CODORUS VALLEY BANCORP INC
Form 10-K
March 24, 2010
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2009
or
o 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)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, $2.50 par value	**NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act: **None**
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
o Yes x No

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

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

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 o	Accelerated filer o
Non-accelerated filer o	Smaller Reporting Company x

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

The aggregate market value of Codorus Valley Bancorp, Inc. s voting stock held by non-affiliates was approximately $23,538,171 as of June 30, 2009.

As of March 17, 2010, Codorus Valley Bancorp, Inc. had 4,079,410 shares of common stock outstanding, par value $2.50 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference to the registrant s Proxy Statement for the Annual Meeting of Shareholders to be held May 18, 2010.

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PART I

Item 1: Business

Codorus Valley Bancorp, Inc. (Codorus Valley or the Corporation) is a Pennsylvania business corporation, incorporated on October 7, 1986. On March 2, 1987, Codorus Valley became a bank holding company under the Bank Holding Company Act of 1956. PeoplesBank, A Codorus Valley Company (PeoplesBank) is its wholly owned bank subsidiary. SYC Realty Co., Inc. is its wholly owned nonbank subsidiary. Codorus Valley s business consists primarily of managing PeoplesBank, and its principal source of income is dividends received from PeoplesBank. On December 31, 2009, Codorus Valley had total consolidated assets of $893 million, total deposits and other liabilities of $821 million, and total shareholders equity of $72 million.

Bank subsidiary

PeoplesBank, organized in 1934, is a Pennsylvania chartered bank. It is not a member of the Federal Reserve System. PeoplesBank offers a full range of business and consumer banking services through seventeen financial centers located throughout York County, Pennsylvania and in Hunt Valley and Bel Air, Maryland. It also offers investment, insurance, trust and real estate settlement services. The Federal Deposit Insurance Corporation insures the deposits of PeoplesBank to the maximum extent provided by law. On December 31, 2009, PeoplesBank had total gross loans of $647 million and total deposits of $723 million. PeoplesBank s market share of deposits for York County, PA was approximately 11 percent as of June 30, 2009 (the latest available date) making it the third largest depository in the County.

PeoplesBank is not dependent on deposits or exposed to a loan concentration to a single customer, or a small group of customers. Therefore, the loss of a single customer, or a small customer group, would not have a material adverse effect on the financial condition of PeoplesBank. At year-end 2009, the largest indebtedness of a single PeoplesBank client was $8,612,000, or 1.3 percent of the total loan portfolio, which was within the regulatory lending limit.

Most of the Corporation s business is with customers in York County, Pennsylvania and northern Maryland. Although this limited market area may pose a concentration risk geographically, we believe that the diverse local economy and our detailed knowledge of the customer base lessens this risk. At year-end 2009 and 2008, the Corporation had two industry concentrations that exceeded 10 percent of the total loan portfolio: real estate construction and land development was 16.3 and 17.5 percent of the portfolio, respectively, and commercial real estate leasing was 15.1 and 14.9 percent of the portfolio, respectively. Loans to borrowers within these industries are usually collateralized by real estate.

Nonbank subsidiaries of PeoplesBank

Codorus Valley Financial Advisors, Inc. is a wholly owned subsidiary of PeoplesBank that sells non-deposit investment products. This subsidiary began operations in January 2000 and, prior to a name change in December 2005, operated under the name SYC Insurance Services, Inc. SYC Settlement Services, Inc. is a wholly owned subsidiary of PeoplesBank that has provided real estate settlement services since January 1999. During October 2009, PeoplesBank created two nonbank subsidiaries for the purpose of temporarily holding foreclosed properties pending eventual liquidation. On December 31, 2009, only one of these subsidiaries was active. The operations of nonbank subsidiaries are consolidated for financial reporting purposes. Historically, the nonbank subsidiaries of PeoplesBank have not had a material impact on consolidated operating results.

Nonbank subsidiaries of Codorus Valley Bancorp, Inc.

In June 2006, Codorus Valley formed CVB Statutory Trust No. 2, a wholly-owned special purpose subsidiary whose sole purpose is 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 100 percent of the common stock of these nonbank subsidiaries, which are not consolidated for financial reporting purposes. These obligations are reported as debt on the Corporation s balance sheet.

On June 20, 1991, SYC Realty was incorporated as a wholly owned subsidiary of Codorus Valley. Codorus Valley created this nonbank subsidiary primarily for the purpose of disposing of selected properties obtained by PeoplesBank in satisfaction of debts previously contracted. SYC Realty commenced business operations in October 1995.

Employees

At year-end 2009, PeoplesBank employed 182 full-time employees and 32 part-time employees, which equated to 201 full-time equivalents. Employees are not covered by a collective bargaining agreement and management considers its relations with employees to be satisfactory.

Segment Reporting

Management has determined that it operates in only one segment, community banking. The Corporation s non-banking activities are insignificant to the consolidated financial statements.

Competition

The banking industry in PeoplesBank s service area, principally York County, Pennsylvania, and northern Maryland, specifically, Baltimore, Harford and Carroll counties, is extremely competitive. PeoplesBank competes through service, price and by leveraging its hometown image. It competes with commercial banks and other financial service providers such as thrifts, credit unions, consumer finance companies, investment firms and mortgage companies. Some financial service providers operating in PeoplesBank s service area operate on a national and regional scale and possess resources that are greater than PeoplesBank s.

Supervision and regulation

Codorus Valley is registered as a bank holding company, and is subject to regulation by the Board of Governors of the Federal Reserve System (Federal Reserve), under the Bank Holding Company Act of 1956, as amended. The Bank Holding Company Act requires bank holding companies to file periodic reports with, and subjects them to examination by, the Federal Reserve. The Federal Reserve has issued regulations under the Bank Holding Company Act that require a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. As a result, the Federal Reserve may require Codorus Valley to use its resources to provide adequate capital funds to PeoplesBank during periods of financial stress or adversity.

The Bank Holding Company Act prohibits Codorus Valley from acquiring direct or indirect control of more than 5 percent of the outstanding voting stock of any bank, or substantially all of the assets of any bank, or merging with another bank holding company, without the prior approval of the Federal Reserve. The Pennsylvania Department of Banking must also approve certain similar transactions.

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Pennsylvania law permits Pennsylvania bank holding companies to control an unlimited number of banks.

The Bank Holding Company Act restricts Codorus Valley to activities that the Federal Reserve has found to be closely related to banking, and which are expected to produce benefits for the public that will outweigh any potentially adverse effects. Therefore, the Bank Holding Company Act prohibits Codorus Valley from engaging in most nonbanking businesses, or acquiring ownership or control of more than 5 percent of the outstanding voting stock of any company engaged in a nonbanking business, unless the Federal Reserve has determined that the nonbanking business is closely related to banking. Under the Bank Holding Company Act, the Federal Reserve may require a bank holding company to end a nonbanking business if it constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

The Corporation s recent participation in the U.S. Department of the Treasury s Capital Purchase Program, previously disclosed in filings with the SEC and also summarized under the Shareholders Equity and Capital Adequacy section of this report, requires regulatory approval to increase quarterly cash dividends on common stock above $0.12 per share or to repurchase common stock, and places restrictions on compensation to certain senior executives and highly compensated employees.

The operations of PeoplesBank are subject to federal and state statutes applicable to banks chartered under the banking laws of the Commonwealth of Pennsylvania and whose deposits the Federal Deposit Insurance Corporation (FDIC) insures. PeoplesBank must furnish annual and quarterly reports to the FDIC.

