loans that are deemed impaired are evaluated for impairment loss based on the net realizable value of the collateral, as applicable. Loans that are not collateral dependent will rely on the present value of expected future cash flows discounted at the loan's effective interest rate to determine impairment loss. Large groups of smaller balance homogeneous loans such as residential mortgage loans, home equity loans and other consumer loans are collectively evaluated for impairment, unless they are classified as impaired.

An allowance for loan losses is established for an impaired commercial loan if its carrying value exceeds its estimated fair value. For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals of the underlying collateral. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the most recent appraisal and the condition of the property. Appraisals are generally discounted to provide for selling costs and other factors to determine an estimate of the net realizable value of the property. For commercial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets. In instances when specific consumer related loans become impaired, they may be partially or fully charged off, which obviates the need for a specific allowance.

Loans whose terms are modified are classified as troubled debt restructurings if the Corporation grants borrowers experiencing financial difficulties concessions that it would not otherwise consider. Concessions granted under a troubled debt restructuring may involve an interest rate that is below the market rate given the associated credit risk of the loan or an extension of a loan's stated maturity date. Loans classified as troubled debt restructurings are designated as impaired. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for a reasonable period of time, generally six consecutive months after modification and future payments are reasonably assured.

Banking regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to the Corporation. Based on an analysis of the loan portfolio, the Corporation believes that the level of the allowance for loan losses at March 31, 2016 is adequate.

Foreclosed Real Estate

Foreclosed real estate, included in other assets, is comprised of property acquired through a foreclosure proceeding or property that is acquired through in-substance foreclosure. Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Any difference between the carrying value and the new cost basis is charged against the allowance for loan losses. Appraisals, obtained from an independent third party, are generally used to determine fair value. After foreclosure, management reviews valuations at least quarterly and adjusts the asset to the lower of cost or fair value minus estimated costs to sell through a valuation allowance or a write-down. Costs related to the improvement of foreclosed real estate are generally capitalized until the real estate reaches a saleable condition subject to fair value limitations. Revenue and expense from operations and changes in the valuation allowance are included in noninterest expense. When a foreclosed real estate asset is ultimately sold, any gain or loss on the sale is included in the income statement as a component of noninterest expense. At March 31, 2016, foreclosed real estate, net of allowance, was $2,779,000, compared to $2,913,000 at December 31, 2015. Included within loans receivable as of March 31, 2016, was a recorded investment of $224,000 of consumer mortgage loans secured by residential real estate properties, for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdiction.

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Goodwill and Core Deposit Intangible Assets

Goodwill arising from acquisitions is not amortized, but is subject to an annual impairment test. This test consists of a qualitative analysis. If the Corporation determines events or circumstances indicate that it is more likely than not that goodwill is impaired, a quantitative analysis must be completed. Analyses may also be performed between annual tests. Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting an appropriate control premium. The Corporation completes its annual goodwill impairment test on October 1st of each year. Based upon a qualitative analysis of goodwill, the Corporation concluded that the amount of recorded goodwill was not impaired as of October 1, 2015.

Core deposit intangibles represent the value assigned to demand, interest checking, money market, and savings accounts acquired as part of an acquisition. The core deposit intangible value represents the future economic benefit of potential cost savings from acquiring core deposits as part of an acquisition compared to the cost of alternative funding sources and the alternative cost to grow a similar core deposit base. The core deposit intangible asset resulting from the merger with Madison Bancorp, Inc. was determined to have a definite life and is being amortized using the sum of the years' digits method over ten years. All intangible assets must be evaluated for impairment if certain events or changes in circumstances occur. Any impairment write-downs would be recognized as expense on the consolidated statements of income.

At March 31, 2016, the Corporation does not have any indicators of potential impairment of either goodwill or core deposit intangibles.

Per Common Share Data

All per share computations include the effect of stock dividends distributed. The computation of net income per common share is provided in the table below.

	Three months ended March 31,	
(in thousands, except per share data)	**2016**	**2015**
Net income available to common shareholders	$2,801	$2,404
Weighted average shares outstanding (basic)	7,960	6,128

Effect of dilutive stock options	64	80
Weighted average shares outstanding (diluted)	8,024	6,208
Basic earnings per common share	$0.35	$0.39
Diluted earnings per common share	$0.35	$0.39
Anti-dilutive stock options excluded from the computation of earnings per share	74	37

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Comprehensive Income

Accounting principles generally accepted in the United States require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the shareholders' equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Cash Flow Information

For purposes of the statements of cash flows, the Corporation considers interest bearing deposits with banks, cash and due from banks, and federal funds sold to be cash and cash equivalents.

Supplemental cash flow information is provided in the table below.

	Three months ended March 31,	
(dollars in thousands)	**2016**	**2015**
Cash paid during the period for:		
Income taxes	$80	$350
Interest	$2,007	$1,998

Recent Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718). This standard introduces amendments intended to simplify the accounting for stock compensation. Specifically, the ASU requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the income statement. The new standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. From the lessee's perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing lease. If the lessor does not convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

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In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This standards update provides a framework that replaces most existing revenue recognition guidance. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for interim and annual reporting periods beginning after December 15, 2017, with earlier adoption permitted. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

Note 2-Merger with Madison Bancorp, Inc.

On July 22, 2014, the Corporation entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Madison Bancorp, Inc., a Maryland corporation (“Madison”), and CVLY Corp., a Pennsylvania corporation and wholly-owned subsidiary of the Corporation (“Acquisition Subsidiary”). Pursuant to the Merger Agreement, Madison agreed to cause its wholly-owned subsidiary, Madison Square Federal Savings Bank (“MSFSB”), to merge with and into the Corporation’s wholly-owned bank subsidiary, PeoplesBank, with PeoplesBank being the surviving bank in the Bank Merger.