The FDIC is the primary federal regulator of PeoplesBank. It regularly examines banks in such areas as loss allowances, loans, investments, management practices and other aspects of operations. These examinations are designed for the protection of PeoplesBank s depositors rather than Codorus Valley s shareholders. The FDIC provides deposit insurance to banks, which covers all deposit accounts. The standard insurance amount is currently $250,000 per depositor. The $250,000 limit is permanent for certain retirement accounts and is temporary for all other deposit accounts through December 31, 2013. In August 2009, the FDIC extended the Transaction Account Guarantee portion of the Temporary Liquidity Guarantee Program for six months through June 30, 2010, which provides unlimited coverage for non-interest bearing deposit accounts. PeoplesBank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC for Deposit Insurance Fund (DIF) member institutions. The FDIC has established a risk-based assessment system under which institutions are classified into one of four categories and pay premiums according to perceived risk to the FDIC s DIF. The DIF target reserve ratio is 1.15 percent, and during 2009, the time to achieve this target ratio was extended from five to seven years. As of April 2009, a Risk Category 1 institution, which includes PeoplesBank, is charged an FDIC assessment rate that ranges from 7 to 24 basis points. Institutions in Risk Categories II, III and IV are assessed premiums at progressively higher rates. Effective June 30, 2009, the FDIC imposed a special assessment on all member banks based on 5 basis points of total assets less Tier 1 capital. The special assessment for PeoplesBank totaled $382,000. The purpose of the special assessment was to help replenish the FDIC s DIF, which is being depleted as a result of an increasing number of bank failures.

A more permanent means of funding the FDIC s DIF is to require banks to prepay several years of deposit insurance premiums. In accordance with the FDIC s final rule in November 2009 pertaining to prepaid assessments for the banking industry, PeoplesBank disbursed approximately $4.4 million to the FDIC on December 30, 2009. This prepaid amount represented the regular quarterly assessments for the fourth quarter of 2009 and all of 2010 through 2012. The prepayment was based on an institution s assessment rate and assessment base for the third quarter of 2009, assuming a 5 percent annual growth in deposits each year. While the FDIC plan is to maintain current assessment rates through 2010, effective

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January 1, 2011, and January 1, 2012, the rates are scheduled to increase by three basis points across the board. Insured institutions will record the entire prepaid assessment as a prepaid asset and amortize an appropriate amount to expense to coincide with the time period. For example, the premium expense associated with the first quarter of 2010 will be expensed in that period, and the related prepaid asset reduced by the same amount. This accounting process will continue every quarter until the prepaid asset is depleted or returned to the institution to the extent it is not exhausted at some future date determined by the FDIC.

Federal and state banking laws and regulations govern such things as: the scope of a bank s business; permissible investments; the reserves against deposits a bank must maintain; the types and terms of loans a bank may make and the collateral it may take; the activities of a bank with respect to mergers and consolidations; the establishment of branches; and the sale of nondeposit investment products by the bank and its insurance subsidiary. The Pennsylvania Insurance Department, the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) control and supervise the licensing and activities of employees engaged in the sale of nondeposit investment products.

Pennsylvania business and banking laws restrict dividend payments if such payment would render the Corporation insolvent or result in negative net worth, and the Corporation and PeoplesBank are subject to regulatory capital requirements. More information about dividend restrictions and capital requirements can be found in Note 11-Regulatory Matters.

The Federal Reserve Act imposes restrictions on a subsidiary bank of a bank holding company, such as PeoplesBank. The restrictions affect extensions of credit to the bank holding company and its subsidiaries, investments in the stock or other securities of the bank holding company and its subsidiaries, and taking such stock or securities as collateral for loans. The Federal Reserve Act and Federal Reserve regulations also place limitations and reporting requirements on extensions of credit by a bank to the principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulation may affect the terms upon which any person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

PeoplesBank and the banking industry, in general, are affected by the monetary and fiscal policies of the U.S. treasury and government agencies, including the Federal Reserve. Through open market securities transactions, changes in its federal funds and discount rates and reserve requirements, the Federal Reserve exerts considerable influence over the cost and availability of funds for lending and investment.

A brief discussion of selected federal agency requirements that affect Codorus Valley and/or PeoplesBank follows.

American Recovery and Reinvestment Act of 2009 (ARRA) In February 2009, the ARRA, was enacted by the U.S. Congress in response to the recent financial crisis. The basic intent behind the ARRA is to preserve jobs and promote economic recovery, to assist those most impacted by the recession, to provide investments needed to increase efficiency by spurring technological advances in science and health, to invest in transportation and environmental protection and other infrastructure that will provide long-term economic benefits, and to stabilize state and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local taxes.

Emergency Economic Stabilization Act of 2008 (EESA) In October of 2008, the EESA, also known as the Troubled Asset Relief Act (TARP), was enacted. Under TARP, the U.S. Department of the Treasury (Treasury) initiated a Capital Purchase Program (CPP), which allows qualified financial institutions to issue preferred stock to the Treasury, subject to certain limitations and terms. The EESA was developed to attract broad participation by strong financial institutions to stabilize the financial system and increase lending to benefit the national economy and U.S. citizens. As previously reported, on January 9, 2009, the Corporation sold 16,500 shares of nonvoting perpetual preferred stock and a common stock warrant to the Treasury and received $16.5 million in capital funds. More information about this capital transaction is provided within the Shareholders Equity and Capital Adequacy section of this report.

Sarbanes-Oxley Act of 2002 The Sarbanes-Oxley Act (SOA) was signed into law in July 2002 and applies to all companies, both U.S. and non-U.S, that file periodic reports under the Securities Exchange Act of 1934. The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SEC is responsible for establishing rules to implement various provisions of the SOA. The SOA includes specific disclosure requirements and corporate governance rules, require the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandate further studies of certain issues by the SEC. The SOA represents significant regulation of the accounting profession and corporate governance practices, such as the relationship between a board of directors and management and between a board of directors and its committees.

Section 404 of the SOA became effective for the year ended December 31, 2004, for companies whose public float (the product of outstanding shares times the share price on a specified date) was above $75 million. For smaller companies (non-accelerated and smaller reporting company filers), including Codorus Valley, the effective date, after several postponements, was the fiscal year ending on or after December 15, 2007. Section 404 requires publicly held companies to document, test and certify that their internal control systems over financial reporting are effective. Effective for fiscal years ending on or after June 15, 2010, non-accelerated and smaller reporting company filers are required to provide an auditor attestation report in their annual report regarding internal control over financial reporting.

USA Patriot Act of 2001 In October of 2001, the USA Patriot Act of 2001 was enacted to strengthen U.S. law enforcement s and the intelligence communities abilities to work cohesively to combat terrorism on a variety of fronts. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations on financial institutions, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Periodically, various types of federal and state legislation are proposed that could result in additional regulation of, and restrictions on, the business of Codorus Valley and PeoplesBank. It cannot be predicted whether such legislation will be adopted or, if adopted, how such legislation would affect the business of Codorus Valley and its subsidiaries. As a consequence of the extensive regulation of commercial banking activities in the United States of America, Codorus Valley and PeoplesBank s business is particularly susceptible to being affected by federal legislation and regulations. The general cost of compliance with numerous and multiple federal and state laws and regulations does have, and in the future may have, a negative impact on Codorus Valley s results of operations.

Other information

This Annual Report on Form 10-K is filed with the Securities and Exchange Commission (SEC). Copies of this document and other SEC filings by Codorus Valley Bancorp, Inc. may be obtained electronically at PeoplesBank s website at www.peoplesbanknet.com (select About Us, then select Investor Relations, then select SEC filings), or the SEC s website at www.sec.gov/edgarhp.htm. Copies can also be obtained without charge by writing to: Treasurer, Codorus Valley Bancorp, Inc., P.O. Box 2887, York, PA 17405-2887.

Item 1A: Risk Factors

Not applicable to smaller reporting companies.

Item 1B: Unresolved Staff Comments

Not applicable.

Item 2: Properties

Codorus Valley Bancorp, Inc. owns the Codorus Valley Corporate Center (Corporate Center), subject to a $1.5 million lien held by its wholly owned subsidiary, PeoplesBank. The Corporate Center is located at 105 Leader Heights Road, York Township, York, PA. This facility serves as the corporate headquarters and is approximately 40,000 square feet, a portion of which is leased to third-parties. The Corporate Center is adjacent to PeoplesBank s Data Operations Center and the Leader Heights banking office.

PeoplesBank operates 17 branch banking offices. Of this total, 6 are owned by PeoplesBank without liens and located in York County, PA, and 11 are leased by PeoplesBank and are located in York County, PA, and in Baltimore and Harford Counties in Maryland.

We believe that the above properties owned and leased by the Corporation and its subsidiary are adequate for present levels of operation.

Item 3: Legal proceedings

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 financial position and/or operating results of the Corporation. Management is not aware of any proceedings known or contemplated by governmental authorities.

Item 4: Removed and Reserved

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PART II

Item 5: Market for Codorus Valley Bancorp, Inc. s common equity, related shareholder matters and issuer purchases of equity securities

Market Information

The common shares of Codorus Valley Bancorp, Inc. are traded on the NASDAQ Global Market under the symbol CVLY. Codorus Valley had approximately 1,005 registered shareholders of record as of March 1, 2010. The following table sets forth high and low sales prices and dividends paid per common share for Codorus Valley as reported by NASDAQ during the periods indicated. The sales prices and cash dividends per common share listed are adjusted for common stock dividends.

	2009			2008		
Quarter	High	Low	Dividends per share	High	Low	Dividends per share
First	$ 9.05	$ 6.50	$ 0.120	$ 16.90	$ 14.60	$ 0.133
Second	9.86	6.05	0.080	17.40	13.62	0.133
Third	7.50	5.75	0.030	14.25	5.40	0.120
Fourth	6.24	5.12	0.030	11.86	7.75	0.120

Codorus Valley has a long history of paying quarterly cash dividends on its common stock. Codorus Valley presently expects to pay future cash dividends; however, the payment of such dividends will depend primarily upon the earnings of its subsidiary, PeoplesBank. Management anticipates that substantially all of the funds available for the payment of cash dividends by Codorus Valley will be derived from dividends paid to it by PeoplesBank. The payment of cash dividends is also subject to restrictions on dividends and capital requirements as reported in Note 11-Regulatory Matters. The Corporation s recent participation in the U.S. Department of the Treasury s Capital Purchase Program (CPP), previously disclosed in filings with the SEC and also summarized under the Shareholders Equity and Capital Adequacy section of this report, requires regulatory approval to increase quarterly cash dividends on common stock above $0.12 cents per share. Beginning in 2009, the Corporation paid cash dividends of 5 percent per annum on outstanding preferred stock that it sold to the U.S. Treasury under its CPP.

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Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information about options outstanding and securities available for future issuance under the Corporation s 1996 Stock Incentive Plan, 1998 Independent Directors Stock Option Plan, 2000 Stock Incentive Plan, 2001 Employee Stock Bonus Plan, 2007 Long Term Incentive Plan and 2007 Employee Stock Purchase Plan.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	212,790	$ 10.99	286,118(1)
Equity compensation plans not approved by security holders			14,373(2)
Total	212,790	$ 10.99	300,491

(1) Includes 152,056 shares available for issuance under the 2007 Employee Stock Purchase Plan.

(2) Shares available for issuance under the 2001 Employee Stock Bonus Plan. The plan provides for issuance of shares of common stock to employees as performance-based compensation.

Purchases of equity securities by the issuer and affiliated purchasers

For years ended December 31, 2009 and 2008, the Corporation did not acquire any of its common stock under the current program. The Corporation s recent participation in the U.S. Department of the Treasury s Capital Purchase Program, previously disclosed in filings with the SEC and also summarized under the Shareholders Equity and Capital Adequacy section of this report, requires regulatory approval to repurchase the Corporation s common stock.

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Item 6: Selected financial data

Codorus Valley Bancorp, Inc.

	2009	2008	2007	2006	2005
Summary of operations *(in thousands)*					
Interest income	$ 40,310	$ 36,732	$ 39,169	$ 33,319	$ 25,572
Interest expense	16,358	15,809	18,489	15,077	9,149
Net interest income	23,952	20,923	20,680	18,242	16,423
Provision for (recovery of) loan losses	3,715	1,870	(554)	650	775
Noninterest income	7,497	6,665	5,688	5,465	5,003
Noninterest expense	24,491	20,044	18,368	15,890	14,482
Income before income taxes (benefit)	3,243	5,674	8,554	7,167	6,169
Provision (benefit) for income taxes	(191)	1,209	2,180	1,845	1,552
Net income	3,434	4,465	6,374	5,322	4,617
Preferred stock dividends and discount accretion	957				
Net income available to common shareholders	$ 2,477	$ 4,465	$ 6,374	$ 5,322	$ 4,617
Per common share *(adjusted for stock dividends)*					
Net income, basic	$ 0.61	$ 1.13	$ 1.64	$ 1.38	$ 1.21
Net income, diluted	$ 0.61	$ 1.12	$ 1.61	$ 1.35	$ 1.18
Cash dividends paid	$ 0.26	$ 0.51	$ 0.56	$ 0.44	$ 0.41
Stock dividends distributed		5%	5%	10%*	5%
Book value	$ 13.60	$ 12.99	$ 12.33	$ 11.08	$ 10.08
Cash dividend payout ratio	42.3%	45.1%	33.8%	32.0%	33.6%
Weighted average shares outstanding	4,042,910	3,965,996	3,881,501	3,846,877	3,831,399
Weighted average diluted shares outstanding	4,042,910	3,990,956	3,965,980	3,937,050	3,907,787
* includes a special 5% stock dividend					
Profitability ratios					
Return on average shareholders equity (ROE)	4.9%	8.9%	13.9%	13.0%	12.3%
Return on average assets (ROA)	0.41%	0.71%	1.11%	1.05%	1.06%
Net interest margin	3.23%	3.68%	3.97%	3.97%	4.16%
Efficiency ratio	74.6%	70.6%	67.4%	65.1%	66.1%
Net overhead ratio	2.07%	2.14%	2.20%	2.04%	2.16%
Capital ratios					
Tier 1 risk-based capital	11.8%	10.0%	12.1%	12.0%	10.6%
Total risk-based capital	12.9%	10.8%	12.9%	12.7%	11.3%
Average shareholders equity to average assets	8.4%	7.9%	8.0%	8.1%	8.6%
Summary of financial condition at year-end *(in thousands)*					
Investment securities	$ 178,454	$ 77,287	$ 84,369	$ 80,926	$ 69,664
Loans	647,143	580,451	447,497	407,260	369,631
Assets	892,831	702,766	594,607	548,212	476,052
Deposits	722,957	598,129	511,968	456,645	385,154
Borrowings	92,748	47,779	30,660	45,339	49,493
Equity	72,012	52,181	48,415	42,786	38,729
Other data					
Number of bank offices	17	17	14	14	14
Number of employees (*full-time equivalents*)	201	200	179	168	163
Wealth Management assets, market value (*in thousands*)	$ 325,482	$ 261,153	$ 320,655	$ 259,453	$ 213,735

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Item 7: Management s discussion and analysis of financial condition and results of operations

Management s discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in the accompanying consolidated financial statements for Codorus Valley Bancorp, Inc., (Codorus Valley or the Corporation) a bank holding company, and its wholly owned subsidiary, PeoplesBank, A Codorus Valley Company, (PeoplesBank) are provided below. Codorus Valley s consolidated financial condition and results of operations consist almost entirely of PeoplesBank s financial condition and results of operations. Current performance does not guarantee and may not be indicative of similar performance in the future.

Forward-looking statements

Management of the Corporation has made forward-looking statements in this Annual Report. These forward-looking statements may be subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of the Corporation and its subsidiaries. When words such as believes, expects, anticipates or similar expressions occur in this Form 10-K, management is making forward-looking statements.

Shareholders should note that many factors, some of which are discussed elsewhere in this report and in the documents that are incorporated by reference, could affect the future financial results of the Corporation and its subsidiaries, both individually and collectively, and could cause those results to differ materially from those expressed in the forward-looking statements contained or incorporated by reference in this Annual Report. These factors include, but are not limited to, the following:

- operating, legal and regulatory risks;
- a prolonged economic downturn;
- an increase in nonperforming assets requiring loss provisions and the incurrence of carrying costs;
- declines in the market value of investment securities considered to be other than temporary;
- the effects of and changes in the rate of FDIC premiums, including special assessments;
- interest rate fluctuations which could increase our cost of funds or decrease our yield on earning assets and therefore reduce our net interest income;
- future legislative or administrative changes to the TARP Capital Purchase Program;
- unavailability of capital when needed or available at an excessive cost;
- political and competitive forces affecting banking, securities, asset management and credit services businesses; and
- the risk that management s analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

The Corporation undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report.