The acquisition of Madison and MSFSB was completed on January 16, 2015, as reported on a Form 8-K filed on the same date. Pursuant to the Merger Agreement, each share of Madison common stock was converted into the right to receive $22.90 in cash, without interest, and each outstanding option to purchase Madison common stock was converted into the right to receive cash based on a formula set forth in the Merger Agreement. Total consideration paid was $14,425,000, which included the purchase of 608,116 shares of Madison common stock as well as the cash out of 41,270 options to purchase Madison common stock with an average exercise price of $10.81 per share.

The merger was accounted for using acquisition accounting, which requires the Corporation to allocate total consideration transferred to the assets acquired and liabilities assumed, based on their respective fair value at the merger date, with any remaining excess consideration being recorded as goodwill. The table below presents the detail of the total acquisition cost as well as a summary of the assets acquired and liabilities assumed recorded at their estimated fair value, as of the January 16, 2015 acquisition date.

(in thousands, except per share data)	**January 16, 2015**	
Cash paid for outstanding shares of Madison common stock and outstanding options		$14,425
Assets Acquired:		
Cash and due from banks	$35,516	
Securities, available for sale	1,396	

Loans	77,228	
Premises and equipment	2,601	
Other assets	17,567	
Total assets acquired		134,308
Liabilities Assumed:		
Deposits	120,545	
Other liabilities	1,639	
Total liabilities assumed		122,184
Net goodwill resulting from merger		$2,301

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The fair value of total assets acquired as a result of the merger totaled $134,308,000, which included $1,396,000 of securities which were subsequently sold in the first quarter of 2015. Additionally, other assets of $17,567,000 included $15,256,000 of receivables related to investment securities sold prior to the merger, pending receipt of sales proceeds, which were subsequently collected. The transaction also resulted in a core deposit intangible of $39,000 and goodwill of $2,301,000. Goodwill arising from the acquisition consists largely of synergies and the cost savings expected to result from the combining of operations and is not expected to be deductible for income tax purposes.

The following table presents unaudited pro forma information as if the merger between PeoplesBank and MSFSB had been completed on January 1, 2014. The pro forma information does not necessarily reflect the results of operations that would have occurred had MSFSB merged with PeoplesBank at the beginning of 2014. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions or revenues, cost savings, or other factors.

(in thousands, except per share data)	**Pro forma for the year ended December 31, 2014**
Net interest income	$ 44,598
Noninterest income	8,246
Net income available to common shareholders	10,972
Pro forma earnings per share:	
Basic	$ 1.87
Diluted	$ 1.83

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Note 3-Securities

A summary of securities available-for-sale at March 31, 2016 and December 31, 2015 is provided below. The securities available-for-sale portfolio is generally comprised of high quality debt instruments, principally obligations of the United States government or agencies thereof and investments in the obligations of states and municipalities. The majority of municipal bonds in the portfolio are general obligation bonds, which can draw upon multiple sources of revenue, including taxes, for payment. Only a few bonds are revenue bonds, which are dependent upon a single revenue stream for payment, but they are for critical services such as water and sewer. In many cases, municipal debt issues are insured or, in the case of school districts of selected states, backed by specific loss reserves. At March 31, 2016, the fair value of the municipal bond portfolio was concentrated in the states of Pennsylvania at 64 percent and Texas at 12 percent.

	Amortized	**Gross Unrealized**		**Fair**
(dollars in thousands)	**Cost**	**Gains**	**Losses**	**Value**
March 31, 2016				
Debt securities:				
U.S. agency	$14,071	$8	$(19)	$14,060
U.S. agency mortgage-backed, residential	104,240	2,473	0	106,713
State and municipal	78,213	1,011	(81)	79,143
Total debt securities	$196,524	$3,492	$(100)	$199,916
December 31, 2015				
Debt securities:				
U.S. agency	$17,554	$0	$(140)	$17,414
U.S. agency mortgage-backed, residential	119,266	1,472	(157)	120,581
State and municipal	74,573	937	(35)	75,475
Total debt securities	$211,393	$2,409	$(332)	$213,470

The amortized cost and estimated fair value of debt securities at March 31, 2016 by contractual maturity are shown below. Actual maturities may differ from contractual maturities if call options on select debt issues are exercised in the future. Mortgage-backed securities are included in the maturity categories based on average expected life.

	Available-for-sale	
	Amortized	**Fair**
(dollars in thousands)	**Cost**	**Value**
Due in one year or less	$14,558	$14,636
Due after one year through five years	127,334	129,886
Due after five years through ten years	43,763	44,340
Due after ten years	10,869	11,054
Total debt securities	$196,524	$199,916

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Gross realized gains and losses on sales of securities available-for-sale are shown below. Realized gains and losses are computed on the basis of specific identification of the adjusted cost of each security and are shown net as a separate line item in the income statement.

	Three months ended March 31,	
(dollars in thousands)	**2016**	**2015**
Realized gains	$194	$371
Realized losses	0	0
Net gains	$194	$371

Securities, issued by agencies of the federal government, with a carrying value of $138,871,000 and $186,097,000 on March 31, 2016 and December 31, 2015, respectively, were pledged to secure public and trust deposits, repurchase agreements and other short-term borrowings.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time, for securities that have been in a continuous unrealized loss position, at March 31, 2016 and December 31, 2015.