Critical accounting estimates

Disclosure of Codorus Valley s significant accounting policies is included in Note 1 to the consolidated financial statements of this Annual Report. Some of these policies require management to make significant judgments, estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities.

Management makes significant estimates in determining the allowance for loan losses, valuation of foreclosed real estate, and evaluation of other than temporary impairment losses of securities. Management considers a variety of factors in establishing allowance for loan losses such as current

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economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strength of borrowers, adequacy of collateral, if collateral dependent, or present value of future cash flows and other relevant factors. Foreclosed real estate is initially recorded at fair value minus estimated costs to sell at the date of foreclosure, establishing a new cost basis. Appraisals 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. Estimates related to the value of collateral can have a significant impact on whether or not management continues to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded on the statement of financial condition.

The Corporation records its available-for-sale securities portfolio at fair value. Fair values for these securities are determined based on methodologies in accordance with FASB Accounting Standards Codification (ASC) Topic 820 (Prior authoritative literature: SFAS No. 157, Fair Value Measurement and Disclosures), and as clarified by several FASB staff positions. Fair values for debt securities are volatile and may be influenced by any number of factors, including market interest rates, prepayment speeds, discount rates, credit ratings and yield curves. Fair values for debt securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security. When the fair value of a debt security is below its amortized cost and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exits. Available-for-sale and held-to-maturity debt securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers whether the Corporation has the intent to sell its debt securities prior to market recovery or maturity and whether it is more likely than not that the Corporation will be required to sell its debt securities prior to market recovery or maturity. Often, information available to conduct these assessments is limited and rapidly changing; making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the debt security may be different than previously estimated, which could have a material effect on the Corporation s results of operations and financial condition.

Management discussed the development and selection of critical accounting estimates and related Management Discussion and Analysis disclosure with the Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within this report. Additional information is contained in Management s Discussion and Analysis regarding critical accounting estimates, including the provision and allowance for loan losses, located on pages 19 and 33 of this report.

OVERVIEW

Executive summary

During 2009, the Corporation achieved record balance sheet growth in spite of prolonged weak economic conditions (Great Recession), which officially began in December 2007. Total assets increased $190 million or 27 percent above year-end 2008, primarily in the commercial loan and investment securities portfolios. Of this total, $80 million pertained to a leverage strategy that management employed to generate sufficient margin spread to offset the cost of preferred dividends on the $16.5 million of capital it raised in January 2009 by selling preferred stock to the U.S. Treasury under the Treasury s Capital Purchase Program (CPP). The CPP was primarily targeted to financially healthy institutions like Codorus Valley. The capital infusion enabled management to accomplish loan goals by extending credit to creditworthy borrowers. Loan growth was achieved by increasing the business banking staff and taking advantage of market opportunities that emerged from changes in the

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competitive landscape. Deposit growth during 2009 also set a new record, as total deposits increased $125 million or 21 percent above year-end 2008. Federally insured bank deposits continue to provide safe haven to our clients who remain concerned about the economy, volatility in the capital markets and the high level of unemployment. The addition of three financial centers in the prior year and competitive pricing also contributed to the increase in deposit volumes during 2009.

While balance sheet growth was very strong in 2009, outpacing the average growth reported by our peer group, earnings declined for the second consecutive year. Earnings for the Corporation were negatively impacted by the economic forces that have affected the entire financial services industry. Net income for 2009 decreased 45 percent compared to 2008, due to an increase in the provision for loan losses, net interest margin compression and increases in operating expenses associated with franchise expansion, FDIC deposit insurance premiums and carrying costs on impaired assets. Accordingly, key financial ratios, such as return on average assets and return on average equity, also decreased, although Codorus Valley outperformed its peer group average for bank holding companies for the Third Federal Reserve District for 2009. The Corporation has no direct loss exposure to subprime lending or investments collateralized by subprime mortgage collateral because it does not participate in the subprime lending market, nor does it invest in securities backed by subprime mortgages.

In the period ahead, management will remain focused on profitable balance sheet growth, acquiring and nurturing client relationships and risk management. Management expects the national and local economies to struggle throughout 2010 and possibly beyond. Risks and uncertainties include prolonged weakness in economic and business conditions, which could increase credit-related losses, possible declines in the market value of investment securities considered to be other-than-temporary, a relatively high level of unemployment, and further erosion of the real estate market.

Financial Highlights

The Corporation earned net income available to common shareholders of $2,477,000 or $0.61 per share ($0.61 diluted) for 2009, compared to $4,465,000 or $1.13 per share ($1.12 diluted) earned in 2008. The $1,988,000 or 45 percent decrease in net income available to common shareholders was primarily the result of increases in the provision for loan losses, noninterest expenses and preferred dividends, which offset increases in net interest income and noninterest income and a decrease in income taxes.

The $1,845,000 or 99 percent increase in the provision for loan losses was the result of additions to the allowance for impaired commercial real estate loans and significant growth in the loan portfolio. Allocations to the allowance were deemed necessary due to continued uncertainty in the economy, depressed real estate values and an increase in the level of nonperforming loans.

The $4,447,000 or 22 percent increase in noninterest expense was due primarily to an increase in operating expenses associated with expansion of the banking franchise, an increase in Federal Deposit Insurance Corporation (FDIC) deposit insurance premiums, and an increase in carrying costs and loss provisions associated with impaired loans and foreclosed real estate. During 2009, the Corporation absorbed the full year s cost impact of adding three financial centers in the prior year. Expansion of the banking franchise was successful and all of the new offices generated loan and deposit volumes that exceeded management s expectations. Current period FDIC insurance premiums totaled $1,477,000, an increase of $1,135,000 or 332 percent above 2008. Of the total insurance premiums, $382,000 pertained to a special FDIC assessment effective June 30, 2009, which was imposed on all commercial financial institutions based on an FDIC assessment formula. The remaining increase in deposit insurance premiums was caused by an industry-wide increase in assessment rates by the FDIC and an increase in the volume of deposits upon which the assessment is based. Carrying costs and loss provisions associated with impaired loans and foreclosed real estate increased $869,000 above the prior year, which reflected increases in the volume of impaired loans and foreclosed real estate. A $242,000 non-

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recurring cost of restructuring employee benefit plans in the current period also contributed to the increase in noninterest expense. Restructuring the benefit plans resulted in a federal income tax benefit so that the overall transaction had an insignificant impact on net income.

Net interest income for 2009 was $23,952,000, an increase of $3,029,000 or 14 percent above 2008 due to a larger volume of earning assets, principally business loans and investment securities. The net interest margin was 3.23 percent for 2009, compared to 3.68 percent for 2008. Total noninterest income was $7,497,000 for 2009, an increase of $832,000 or 12 percent above 2008. The increase in noninterest income was primarily attributable to increases in gains from the sale of mortgages and investment securities, and income from bank owned life insurance. The provision for income taxes for 2009 was a $191,000 credit (benefit), compared to a $1,209,000 expense for 2008. The decrease in income tax was the result of a decrease in pretax income, an increase in tax-exempt income and the recognition of a non-recurring $242,000 tax benefit associated with restructuring employee benefit plans.

On December 31, 2009, total assets were approximately $893 million, an increase of $190 million or 27 percent above December 31, 2008. Asset growth occurred primarily in the business loans and investment securities portfolios, which were funded primarily by an increase in deposits generated from local markets and, to a lesser degree, borrowing from the Federal Home Loan Bank of Pittsburgh. The increase in investment securities and borrowings were the result of an $80 million leverage strategy employed to offset the costs of dividends on preferred stock issued to the U.S. Treasury under the Treasury s Capital Purchase Program.

Comparatively, the Corporation earned $4,465,000 or $1.13 per share ($1.12 diluted) for 2008, compared to $6,374,000 or $1.64 per share ($1.61 diluted) for 2007. The $1,909,000 or 30 percent decrease in earnings for 2008 was primarily the result of a $2,424,000 increase in the provision for loan losses. The 2008 provision was primarily increased to support strong loan growth in the Corporation s business loan portfolio and to account for increased risk associated with the ongoing economic recession. In contrast, during 2007 the Corporation recognized the positive financial impact of a onetime $839,000 pre-tax recovery ($554,000 after-tax) of loan losses that were incurred by PeoplesBank during 2002-2003. Due to the adequacy of the allowance for loan losses in 2007, the full amount of the recovery was recorded as a reduction to the loan loss provision at that time. On a comparable basis, net income for 2008 decreased $1,355,000 or 23 percent below 2007, as adjusted ($6,374,000 reported 2007 earnings less $554,000 for the after-tax effect of the loan loss recovery). Net income for the 2008 period was also constrained by net interest margin compression as yields on earning assets declined more rapidly than rates paid on deposits due in part to aggressive interest rate cuts by the Federal Reserve Bank to stimulate the struggling U.S. economy. The net interest margin for 2008 was 3.68 percent, compared to 3.97 percent for 2007. Operating costs increased during 2008 primarily as a result of corporate expansion and increased Federal Deposit Insurance Corporation deposit premiums. During 2008, PeoplesBank opened three full service financial centers. At year-end 2008, total assets were $703 million, an increase of approximately $108 million, or 18 percent, above year-end 2007. Asset growth occurred primarily in the business loan portfolio and secondarily in the home equity loan portfolio. Asset growth was funded by deposit growth, principally time deposits, and to a lesser degree overnight borrowings.

Annual cash dividends per share, as adjusted, totaled $0.26 for 2009, compared to $0.51 for 2008. A five percent stock dividend was distributed in 2008. Book value per share, as adjusted, was $13.60 for year-end 2009, compared to $12.99 for year-end 2008.

Net income as a percentage of average total assets (return on assets or ROA), was 0.41 percent for 2009, compared to 0.71 percent for 2008. Net income as a percentage of average shareholders equity (return on equity or ROE), was 4.88 percent for 2009, compared to 8.91 percent for 2008. The decrease in the ROA and ROE ratios for 2009 reflected the decrease in net income. The decrease in the ROE ratio was

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also affected by an increase in shareholders equity from the issuance of $16.5 million of preferred stock in January 2009. The efficiency ratio (noninterest expense as a percentage of net interest income plus noninterest income on a tax equivalent basis) was 74.6 percent for 2009, compared to 70.6 percent for 2008. The increase in the efficiency ratio was the result of an increase in operating expenses, including FDIC deposits insurance premiums and carrying costs on impaired assets.

At December 31, 2009, nonperforming assets as a percentage of total loans and net foreclosed real estate was 5.33 percent, compared to 1.83 percent at year-end 2008. Information regarding nonperforming assets is provided in the Risk Management section of this report, including Table 10 Nonperforming Assets. The allowance for loan losses as a percentage of total loans was 1.11 percent for year-end 2009 and 0.82 percent for year-end 2008. Information regarding the allowance is provided in the Risk Management section of this report, including Tables 11 - Analysis of Allowance for Loan Losses and 12 Allocation of Allowance for Loan Losses. Through its evaluation of probable loan losses and the current loan portfolio, management believes that the allowance is adequate to support losses inherent in the portfolio at December 31, 2009.

Throughout 2009, the Corporation maintained a capital level above minimum regulatory quantitative requirements. Currently, there are three federal regulatory definitions of capital that take the form of minimum ratios. Table 9 Capital Ratios, shows that the Corporation and PeoplesBank were well capitalized on December 31, 2009.

A more detailed analysis of the factors and trends affecting earnings follows.

INCOME STATEMENT ANALYSIS

Net Interest Income

The Corporation s principal source of revenue is net interest income, which is the difference between interest income earned on loans and investment securities, and interest expense incurred on deposits and borrowed funds. Fluctuations in net interest income are caused by changes in interest rates, volumes and the composition or mix of interest rate sensitive assets and liabilities. Unless otherwise noted, the discussion that follows is based on interest income and interest expense as reported in the consolidated statements of income, not on a tax equivalent basis.

Net interest income for 2009 was $23,952,000, an increase of $3,029,000 or 14 percent above 2008. The increase was primarily the result of an increase in the average volume of earnings assets. The net interest margin, on a tax equivalent basis, was 3.23 percent, compared to 3.68 percent for 2008. Net interest margin is net interest income (tax equivalent basis) as a percentage of average earning assets. The decrease in the net interest margin reflected many factors, which included: the low level of market interest rates, which depressed yields on variable (floating) rate loans, overnight investments and investment securities; an elevated level of nonperforming assets; excess liquidity; and the impact of the leverage strategy implemented earlier this year. During the second half of 2009, management responded to the low interest rate environment by imposing interest rate floors on business loans, which helped to increase the margin for the third and fourth quarters.

For 2009, total interest income increased $3,578,000 or 10 percent, compared to 2008 due primarily to an increase in the average volume of earning assets. Earnings assets averaged $777 million and yielded 5.34 percent (tax equivalent basis) for the current period, compared to $587 million and 6.38 percent, respectively, for 2008. The $190 million or 32 percent increase in the average balance of earning assets was primarily the result of strong growth in the business loan and investment securities portfolios. The increase in business loans reflected additions to the business banking staff and changes in the competitive landscape that benefited the Corporation. The increase in investment securities, principally

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U.S. agency mortgage-backed bonds and tax-exempt municipals bonds, resulted from the leverage strategy, which is discussed in the Investment Securities section of this report. The leverage strategy made a positive contribution to net interest income; however, the two percent tax equivalent margin spread resulting from this strategy constrained the Corporation s net interest margin.

For 2009, total interest expense increased $549,000 or 3 percent, compared to 2008 due to a larger volume of interest bearing liabilities. Total interest bearing liabilities averaged $708 million at an average rate of 2.31 percent, compared to $528 million and 2.99 percent, respectively, for 2008. The $180 million or 34 percent increase in average interest bearing liabilities was the result of increases in the average volume of time deposits, money market deposits and long-term debt. Federally insured bank deposits provided safe haven to our clients who are increasingly concerned about the economy, volatility in the capital markets and the high level of unemployment. The recent addition of three financial centers in 2008 and competitive pricing also contributed to the increase in deposit volumes for the current period. The increase in long-term debt provided the financing for the leverage strategy, which is discussed in the Long-term Debt section of this report.

Comparatively, for 2008, net interest income increased $243,000 or 1 percent above 2007 due primarily to an increase in the average volume of earning assets. The net interest margin, on a tax equivalent basis, was 3.68 percent, compared to 3.97 percent for 2007. The margin for 2008 was affected in part by a $992,000 decrease in loan fees compared to 2007. Prior year loan fees were unusually high due to the inclusion of approximately $612,000 in loan fees from selected business loan accounts, including a recovery of fees from a large delinquent account. Earning assets averaged $587 million and yielded 6.38 percent (tax equivalent basis) for 2008, compared to $537 million and a yield of 7.42 percent, respectively, for 2007. The $50 million or 9 percent increase in earning assets was the result of growth in the business and home equity loan portfolios. Total interest bearing liabilities averaged $528 million at an average rate of 2.99 percent for 2008, compared to $481 million and 3.84 percent, respectively, for 2007. The $47 million or 10 percent increase in the average volume of interest bearing liabilities occurred primarily in short-term fixed rate CDs. Deposit growth for 2008 was attributable to rate promotions, the addition of three financial centers and volatility within the capital markets. During 2008, customers replaced floating rate money market and time deposits with higher yielding fixed rate time deposits to increase their return. In spite of decreasing short-term market interest rates during 2008, short-term CD rates remained relatively high as a result of competitive pricing pressures. Interest expense on long-term debt for 2008 decreased from the prior year due to a decrease in volume, which resulted from a scheduled maturity in 2007 that was not refinanced and the pay-off of two borrowings that totaled $6.5 million prior to maturity that also occurred in 2007.

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Tables 1 and 2 are presented on a tax equivalent basis to make it easier to compare taxable and tax-exempt assets. Income from tax-exempt assets, primarily loans to or securities issued by state and local governments, is increased by the amount of federal income taxes which would have been incurred if the income was taxable at the rate of 34 percent.