	Less than 12 months			**12 months or more**			**Total**		
(dollars in thousands)	**Number of Securities**	**Fair Value**	**Unrealized Losses**	**Number of Securities**	**Fair Value**	**Unrealized Losses**	**Number of Securities**	**Fair Value**	**Unrealized Losses**
March 31, 2016									
Debt securities:									
U.S. agency	2	$5,986	$ (19)	0	$0	$ 0	2	$5,986	$ (19)
State and municipal	22	12,357	(76)	2	1,036	(5)	24	13,393	(81)
Total temporarily impaired debt securities, available-for-sale	24	$18,343	$ (95)	2	$1,036	$ (5)	26	$19,379	$ (100)
December 31, 2015									
Debt securities:									
U.S. agency	6	$17,414	$ (140)	0	$0	$ 0	6	$17,414	$ (140)
U.S. agency mortgage-backed, residential	8	18,991	(157)	0	0	0	8	18,991	(157)
State and municipal	27	11,272	(26)	4	1,886	(9)	31	13,158	(35)
Total temporarily impaired debt securities, available-for-sale	41	$47,677	$ (323)	4	$1,886	$ (9)	45	$49,563	$ (332)

Securities available-for-sale are analyzed quarterly for possible other-than-temporary impairment. The analysis considers, among other factors: 1) whether the Corporation has the intent to sell its securities prior to market recovery or maturity; 2) whether it is more likely than not that the Corporation will be required to sell its securities prior to market recovery or maturity; 3) default rates/history by security type; 4) third-party securities ratings; 5) third-party guarantees; 6) subordination; 7) payment delinquencies; 8) nature of the issuer; and 9) current financial news.

The Corporation believes that unrealized losses at March 31, 2016 were primarily the result of changes in market interest rates and that the Corporation has the ability to hold these investments for a time necessary to recover the amortized cost. Through March 31, 2016, the Corporation has collected all interest and principal on its investment securities as scheduled. The Corporation believes that collection of the contractual principal and interest is probable and, therefore, all impairment is considered to be temporary.

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Note 4—Restricted Investment in Bank Stocks

Restricted stock, which represents required investments in the common stock of correspondent banks, is carried at cost and, as of March 31, 2016 and December 31, 2015, consisted primarily of the common stock of the Federal Home Loan Bank of Pittsburgh (FHLBP) and, to a lesser degree, Atlantic Community Bankers Bank (ACBB). Under the FHLBP's Capital Plan, PeoplesBank is required to maintain a minimum member stock investment, as a condition of becoming and remaining a member and as a condition of obtaining borrowings from the FHLBP. The FHLBP uses a formula to determine the minimum stock investment, which is based on the volume of loans outstanding, unused borrowing capacity and other factors.

The FHLBP paid dividends during the periods ended March 31, 2016 and 2015. The FHLBP restricts the repurchase of the excess capital stock of member banks. The amount of excess capital stock that can be repurchased from any member is currently the lesser of five percent of the member's total capital stock outstanding or its excess capital stock outstanding.

Management evaluates the restricted stock for impairment in accordance with FASB ASC Topic 942. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. Using the FHLBP as an example, the determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLBP as compared to the capital stock amount for the FHLBP and the length of time this situation has persisted; (2) commitments by the FHLBP to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLBP; and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLBP. Management believes no impairment charge was necessary related to the restricted stock during the periods ended March 31, 2016 and 2015.

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Note 5—Loans

Loan Portfolio Composition

The table below provides the composition of the loan portfolio at March 31, 2016 and December 31, 2015. The portfolio is comprised of two segments, commercial and consumer loans. The commercial loan segment is disaggregated by industry class which allows the Corporation to monitor risk and performance. Those industries representing the largest dollar investment and most risk are listed separately. The "Other" commercial loans category is comprised of various industries. The consumer related segment is comprised of residential mortgages, home equity and other consumer loans. The Corporation has not engaged in sub-prime residential mortgage originations.

(dollars in thousands)	**March 31, 2016**	**% Total Loans**	**December 31, 2015**	**% Total Loans**
Builder & developer	$141,923	12.3	$133,978	11.9
Commercial real estate investor	210,016	18.3	191,994	17.1
Residential real estate investor	158,813	13.8	161,144	14.3
Hotel/Motel	83,589	7.3	84,171	7.5
Wholesale & retail	77,645	6.7	77,694	6.9
Manufacturing	32,988	2.9	30,325	2.7
Agriculture	41,366	3.6	41,217	3.7
Other	218,670	19.0	215,891	19.2
Total commercial related loans	965,010	83.9	936,414	83.4
Residential mortgages	68,418	5.9	70,094	6.2
Home equity	86,136	7.5	86,408	7.7
Other	30,583	2.7	30,295	2.7
Total consumer related loans	185,137	16.1	186,797	16.6
Total loans	$1,150,147	100.0	$1,123,211	100.0

Loan Risk Ratings

The Corporation's internal risk rating system follows regulatory guidance as to risk classifications and definitions. Every approved loan is assigned a risk rating. Generally, risk ratings for commercial related loans and residential mortgages held for investment are determined by a formal evaluation of risk factors performed by the Corporation's underwriting staff. For consumer loans, and commercial loans up to $750,000, the Corporation uses third-party credit scoring software models for risk rating purposes. The loan portfolio is monitored on a continuous basis by loan officers, loan review personnel and senior management. Adjustments of loan risk ratings are generally performed by the Special Asset Committee, which includes senior management. The Committee, which meets monthly, makes changes, as appropriate, to risk ratings when it becomes aware of credit events such as payment delinquency, cessation of a business or project, bankruptcy or death of the borrower, or changes in collateral value.