Table 1-Average Balances and Interest Rates (tax equivalent basis)

	2009			2008			2007		
(dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
Assets									
Interest bearing deposits with banks	$ 15,893	$ 40	0.25%	$ 170	$ 3	1.82%	$ 133	$ 8	5.71%
Federal funds sold	2,513	8	0.32	12,049	331	2.75	22,622	1,149	5.08
Investment securities:									
Taxable	95,770	3,426	3.58	48,351	2,431	5.03	54,066	2,799	5.18
Tax-exempt	59,266	3,042	5.13	31,644	1,833	5.79	29,669	1,733	5.84
Total investment securities	155,036	6,468	4.17	79,995	4,264	5.33	83,735	4,532	5.41
Loans:									
Taxable (1)	592,199	34,254	5.78	489,237	32,469	6.64	424,645	33,764	7.95
Tax-exempt	11,603	729	6.28	5,386	344	6.39	5,477	350	6.39
Total loans	603,802	34,983	5.79	494,623	32,813	6.63	430,122	34,114	7.93
Total earning assets	777,244	41,499	5.34	586,837	37,411	6.38	536,612	39,803	7.42
Other assets (2)	57,054			44,339			38,873		
Total assets	$ 834,298			$ 631,176			$ 575,485		
Liabilities and Shareholders Equity									
Deposits:									
Interest bearing demand	$ 214,147	$ 2,049	0.96%	$ 171,329	$ 2,177	1.27%	$ 198,008	$ 6,054	3.06%
Savings	22,707	90	0.40	19,986	119	0.59	18,657	111	0.60
Time	387,609	12,063	3.11	301,239	12,058	4.00	224,850	10,252	4.56
Total interest bearing deposits	624,463	14,202	2.27	492,554	14,354	2.91	441,515	16,417	3.72
Short-term borrowings	4,002	53	1.32	5,547	83	1.50			
Long-term debt	80,003	2,103	2.63	30,095	1,372	4.56	39,730	2,072	5.21
Total interest bearing liabilities	708,468	16,358	2.31	528,196	15,809	2.99	481,245	18,489	3.84
Noninterest bearing deposits	51,516			48,804			44,942		
Other liabilities	3,962			4,051			3,477		
Shareholders equity	70,352			50,125			45,821		
Total liabilities and shareholders equity	$ 834,298			$ 631,176			$ 575,485		
Net interest income		$ 25,141			$ 21,602			$ 21,314	
Net interest margin (3)			3.23%			3.68%			3.97%

(1) Interest includes net loan fees of $1,033,000 in 2009, $981,000 in 2008, and $1,973,000 in 2007.

(2) Average balance includes average nonperforming loans of $14,556,000 in 2009, $8,279,000 in 2008, and $4,122,000 in 2007, bank owned life insurance, foreclosed real estate and unrealized holding gains (losses) on investment securities.

(3) Net interest income as a percentage of average earning assets.

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Table 2-Rate/Volume Analysis of Changes in Net Interest Income (tax equivalent basis)

	2009 vs. 2008 Increase (decrease) due To change in			2008 vs. 2007 Increase (decrease) due To change in		
(dollars in thousands)	Volume	Rate	Net	Volume	Rate	Net
Interest Income						
Interest bearing deposits with banks	$ 287	$ (250)	$ 37	$ 2	$ (7)	$ (5)
Federal funds sold	(262)	(61)	(323)	(537)	(281)	(818)
Investment securities:						
Taxable	2,384	(1,389)	995	(296)	(72)	(368)
Tax-exempt	1,600	(391)	1,209	115	(15)	100
Loans:						
Taxable	6,833	(5,048)	1,785	5,136	(6,431)	(1,295)
Tax-exempt	397	(12)	385	(6)		(6)
Total interest income	11,239	(7,151)	4,088	4,414	(6,806)	(2,392)
Interest Expense						
Deposits:						
Interest bearing demand	544	(672)	(128)	(816)	(3,061)	(3,877)
Savings	16	(45)	(29)	9	(1)	8
Time	3,457	(3,452)	5	3,483	(1,677)	1,806
Short-term borrowings	(23)	(7)	(30)		83	83
Long-term debt	2,275	(1,544)	731	(503)	(197)	(700)
Total interest expense	6,269	(5,720)	549	2,173	(4,853)	(2,680)
Net interest income	$ 4,970	$ (1,431)	$ 3,539	$ 2,241	$ (1,953)	$ 288

Changes which are due to both volume and rate are allocated in proportion to their relationship to the amount of change attributed directly to volume or rate.

Provision for Loan Losses

The provision for loan losses is an expense charged to earnings to address estimated losses attributable to uncollectible loans. The provision reflects management s judgment of an appropriate level for the allowance for loan losses. The Risk Management section of this report, including Tables 10 Nonperforming Assets, 11 Analysis of Allowance for Loan Losses, and 12 Allocation of Allowance for Loan Losses provides detailed information about the allowance, provision and credit risk. For 2009, the provision was $3,715,000, compared to a $1,870,000 expense in 2008 and a $554,000 credit (recovery) in 2007. The current period provision was increased due to many factors including a decline in loan quality as a result of economic conditions, depressed real estate values and increased unemployment. A significant increase in the loan portfolio balance during the current period also contributed to the increase in the provision. The provision for 2008 was also relatively high compared to prior periods due to many of these same factors. In contrast, during 2007, the Corporation recognized the positive financial impact of a one-time $839,000 pre-tax recovery ($554,000 after-tax) of loan losses that were incurred by PeoplesBank during 2002-2003. Due to the adequacy of the Corporation s allowance for loan losses in 2007, the full amount of the recovery was recorded as a reduction to the loan loss provision at that time.

Noninterest Income

The following table presents the components of total noninterest income for each of the past three years. A key operating strategy is to increase noninterest or fee based income by offering new services, enhancing traditional services and expanding sales into new geographic markets.

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Table 3-Noninterest Income

(dollars in thousands)	**2009**	**2008**	**2007**
Trust and investment services fees	$ 1,348	$ 1,276	$ 1,260
Income from mutual fund, annuity and insurance sales	1,345	1,829	1,506
Service charges on deposit accounts	2,347	2,273	1,979
Income from bank owned life insurance	636	308	271
Other income	572	477	431
Gain on sales of loans held for sale	960	379	248
Gain (loss) on sales of securities	289	123	(7)
Total noninterest income	$ 7,497	$ 6,665	$ 5,688

Total noninterest income for 2009 increased $832,000 or 12 percent above the prior year. Core noninterest income, which excludes the gain on sales of securities, increased 10 percent. The discussion that follows addresses changes in noninterest income.

Trust and investment services fees The $72,000 or 6 percent increase in income from trust operations was the result of appreciation in market value, growth in the settlement advisory business and a $30,000 increase in estate fee income. For the year 2008, income was generally flat as a result of depressed capital markets and the impact on corresponding fees, which generally are calculated based on the market price of assets under management. Income in prior periods was affected to a minor degree by the transfer of selected fee based accounts to Codorus Valley Financial Advisors (see Income from mutual fund, annuity and insurance sales below).

Income from mutual fund, annuity and insurance sales The $484,000 or 26 percent decrease in income from the sale of mutual fund, annuity and insurance products by Codorus Valley Financial Advisors, a subsidiary of PeoplesBank, was a result of depressed capital markets and the impact it had on the volume of sales and fees. A portion of our fees are calculated on market prices of assets under management. Significant capital market losses during the latter part of 2008 through the first quarter of 2009 made many investors risk adverse, resulting in a decline in the demand for capital based products.

Service charges on deposit accounts The $74,000 or 3 percent increase in service charges on deposit accounts was due primarily to an increase in debit card fees related to an increase in the number of deposit accounts and transactions.

Income from bank owned life insurance (BOLI) The $328,000 or 106 percent increase in income from BOLI was due to an additional investment of approximately $4 million in November 2008 and an increase in the crediting rates on existing policies that were transferred to new insurance providers. The additional investment in BOLI provides a competitive tax-free return to the Corporation while providing a life insurance benefit to additional members of the management team.