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The Corporation uses ten risk ratings to grade loans. The first seven ratings, representing the lowest risk, are combined and given a "pass" rating. A pass rating is a satisfactory credit rating, which applies to a loan that is expected to perform in accordance with the loan agreement and has a low probability of loss. A loan rated "special mention" has a potential weakness which may, if not corrected, weaken the loan or inadequately protect the Corporation's position at some future date. A loan rated "substandard" is inadequately protected by the current net worth or paying capacity of the borrower or of the collateral pledged. A substandard loan has a well-defined weakness or weaknesses that could jeopardize liquidation of the loan, which exposes the Corporation to loss if the deficiencies are not corrected. A loan classified "doubtful" has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and value highly improbable and the possibility of loss extremely high. When circumstances indicate that collection of the loan is doubtful, the loan is risk rated "nonaccrual," the accrual of interest income is discontinued, and any unpaid interest previously credited to income is reversed. The table below does not include the regulatory classification of "doubtful," which is subsumed within the nonaccrual risk rating category, nor does it include the regulatory classification of "loss" because the Corporation promptly charges off known loan losses.

The table below presents a summary of loan risk ratings by loan class at March 31, 2016 and December 31, 2015.

(dollars in thousands)	**Pass**	**Special Mention**	**Substandard**	**Nonaccrual**	**Total**
March 31, 2016					
Builder & developer	$131,096	$6,888	$ 3,847	$ 92	$141,923
Commercial real estate investor	203,806	388	5,822	0	210,016
Residential real estate investor	150,934	6,605	863	411	158,813
Hotel/Motel	83,178	0	0	411	83,589
Wholesale & retail	69,121	8,496	0	28	77,645
Manufacturing	29,586	2,776	626	0	32,988
Agriculture	40,627	349	0	390	41,366
Other	215,757	1,284	862	767	218,670
Total commercial related loans	924,105	26,786	12,020	2,099	965,010
Residential mortgage	68,121	0	97	200	68,418
Home equity	85,711	74	0	351	86,136
Other	30,189	118	129	147	30,583
Total consumer related loans	184,021	192	226	698	185,137
Total loans	$1,108,126	$26,978	$ 12,246	$ 2,797	$1,150,147
December 31, 2015					
Builder & developer	$122,919	$6,775	$ 3,873	$ 411	$133,978
Commercial real estate investor	185,621	396	5,957	20	191,994
Residential real estate investor	153,072	6,601	874	597	161,144
Hotel/Motel	83,751	0	0	420	84,171
Wholesale & retail	69,973	7,678	0	43	77,694
Manufacturing	26,705	2,990	630	0	30,325
Agriculture	40,795	0	0	422	41,217

Other	212,971	1,131	855	934	215,891
Total commercial related loans	895,807	25,571	12,189	2,847	936,414
Residential mortgage	69,930	0	97	67	70,094
Home equity	85,690	516	0	202	86,408
Other	29,973	75	130	117	30,295
Total consumer related loans	185,593	591	227	386	186,797
Total loans	$1,081,400	$26,162	$ 12,416	$ 3,233	$1,123,211

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Impaired Loans

The table below presents a summary of impaired loans at March 31, 2016 and December 31, 2015. Generally, impaired loans are loans risk rated substandard and nonaccrual. An allowance is established for individual commercial loans where the Corporation has doubt as to full recovery of the outstanding principal balance. The recorded investment represents outstanding unpaid principal loan balances adjusted for charge-offs.

	With No Allowance		**With A Related Allowance**			**Total**	
(dollars in thousands)	**Recorded Investment**	**Unpaid Principal**	**Recorded Investment**	**Unpaid Principal**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal**
March 31, 2016							
Builder & developer	$3,939	$ 4,074	$0	$ 0	$ 0	$3,939	$ 4,074
Commercial real estate investor	5,822	5,837	0	0	0	5,822	5,837
Residential real estate investor	462	1,186	812	854	192	1,274	2,040
Hotel/Motel	411	411	0	0	0	411	411
Wholesale & retail	293	293	0	0	0	293	293
Manufacturing	626	626	0	0	0	626	626
Agriculture	0	0	390	390	263	390	390
Other commercial	1,629	1,744	0	0	0	1,629	1,744
Total impaired commercial related loans	13,182	14,171	1,202	1,244	455	14,384	15,415
Residential mortgage	297	339	0	0	0	297	339
Home equity	351	391	0	0	0	351	391
Other consumer	276	293	0	0	0	276	293
Total impaired consumer related loans	924	1,023	0	0	0	924	1,023
Total impaired loans	$14,106	$ 15,194	$1,202	$ 1,244	$ 455	$15,308	$ 16,438
December 31, 2015							
Builder & developer	$4,284	$ 4,917	$0	$ 0	$ 0	$4,284	$ 4,917
Commercial real estate investor	5,977	5,991	0	0	0	5,977	5,991
Residential real estate investor	649	1,199	822	864	142	1,471	2,063
Hotel/Motel	420	420	0	0	0	420	420
Wholesale & retail	309	309	0	0	0	309	309
Manufacturing	630	630	0	0	0	630	630
Agriculture	0	0	422	422	263	422	422
Other commercial	1,789	1,904	0	0	0	1,789	1,904
Total impaired commercial related loans	14,058	15,370	1,244	1,286	405	15,302	16,656
Residential mortgage	164	188	0	0	0	164	188
Home equity	202	242	0	0	0	202	242
Other consumer	247	265	0	0	0	247	265
Total impaired consumer related loans	613	695	0	0	0	613	695
Total impaired loans	$14,671	$ 16,065	$1,244	$ 1,286	$ 405	$15,915	$ 17,351

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The table below presents a summary of average impaired loans and related interest income that was included in net income for the three months ended March 31, 2016 and 2015.

	With No Related Allowance			With A Related Allowance			Total		
(dollars in thousands)	Average Recorded Investment	Total Interest Income	Cash Basis Interest Income	Average Recorded Investment	Total Interest Income	Cash Basis Interest Income	Average Recorded Investment	Total Interest Income	Cash Basis Interest Income
Three months ended March 31, 2016									
Builder & developer	$4,111	$ 59	$ 0	$0	$ 0	$ 0	$4,111	$ 59	$ 0
Commercial real estate investor	5,899	76	0	0	0	0	5,899	76	0
Residential real estate investor	555	5	0	817	7	0	1,372	12	0
Hotel/Motel	416	2	2	0	0	0	416	2	2
Wholesale & retail	301	3	0	0	0	0	301	3	0
Manufacturing	628	10	0	0	0	0	628	10	0
Agriculture	0	0	0	406	0	0	406	0	0
Other commercial	1,709	18	4	0	0	0	1,709	18	4
Total impaired commercial related loans	13,619	173	6	1,223	7	0	14,842	180	6
Residential mortgage	230	0	0	0	0	0	230	0	0
Home equity	277	1	1	0	0	0	277	1	1
Other consumer	261	3	2	0	0	0	261	3	2
Total impaired consumer related loans	768	4	3	0	0	0	768	4	3
Total impaired loans	$14,387	$ 177	$ 9	$1,223	$ 7	$ 0	$15,610	$ 184	$ 9
Three months ended March 31, 2015									
Builder & developer	$3,946	$ 60	$ 1	$2,045	$ 0	$ 0	$5,991	$ 60	$ 1
Commercial real estate investor	4,474	296	249	1,876	32	32	6,350	328	281
Residential real estate investor	1,077	16	0	795	(3)	0	1,872	13	0
Hotel/Motel	515	3	3	0	0	0	515	3	3
Wholesale & retail	392	5	2	0	0	0	392	5	2
Manufacturing	652	10	0	0	0	0	652	10	0
Agriculture	0	0	0	428	7	0	428	7	0
Other commercial	1,299	24	2	237	0	0	1,536	24	2
Total impaired commercial related loans	12,355	414	257	5,381	36	32	17,736	450	289
Residential mortgage	175	2	3	0	0	0	175	2	3

Home equity	125	0	0	0	0	0	125	0	0
Other consumer	390	6	4	0	0	0	390	6	4
Total impaired consumer related loans	690	8	7	0	0	0	690	8	7
Total impaired loans	$13,045	$ 422	$ 264	$5,381	$ 36	$ 32	$18,426	$ 458	$ 296

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Past Due and Nonaccrual

The performance and credit quality of the loan portfolio is also monitored by using an aging schedule that shows the length of time a loan is past due. The table below presents a summary of past due loans, nonaccrual loans and current loans by loan segment and class at March 31, 2016 and December 31, 2015.

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	≥ 90 Days Past Due and Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans
March 31, 2016							
Builder & developer	$570	$0	$ 307	$ 92	$ 969	$140,954	$141,923
Commercial real estate investor	215	0	0	0	215	209,801	210,016
Residential real estate investor	0	0	0	411	411	158,402	158,813
Hotel/Motel	0	0	0	411	411	83,178	83,589
Wholesale & retail	119	138	0	28	285	77,360	77,645
Manufacturing	0	0	0	0	0	32,988	32,988
Agriculture	0	0	200	390	590	40,776	41,366
Other	0	0	193	767	960	217,710	218,670
Total commercial related loans	904	138	700	2,099	3,841	961,169	965,010
Residential mortgage	271	0	79	200	550	67,868	68,418
Home equity	156	54	75	351	636	85,500	86,136
Other	150	59	12	147	368	30,215	30,583
Total consumer related loans	577	113	166	698	1,554	183,583	185,137
Total loans	$1,481	$251	$ 866	$ 2,797	$ 5,395	$1,144,752	$1,150,147
December 31, 2015							
Builder & developer	$398	$308	$ 0	$ 411	$ 1,117	$132,861	$133,978
Commercial real estate investor	216	396	0	20	632	191,362	191,994
Residential real estate investor	0	304	0	597	901	160,243	161,144
Hotel/Motel	0	0	0	420	420	83,751	84,171
Wholesale & retail	0	119	0	43	162	77,532	77,694
Manufacturing	0	0	0	0	0	30,325	30,325
Agriculture	0	0	0	422	422	40,795	41,217
Other	324	0	198	934	1,456	214,435	215,891
Total commercial related loans	938	1,127	198	2,847	5,110	931,304	936,414
Residential mortgage	0	0	249	67	316	69,778	70,094
Home equity	485	71	0	202	758	85,650	86,408
Other	171	163	37	117	488	29,807	30,295
Total consumer related loans	656	234	286	386	1,562	185,235	186,797
Total loans	$1,594	$1,361	$ 484	$ 3,233	$ 6,672	$1,116,539	$1,123,211

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Troubled Debt Restructurings

Loans classified as troubled debt restructurings (TDRs) are designated impaired and arise when the Corporation grants borrowers experiencing financial difficulties concessions that it would not otherwise consider. Concessions granted with respect to these loans generally involve an extension of the maturity date or a below market interest rate relative to new debt with similar credit risk. Generally, these loans are secured by real estate. If repayment of the loan is determined to be collateral dependent, the loan is evaluated for impairment loss based on the fair value of the collateral. For loans that are not collateral dependent, the present value of expected future cash flows, discounted at the loan's original effective interest rate, is used to determine any impairment loss.