Other income The $95,000 or 20 percent increase in other income was due primarily to increases in income from real estate settlement services provided by SYC Settlement Services, a subsidiary of PeoplesBank, and merchant credit card services.

Gain on sales of loans held for sale The $581,000 or 153 percent increase in gain from the sale of mortgages was the result of an increase in the volume of sales. During the current period, the low level of market interest rates and the first time homebuyers credit program, both influenced by the federal government to stimulate the economy, increased mortgage banking activity.

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Gain (loss) on sales of securities The $166,000 or 43 percent increase in gain from the sale of securities for 2009 was the result of an increase in the volume sold. During 2009 and 2008, market interest rates decreased, affording the Corporation an opportunity to realize gains from the sale of investment securities with a carrying value of $9 million and $6.5 million, respectively.

Noninterest Expense

The following table presents the components of total noninterest expense for each of the past three years.

Table 4-Noninterest Expense

(dollars in thousands)	**2009**	**2008**	**2007**
Personnel	$ 13,099	$ 11,451	$ 10,676
Occupancy of premises, net	1,792	1,586	1,333
Furniture and equipment	1,663	1,437	1,324
Postage, stationery and supplies	465	471	449
Professional and legal	411	462	392
Marketing and advertising	626	712	675
FDIC insurance	1,477	342	55
Debit card processing	512	493	422
Charitable donations	250	663	436
Telephone	508	225	167
Foreclosed real estate	487	204	72
Impaired loan carrying costs	744	158	(7)
Other	2,457	1,840	2,374
Total noninterest expense	$ 24,491	$ 20,044	$ 18,368

Total noninterest expense for 2009 increased $4,447,000 or 22 percent above the prior year. The discussion that follows addresses changes in noninterest expense.

Personnel The $1,648,000 or 14 percent increase in personnel expense, comprised of wages, sales commissions, payroll taxes and employee benefits, resulted primarily from the full year s effect of staff additions associated with expansion of the banking franchise in the prior year. During 2008, PeoplesBank added three full service financial centers, one in the first quarter and two in the fourth quarter of that year. A non-recurring cost of $242,000 in the first quarter of 2009 to restructure employee benefit plans also contributed to the increase in personnel expense. However, restructuring the benefit plans resulted in a federal income tax benefit so that the overall transaction had an insignificant impact on net income.

Occupancy of premises, net The $206,000 or 13 percent increase in occupancy of premises expense, comprised of rent, depreciation, maintenance, insurance, real estate taxes and utilities, increased primarily as a result of expanding the banking franchise.

Furniture and equipment The $226,000 or 16 percent increase in furniture and equipment expense was primarily the result of an increase in depreciation expense from capital expenditures that supported franchise expansion and information technology initiatives.

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Postage, stationery and supplies This operating expense category was relatively stable over the past three years.

Professional and legal The $51,000 or 11 percent decrease in professional and legal expense was due in part to a reduction in professional fee expenses associated with trust operations, which resulted from the timing of payments to various vendors and declines in the value and number of accounts upon which service fees were based. For 2008, the increase in professional and legal expenses was due primarily to an increase in consulting expense associated with improving customer relationship management.

Effective December 31, 2010, and annually thereafter, the Corporation s public accounting firm is required to audit and opine on the Corporation s controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. As a result of this requirement, management anticipates a moderate increase in CPA expense for 2010.

Marketing and advertising The $86,000 or 12 percent decrease in marketing expense was due primarily to a reduction in the marketing budget.

FDIC insurance The $1,135,000 or 332 percent increase in Federal Deposit Insurance Corporation (FDIC) premiums was the result of an industry-wide increase in assessment rates, an increase in the volume of deposits upon which the assessment is based, and a special assessment totaling $382,000. Effective June 30, 2009, the FDIC imposed a special assessment on all commercial financial institutions, based on 5 basis points of total assets less Tier 1 capital. The purpose of the rate increases and the special assessment by the FDIC in 2009 was to provide a temporary means of funding its depleted Deposit Insurance Fund (DIF). A more permanent means of funding the DIF is to require banks to prepay several years of deposit insurance premiums.

In accordance with the FDIC s final rule (November 2009) pertaining to prepaid assessments for the banking industry, PeoplesBank disbursed approximately $4.4 million to the FDIC on December 30, 2009. This prepaid amount represented the regular quarterly assessments for the fourth quarter of 2009 and all of 2010 through 2012, when the regular third quarter 2009 assessment payment was due. The prepayment was based on an institution s assessment rate and assessment base for the third quarter of 2009, assuming a 5 percent annual growth in deposits each year. While the FDIC plan is to maintain current assessment rates through 2010, effective January 1, 2011, and January 1, 2012, the rates are scheduled to increase by three basis points across the board. Insured institutions will record the entire prepaid assessment as a prepaid asset and amortize an appropriate amount to expense to coincide with the time period. For example, the premium expense associated with the first quarter of 2010 will be expensed in that period and the related prepaid asset reduced by the same amount. This accounting process will continue every quarter until the prepaid asset is depleted or returned to the institution to the extent it is not exhausted at some future date determined by the FDIC.

Debit card processing Annual increases in debit card processing expense were primarily the result of increases in the number of new accounts and transaction volume. This expense category also includes the cost of operating automated teller machines.

Charitable donations The $413,000 or 62 percent decrease in charitable donations for 2009 reflected a particularly large donation expense in 2008. During the first quarter of 2008, the Corporation accrued a $444,000 donation commitment for educational improvement that qualified for a $400,000 (90%) state tax credit. The tax credit was used to reduce the Pennsylvania shares tax expense, included in the other expense category, for that year.

Telephone The $283,000 or 126 percent increase in telephone expense reflected one-time conversion costs to a new carrier, telecommunication enhancements and expansion of the banking franchise. During 2008, the Corporation s telecommunications carrier abruptly declared bankruptcy, which temporarily disrupted service and resulted in disputes pertaining to the validity of billing charges. A portion of the increase in 2009 telephone expense pertained to catch-up billings from the prior year from the replacement telecommunications carrier.

Foreclosed real estate The $283,000 or 139 percent increase in foreclosed real estate expense generally reflected a larger portfolio of foreclosed real estate properties. Typical carrying expenses include insurance, real estate taxes, appraisals, legal fees and losses associated with declines in the net realizable value of the property.

Impaired loan carrying costs The $586,000 or 371 percent increase in impaired loan carrying costs generally reflected a larger portfolio of impaired loans. Typical carrying expenses are similar to foreclosed real estate.

Other The $617,000 or 34 percent increase in other expense was primarily the result of a $425,000 increase in Pennsylvania shares tax because the level of shares tax for 2008 was unusually low as a result of recognizing a $400,000 tax credit in that year. The tax credit is described above in the charitable donations line item. The remaining increase in other expense for 2009, comprised of many underlying expenses, was due to normal business growth. Other expense was relatively high in 2007 due largely to the recognition of a $437,000 prepayment penalty in connection with paying off a $5 million Federal Home Loan Bank advance prior to maturity. The Corporation paid off the advance, which was due July 2014 and had an above market interest rate of 6.43 percent, to reduce interest expense in future periods.

Income Taxes

Income taxes for 2009 were a $191,000 credit, or tax benefit, compared to a $1,209,000 expense for 2008. The decrease in income tax was the result of a decrease in pre-tax income and an increase in tax-exempt income. Comparatively, the provision for 2008 decreased $971,000 or 45 percent below 2007 due primarily to a 34 percent decrease in pre-tax income. For all three years, the Corporation s statutory federal income tax rate was 34 percent. The Corporation s effective income tax rate was a negative 6 percent for 2009, 21 percent for 2008 and 26 percent for 2007. The effective tax rate differs from the statutory tax rate due to the impact of low-income housing credits and tax-exempt income including income from bank owned life insurance. The effective tax rate for 2009 decreased primarily as a result of the decrease in pre-tax income and an increase in tax-exempt income.

BALANCE SHEET REVIEW

Overnight investments

Overnight investments, comprised of interest bearing deposits with banks and federal funds sold, totaled $18 million on December 31, 2009, compared to $3 million on December 31, 2008. The level of overnight investment at year-end 2009 reflected an increase in investable funds from deposit growth, which temporarily exceeded the growth in loans and investment securities.