A nonaccrual TDR represents a nonaccrual loan, as previously defined, which includes an economic concession. Nonaccrual TDRs are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive payments after the modification and future principal and interest payments are reasonably assured. In contrast, an accruing TDR represents a loan that, at the time of the modification, has a demonstrated history of payments and management believes that future loan payments are reasonably assured under the modified terms.

There were no loans whose terms have been modified under TDRs during the three months ended March 31, 2016 and 2015. There were no defaults during the three months ended March 31, 2016 for TDRs entered into during the previous 12 month period.

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NOTE 6 – Allowance for Loan Losses

The table below shows the activity in and the composition of the allowance for loan losses by loan segment and class detail as of and for the three months ended March 31, 2016 and 2015.

	Allowance for Loan Losses				
	January 1, 2016				**March 31, 2016**
(dollars in thousands)	**Balance**	**Charge-offs**	**Recoveries**	**Provision**	**Balance**
Builder & developer	$1,934	$ 0	$ 0	$ 129	$2,063
Commercial real estate investor	2,337	0	0	270	2,607
Residential real estate investor	2,101	(186)	0	252	2,167
Hotel/Motel	837	0	0	(5)	832
Wholesale & retail	701	0	1	(10)	692
Manufacturing	223	(140)	0	228	311
Agriculture	548	0	0	1	549
Other commercial	2,054	(42)	0	124	2,136
Total commercial related loans	10,735	(368)	1	989	11,357
Residential mortgage	67	(24)	0	30	73
Home equity	161	0	0	1	162
Other consumer	261	(27)	4	(27)	211
Total consumer related loans	489	(51)	4	4	446
Unallocated	1,480	0	0	(193)	1,287
Total	$12,704	$ (419)	$ 5	$ 800	$13,090

	Allowance for Loan Losses				
	January 1, 2015				**March 31, 2015**
(dollars in thousands)	**Balance**	**Charge-offs**	**Recoveries**	**Provision**	**Balance**
Builder & developer	$2,236	$ 0	$ 0	$ (113)	$2,123
Commercial real estate investor	2,204	0	0	407	2,611
Residential real estate investor	1,484	(489)	2	485	1,482
Hotel/Motel	671	0	0	17	688
Wholesale & retail	691	0	14	7	712
Manufacturing	201	0	0	(6)	195
Agriculture	329	0	0	9	338
Other commercial	1,554	(190)	0	56	1,420
Total commercial related loans	9,370	(679)	16	862	9,569
Residential mortgage	64	(28)	20	92	148
Home equity	176	(40)	0	67	203

Other consumer	216	(23)	7	(16)	184
Total consumer related loans	456	(91)	27	143	535
Unallocated	1,336	0	0	(5)	1,331
Total	$11,162	$ (770)	$ 43	$ 1,000	$11,435

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The table below shows the allowance amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment at March 31, 2016 and 2015 and December 31, 2015.

	Allowance for Loan Losses			Loans		
(dollars in thousands)	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Balance
March 31, 2016						
Builder & developer	$0	$ 2,063	$2,063	$3,939	$ 137,984	$141,923
Commercial real estate investor	0	2,607	2,607	5,822	204,194	210,016
Residential real estate investor	192	1,975	2,167	1,274	157,539	158,813
Hotel/Motel	0	832	832	411	83,178	83,589
Wholesale & retail	0	692	692	293	77,352	77,645
Manufacturing	0	311	311	626	32,362	32,988
Agriculture	263	286	549	390	40,976	41,366
Other commercial	0	2,136	2,136	1,629	217,041	218,670
Total commercial related	455	10,902	11,357	14,384	950,626	965,010
Residential mortgage	0	73	73	297	68,121	68,418
Home equity	0	162	162	351	85,785	86,136
Other consumer	0	211	211	276	30,307	30,583
Total consumer related	0	446	446	924	184,213	185,137
Unallocated	0	1,287	1,287	-	-	-
Total	$455	$ 12,635	$13,090	$15,308	$ 1,134,839	$1,150,147
December 31, 2015						
Builder & developer	$0	$ 1,934	$1,934	$4,284	$ 129,694	$133,978
Commercial real estate investor	0	2,337	2,337	5,977	186,017	191,994
Residential real estate investor	142	1,959	2,101	1,471	159,673	161,144
Hotel/Motel	0	837	837	420	83,751	84,171
Wholesale & retail	0	701	701	309	77,385	77,694
Manufacturing	0	223	223	630	29,695	30,325
Agriculture	263	285	548	422	40,795	41,217
Other commercial	0	2,054	2,054	1,789	214,102	215,891
Total commercial related	405	10,330	10,735	15,302	921,112	936,414
Residential mortgage	0	67	67	164	69,930	70,094
Home equity	0	161	161	202	86,206	86,408
Other consumer	0	261	261	247	30,048	30,295
Total consumer related	0	489	489	613	186,184	186,797
Unallocated	0	1,480	1,480	-	-	-
Total	$405	$ 12,299	$12,704	$15,915	$ 1,107,296	$1,123,211
March 31, 2015						
Builder & developer	$703	$ 1,420	$2,123	$6,009	$ 120,628	$126,637

Commercial real estate investor	800	1,811	2,611	6,149	155,486	161,635
Residential real estate investor	113	1,369	1,482	2,006	109,491	111,497
Hotel/Motel	0	688	688	509	80,932	81,441
Wholesale & retail	0	712	712	390	77,065	77,455
Manufacturing	0	195	195	649	32,446	33,095
Agriculture	100	238	338	424	43,425	43,849
Other commercial	0	1,420	1,420	1,625	191,952	193,577
Total commercial related	1,716	7,853	9,569	17,761	811,425	829,186
Residential mortgage	0	148	148	204	74,461	74,665
Home equity	0	203	203	141	83,488	83,629
Other consumer	0	184	184	388	32,924	33,312
Total consumer related	0	535	535	733	190,873	191,606
Unallocated	0	1,331	1,331	-	-	-
Total	$1,716	$ 9,719	$11,435	$18,494	$ 1,002,298	$1,020,792

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Note 7—Deposits

The composition of deposits as of March 31, 2016 and December 31, 2015 is shown below.

(dollars in thousands)	**March 31, 2016**	**December 31, 2015**
Noninterest bearing demand	$168,510	$162,982
NOW	105,607	102,943
Money market	373,689	360,983
Savings	73,653	69,646
Time deposits less than $100,000	238,014	238,392
Time deposits $100,000 to $250,000	123,488	122,730
Time deposits $250,000 or more	37,872	36,473
Total deposits	$1,120,833	$1,094,149

Note 8—Short-Term Borrowings and Long-Term Debt

Short-term borrowings consist of securities sold under agreements to repurchase, federal funds purchased and other borrowings. At March 31, 2016, the balance of securities sold under agreements to repurchase was $19,922,000 compared to $74,510,000 at December 31, 2015. At March 31, 2016, the balance of other short-term borrowings was $6,664,000. At December 31, 2015 there were no other short-term borrowings.

The following table presents a summary of long-term debt as of March 31, 2016 and December 31, 2015. PeoplesBank's long-term debt obligations to the FHLBP are fixed rate instruments. Under terms of a blanket collateral agreement with the FHLBP, the obligations are secured by FHLBP stock and PeoplesBank qualifying loan receivables, principally real estate secured loans.

(dollars in thousands)	**March 31, 2016**	**December 31, 2015**
PeoplesBank's obligations:		
Federal Home Loan Bank of Pittsburgh (FHLBP)		
Due July 2016, 2.35%	5,000	5,000
Due September 2016, 1.18%	10,000	10,000
Due October 2016, 1.06%	10,000	10,000
Due October 2016, 1.10%	10,000	10,000

Due April 2017, 0.97%	10,000	10,000
Due November 2017, 1.19%	5,000	5,000
Due March 2018, 1.17%	10,000	10,000
Due June 2018, 1.87%	5,000	5,000
Due November 2018, 1.62%	5,000	5,000
Due June 2019, 2.10%	5,000	5,000
Due June 2019, 1.64%	5,000	5,000
Due June 2020, 1.87%	15,000	15,000
Due June 2021, 2.14%	15,000	15,000
Total FHLBP	110,000	110,000
Codorus Valley Bancorp, Inc. obligations:		
Junior subordinated debt		
Due 2034, 2.65%, floating rate based on 3 month LIBOR plus 2.02%, callable quarterly	3,093	3,093
Due 2036, 2.16% floating rate based on 3 month LIBOR plus 1.54%, callable quarterly	7,217	7,217
Total long-term debt	$ 120,310	$ 120,310

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In June 2006, Codorus Valley formed CVB Statutory Trust No. 2, a wholly-owned special purpose subsidiary whose sole purpose was to facilitate a pooled trust preferred debt issuance of $7,217,000. In November 2004, Codorus Valley formed CVB Statutory Trust No. 1 to facilitate a pooled trust preferred debt issuance of $3,093,000. The Corporation owns all of the common stock of these nonbank subsidiaries, and the debentures are the sole assets of the Trusts. The accounts of both Trusts are not consolidated for financial reporting purposes in accordance with FASB ASC 810. For regulatory capital purposes, all of the Corporation's trust preferred securities qualified as Tier 1 capital for all reported periods. Trust preferred securities are subject to capital limitations under the FDIC's risk-based capital guidelines. The Corporation used the net proceeds from these offerings to fund its operations.

Note 9—Regulatory Matters

Codorus Valley and PeoplesBank are subject to various regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if imposed, could have a material adverse effect on Codorus Valley's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Codorus Valley and PeoplesBank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators.

On July 2, 2013, the Board of Governors of the Federal Reserve System finalized its rule implementing the Basel III regulatory capital framework, which the FDIC adopted on July 9, 2013. Under the rule, minimum requirements increased both the quantity and quality of capital held by banking organizations. Consistent with the Basel III framework, the rule included a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5 percent, and a common equity Tier 1 conservation buffer of 2.5 percent of risk-weighted assets, that applies to all supervised financial institutions, which is to be phased in over a four year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019. The rule also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4 percent to 6 percent, and includes a minimum leverage ratio of 4 percent for all banking organizations. The new rule also increased the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors. The rule for smaller, less complex institutions, including the Corporation, took effect January 1, 2015.

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As of March 31, 2016, Codorus Valley and PeoplesBank met the minimum requirements of the Basel III framework, and PeoplesBank's capital ratios exceeded the amount to be considered "well capitalized" as defined in the regulations. The table below provides a comparison of the Corporation's and PeoplesBank's risk-based capital ratios and leverage ratios to the minimum regulatory requirement for the periods indicated.