Investment Securities

The investment securities portfolio is an interest earning asset, second in size to the loan portfolio. Investment securities serve as an important source of revenue and liquidity. They also serve as collateral for public and trust deposits, securities sold under agreements to repurchase and to support borrowings.

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The investment securities portfolio is managed to comply with the Corporation s Investment Securities Policy, and accounted for in accordance with FASB ASC Topic 320 (Prior authoritative literature: FAS No. 115, Accounting for Certain Investments in Debt and Equity Securities). Decisions to purchase or sell securities are based on an assessment of current economic and financial conditions, including the interest rate environment and liquidity and income requirements.

Table 5-Investment Securities

(dollars in thousands)	2009		2008		2007	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available-for-sale						
U.S. agencies	$ 13,526	$ 13,646	$ 5,001	$ 5,135	$ 21,512	$ 21,622
U.S. agency mortgage-backed	82,579	84,260	32,946	33,952	26,767	26,856
State and municipal	73,446	75,341	32,392	33,076	30,739	30,972
Debt securities-corporate trust preferred	987	930				
Total	$ 170,538	$ 174,177	$ 70,339	$ 72,163	$ 79,018	$ 79,450
Held-to-maturity						
Debt securities-corporate trust preferred	$	$	$ 2,432	$ 2,283	$ 3,448	$ 3,624

On December 31, 2009, the fair value of the securities available-for-sale totaled $174 million, compared to $72 million at year-end 2008. The increase in the investment securities portfolio was primarily the result of implementing an $80 million leverage strategy that involved investing in investment grade U.S. agency mortgage-backed bonds (3-4 year average lives) and tax-exempt municipal bonds (5-10 year maturities), which were financed by borrowing from the Federal Home Loan Bank of Pittsburgh. The leverage strategy, which was completed in April 2009, generated an approximately two percent tax equivalent margin spread, which covers the dividends payable and related costs associated with the recent issuance of preferred stock described in the Shareholders Equity and Capital Adequacy section of this report. During the current period, PeoplesBank took advantage of the low interest rate environment and sold approximately $9 million in U.S. agency mortgage-backed bonds, which generated $291,000 in gains that were recognized in income. Sale proceeds were reinvested in U.S. agency mortgage-backed bonds and tax-exempt municipal bonds. On December 31, 2009, the available-for-sale portfolio was comprised of the following securities mix based on amortized cost: U.S. agency mortgage-backed bonds (48.4%); municipal bonds (43.1%); U.S. agency bonds (7.9%); and one corporate trust preferred bond (0.6%). Securities available-for-sale are generally comprised of high quality debt instruments as shown in Note 3 Securities Available-for-Sale and Held-to-Maturity. Note 3 shows that unrealized gains for the available-for-sale portfolio exceeded unrealized losses for year-end 2009 due to declining market interest rates. Table 6 Securities Maturity Schedule shows that the available-for-sale portfolio had a yield of 4.38 percent on December 31, 2009, compared to 5.39 percent on December 31, 2008.

Securities classified as held-to-maturity, recorded at amortized cost, reflect management s intent and the Corporation s ability to hold these instruments to maturity. On December 31, 2009, there were no securities held-to-maturity, compared to four securities totaling $2.4 million for year-end 2008. The held-to-maturity portfolio for both years consisted of single issue trust preferred securities issued by commercial bank holding companies. These trust preferred securities are junior subordinated debt that pay a fixed rate of interest semi-annually, are subject to call (at a premium) by the issuer and mature in years 2026-2028. During the fourth quarter of 2009, one of the securities was called at a slight premium by the issuer and two securities were sold at a slight loss due to management s concern about the credit quality of the issuers and as a means of increasing capital at PeoplesBank. The remaining trust preferred security, which had a net carrying amount of $987,000 ($1 million par value) and a 7.98 percent yield,

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was reclassified to available for sale and the $57,000 unrealized loss associated with it was included in the equity section of the balance sheet. This security, an obligation of the Bank of America, was rated below investment grade by a national rating service on December 31, 2009. Management closely monitors this security and plans to ultimately sell it when its price improves along with the recovery of the financial services sector.

Table 6-Securities Maturity Schedule (amortized cost basis)

	December 31, 2009 Maturity Distribution					
(dollars in thousands)	**One year or less**	**One through five years**	**Five through ten years**	**After ten years**	**Total Amount**	**Yield(1)**
Available-for-sale						
U.S. agencies	$ 3,500	$ 10,026	$	$	$ 13,526	2.13%
U.S. agency mortgage-backed (2)		72,511	10,068		82,579	3.97%
State and municipal	2,543	28,701	37,137	5,065	73,446	5.21%
Debt securities-corporate trust preferred				987	987	7.98%
Total	$ 6,043	$ 111,238	$ 47,205	$ 6,052	$ 170,538	4.38%
Yield (1)	5.41%	3.89%	5.11%	6.50%	4.38%	

(1) Weighted average yields (tax equivalent basis) were calculated on the amortized cost basis.
(2) U.S. agency mortgage-backed securities are included in the maturity categories based on average expected life.

Restricted Investment in Bank Stocks

At December 31, 2009, PeoplesBank held $4,277,000 in restricted common stock, compared to $2,692,000 at year-end 2008. The increase was required to obtain advances from the Federal Home Loan Bank of Pittsburgh (FHLBP) to finance the leverage strategy previously discussed. Investment in restricted stock is a condition of obtaining credit from the FHLBP and the Atlantic Central Bankers Bank (ACBB) organizations. Of the total, $4,202,000 consisted of stock issued by the FHLBP and $75,000 issued by the ACBB. In December 2008, the FHLBP announced the suspension of the payment of dividends on its common stock and its repurchase of capital stock as strategies to preserve its capital. Information about impairment considerations for restricted stock is provided in Note 1-Summary of Significant Accounting Policies.

Loans

On December 31, 2009, total loans were $646 million, an increase of approximately $73 million or 13 percent above year-end 2008. Table 7 presents the composition of total loans on a comparative basis for five year-end periods. The table shows a trend of growth and corporate emphasis on commercial lending. At year-end 2009, commercial related loans increased $72 million or 16 percent above year-end 2008, while consumer related loans were relatively flat. The increase in commercial loans for 2009 was due in part to an increase in the business banking staff and the addition of two business banking offices in Maryland. Commercial loan portfolio growth was also positively impacted by changes in the competitive landscape caused by the acquisition of local competitors by larger financial institutions headquartered outside of our market area. As a result of the recessionary economy and rising unemployment there has been little or no demand for consumer loans, particularly installment loans. The average yield (tax equivalent basis) earned on total loans was 5.79 percent for 2009, compared to

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6.63 percent for 2008. The decline in loan yields, particularly floating rate loans, reflected a series of aggressive interest rate cuts by the Federal Reserve Bank from September 2007 through April 2008 and again during the fourth quarter of 2008 in its continuing efforts to stimulate the recessionary economy. The historically low level of the LIBOR reflects the impact of a global economic slowdown and disrupted credit markets.

During 2009 and 2008, PeoplesBank s mortgage banking staff focused on originating and selling residential mortgages without retaining servicing rights. Mortgage loan production, principally from refinances, was particularly strong for 2009, as low market interest rates and first time homebuyer tax credits fueled demand. These loans are classified on the balance sheet as loans held for sale and reported at the lower of cost or fair value. On December 31, 2009, loans held for sale were $1.3 million, compared to $7.4 million at year-end 2008.

Table 7-Loan Portfolio Composition

	December 31,									
(dollars in thousands)	**2009**	**%**	**2008**	**%**	**2007**	**%**	**2006**	**%**	**2005**	**%**
Commercial, industrial and agricultural	$ 415,404	64.3	$ 348,111	60.7	$ 243,144	54.5	$ 218,673	53.9	$ 207,545	56.4
Real estate - construction and land development	104,986	16.3	100,088	17.5	83,625	18.8	91,414	22.5	74,478	20.2
Total commercial related loans	520,390									