	Actual		**Minimum for Capital Adequacy (1)**		**Well Capitalized Minimum (2)**	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Codorus Valley Bancorp, Inc. *(consolidated)*						
at March 31, 2016						
Capital ratios:						
Common equity Tier 1	$145,460	12.55%	$59,388	5.125%	n/a	n/a
Tier 1 risk based	155,460	13.42	76,770	6.625	n/a	n/a
Total risk based	168,550	14.55	99,946	8.625	n/a	n/a
Leverage	155,460	10.99	56,560	4.00	n/a	n/a
at December 31, 2015						
Capital ratios:						
Common equity Tier 1	$143,456	12.56%	$51,395	4.50 %	n/a	n/a
Tier 1 risk based	165,456	14.49	68,527	6.00	n/a	n/a
Total risk based	178,160	15.60	91,370	8.00	n/a	n/a
Leverage	165,456	11.73	56,398	4.00	n/a	n/a
PeoplesBank, A Codorus Valley Company						
at March 31, 2016						
Capital ratios:						
Common equity Tier 1	$152,053	13.16%	$59,214	5.125%	$75,101	6.50 %
Tier 1 risk based	152,053	13.16	76,545	6.625	92,432	8.00
Total risk based	165,143	14.29	99,653	8.625	115,540	10.00
Leverage	152,053	10.78	56,425	4.00	70,532	5.00
at December 31, 2015						
Capital ratios:						
Common equity Tier 1	$149,073	13.10%	$51,227	4.50 %	$73,994	6.50 %
Tier 1 risk based	149,073	13.10	68,302	6.00	91,070	8.00
Total risk based	161,777	14.21	91,070	8.00	113,837	10.00
Leverage	149,073	10.60	56,248	4.00	70,310	5.00

(1) Minimum amounts and ratios as of March 31, 2016 include the first year phase in of the capital conservation buffer of 0.625 percent required by the Basel III framework. The conservation buffer is to be phased in over a four year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019.

(2) To be “well capitalized” under the prompt corrective action provisions in the Basel III framework. “Well capitalized” applies to PeoplesBank only.

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Note 10—Shareholders' Equity

Public Offering of Common Stock

On December 15, 2015, the Corporation completed a public offering of 1,519,000 shares of common stock at a price of $19.75 per share. On December 23, 2015, the Corporation announced that the underwriters of the previously closed public offering had exercised in full their option to purchase an additional 227,850 shares of the Corporation's common stock at a public offering price of $19.75 per share.

The Corporation raised net proceeds of approximately $32,500,000, resulting from the gross amount of the public offering transaction and the exercise of the purchase options of $34,500,000, less related underwriting discounts, commissions and offering expense of approximately $2,000,000. Approximately $19,800,000 of the net proceeds from the public offering were invested in the Corporation's Bank subsidiary, PeoplesBank. A portion of the proceeds were used to redeem the remaining $12,000,000 of Series B preferred held by the United States Department of Treasury on February 18, 2016. The remaining proceeds were used for general corporate purposes.

Preferred Stock Issued under the US Treasury's Small Business Lending Fund Program

The U.S. Department of the Treasury ("Treasury") had a capital investment in the Corporation pursuant to the Corporation's participation in the Treasury's Small Business Lending Funding Program ("SBLF Program"). In August 2011, the Corporation sold to the Treasury, for an aggregate purchase price of $25,000,000, 25,000 shares of non-cumulative, perpetual preferred stock, Series B, $1,000 liquidation value, $2.50 par value. On May 30, 2014, the Corporation redeemed 13,000 of the 25,000 outstanding shares of the Corporation's preferred stock that had been issued to the Treasury, leaving 12,000 outstanding shares representing $12,000,000 of preferred stock. On February 18, 2016, the Corporation redeemed the remaining $12,000,000 of Series B preferred stock issued to the Treasury as reported on Form 8-K filed on February 19, 2016.

The annualized dividend rate on the preferred stock issued under the SBLF Program was 1 percent for the three months ended March 31, 2016 and 2015.

Common Stock Dividend

Periodically, the Corporation distributes stock dividends on its common stock. The Corporation distributed a 5 percent stock dividend on December 8, 2015 and December 9, 2014 which resulted in the issuance of 294,161 and 275,900 additional common shares, respectively.

Note 11—Contingent Liabilities

There are no legal proceedings pending against Codorus Valley Bancorp, Inc. or any of its subsidiaries which are expected to have a material impact upon the consolidated financial position and/or operating results of the Corporation, other than routine litigation incidental to the business. Management is not aware of any proceedings known or contemplated by government authorities.

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Note 12—Guarantees

Codorus Valley does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by PeoplesBank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $18,210,000 of standby letters of credit outstanding on March 31, 2016, compared to $19,037,000 on December 31, 2015. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding letters of credit. The amount of the liability as of March 31, 2016 and December 31, 2015, for guarantees under standby letters of credit issued, was not material. Many of the commitments are expected to expire without being drawn upon and, therefore, generally do not present significant liquidity risk to the Corporation or PeoplesBank.

Note 13—Fair Value of Assets and Liabilities

The Corporation uses its best judgment in estimating the fair value of the Corporation's assets and liabilities; however, there are inherent weaknesses in any estimation technique. Therefore, the fair value estimates herein are not necessarily indicative of the amounts that could be realized in sales transactions on the dates indicated. The estimated fair value amounts have been measured as of their respective period-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values subsequent to the respective reporting dates may be different than the amounts reported at each period end.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date. GAAP establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that utilize model-based techniques for which all significant assumptions are observable in the market.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement; inputs to the valuation methodology that utilize model-based techniques for which significant assumptions are not observable in the market; or inputs to the valuation methodology that require significant management judgment or estimation, some of which may be internally developed.

Since management maximizes the use of observable inputs and minimizes the use of unobservable inputs when determining fair value, an asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Management reviews and updates the fair value hierarchy classifications on a quarterly basis.